

# Why the NYSE deal is bad news

By Colin Barr  
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**Deal talk has exchange stocks grooving. But more mergers spell disaster for markets already tilted dangerously in favor of big companies and fast traders.**

Shares of NYSE Euronext (**NYX**) surged 14% Wednesday after the New York Stock Exchange parent **said** it was in advanced discussions to merge with Germany's biggest exchange, Deutsche Borse of Frankfurt. The talks come on the heels of this week's **tie-up** between the London Stock Exchange and Canada's TMX Group.

## Buttonwood burst

NYSE shares still far below bubble levels



After the exchange bubble

The deal is feeding some long-awaited gains for investors in exchange operators, which were hot in the late stages of the last stock market run-up but have cooled considerably since (see chart, right). Among the big gainers Wednesday were the other big U.S. exchange operators, including the Nasdaq (**NDAQ**), up 6%, the CBOE (**CBOE**), up 5%, and the Chicago Mercantile Exchange (**CME**), up 2%.

But bigger stock exchanges don't bring good tidings for the rest of us. Indeed, another round of exchange mergers will only intensify problems that skeptics have been railing about for years – particularly since last spring's Flash Crash.

The stock markets, critics contend, no longer serve the purpose they were created to serve, helping small and midsize companies grow by raising capital cheaply from the public.

Instead, the big exchanges increasingly battle one another to serve the biggest companies -- and to bring in low-margin trading volume that comes as often as not from computers seeking out freebies like trading rebates.

Like their cousins the too-big-to-fail banks, the exchanges now profit as much at the expense of the U.S. economy as to its benefit. Is this transformation -- culminating in a merger creating a company to be incorporated in the Netherlands -- what has become of the fabled U.S. stock market that started in 1792 under a buttonwood tree? Say it ain't so.

"You see a lot more volume on the stock exchanges, but it's mostly short-term traders playing games," said **Sal Arnuk** of institutional broker **Themis Trading**. "That actually deters long-term investing."

Ever since the stock exchanges were allowed a decade or so ago to turn themselves from client-centered mutual organization to profit-maximizing public companies, stock market listings and initial public offerings have dwindled.

Meanwhile, the exchanges have grown bigger through successive rounds of mergers. Driven to show returns to their shareholders, the exchanges went from serving small companies trying to raise capital, to catering to big companies and, increasingly, fast, high-volume traders.

"The market structure is optimized for big-cap companies," David Weild, a senior adviser to consulting firm Grant Thornton who was a vice chairman at the Nasdaq. "Everyone who looks at it is coming to the same conclusion."

These shifts, along with rules that narrowed the bid-asked spreads on stock trades and deregulated financial services companies, have led to a long series of unintended consequences that turned the public markets into more and more of a casino.

In typical fashion, regulators and legislators sought to bring low-cost investing to Main Street -- but didn't realize what else might come along for the ride. Welcome to Vegas.

"Over the past decade, the exchanges have fragmented and split off like bacteria," said Arnuk. "And every change has been in favor of the fast trading model that you saw from the Dateks of the world in the late 1990s."

The question now is how to fix it. Arnuk questions the for-profit exchange model, saying the exchanges should be utilities that look after their customers and the markets, rather than acting like bonus-seeking bankers.

Others consider ideas like an SEC-backed exchange that would focus on the needs of small companies. But that is not an easy sell at a time when the SEC is writing new rules by the dozen and under the gun for its failures in the Madoff, Stanford and Petters Ponzi schemes.

What's clear, though, is that the current system isn't working and someone has to fix it.

"We solved the problem of investors paying too much to trade stocks, but we traded it for a problem that hurts the economy," said Weild. "We need to rethink how we do this."