BRINGING THE WORLD TO LONDON
AN INTRODUCTION TO THE MAIN MARKET OF THE LONDON STOCK EXCHANGE

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So the Code of Conduct has its first success! The introduction of SIX x-clear into the UK market by the London Stock Exchange allows its clients a choice of CCP provider. Since the announcement of SIX x-clear’s introduction in 2006, price cuts by the incumbent – LCH. Clearnet Ltd – have seen some clients reduce the fees that they pay by more than 60%. FACT

However, interoperability has been working since 2003 when virt-x (now SIX Swiss Exchange) decided that they would have a dual CCP clearing model. This model has worked successfully since then, especially in these turbulent times. This contradicts the comments put forward by some of the new CCPs who believe that interoperability increases risk. FACT

So why is interoperability needed? The proliferation of MTFs has begun a sea change in the minds and attitudes of traders on both the buy-side and sell-side. But liquidity has yet to move to the MTFs. It could be that the efficient vertically integrated market structures which the national exchanges had set up and were said to be one of the main reasons for higher costs, have been replicated by the MTFs with an added layer included in the form of settlement banks. FACT

It is the view of SIX x-clear that interoperability providing clearing choice in the form of a one stop clearing house to customers is a way of reducing costs by allowing for more efficient cross netting over a number of execution venues on which the same stocks are traded, cross margining, more effective and careful handling of collateral and soft cost savings by having just one process to manage and monitor. FACT

As we have seen in recent times, interoperability reduces the risk associated with an exchange or MTF. As banks have collapsed, CCPs have stood strong in the middle of all trades providing the comfort that counterparties and regulators desire. It is now realised that although lower prices are great, efficient and effective risk management is far more important. And if there is one function in which a CCP should be expert in, it is risk management - preferably a real time risk management system which SIX x-clear operates rather than just once or twice a day. FACT

So is interoperability fact or fiction? With the need for effective risk management and lower costs it can be seen that interoperability works and is here to stay. We at SIX x-clear aim to be at the forefront of providing clients with the choice of CCP provider over a number of exchanges and MTFs. By gaining increased trade flow we will look to reduce fees without ever forgetting that our prime function is the reduction of risk. We are talking to all the major exchanges in Europe, we are talking to all the MTFs and with client support we can bring a choice of CCP provider to all of them. FACT

When will we have our first contact with you? Will this soon be FACT or FICTION?
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As Lord Mayor of London, I am delighted to write this foreword for the London Stock Exchange.

My principal role as Lord Mayor is to be an ambassador for all UK-based financial and professional services, and in particular to promote London as one of the world’s leading international financial centres. The London Stock Exchange has long been one of the jewels in the crown of London, sitting as it does at the heart of the Square Mile.

There are many reasons why London has achieved its position as a leading global financial centre: the scope of its financial services offering is very deep and wide, offering everything from carbon trading to insurance, asset management to foreign exchange, sovereign wealth funds to Islamic finance; and of course, it is an important centre for capital raising.

When I travel overseas to promote the City and its ‘brand’, a frequent topic of discussion with businesses and Government is London’s role as a centre for raising capital.

The Exchange’s Main Market and AIM are the most frequently mentioned, as London’s longest established markets. These markets are excellently placed to assist when companies seek new and further capital – indeed, equity finance may be a better route than illiquid credit markets.

Despite the obvious difficulties currently being experienced in the world’s financial markets, the strengths that underpin London’s status as a global financial centre are still in place. There will always be a major role for the Exchange in providing access to capital for companies, as the world’s most international exchange.

Today, in the liberal and accessible London marketplace, the London Stock Exchange cannot afford to stand still. By retaining its world-class reputation and becoming an even more competitive, lean and forward-looking institution, I believe that the London Stock Exchange will be well-placed to remain the most international capital market in the world.
For over 50 years we have worked in partnership with our clients to offer solutions, not just a service. So if you’re searching for a partner in share registration and employee benefits to help you meet your objectives why not talk to us, we have a wealth of experts on hand to help.

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t gives me great pleasure to introduce Bringing the world to London: an introduction to the Main Market, presenting a series of articles on the Main Market from key financial commentators. The Main Market gives investors from around the globe access to companies from an unrivalled range of countries and sectors. I hope that this new publication will provide an insight into the market and its community; the factors that contribute to its success, what makes it tick and the key players who are involved on a daily basis, as well as demystifying some of its more technical aspects.

The Main Market is London’s flagship market – one of four market options designed to fit issuers’ differing needs, from biotechnology start-up, to sophisticated investment proposition, to global blue chip. It provides established companies from around the world the benefits of an increased profile, access to an unrivalled pool of international investment and the opportunity to benefit from superior liquidity on our sophisticated trading services. While the second half of 2008 produced some of the most difficult market conditions many of us can remember, affecting both investor confidence and the number of companies joining capital markets across the world, the Main Market’s advantages remain compelling.

For the fact is, despite the turbulence of the credit crunch, our markets have remained open throughout, allowing companies to continue to raise significant sums of money. Indeed, recent times have underlined the fact that our markets are not just about attracting new companies. The Main Market provides firms with more than just ‘one-off’ financing opportunities – it provides the environment in which companies can develop long-term relationships with their investors. Thanks to London’s deep pool of investment capital, companies returned to the market when they needed access to further funds to grow and develop their businesses, or as a more efficient alternative to other forms of finance, with more
In 2008, the Main Market welcomed 68 new companies, raising £6.1 billion between them.

than £60 billion raised in secondary issues on the Main Market during 2008.

I believe that it is our choice of four markets, developed for the specific needs of companies of all different types, ages, sizes and sectors, that has seen us continue to provide access to the capital that many companies need to continue their plans for growth and development during these difficult times.

In 2008, the Main Market welcomed 68 new companies, raising £6.1 billion between them. This included Resolution Limited, which raised £660 million, a substantial amount even by the standards of the last five years. We continue to welcome many corporates from emerging markets, such as Byblos Bank, the first Lebanese company to join the Exchange’s markets in 12 years, which listed on the Main Market in January 2009.

The broad range of securities that can be admitted to the Main Market, and the varied investment opportunities that they offer, are also a factor in its popularity. For example, 75 Exchange Traded Funds (ETFs) were admitted to the Main Market in 2008, including the world’s first ETF from Kuwait, a testament to the Main Market’s global reach. The growing popularity of ETFs with both retail investors and institutional investors is in part due to the regulatory transparency that a Main Market listing offers.

Looking to the future, there is no question that the current volatile market conditions present challenges for capital markets and the issuers and investors they serve. But the London Stock Exchange and its Main Market are well positioned to help companies and investors to meet these challenges. The capital raising opportunities, depth of liquidity and low cost of capital, the efficiency of our trading services, coupled with the investment choices available, increased media and analyst interest and world-renowned regulatory standards, will all ensure that the Main Market remains a compelling place to be.
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We advise issuers and underwriters on equity offerings of all kinds, including IPOs, primary and secondary offerings, private placements and exchange offers. Our lawyers have extensive experience handling listings on leading exchanges across Europe, Asia and the Americas. We advised on the largest European IPO of 2008 to date, a triple listing in London, Warsaw and Prague.

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London has developed a unique position in the world as a financial centre, with its own pattern of regulation and governance.

**BY NICK GOODWAY**

**LONDON AS A GLOBAL FINANCIAL CENTRE**

Buckingham Palace, the Tower of London, the Houses of Parliament, the London Eye and the London Stock Exchange are all instantly recognisable symbols, not just of the capital of Britain, but of this country’s position in the world throughout the ages.

Today the modern office buildings, which house thousands of people working in the banking, broking and financial services industry in both the City and Canary Wharf, bear testimony to the fact that London remains at the heart of the world’s financial system, despite the current challenging economic climate.

And at the heart of that lies the London Stock Exchange – the world’s oldest institution for trading the stocks and shares of publicly quoted companies from around the globe.

The world’s financial markets have undergone a massive revolution in recent years. The Exchange has undergone greater changes in the past 22 years than in the preceding 200 years of its history. And it has emerged not only leaner and fitter, but also stronger and more active on the world stage.

The key decision came in the early 1980s when the then Chairman Sir Nicholas Goodison – prompted by the Office of Fair Trading – persuaded his members to embrace competition, first by abolishing fixed commissions and then by opening the Exchange to outside members and new capital. This led to the mergers of Exchange member firms with home and foreign-owned banks and laid the foundation for the modern international securities houses that today dominate financial markets.

It was therefore no coincidence that so many of these developed in London, or have London as a key operating base, nor that London became the centre for international securities trading.

The Exchange, and its Main Market, are at the core of the British and increasingly of the global economy. By enabling companies to issue equity, debt and other types of security to investors, the Main Market provides the means by which companies may raise capital to grow their businesses. It encourages employers to share their success with their employees through share bonus and share savings schemes. And for the wider public it provides a home for their savings and pension funds, which in the long term has consistently seen equity returns outperform any other kind of investment.

History and geography have always given Britain a head start in the world of trade and commerce. As an island nation, Britain naturally formed trade alliances with its neighbours in Europe and then later further afield in India, Africa, Asia and the Americas. The great ports of London, Liverpool and Southampton saw trade flow not just in and out of them, but also through them on their way to other destinations across the globe.

In the modern era, Britain’s position on the Greenwich meridian ensures that, as the trading day comes to a close in the Far East, the baton can be picked up by London dealers who then overlap for several hours before they finally pass it on to New York. The language of trade and commerce is
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Even before Big Bang, London was already developing as one of the big three financial centres of the world

almost universally English. The words 'shares' and 'stocks' both derive from Old English. Even the two most important words of all – 'buy' and 'sell' – are also Old English.

Today, the Exchange is home to almost 3,200 companies from more than 70 countries. That makes it the largest exchange in Europe and the platform for probably the most diverse selection of companies in the world.

But London has had to battle to retain that pre-eminent position in a world where the importance of financial services to economic growth has been rapidly recognised, from Shanghai through Mumbai to Sao Paulo.

The London Stock Exchange began life in the coffee houses of the capital in the 17th century and for almost 200 years continued in varying forms, owned by its own membership. These members, or stockbrokers and stock jobbers, wrote the rules and enforced them. This worked amazingly well. So much so that in 1923, the Exchange was awarded its own coat of arms bearing the words 'Dictum Meum Pactum' (My Word is My Bond).

But by the mid-1980s, Government and the Exchange realised that the modern era needed a modern system. The old rules were too restrictive and the membership of the Exchange was seen as a club – unwilling to allow outsiders in and keen to protect its valuable rights.

‘Big Bang’ in 1986 let outsiders like foreign banks buy into member firms, the split between brokers and jobbers ended, minimum fees for trading were abolished, the Exchange changed from being a mutually owned society to a private limited company and trading shifted from face-to-face dealing on the Exchange floor to electronic dealing via telephone and computers.

Change begets change. In the following years, the Exchange’s Council became a Board of Directors; the Exchange responded to lobbying from entrepreneurs and the venture capital industry and created AIM, a junior market to give smaller growing companies unsuited to the Main Market the opportunity to access equity capital; the regulation of Main Market-listed companies moved to the new Financial Services Authority (FSA); trading became fully electronic; the Exchange listed on its own Main Market; and in 2004 it made the move from the Exchange Tower to the more compact, but ultra-modern, headquarters in Paternoster Square.

The move was symbolic of the role the Exchange, and indeed the City, was ready to take in the third millennium. If the building was considerably smaller, the Exchange’s reach was becoming ever greater. It merged with Borsa Italiana. It forged alliances with exchanges in Tokyo, Johannesburg, Tel Aviv, Oslo, Moscow and Latin America. It opened a broadcast centre for the world’s media, from the BBC to CNN, to broadcast financial news with a living backdrop of the City.

But the Exchange could not develop so rapidly in a vacuum. London was racing ahead at the same time.

Even before Big Bang, London was already developing as one of the big three financial centres of the world, alongside New York and Tokyo. It attracted talent from around the world to work alongside a massive pool of well-educated, responsible, local workers.

London became known as the most innovative financial centre. It developed the Eurobond, led the world in the privatisation of state-owned industries and businesses and created financial products that allowed investors to speculate on everything from the way shares would move to the weather next month.

All the major banks today have offices in the capital, almost all of which cover not just the local area, but have the grand title of HQ Europe, Middle East and Africa. In recent years, that has become more and more important as the shift in wealth and capital flows has seen the vitality of emerging countries in capital markets.
London is no longer merely a source of British capital, although its domestic savers, insurers and pension funds remain a key part of the market. It is now a massive conduit of capital flowing from the fund management firms of the United States, the pension funds of Europe and the sovereign wealth funds of the Middle and Far East.

Access to capital is at the heart of the Exchange’s business. To maintain those flows of capital, it has to be trusted, robust and efficient. Trust in London as a financial centre has been reinforced by successive governments and enlightened executives in the City’s financial institutions.

Regulation in London is recognised as being effected with a balanced but firm rod. The FSA has moved strongly towards ‘principles-based regulation’ under which it seeks not to regulate the minutiae of day-to-day transactions, but to ensure instead that the conduct of firms and the way they use the markets conforms to high-level principles of integrity and honesty. Liaising closely with the Exchange, it has proved effective in catching and prosecuting market abuse. It has acted quickly when potential problems have occurred, such as banning short-selling of banks’ shares.

There is considerable guidance for Main Market companies to explain what is expected of them, how they are expected to conduct their relations with investors, and their reporting requirements – which include regular contacts between companies and their investors, and timely updates if circumstances change. It also oversees corporate governance based on the Combined Code, which was created by both companies and investors to ensure that UK Primary Listed companies (and indeed international companies) are among the most transparent in the world in revealing how they are managed and run, and how their directors are compensated.

These principles endeavour to ensure that management of London-listed companies is among the best in the world. Good management of publicly quoted companies is well rewarded. Poor management often finds that investors can very rapidly get rid of it.

London’s Panel on Takeovers and Mergers is seen as the leading force in the area of mergers and acquisitions. It is still self-regulated and enforced by the very people who practise deal-making. Proof of its success is the fact that much of the European directive on takeovers comes straight from the Panel’s own code.

Strictly speaking, the rules of the Panel apply only to UK incorporated issuers, but it sets a tone that even those who will not be affected by it find attractive. Indeed, that framework of tight but pragmatic regulation is one of the key reasons so many overseas companies have chosen not only to have Secondary, but increasingly Primary Listings of their shares on the Exchange.

But the Exchange has also had to ensure that it works as efficiently as any of its rivals to maintain its attractions. In recent years it has embraced and in some cases led technological change.

Trading speeds on the Exchange’s platforms are now among the fastest in the world. The fees it charges for trading have been falling rapidly, with the biggest players charged the lowest fees to ensure that liquidity remains strong. And the Exchange’s electronic platforms have gained an enviable reputation for robustness. Even in the most volatile of markets, trading carries on. Suspensions generally occur when there have been extreme unexplained share movements, which imply there is a false market in a company’s shares; or alternatively when there is a corporate move planned, which will completely change the nature and value of a business. Key to that is the quality of data that the Exchange provides to the global financial community. Collected from its own customers, pricing is efficient, clearly displayed on thousands of screens around the world in real-time. Efficient pricing is at the core of orderly markets.

At the same time, the Exchange has not sat back and rested on its pre-eminence in the cash equities market. Through EDX London it has created one of the world’s most liquid and efficient markets for the trading of Nordic and Russian stock and index derivatives. It is now working on Baikal, a project for trading in the so-called ‘dark pool of liquidity’ across Europe.

Rivals have also burst onto the London scene in recent months, threatening to capture market share from the Exchange. But although it is early days, the indications are that as much as they have tried to poach trading from the Exchange, they have actually succeeded in creating greater liquidity in London and taken little away from the older market.

The future will not be easy for anyone in the global financial services industry. But it is the robustness, efficiency and openness of the London Stock Exchange that ensures it will retain its pre-eminence, whatever lies ahead.
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Globalisation has transformed the financial world in the past decade, but efficient and innovative capital markets are vital if its capital surpluses are to be directed to its most productive uses. **BY GARY PARKINSON**

**HARVESTING THE DIVIDEND FROM GLOBALISATION**
outh Africa, Australia, Chile, Germany, Russia, India, Mexico, Kuwait, Kazakhstan, United Arab Emirates, Czech Republic, Poland, Egypt, Pakistan, South Korea, China, Argentina, Vietnam, Bahrain and Japan. (Pause. Draw breath.)

No, this isn’t the national team of your average premiership football team, it’s just some of the 70 disparate homelands of the companies that can now be found on the London Stock Exchange’s Main Market. At the last count, about 700 of the 1,500-odd firms on the Main Market are either incorporated overseas, or do the lion’s share of their business outside the UK. The recipe that transformed London into the most international of stock markets comprised a handful of ingredients – the first two being accidents of geography and language.

Philip Secrett, corporate finance partner at accountants Grant Thornton, says: “London sits at the crossroads of Europe and the overlap of time zones with the US and the Far East make it a natural place for foreign companies to do business. That, and the fact that we speak English – the global business language – have been acute drivers for why London has done so well.”

It was back in the 1970s when the world’s big companies discovered a real appetite to be still bigger, to expand and do business on a global scale, across different countries and continents, sometimes organically but more often by acquisition. To satisfy those ambitions required capital.

London’s heritage of empire and colonialism meant it already claimed strong ties with many companies doing much of their business in far-flung corners of the globe. International companies had long looked to the City for funding – the Chilean copper miner Antofagasta, for example, has been on London’s markets for 130 years.

But it was not until 1986 and Big Bang that London was able to meet the expansionist globalisation movement head-on. The electronic trading revolution was accompanied by an invasion of the City by the big Wall Street investment banks – the likes of Goldman Sachs, Morgan Stanley and Merrill Lynch – that was quickly followed by waves of newcomers from Europe and elsewhere, with Swiss, French and Japanese banks all setting up shop in London.

Old-fashioned British stockbrokers – more used to servicing private clients from staid, oak-panelled offices across the City – soon found themselves working for the brash new kids on the block. Names that had graced the City for hundreds of years simply disappeared, mopped up in short order by the big investment banks.

They brought with them an international investor base. Gone were the days of the crusty British broker investing a modest nest egg for Granny Parkinson in Tunbridge Wells, replaced by a deep well of cash from pension and investment funds from around the world.

Suddenly, the international money was there and looking for a home that could satisfy and further fuel ambitious corporations. And with the advent of electronic trading, capital could be moved around in the blink of an eye.

Efficient capital markets meant capital surpluses could be directed to their most productive uses. Globalisation was cooking on gas.

Through the 1990s, London continued to win healthy international listings, in part because of the City’s expertise garnered from the wave of privatisations set in motion by the Thatcher Government.

Meanwhile, the Exchange built on Big Bang. It closed its trading floor, and in 1997 moved share trading on to the brand new Stock Exchange Electronic Trading Service (SETS). This is the Exchange’s electronic order book-based trading system, which lets brokers input buy and sell orders directly into the system. Buyers and sellers are matched and the trade executed automatically.

SETS sparked nothing short of a trading revolution in London. Before SETS, perhaps 10,000 trades a day could be expected. On a brisk day now, a million trades are not uncommon.

**SETS sparked nothing short of a trading revolution in London**

But if London’s secondary market was now fast and liquid, its international credentials, expertise and success long-established, it still took a monumental own goal across the Atlantic for the City finally to leapfrog New York to become the world’s pre-eminent financial centre.


In contrast to America’s heavy-handedness, investors applauded the UK’s level-headed rulebook, its principle-based approach that complemented a more flexible tax regime and top-drawer corporate governance rules. UK law proved an important added draw, used as it is for most international dispute legislation.

A raft of international firms, investors and entrepreneurs flocked to London.

A listing on the Exchange’s Main Market was, and remains, cheaper than any other major financial centre. Tracey Pierce, head of primary markets at the Exchange, says: “London is the most cost-
It takes more than making correct investment decisions to run a successful investment business. Cost control, regulatory compliance, and operational processing are just some of the distractions that absorb valuable resources and jeopardise your margins.

Retaining an agile cost base is essential. You need to have the flexibility to add capacity when needed, but without the overheads when the demand isn’t there:

- If volumes increase by 50%, you need to be sure your business can continue to deliver on your commitments to your customers.
- If volumes halve, you want to be able to control your expenses in order to maintain your margins.

One way to achieve this is to outsource those parts of your business in which you don’t need to specialise, leaving you to focus on the parts which give you competitive advantage.

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OMX Securities can also help you increase your revenue. For example, our Treasury Management Service can actively manage your client money, maximising returns to you without affecting those to your customers. To find out more, talk to us today.

If you are looking to reduce your costs while maintaining control of your business, visit www.omxsecurities.com, or call us on 0121 236 0336.
effective place for companies to raise capital. The equity cost of capital at both initial public offering stage and beyond is lower in London than in any other major financial centre, particularly compared with New York.

“Underwriting fees are twice as much in the US markets compared with London, and this comes on top of exceptionally high litigation risk and regulatory costs.”

By 2005, London had overtaken New York as the global financial capital of the world. That year, 141 companies made their London debut – 95 of them on the Main Market’s kid brother, the Alternative Investment Market (more commonly known as AIM). Together they raised a touch over £6.7 billion. Within two years that number more than doubled.

The enormous weight of money wielded by traditional pension funds and institutional investors was augmented by the cash-rich hedge funds, venture capitalists and private equity firms that colonised London’s West End. At the last count, the performance of more than £199 billion of UK assets in pension, insurance and investment funds is now measured against the FTSE 100, FTSE 250, FTSE Small Cap and FTSE All Share indices.

London provides a gateway to the European Union for companies looking to access Europe as part of fulfilling their global ambitions. The EU accounts for 31 per cent of the global economy, more than the US with 26 per cent, and has a population of 490 million people.

“The companies looking to London want to be truly international, truly global,” Pierce says. “A number of their home countries have their own, often well-developed stock market.

“It’s partly a prestige thing. It says ‘we’re a global company with global ambitions’. It shows they can be quoted among all the other top blue-chips and can comply with the highest standards of corporate governance and disclosure.”

Following its merger with Borsa Italiana in 2007, the London Stock Exchange Group is Europe’s number-one equities business, commanding about half of the FTSE Eurofirst 100 companies – a barometer of the 100 biggest firms across the Eurozone by market value – and has the most liquid order book by value and number of shares traded.

The London Stock Exchange Group also offers the leading markets for the electronic trading of securitised derivatives and exchange-traded funds, giving investors easy and liquid exposure to a wide range of indices; and fixed income on the MTS bond-trading platform. Equities derivatives, primarily Russian and Scandinavian, change hands through EDX in London and IDEM in Italy.

London’s carefully nurtured pre-eminence as a financial centre must be assiduously guarded in the wake of banking and credit crises that have rewritten the global financial landscape.

The credit crunch that has gummed up financial markets for the past 18 months has already prompted a dramatic contraction of the number of firms listing on all of the leading global stock markets, including the Exchange’s Main Market.

The most recent figures show just six foreign firms raised a shade under £3 billion between them in the first six months of 2008. That’s against £12.9 billion raised by 45 foreign listings in 2007. But while the credit crunch may be damaging London’s business from overseas, it has prompted a jump in the overall amount raised from investors. In April 2008, Royal Bank of Scotland asked shareholders to stump up £12 billion, followed closely by a £4 billion cash-call from rival HBOS.

The Exchange remains sanguine about the likely future impact of log-jammed credit markets on its business. “Clearly the credit crunch has an impact on the equity market,” Pierce says. “But if credit becomes more expensive and difficult to obtain, it should, in theory, make equity a more attractive means to raise capital.”

Pierce is spearheading the Exchange’s push to pick up foreign business. Dedicated marketing teams are trumpeting London’s attractions to companies in Latin America, Central and Eastern Europe, Asia and the Middle East. That alone won’t guarantee that London stays ahead of the chasing pack. A heavy responsibility rests with politicians and rule-makers who, in the eye of the current financial storm, may find calls to rein back the City with tougher tax and regulatory regimes difficult to resist.

“The pragmatic approach to, and application of, regulation is going to be crucial,” Secrett says. “Clearly something was broken, but what’s fundamental to London’s continued success is for any regulatory or policy response to current events to be proportionate and pragmatic.” The free-wheeling excesses of the past must indeed be curbed, but not at the expense of London’s financial competitiveness in the years to come.

Gary Parkinson is editor of BBC 5 Live’s Wake Up To Money.
The capital markets industry - and especially the world of exchanges - has always been characterised by three main trends: The sudden rise of new players, the need for constant innovation and a highly volatile business environment. In the recent past, with the movement towards a world where economic power is split between multiple centres around the globe, we are also seeing new and interesting developments within the exchange industry.

Driven partly by the trend for demutualisation, many stock exchanges around the world have gone public, making the industry more dynamic and more competitive. As a result, exchanges are looking to deliver value to their shareholders by creating new revenue streams. Attracting new listings from around the world is one strategic option to achieve value creation and this has been a major focus of the London Stock Exchange. Efficiency, depth of liquidity, a strong regulatory regime, advanced technology infrastructure and prestige are the main levers to attract new listings, and established markets can provide this more easily.

The option for smaller exchanges and emerging markets might be to create value from local market knowledge and the design of new vehicles through which smaller businesses can access the capital market with more of a regional focus. At the same time, sharing the option for exchanges in the developed world to create new revenues streams by establishing dedicated alliances and business partnerships with their emerging market cousins.

Over the next year investors are going to begin looking to where they might make up for some of the losses they have recently suffered. Minds are prone to wonder where economic growth might be strongest and opportunities most plentiful. It is likely to conclude that the answer lies, in large part, in emerging markets. Despite the current volatility and ripple effect of the credit crunch, emerging markets do have a reasonable outlook, if for no other reason than their playing economic catch-up creates more potential than in leading economies.

On the other end, the financial and economic development of an emerging market follows a number of well-worn steps. As an economy progresses, markets will naturally open, and there develops a need to establish a stock exchange to allow companies to efficiently raise capital. The question for emerging market exchanges soon becomes one of how to attract foreign capital, as well as keep domestic capital investing at home. The answer is to establish credibility: a strong set of regulations and a general degree of trust. While establishing credibility does not guarantee success, failure to establish credibility makes success impossible. This is especially important as the further development of a financial market is dependent on even more trust needed to be able to access capital and the bond itself. It is only natural that the more uncertain market regulations are, the more investors are likely to demand a premium. Therefore - stringing the above mentioned thoughts together - the challenge for an emerging market exchange is how to gain credibility as rapidly as possible.

It is naturally going to take time to gain investors' trust, as well as for investors to become familiar with local rules. As markets grow, the benefits are likely to rapidly become significant: In a spiral of self reinforcing success, once credibility is established, markets can benefit from significantly enhanced liquidity.
With liquidity begetting liquidity, greater investments can be made with greater certainty, all of which will allow risk premiums to fall. Falling risk premiums point to more plentiful and lower cost capital, which in turn will allow economic growth to be maintained.

We believe that alliances and business partnerships from exchanges in the developed world with exchanges in emerging markets represent an opportunity to accelerate this process to the benefit of all concerned.

Such alliances can for example give rise to greater legal certainty and clarity. Increasing global cooperation in rule making will make it easier for emerging market exchanges to adopt commonly understood rules that work effectively in mature markets and to more readily benefit from sharing exchange mechanisms and existing investment rules.

Through dedicated technology alliances, emerging markets can also leverage advanced technology for trading. Such alliances will increase acceptance and trust in emerging markets through known trading models and could help to secure a larger slice of the local pie which otherwise might be routed to other trading venues (internalisation, over-the-counter-trading). And alliances can be about more than technology - they could also cover cooperation in product definition using terms that western investors are familiar with.

Alliances also offer a good possibility for exchanges in the developed world to respond to the pressure for new revenue streams by exporting technology, provide listing opportunities or help create new products to satisfy sophisticated customer needs. Even accepting the current turmoil in the financial markets might continue for some time, it seems likely that alliances are going to dominate the exchange landscape over the next few years. Ensuring that everything from regulatory regimes to information technology systems is built with the potential for establishing alliances is going to be the mark of a high performer.

Of course there are further options to create new revenue streams and each publicly listed exchange will have to find individual answer(s) to respond to its shareholder’s demand to deliver value in an environment that gets ever more globalised.

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The world of exchanges is changing and, in recent times of financial uncertainty, a traditional exchange appears to offer investors more stability and security.

BY DEBRA DELUCA

HOW WORLD STOCK MARKETS

A McKinsey study prepared for New York Mayor Mike Bloomberg a couple of years ago highlighted how and why London is upstaging New York as an international financial centre. It is an interesting document, but the key point to emerge is that London is the beneficiary of a long-term trend.

One of the reasons is that the developed economies of Europe and the developing markets of Asia are beginning to use the capital markets more intensively. London, with its skills, its language and its international traditions, is the obvious place for them to come. In another study last year, McKinsey reckoned that for some years now the growth rate in the use of financial assets has been twice as fast in Europe as it was in America, hence the firm long-term trend away from New York. This, in turn, has huge relevance for the London Stock Exchange – it is a market plum in the centre of the greatest growth surge in financial markets the world has ever seen.

The London Stock Exchange upstages Nasdaq for the same reasons London upstages New York – it is the right market, in the right place at the right time. Critics who say the Exchange does not have a strategy, because it has generally stood aloof from the orgy of consolidation among exchanges, have largely missed the point. It does not need a strategy based on acquisition or consolidation because the business of the world is coming to it anyway. All the Exchange needs to do is ensure that it keeps its technological edge so that its markets remain cost-effective and efficient enough to handle it all.

The deals it has done, notably the merger with Borsa Italiana, which confirmed its position as Europe’s largest exchange, brought significant additional capability in clearing and the European government bond market.

This, indeed, is the main change in the world and one which can be expected to reassert itself when the current market turmoil has come to an end. Technology makes it possible for investors to put money into every market in the world and to monitor their investments as closely as if they were within their own country. Technology also allows compa-
Exchanges and their markets have not really changed at all

Exchanges no longer work because of competition from alternative electronic trading venues, such as Chi-X, Turquoise, BATS and others recently launched in London. They argued that physical markets would be rendered obsolete by the modern electronic trading facilities.

More than anything, this underlines the problems that even informed observers have with understanding how the world of exchanges is changing. For example, if the traditional stock exchange model is doomed, why would one want to build a new one in Qatar? And not just there – since the collapse of communism, almost
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Alternative trading venues can replicate the computer systems of the Exchange and the algorithms which control its trading engine. However, they cannot replicate the trust people have in its prices.

20 years ago, exchanges have been established in most of the countries in Eastern Europe underlining how, in the minds of most people, a stock exchange remains an essential building block for a modern economy.

But, given that on this evidence of proliferation the traditional stock exchange is not doomed, then why do so many people automatically assume that the new electronic trading venues, or Multilateral Trading Facilities (MTFs) will attract all the business? The more so because previous efforts to create rivals to established stock exchanges failed when liquidity did not move to those new rivals. They seem to have forgotten that in London at the turn of the millennium, Jiway and Nasdaq Europe both failed to establish themselves and Virt-X ultimately retreated back to its parent in Switzerland.

The truth is that there is room for both models and they do different things. Traditional stock exchanges have a role because there is no better mechanism for funnelling capital to new businesses, and for allowing entrepreneurs to crystallise value via a share flotation. Electronic markets have a role in servicing new liquidity providers, themselves driven by computers dealing in fractions of a second and creating the liquidity which aids market efficiency.

Some markets achieve a scale that brings them international recognition – one of which is the Main Market in London. They replicate the functions of the local exchanges but on a much larger scale, mobilising huge pools of capital for internationally recognised businesses.

When internationally sized exchanges achieve a certain scale, the volume of secondary trading becomes so large that it provides scope for competition from the MTFs. These carefully targeted MTFs have the opportunity to generate more intense trading among firms with the technology to exploit the opportunity. But these platforms cannot replicate, and do not claim to replicate, all the functions and role of a traditional full-service stock exchange.

The difference has also been highlighted by the past year of turmoil in financial markets, where one of the winners could be the Exchange, and stock exchanges generally. The crisis has brought into focus the key difference between an officially constituted exchange and any other market – be it a standalone trading platform or an over-the-counter telephone market. That factor is trust. Trust is the unique quality an exchange has, which other platforms don’t have.

So much of what went wrong in the credit markets was because there was no objective pricesetting mechanism for products, which in more confident times were freely traded over the counter at prices derived from mathematical models. Once people came to believe the models no longer provided the right answer, there was no basis for pricing or trading. That was never a problem with Exchange products.

Alternative trading venues can replicate the computer systems of the Exchange and the algorithms which control its trading engine. However, they cannot replicate the trust people have in its prices, which is in turn born of a panoply of activities and permission – and indeed history – which the critics conveniently choose to ignore. Trading is not only about execution. The real differentiator between different venues is a whole range of other factors – technology, talent, tradition and trust – which is what London’s Main Market has in abundance and which will always be the essence of an exchange, however much it may appear to change on the surface.
In view of the economic crisis, investors now seem keener than ever to spread risk. **ANDREW JOHNSON** considers the effectiveness of this approach.

The dotcom boom and bust forged a revolution in the way investors managed their money. It sparked a realisation that the same way to avoid madness in one set of markets was to spread risk across a broader range of investments and around the world. Regulatory pressures on companies in the developed world to safeguard their financial strength provided a further driver into new areas.

However, the financial crisis has landed a few blows on the idea. Questions have been asked. What is the point of spreading risk when all asset classes are heading straight down the same route?

But more far-sighted investors are already investigating the opportunities for generating strong returns over the next two to five years, and the ideas forged over the past five years will be key.

Broadly speaking, the major trend has seen money flow away from domestic stocks into two broad areas. The first area is that of ‘alternative investments', a term covering anything from hedge funds to private equity. Among them would be commodities, foreign currency, water, agriculture and green energy. One of the most popular has been infrastructure because of the long-term income it can provide to pension funds. The second has been a move into new areas of the world. In particular, investors have looked at the best ways of tapping into the explosive growth enjoyed by China, India and other emerging markets.

As well as London-based asset managers going to the world, the world has come to London. The number of foreign companies listed on the Main Market has ballooned as firms, many based in the new economies, have sought to tap into all that the London market stands for.
These shifts have been accompanied by new ways of investing. Money has moved away from active funds, with a manager in control, to index-tracking, passive funds. The London Stock Exchange has catered to this trend by offering Exchange Traded Funds (ETFs), which track an index with no need to invest in each underlying asset. The advantage of doing this is that investors can diversify in an environment regulated in the UK.

Active managers, especially those running hedge funds, have responded by demanding a greater say in how companies should be run as they seek to generate high returns. This has run parallel to a swathe of new corporate governance guidelines in the wake of a series of fat-cat scandals earlier this century. The most notorious were the huge payouts given to the Marconi executives who drove the one-time FTSE-quoted telecoms giant to the brink of bankruptcy.

London has played a central role in all these trends, with the UK one of the world’s three great capital pools, alongside the United States. The Investment Management Association (IMA) estimates its members handle nearly £1.4 trillion in funds out of a total global pool of £32 trillion. Its figures show the shift away from traditional equities, bonds and cash into the new areas.

Back in 2003, funds held 68 per cent of their investments in the stock markets, a further 31 per cent in bonds, and only 1 per cent in other classes. This was at a time when the FTSE 100 Index was in a deep trough as the dotcom bubble exploded.

By the start of 2008, however, the proportion held in equities had dropped to 58 per cent, while bonds made up 35 per cent and those in other asset classes had risen to 7 per cent.

Even those figures do not reflect the true shift of cash out of the UK stock markets into a wider range of assets. The IMA says that the 58 per cent also includes investment in foreign equities. During 2006, the IMA says, UK pension funds invested more abroad than they did at home.

And there is a good reason why diversification was popular: it worked. It offered nearly the same returns as the traditional model of domestic equities, bonds and cash – and much less volatility. Recently, Barclays analysts compared a portfolio made up of equities from developed and emerging markets, bonds, property, private equity, commodities, infrastructure and emerging market
The case for diversification – that though one class of investment may fall, others do not – did not stand up in the face of panic selling across the board.

Hedge funds and banks became forced sellers as they realised they could not borrow money. That undermined oil and other commodity prices, currencies and stock markets around the world.

Global recession fears sent stock markets tumbling worldwide as analysts began to reject the idea that emerging markets were ‘de-coupled’ from the developed world. One analyst said the notion had been truly “hung, drawn and quartered”.

The crisis showed just how connected assets are. No matter how different assets might seem on the surface, they all depend on money and, in particular, on credit. As credit dried up so the arteries of the financial system no longer functioned. That forced those unable to borrow, or who had borrowed too much, to sell their assets. “The money markets are like a heart,” said one investment banker. “They are something you don’t notice until they stop.”

How the crisis will affect investment decisions in the future remains to be seen. Much could depend on the measures introduced by regulators and governments to stop a similar crisis in future. They could force investors to be more cautious in taking on risk, or to hold higher reserves of capital, moves which could affect long-term returns.

In response to the dotcom crisis, UK watchdogs forced insurers to sell shares – as it happened right at the bottom of the market, the time they should have been buying. If the regulatory response is ill-judged this time, it could unfairly punish those who have borrowed prudently. And those who wish to invest could be prevented from taking advantage of a golden opportunity to buy assets that are cheap on a long-term view. These include global equities, emerging markets and commodities. There will still be a role for hedge funds, although the scrutiny they will be facing from their backers will be intense. Many are expected to fail, not least by the hedge fund industry itself.

As the world goes into recession, there will also be a role for private equity houses, whose skills lie in identifying distressed or undervalued businesses and in turning them round. There could be more innovative investment structures put in place to give traditional, equity investors a greater share in the potential upside.

Given the short-term uncertainties over the global economy, index-trackers and ETFs are likely to be out of favour in the short term. While shares are cheap historically, many investors believe they are still too expensive given the pounding corporate profits could take over the next year or so.

Instead, investors are seeking skilled active fund managers to stock-pick their way through recession. They also believe corporate bonds are cheap. Some emerging markets will be avoided, especially those with heavy debt burdens. But India and China are still expected to grow strongly.

Experts recommend a switch from Chinese companies dependent on exports to those focused on infrastructure and internal consumption as the government pumps money into the economy. One of the fallouts from the dotcom crash was new guidelines on corporate governance and a greater willingness for investors to become actively involved. One result of this is the average tenure for a FTSE 100 chief executive dropped by 20 per cent to 4.6 years, as shareholders demanded they deliver and deliver quickly. As a result, it has become harder for companies to pursue patient, long-term investment strategies as they constantly pursue short-term ‘shareholder value’.

To some extent, the corporate governance changes following in the wake of the financial crisis are attempting to address that problem. The Government has already demanded that bank executive bonuses should be more geared towards long-term performance rather than on hitting annual targets.

The credit crisis also threw up an apparently contradictory problem, where weak boards allowed executives to remain in power unchecked for too long. City watchdog, the Financial Services Authority, is believed to be looking to vet banking non-executives to ensure they actually understand the risks involved. In an ideal world, you would have investors willing to engage with companies for mutual long-term interest, backed by strong, independent non-executives.

But underlying all this is a more fundamental problem: that the asset managers who ultimately own these companies are themselves rewarded on a short-term basis. Until this is tackled, long-term considerations are unlikely to dominate. As one observer said: “You might see restraint for a while, but why should anything change?”

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Globalisation and internationalisation are key issues facing the London Stock Exchange.

BY PETER CUNLIFFE

INTERNATIONALISATION
OF THE
MAIN MARKET

Globalisation is nothing new for the London Stock Exchange, which can trace its roots to the opening up of the international economy in the 16th and 17th centuries. The share-dealing culture that began life in the coffee houses in London’s alleyways was driven by the desire to explore trading opportunities in the Far East.

Among the earliest joint stock companies, raising funds by issuing shares to investors, was the Muscovy Trading Company, founded in 1551 to seek a north-east passage to China, but instead forging strong links with Russia. The East India Company, which started life in 1600, sought to end Dutch dominance of the spice trade and ended up laying the foundations for the British Empire in India.

Over two centuries, in the run-up to the formal establishment of the London Stock Exchange in 1801, British investors showed that as far as making money was concerned they were in no way parochial. The Exchange and its precursors provided the means by which those seeking to raise cash, either for overseas adventures or commercial and industrial developments closer to home, were able to tap into a pool of money, initially from wealthy individuals, but later from broader-based funds. Over time, the Exchange attracted funds from outside the UK, keen to take advantage of a market that always had an international focus.

Today, the Exchange can boast that it offers access to the deepest capital pool in Europe, with an estimated £4,400 billion invested in companies on the Main Market by pension funds, insurance funds and investment trusts alone. And the last decade has seen a rush of companies keen to draw on those funds, with the Main Market now home to some 1,500 companies from 70 countries, making it the world’s most international market.

That internationalisation is clearest in the make-up of the FTSE 100 Index. When the index was first created in 1984 it was a list of blue-chip British stocks, though many of them were what we would now call multinationals with interests spanning the globe.

Now, the FTSE 100 is a much more cosmopolitan club and the index is no longer a simple collection of Britain’s biggest companies, or a barometer for the health of the domestic economy. Only a handful of the top 100 are purely UK-focused, among them WM Morrison supermarkets and its rival J Sainsbury. Even Tesco, the country’s biggest retailer, generates a quarter of its total sales from abroad.

In addition, the FTSE 100 has seen a growing number of foreign constituents. Ten years ago
“The bulk of our job is to provide companies with options”

there was an influx of South African companies, firms like Old Mutual in financial services and South African Breweries, now SAB Miller, who sought a higher-profile platform from which to launch their international expansion. In more recent times, natural resources have come to the fore, including the likes of Kazakhmys, Eurasian Natural Resources and Vedanta. This of course is a huge advantage for the London-based investing institutions who thereby have easy access to a key global industry in spite of the fact that the only domestic UK business with mining interests, UK Coal, is not large enough to rank in the FTSE 100.

Allowing for the ups and downs in share prices, mining companies have on average accounted for about 10 per cent of the FTSE 100’s value in 2008. However, Primary Listing in London does not of itself require them to maintain a significant presence in the UK, still less to move their head office here. For instance, Kazakhmys, the Kazakh miner, employs 65,000 people worldwide, but only 40 or so in London, while Mexican silver miner Fresnillo has 1,775 employees, just three of them in the UK.

Of course, investment fashions change and this is reflected in the make-up of the FTSE 100. At the height of the technology boom at the beginning of the millennium it was heavily biased towards technology and computer stocks. Later, oils and pharmaceuticals had their place in the sun, as did banking. Now it is the turn for mining stocks to lose ground and with the slide in many mining shares in recent months, it could be that the Index looks very different in 12 months’ time. This, however, is no more than a reflection of the ebbs and flows in the global economy, and in many ways the FTSE 100 provides a window into that world, a real-time indicator to the world’s investors of the sectors and companies to watch.

Companies can choose where they want to float. Fresnillo could have joined its countrymen who looked to New York, but instead it chose London, partly because of the access to funds, but also because of the more balanced regulation and principles-based corporate governance.

There is no doubt that London has benefited from the introduction in the US in 2002 of the Sarbanes-Oxley Act in the aftermath of the collapse of Enron. The US brought in a system that was designed to protect investors against fraud, but were seen by many business as being too costly and time-consuming. The British authorities, in contrast, are keen to talk about their principles-based approach to regulation, although they are keen to stress that it is a very different concept from ‘light touch’.

Britain’s lawmakers and regulators have set out a framework that aims to tread the fine line between protecting investors, who require the strongest and most transparent corporate governance standards, against the needs of companies anxious to avoid being bogged down in expensive red tape.

Companies can choose between a Primary or Secondary Listing on the Exchange’s Main Market. Primary Listing applies only to ordinary shares and companies are expected to meet the most stringent standards of regulation and disclosure in Europe; the benefit of which is access to the widest investor base, including general retail investors, potential eligibility for membership of the FTSE 100 and access to UK tax wrappers such as Individual Savings Accounts and Self Invested Personal Pension Plans. UK-domiciled companies must currently opt for a Primary Listing.

A Secondary Listing on the Main Market subjects companies to EU Directive requirements. Non-UK domiciled companies can select a Secondary Listing of ordinary shares or depositary receipts on the Main Market. Debt securities can also be listed on the Main Market via dedicated rules. Such listings will only tap into an institutional investor audience.
Among the requirements for a Main Market listing is a minimum market value of £700,000 (£200,000 for debt), publication of a prospectus approved by the Financial Services Authority (FSA) and a minimum of 25 per cent of shares in public hands. In addition, a Primary Listing requires a three-year revenue-earning record, 12 months’ working capital (and a clean working capital statement) and demonstrable control over the business assets for the period.

Nick Langford, head of client management and sales in the primary markets team, says: “The bulk of our job is to provide companies with options.” This could be a Primary or Secondary Listing on the Main Market, but it could also be access to one of several other trading platforms that the London Stock Exchange Group provides, if one of these would appear to suit the client company better. Once the options have been made clear, “it is then up to the adviser to choose the most appropriate route for their client.”

He continues: “We are not a regulator. The UK Listing Authority sets the guidelines on disclosures. We seek to ensure that the regulatory environment is appropriate. There are different disclosure standards and the closer you get to a Primary Listing, the more disclosure is required. Broadly, a Secondary Listing is aimed at attracting predominantly professional investors, while a Primary Listing provides investor exposure from indexed, tracker and benchmark funds, all institutional mandates and general retail investors.”

The influx of foreign companies has triggered a debate about corporate governance standards and whether they risk being stretched. Two years ago, the joint London-Moscow flotation of Russian energy company Rosneft came in for criticism amid concerns about corporate boardroom governance, particularly in companies from the former Soviet bloc. Leading fund management group F&C was among the most critical, warning investors to tread carefully and saying that Rosneft must “sort out its legal problems before going public in London”. Financier George Soros warned it raised “serious ethical issues”.

The £3.5 billion London listing of their depositary receipts on the Main Market eventually went ahead after a legal challenge, but it put a spotlight on regulation and governance that has not gone away. In January 2008, the FSA launched a discussion paper about possible change to the listings regime to make the difference between Primary and Secondary Listings clearer.

This prompted a vigorous debate between the Exchange, the advisory community and the end investors, which has helped considerably to shape the final proposals. Throughout, however, two key principles came to the fore. First was that the London markets exist to provide a choice to investors and corporates and it is important that changes enhance rather than detract from the ability to provide that service. Second, transparency is key. There is no intention to ban certain issues or certain kinds of listing, but what is important is that everything is clearly labelled and participants fully understand the different regulatory or reporting requirements associated with the different labels.

Regulators face a tough balancing act, particularly in the current climate following the battering that financial markets have experienced this year. On the one hand they have to protect, and be seen to protect, investors; but on the other, they need to build a regulatory framework that ensures London remains as competitive now, when trade is conducted in the steel and glass towers of Canary Wharf, as it was when deals were done in the Square Mile’s coffee shops. It is, however, a key aspect of the London experience that they have been balancing such conflicts for several hundred years and have an unrivalled skill in getting it right.

Peter Cunliffe is deputy city editor, Daily Express.
PETER CUNLIFFE provides an overview of the growth of UK and international listings on the Main Market over the past decade.

TSE 100, Dow Jones Industrial Average, Nasdaq, Nikkei 225, Hang Seng, Dax, CAC 40 – the indices of the world’s top stock markets, and the ticker symbols of the companies on them, are a familiar sight as they flow along the bottom of the screen on the financial TV channels and news bulletins.

London may sit alongside the world’s great financial centres, such as New York, Tokyo, Hong Kong, Frankfurt and Paris, but in one key respect it is second-to-none. All of those cities, and their respective exchanges, can boast international credentials, but when it comes to attracting overseas companies to list, none has a magnet as powerful as the capital of the United Kingdom.

The Main Market is home to almost 1,500 companies from 70 different countries. Given Britain’s
history as an international trading nation, the Exchange has never limited its horizons to the English Channel, but in the past decade or so it has stepped up its efforts to win business from abroad. And in the year to the end of March 2008, the Exchange attracted 84 international IPOs from 25 countries. That was more than the NYSE Euronext, Nasdaq and Deutsche Börse combined (in 2007, for instance, the NYSE managed just 34 non-US listings). The amount raised by foreign companies coming to London during the period was £14.5 billion, against £9 billion on the NYSE and Nasdaq together, while London’s Main Market and Professional Securities Market raised a record £12.3 billion from international IPOs.

Unsurprisingly, the backdrop of the credit crunch and the turmoil on global markets had an impact on the appetite of companies to seek listings, and although the number of new issues was down on previous years, the Exchange still managed 73 IPOs raising a total of £7.2 billion, 25 of which were international, and £71 billion in total was raised via new and further issues of equity.

One of the features of the Exchange in the past decade is that it is a multicultural exchange, the listing home to companies from every corner of the globe. It has retained its traditionally strong links internationally, but in recent times has also forged close ties with emerging markets, often in the backyard of its rival exchanges.

With the domestic UK economy – and the respective home turf of the key exchanges – offering relatively slow growth, attention has turned to the emerging markets with the potential for faster growth and an appetite for funding that cannot always be met by their domestic investors.

London has aggressively targeted those fast-growing countries and has established a track record for matching the needs of their capital-hungry companies with those of UK and overseas investors in the City.

High up the Exchange’s hit list is China. The Exchange opened its first overseas office in Hong Kong in 2004 and followed that with the opening of a Beijing office in January 2008. In a symbol of the broader importance of such ties, the Beijing branch was opened by UK Prime Minister Gordon Brown.

Those openings were a signal of intent rather than established ties, a foothold in what will one day be the world’s biggest economy. China has 68 companies quoted in London, including 62 on the junior AIM market and six on the Main Market, across 20 sectors. They include Air China, the national flag carrier, which raised more than $1 billion when it listed in 2004.

Central and Eastern Europe is another key target for the future, with 24 companies already listed on the Main Market, from countries including Poland, Estonia, Croatia, the Czech Republic, Hungary and
“We are confident there are people within local markets who will spread the message about London”

Turkey, spread across banking, telecoms, energy, metals and pharmaceuticals. By weight of numbers, Russia and the former CIS countries provide the biggest bloc, with 54 Main Market listings and another 50 on AIM.

The community of issuers includes 37 Russian, 11 Kazakh, one Georgian and five Ukrainian companies, including Russian oil producer AO Tatneft and Ukraine’s JXX Oil and Gas, while Kazakhstan’s Eurasian Natural Resources and Kazakhmys have made it into the FTSE 100 Index. As well as oil and minerals, sectors include property, banking, telecoms and beer.

Although still small in terms of listings, Latin America has also been earmarked as a key territory of the future. For example, Chilean mining company Antofagasta can trace its history and links with London back to 1888, but has been listed here in its present form since 1982 and is now in the FTSE 100. In recent years it has been joined by another six companies from neighbouring countries, including Argentina, Peru and Mexico.

Nick Langford, head of client management and sales, primary markets at the Exchange says: “We maintain strong relationships with other countries and regions across the globe through regular marketing trips, and in the Asia Pacific region through our offices in Hong Kong and Beijing. For instance, in a year we would aim to visit Latin America six times.

“Even in countries where we may not have offices, we are confident we have built relationships with people within those local markets who will spread the message about London. Part of our job is to educate the advisory community and persuade them that they should be thinking about London.”

He adds: “The market gets ever more competitive. We’ve been more dedicated to international work than other exchanges.

“It doesn’t mean it’s getting any easier, because the competition is getting tougher. On international IPOs we outperform all our major competitors. With more than 700 overseas companies from over 70 countries on our markets, we are the world’s most international stock exchange.”

Despite recent turbulence on international financial markets, Langford and his team continue to seek out leads: “There can be little doubt that market conditions globally are difficult at the moment, but we haven’t seen a decrease in terms of interest from international companies looking to London to raise finance. We are still marketing as much as we ever have, and many of the events we speak at are still packed out by interested companies.”

Despite being just a short flight away from the NYSE, Mexican silver mining company Fresnillo chose London, listing on the Main Market in May 2008 with a market value of £3.9 billion, and soon after moving into the FTSE 100. The dedicated marketing of Langford and his team paid off: Fresnillo’s chief executive, Jaime Lomein, looked at a number of exchanges, but chose London because of its close links with the mining industry and its pool of investors from all over Europe and the Middle East. Fresnillo said it had no trouble raising finance at home, but saw a listing in London as a way of creating a currency in which it could do M&A deals.

In addition to its reservoir of international capital, London has practical attractions for busi-
nnesses, not least its location on the Greenwich Meridian Line, where trading hours overlap with the Far East at one end of the day and New York at the other. Language is widely regarded as an advantage over European rivals.

Fluctuations in currencies mean that at various times the use of the British pound can be seen as a plus, or a minus, when prospective companies are looking at the US and the dollar, or exchanges within the eurozone.

One of the city’s drawbacks can be the expense of doing business there, but with modern technology, such as the internet and video conferencing, executives based overseas are able to keep in touch with their shareholders, even when they are on the other side of the world.

International Ferro Metals Ltd (IFML), a producer of ferrochrome, which is used in stainless steel-making, is something of an international hybrid, with its head office in Sydney, its operations in South Africa and its main stock market listing in London. IFML first joined AIM in September 2005, and was at the time the largest resources IPO on the market, raising £99 million. Two years later it raised another £85 million when it moved up to a listing on the Main Market.

IFML’s chief executive, Stephen Turner, spent nearly four years working on the listing and examining his options, including roadshows in Hong Kong and Singapore. Turner explains: “It’s not just that London is the biggest market, there is a strong history of it investing in the mining and resources industries and it has a very good understanding of Africa.” The listing was a complicated process, though he adds: “Compared to the debt-raising, the listing process and simultaneous equity-raising were relatively quick.”

Ultimately, Turner felt that the Australian and Asian markets could not compete with the trillions of dollars flowing to London. Although AIM provided a good bridge into London, the shares were tightly held by a small number of institutional shareholders, and a move to the Main Market was the next step.

Turner says that heavy regulation in the US helped make London more attractive, particularly as he felt that the Sarbanes-Oxley regulations were “crippling New York’s ability to host IPOs”.

“We found the London Stock Exchange very helpful,” says Turner. “There was a good, co-operative relationship. Since we listed we have had approaches to list on other markets, but at the moment we have no interest in doing so.”

Peter Cunliffe is deputy city editor, Daily Express.

Heavy regulation in the US helped make London more attractive

MAREK JELINEK IS CHIEF FINANCIAL OFFICER OF NWR

“When we planned our IPO, the choice of venue was critical. We have lots of audiences, but since most specialist natural resources and coal investors are in London, this was our main focus. We have also listed in Prague, as most of our resources are based there; and we have listed in Warsaw, since Poland is part of our long-term strategy.

“We felt that we struck a chord with the London-based investors in particular as the equity story is so well understood there. They can see the growth market profile and dynamics of what we’re doing while recognising that we’re a substantial EU business, which brings regulation, transparency and a recognisably legal environment. That is reassuring for those investors.

“We developed a good relationship with the London Stock Exchange, co-operating with them well throughout the process, and the listing ran very smoothly”
A variety of different types of security can be admitted to trading on the Main Market. **Andrew Cave** explains the differences between these instruments and the advantages of each one.

The Main Market draws on a potential capital pool of £2,400 billion in pension, insurance, mutual funds and investment trusts and £165 billion in retail investment accounts, institutional funds benchmarking the FTSE UK Index Series and tracker funds. This adds up to Europe’s deepest pool of public capital, with exposure gained through a wide variety of securities. So what are the main types of instruments that can be admitted to the Main Market, and what are their advantages?

**Ordinary shares**
Ordinary shares represent the risk-sharing part of a company’s capital ordinary shares and are seen as the most representative measure of health of the UK financial markets. They give their owners the right to share in profits of issuing companies through any dividends and to vote at general meetings.

In London, ordinary shares of UK companies listed on the Main Market are traded on either SETS or SETSgX and companies domiciled in the UK must currently opt for a Primary Listing. Those companies incorporated outside the UK may opt for a Primary Listing or a Secondary Listing in London.

Liquidity is underpinned by the execution of more than 90 million trades a year in Main Market securities and the transmission of share price information to more than 139,000 broker terminals internationally. Over the past eight years, investment has helped increase the number of SETS trades and drive down the costs.

**Preference shares**
Preference shares normally pay a fixed rate of interest to shareholders. They do not usually carry voting rights, but their holders receive dividends before ordinary shareholders.

They can be used as a form of additional capital. For example, the UK Government’s injection of emergency funds in October 2008 into some of Britain’s high street banks included issuance of preference shares. In addition, some former building societies have issued preference shares to their members when converting to banks, as the law does not allow them to give cash.

If a company is wound up, preference shares are usually repayable at par value, and rank above the claims of ordinary shareholders but behind banks and other creditors. It is also possible for a company to pay a dividend to preference shareholders before declaring one for holders of ordinary shares. For these reasons, preference shares are generally regarded as slightly lower risk than ordinary shares. However, preference shares do not benefit from dividend increases and cannot be sheltered from tax in an Individual Savings Account (ISA).

**Depository receipts**
Depository receipts (DRs) are negotiable certificates that represent ownership of a given number of a company’s shares. DRs allow investors to purchase equity in companies domiciled in other countries. The two most common types: American Depositary Receipts (ADR) and Global Depositary Receipts (GDR) can both be listed on the Main Market through a dedicated listing route, benefitting from London’s deep pool of global capital, highly international investment perspective and trading platform on the International Order Book.

Both ADRs and GDRs are usually denominated in US dollars and issued by a depositary bank, but they can also be denominated in euros. DRs can also be issued as initial public offers (IPOs) and are aimed at institutional investors. They help increase global trade and foster the exchange of information, technology and regulatory procedures and market transparency. Overseas companies may issue them in London to obtain greater exposure, raise capital and boost liquidity. For investors, they allow exposure to companies quoted on overseas exchanges, including those in emerging markets, while continuing to trade on the Main Market, benefiting from the associated settlement and clearing requirements.

**Investment funds**
Investment funds are pooled funds, offering access to a portfolio of securities managed by professional fund managers, with the aim of spreading investment risk. They may be based in the UK, overseas or offshore and can offer exposure to different countries, regions and sectors and a variety of asset types, such as property, shares or bonds.

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1See page 46 (Routes to the Main Market) for an outline of the FSA’s discussion paper on the listing regime, which discusses ways of changing the primary and secondary listing segments to help participants in the market better understand the obligations on issuers of the various types of listed securities.
There are various different types. Investment trusts are companies that pool funds from the sale of a fixed number of shares and make collective investments in the shares of other companies. The share price does not always reflect the underlying value of the share portfolio held by the investment trust. In such cases, the investment trust is referred to as trading at a discount or premium to net asset value.

Open-ended investment companies (OEICs) expand or contract by issuing or cancelling shares according to demand. They may have an ‘umbrella’ fund structure, allowing for many ‘sub-funds’ with different investment objectives. Investors can invest for income and growth in the same umbrella fund, moving money from one sub-fund to another, as investment priorities or circumstances change.

Venture capital trusts (VCTs) are tax-efficient UK closed-end collective investment schemes designed to provide capital finance for small expanding companies and capital gains for investors by investing in businesses. Investors can claim tax relief on shares issued by VCTs up to £200,000 in value. Capital gains tax relief is also available.

UK Real Estate Investment Trusts (UK-REITS) were launched on 1 January 2007 as a new UK tax transparent vehicle for investing in property. A REIT is a company that owns and manages property on behalf of shareholders.

To be eligible for VCT and UK-REIT status, the schemes must be listed on the Main Market.

Exchange Traded Funds (ETFs) are index tracking funds that are listed on the Main Market. ETFs give investors the chance to buy whole indices as easily as buying a single share. The Exchange launched the world’s first multi-currency platform for ETFs in September 2006, enabling ETFs to be traded simultaneously in both dollars and their sterling or euro denomination.

ETFs are eligible for inclusion in ISAs but do not attract stamp duty. They also attract some of the lowest annual charges of all collective investment schemes.

Debt securities
UK or international issuers of debt can list it on the Main Market through any of the major debt instruments, such as Eurobonds, convertible and exchangeable bonds and medium-term notes. Bonds provide investors with dependable income and the opportunity to diversify their portfolios. London is one of the world’s leading centres for the listing of bonds. More than 15,000 corporate bonds have been listed on the Main Market by companies and sovereign states.

Gilts
Gilts are UK Government debt securities. There are essentially two types of gilts – conventional gilts and index-linked gilts. A conventional gilt is a liability of the Government, which guarantees to pay the holder of the gilt a fixed cash payment (coupon) at regular time intervals until the maturity date, at which point the holder receives the final coupon payment and the return of the principal. The prices of conventional gilts are quoted in terms of £100 nominal, and are denoted by their coupon rate and maturity date. Index-linked gilts have been issued for institutional investors since 1981 and differ from conventional gilts in that the semi-annual coupon payments and the principal are adjusted in line with the UK Retail Prices Index.

Exchange Traded Commodities
In 2006, the Exchange launched the world’s first committed trading platform for Exchange Traded Commodities (ETCs) when 32 securities were listed – the largest simultaneous listing on the Exchange. They were formed to enable ordinary investors to trade an expansive range of commodities through ordinary brokerage accounts.

ETCs are liquid, accessible and simple. They can be created and redeemed on a continuous basis by market makers, matching the liquidity of the underlying markets, and are open-ended securities which can be bought and sold intra-day on the Main Market in the same way as any equity. They provide accurate and transparent commodity exposure to recognised benchmarks in a single trade. They also require no trading or management of futures contracts.

ETCs can be traded with all the same order types available to equities. The minimum trade size is one security and settlement is the trade date plus three business days through CREST.

Covered warrants
Covered warrants, launched on the Main Market in 2002, and issued by major financial institutions or investment banks, have similar functions to options.

They are linked to an underlying security, which can be shares, currencies, commodities or other financial data, such as house price indices.

These are geared investments, giving investors the right but not the obligation to buy or sell underlying securities, such as shares, indices or commodities, at a fixed exercise price on or before an expiry date. They have the attraction of being exempt from stamp duty and work in a similar way to options, but typically have a longer lifespan, with most lasting for six to 12 months, though some can last as long as two years.

However, unlike spread bets or contracts for differences, investors can never lose more than the capital they initially put at risk.

The range of security types available to issue on the Main Market reflects the flexibility of the market, providing issuers with the most suitable capital raising opportunities for their specific needs, and investors with many different investment options.
How can companies list on the Main Market? The answer is that there are a number of different options and the most appropriate route to market will depend on companies’ circumstances, corporate governance structure and capital requirements.

There are three principle ways in which to raise capital on the Main Market. Companies can list equity in the form of shares, which can be traded on the Main Market in more than 20 global currencies. They can issue depositary receipts: negotiable certificates that represent ownership of a given number of a company’s shares, which can be listed and traded independently from the underlying shares on the International Order Book. They can also issue debt instruments, ranging from simple Eurobonds and credit-linked notes to complex asset-backed issues, high-yield bonds and convertible or exchangeable bonds.

There are also two different types of listings: Primary and Secondary. So what are the differences between the main routes to market? How do they operate in practice? What factors need to be considered in deciding which options to pursue? And how might they change in the future?

**Primary Listing**
Shares are the only securities that can have a Primary Listing on the Main Market, which requires companies to meet the highest standards of regulation and disclosure in Europe – ‘super-equivalent’ standards.

They do not necessarily have to be a business’s first or sole listing and a company that is already listed in its home jurisdiction may choose a Primary Listing in the UK without relinquishing its home listing.

However, a Primary Listing means that a company is expected to meet UK regulatory standards that are ‘super-equivalent’ to the European Union’s directives, meaning that they are over and above the EU minimum.

This requires compliance with a series of standards designed to ensure high levels of transparency and makes Primary Listed Main Market companies potentially eligible for the FTSE UK Index Series, including the well-known FTSE 100 Index – one of the most widely recognised share-trading benchmarks in the world.

**Secondary Listing**
Secondary Listings also offer access to trading on the Main Market, but are only available to companies that are not incorporated in the UK. Despite their name, Secondary Listings do not automatically denote that they are a company’s second listing. Instead, they signify that a company has chosen to meet European Union ‘harmonised’ minimum regulatory standards as opposed to the UK ‘super-equivalent’ standards required by a Primary Listing.

Both equity and depositary receipts can be Secondary Listed, though both are typically only offered to professional investors. The Secondary Listing route is also suitable for companies wishing to ‘passport’ their prospectus into the UK. However, companies that only have Secondary Listings or depositary receipts are not eligible for inclusion in the FTSE UK Index Series, no matter their size or market capitalisation.

**Future changes**
The choice of routes to market has enabled London to thrive in the global initial public offerings market in recent years, attracting a considerable number of overseas issuers.

However, in January 2008 the Financial Services Authority (FSA) published a discussion paper reviewing the structure of the UK listing regime, with the aim of best supporting the future competitiveness of the UK capital markets in a rapidly-changing global marketplace, while continuing to protect investors appropriately.
The FSA is proposing changes to separate more clearly securities that are subject to higher standards from those that are subject to minimum standards.

The paper discussed ways of changing the Primary and Secondary Listing segments to help participants in the market better understand the obligations on issuers of the various types of listed securities.

One issue is that while a UK listing is seen as symbolising a distinctive set of standards, compared to those elsewhere in Europe and to ‘non-listed’ markets, Primary Listed securities are governed by much stricter provisions than those that are secondary-listed or take the form of depositary receipts.

This uneven playing field is further slanted, it says, by the fact that overseas companies can currently opt to have a ‘super equivalent’ Primary Listing or a Secondary one governed by less stringent EU standards. UK companies, meanwhile, do not have such a choice and must comply with the stricter regime.

To deal with the situation, the FSA is proposing changes to separate more clearly securities that are subject to higher standards from those that are subject to minimum standards. It proposes to do this by re-labelling Primary Listings as ‘Premium Listings’, while Secondary Listings and depositary receipts would be renamed ‘Standard Listings’.

Additionally, the regulator is exploring the idea of allowing both UK and overseas companies to take Secondary, or ‘Standard Listings’ on the Main Market. Alongside such measures are proposals to bring all Primary Listed companies under the same EU framework for corporate governance disclosures, whether they are UK or overseas issuers. Currently, overseas companies with a Primary Listing are obliged to disclose whether or not they comply with the corporate governance regime in their country of domicile and also explain any significant ways in which their corporate governance practices differ for the UK’s Combined Code on Corporate Governance. The proposals would enhance these disclosures to provide investors with more information on the company’s corporate governance regime and their internal risk management controls, for instance.

The discussion paper sought views on whether overseas companies should be required to instead adopt the same ‘comply and explain’ principles as those that govern UK companies with Main Market listings. This tenet requires companies to either comply with the UK code or explain why they are not doing so. The paper also addressed the depositary receipts market. However, while it notes that the FSA has increased the regulatory resources devoted to overseeing such securities, in line with their relative growth in recent years, it points out that this is a specialist market that is not typically accessed by retail investors.

The market’s response
Reaction to the review has been mixed. The London Stock Exchange Group’s response, issued in April 2008, said that while it is supportive of clearer and more accurate labeling, it is concerned that the impact of FSA’s proposals have not been given sufficient consideration. It believes that the option of dropping Secondary Listings and global depositary receipts from the FSA’s Official List is a “disproportionate response” that may adversely affect existing and prospective issuers and investors and damage the UK’s competitive position. It prefers the re-labelling option, saying this would retain the tiered structure of the Main Market and avoid the other proposal’s “unintended adverse consequences”.

In addition, the Exchange questions proposals for companies listing depositary receipts to require an agent in future. It said this would be “excessive, costly and unnecessary for the depositary receipts market”.

The Association of Private Client Investment Managers and Stockbrokers (APCIMS) is even more sceptical. Its response in April queried whether some of the proposals resulted “more from a desire for intellectual tidiness” than from any clear analysis of whether they are practicable or would benefit the market and investors.

It argued that depriving Secondary Listed companies and depositary receipt issuers of their ‘listed’ status would be unlikely to prevent their being referred to in this way in the future. In addition, it saw the proposals to allow UK issuers to pursue a Secondary Listing to be “born more of a theoretical desire for fair play than as a result of any clear demand or need for such a route.”

While the proposals have resulted in the diverse range of opinions that the FSA expected, however, there is broad consensus on the importance of the brand values of a London listing. And, in its follow-up consultation paper, published in December 2008, the FSA appears to have accepted many of the points raised.

As the submission from APCIMS concluded: “It is clear that the ‘London listing’ brand has some international cachet and whatever reforms are undertaken should have regard to preserving that status.”
Comply or explain: the winning formula?

In current market conditions critics of corporate governance are rife. Many think they can see a fundamental failure of existing corporate governance structures and processes in the global financial markets meltdown.

The “comply or explain” nature of the Combined Code is under attack from those, particularly in the US, who fear that the present troubles, if not created by, have at least been materially contributed to by regulatory arbitrage. To put it in a nutshell the so-called “light touch” approach in London is being blamed for many things while those same critics hold up the post Sarbanes Oxley US system as the flagship of regulatory sophistication.

However such a view is hugely disingenuous in ignoring, as it does, that the current financial downturn undoubtedly started in arguably the most regulated financial system on the planet. It also reeks of fear of a reprise of the dominance in capital markets which London had established over New York before the market downturn. While his proposals now seem unlikely to proceed much further, former US Treasury Secretary Hank Paulson recognised the effect regulatory arbitrage was having and, in March 2008, published the most extensive plans to reform the regulation of the US markets since the 1930s to make them more light touch and principles based – like the UK system!

The problem with strict rules based systems is that compliance can and does become a substitute for decision making. Responsibility for those decisions avoided by complying with the rules is shifted from the board of directors to the rule-setting agency. A lacunae in the rules is just too bad. There is no room for directors and boards to assume full responsibility for the consequences of their actions.

The great strength of the Combined Code, the centrepiece of the UK corporate governance system, is that it is guidance and not a rigid set of rules. The Combined Code has a long history reflecting many of the experiences which have set the course of modern corporate Britain. In giving explanations of deviations from the principles set out in the Combined Code, a board is giving shareholders the opportunity to judge for themselves whether the board has done the right thing. And shareholders are encouraged to speak up. Dialogue between owners and managers is fundamental to the UK system of good governance.

“The problem with strict rules based systems is that compliance can and does become a substitute for decision making”

Responsibility is the watchword of the Combined Code. The board is clearly and collectively responsible for the success of the company. There is no room for individual board members to hide. All the directors are expected to stand up and be counted on the way to reaching a decision. Concerns are expected to be minuted and, should a director resign, any concerns he has should be expressed in writing. The whole board is responsible for the consequences of a decision once it has been made.

There are provisions designed to secure a balance of power. It is the chief executive’s job to run the business and the chairman’s job to run the board. There should be a balance of executive and non-executive directors – a clear variance from standard US procedure where the whole board is often non-executive whilst the company is run by a chief executive who is merely an officer, not a director.

The board must be evaluated on an annual basis and all directors should be subject
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GOVERNANCE AND INVESTMENT PERFORMANCE
London leads the world in the setting of standards and structures for how listed companies should be managed. **James Moore** looks at the key requirements in terms of governance for companies listing on the Main Market, as well as the impact of governance on investment performance.

When the late Sir Derek Higgs unveiled the most recent serious reforms to Britain’s corporate governance guidelines, he was accused by some of London’s wilder commentators of producing “a box-tickers’ charter”. Box-ticking is a phrase that is often used when corporate governance is discussed along with all those pesky ‘principles’ in the Combined Code, laying out how it should be done.

But if it is box-ticking, it is box-ticking that appears to work rather well for investors. The Association of British Insurers (ABI), which is one of the more influential lobby groups in the field, recently produced research that showed that companies with good corporate governance produced appreciably better performance than those with poor governance.

Institutional fund managers have also been taking the Code’s principles increasingly seriously in recent years – becoming far more prepared to use their votes to intervene, either when things go wrong, or to avert what they see as potential disasters before they happen.

Principles is the key word in the Code. The Financial Reporting Council that oversees it, watchdogs such as the ABI, and those who have written or revised the Code, such as Sir Derek, have long stressed that it is not intended to be a straight jacket. Quite the reverse. Companies that have a good reason to veer away from one or more of the Code’s provisions are at liberty to do so – just as long as they can provide a good explanation for doing so.

The basic expectations for companies in Britain with a Primary Listing on the Main Market are now well understood and increasingly widely accepted by UK-based businesses and many of the foreign firms that choose to list their shares in London.

Important among them is the principle that the roles of chairman and chief executive should be separate to prevent too much power being concentrated in one person’s hands. Boards are expected to contain a balance of non-executive and executive directors, with the majority being independent non-executives so that no individual or small group of individuals dominates in the decision-making process.

Directors, who under the Code should be collectively responsible for a company’s success, should also designate a senior independent director to liaise with shareholders where necessary and ensure that directors are put up for regular re-election (usually every three years).

There are principles designed to ensure companies communicate effectively with their shareholders, and on what information should be in an annual report, such as the provision of details on executive remuneration and share options.

There are also recommendations on the composition of certain sensitive board committees – such as remuneration and audit – which are designed to minimise possible conflicts of interest. For its part, the ABI rates how well companies either comply with these principles, or how well they explain why they should not. Reports are produced for member institutions with a green top for good corporate governance, an amber top if there are issues of concern, and a red top where there are serious concerns.

What the ABI’s research found is that far from being a “box-tickers’ charter”, compliance with the Code can have a real impact on a company’s performance. Its report says: “The number of years in which a company received a red top is strongly, and negatively, correlated with its performance. Each additional (annual) red top reduces the industry-adjusted return on assets (ROA) by one percentage point a year. In addition, companies that are red-topped in every year underperform the rest by about three to five percentage points a year in terms of industry adjusted ROA.”

James Upton, who co-authored the research for the ABI, says: “The conclusion we came to is that the biggest effects are at the extreme margins. Companies that have poor corporate governance tend to be badly run and so are not going to perform as they should. Investors will pick up on that and the share price will be hit.

“Companies that are well run, with good access for investors and a good board structure, will see that reflected in their share price. Good governance is not just about box-ticking. It
Flexible it may be, but today’s institutional shareholders still take a careful note of how the companies they invest in behave in relation to the Code.

reflects everything about the company. It is an attitudinal thing. If a management delivers good governance, they tend to have a good understanding of the whole business, receive better information from better reporting lines and, ultimately, they run it better.”

However, Upton insists that having good governance is not necessarily about rigidly complying with every facet in the framework set out by the Code. He says that it is fine for companies to deviate – if they can supply a good explanation under the UK’s ‘comply or explain’ regime, which is starkly different from the more rigid, rules-based approach seen in the US.

“We also found that, under comply or explain, companies which had good explanations also performed well compared to their peers. If you have a credible reason for not complying and you explain well, you are showing that you know your business well, you know what you need for your company’s individual circumstances to do the best job. With the US rule-based system, you can’t change from the norms. It is much more inflexible.”

So, flexible it may be, but today’s institutional shareholders still take a careful note of how the companies they invest in behave in relation to the Code. And those shareholders have proved willing and able to act where they feel the principles are being unnecessarily violated.

Perhaps the most famous example of this was the ousting of Michael Green from the combined ITV business of which he was the architect. The two companies that merged to form ITV (Carlton Communications and Granada) had overseen the embarrassing failure of ITV Digital. But shareholders were also unhappy with Green’s confrontational style and questioned the role he would play as the chairman of the merged ITV business. The result? He was ousted in a shareholder revolt, led by Fidelity’s Anthony Bolton.

Bolton and his colleagues usually prefer conciliation to confrontation, working behind the scenes to improve companies’ governance structures where they feel there are issues. However, the affair did put down a marker and many companies have since taken note – which the ABI’s research suggests is to the benefit of all concerned.

F&C has long been a leading advocate of companies maintaining good corporate governance. George Dallas, the fund manager’s director of corporate governance, explains: “At F&C we believe that corporate governance can be an important investment factor that can impact shareholder value and can provide a more general indication of a company’s overall management quality.

“Governance factors can play a role in investment decisions, but it is also the case that F&C will engage with companies in our portfolio to identify governance weaknesses and call for improvements to a company’s governance policies, structures and processes,” says Dallas.

But does the British approach hold up internationally? Is London really the centre of good practice that it claims to be? The most recent studies suggest that it is, and cite it as a major factor for the City’s success as a financial centre, despite the current crisis caused by the ongoing credit crunch.

Mastercard’s Worldwide Centres of Commerce Index is designed to identify the world’s leading cities and their role in facilitating global commerce. It ranks London top, as does the Global Financial Centres Index, authored by Jeremy Horne and Nick Danev of the Z/Yen Group. While these are general surveys, looking at a wide range of issues, the regulatory framework is an important factor.

What is more, a recent GMI survey focusing more closely on corporate governance judged the City of London to be ahead of New York and mainland Europe in both the style and the substance of the regime in the UK.

Given this, it might be wise for the City and those that oversee its operations to tread cautiously before taking too much note of the siren voices calling for tighter and more rigid regulation in the wake of the banking crisis. It would be a crying shame if this resulted in the baby being thrown out with the bathwater.

Despite all the recent market turbulence, the UK regulatory system is in remarkably good shape and what the research shows is that it is seen as worthwhile by investors. And a Primary Listing on the Exchange’s Main Market shows a company adheres to demonstrable standards that investors appreciate and that drives their appetite for putting their money into that company.
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The weighting of the FTSE 100 Index in world stock market indices is much greater than the proportion of UK GDP to world GDP, showing that the London market has an importance considerably in excess of the UK’s position in the global economy.

BY SIMON ENGLISH

HOW LONDON ABOVE ITS

If it were just a reflection of the size of the country in which it operates, the London Stock Exchange would merely be the fifth most important stock exchange in the world. Britain’s economy is, on most measures, fifth in size after the US, Japan, Germany and China, with a gross domestic product of $2.2 trillion each year. Yet as a place for trading shares, instruments derived from shares, or almost any financial vehicle you can think of, London is, by many measures, top of the pile.

Terry Smith, an entrepreneurial figure in the London market and head of Tullett Prebon, explains: “New York’s great strength is that it serves the US domestic economy, which is the most powerful in the world. London is a much more global financial centre. If the market just depended on the British economy it would be maybe one-sixth or one-fifth of the size.”

Of course, size isn’t everything. A report by the Global Financial Centres Index, which came out in September 2008, ranked world financial centres on the basis of competitiveness. It concluded that London and New York led the field by some way, with London still narrowly ahead.

The report’s authors – Mark Yeadle, Jeremy Horne and Nick Danev – say: “It is interesting to note that London has maintained its dominant ranking globally and within Europe, despite the introduction of the euro. In fact, euro-denominated business operates out of London, despite the fact that when people buy their coffee or take a cab they are using British pounds.”

A greater amount of money might flow through the New York Stock Exchange most days, but London is still regarded as the centre of the world of equities, as an open and less parochial operation than the one in Manhattan. How did it do it?

While other national stock exchanges were worrying about globalisation or the effects of opening up their share markets to overseas companies, the Exchange was undergoing a revolution – it has undergone several since. In 1986 it embraced Big Bang, a radical overhaul pushed through at a time of significant economic change in the UK under the Prime Ministership of Margaret Thatcher, which saw it deregulated and opened up to international competition.

Fixed commissions were abolished along with other restrictive practices, paving the way for the modern City, to which the Exchange remains central. Smith said in an interview with the Daily Telegraph last year: “Big Bang was a success because it enabled London to take a much greater share of the world’s equity business. That one change at the Exchange probably attracted more investment banks, proprietary trading and hedge fund businesses to London than anything else. It attracted huge over-the-counter businesses in foreign exchange, derivatives and bonds. The other big change now is the amount of proprietary trading done by the big investment banks. These things were not directly impacted by Big Bang, but the changes Big Bang introduced had a massive effect on them. London is now operating on a better level than New York as a global financial centre.”

In 1999, the Exchange moved on a step more, divorcing ownership of the bourse from its users. By ending its mutual status and listing its own shares on its Main Market, the Exchange was effectively showing others how to stay competitive in a changing world. Not long after this, Clara Furse – now Dame Clara – arrived as chief executive. A for-
PUNCHES WEIGHT
The world’s financial institutions flocked to London

midable City figure, with a background in financial derivatives, she knew that the Exchange needed to deliver more than just solid results – it needed a long-term strategy to take advantage of the opportunities that were opening up.

Dame Clara was convinced that London could become the dominant marketplace for equities in Europe – a conviction she pursued. She thought that by embracing globalisation, London could be the home for many foreign businesses, a notion that was in keeping with the thoughts of the Labour Government. Britain couldn’t be the strongest economy of the new global order, but it could find a strong niche by opening itself up to both capital and labour.

Not everyone was convinced. The media and some academics worried that the Exchange would be harmed by companies from the rapidly growing economies of Russia, China and India arriving to raise capital. However, even the then London mayor, Ken Livingstone, perhaps not a natural supporter of global capital, could see the point. “In an era of globalisation, to be the most global is to hold a trump card,” he said.

And so the world’s financial institutions flocked to London. International flotations rose at a faster rate than any other market in the last few years. In 2005 alone 93 listings raised £6.7 billion, but these weren’t just from far flung corners of the globe. By 2006, London was accounting for 70 per cent of western Europe’s floats, 80 per cent of which were on the AIM market.

In 2007, 410 companies came to market (both AIM and the Main Market), raising a staggering £26.8 billion. One side-effect of having so many large foreign listings is that the FTSE 100 Index of its largest Primary Listed companies has become a reflection of how the world economy as much as the UK economy is performing – the more so because most of the British companies still quoted in it also earn a significant proportion of their profits overseas. Most see it as a positive development. “The London market boasts listings from a rich variety of companies, so it is no longer a barometer of just Britain’s economic performance. It is increasing its edge as the world’s most globalised market,” said Livingstone.

By pursuing this strategy, the Exchange achieved more than just increasing its own prominence. It helped the profile of Britain as a place where business could be done at a time when others were looking inwards. As it reeled from the fraud explosion that began with Enron and saw several of its biggest companies collapse, America tightened up regulations in all sorts of areas, most notably through the notorious Sarbanes-Oxley legislation, which demanded onerous new accounting disclosures.

One side-effect was to scare away new companies looking for fresh capital. America didn’t seem to mind, at least at first, that it was missing out on big flotations – and London was happy to take up the opportunities.

The last year has been rocky for all markets – the FTSE 100 has tumbled and a new generation of investors have learnt that shares do indeed go down as well as up. The banking crisis of the last year sparked concerns about a lack of regulatory oversight – tougher rules can be expected. It isn’t the job of the Exchange to know whether banks are solvent or not, but the wider regulatory regime of which it is a part came under fire. Yet the Exchange remains healthy. It faces numerous competitive threats, from the likes of Dubai and elsewhere. The combination of Singapore and Hong Kong could create a third global financial centre to rival London and New York – but it hasn’t yet.

In the home market, new trading platforms open, or announce an intention to open, all the time. Analysts say the Exchange’s franchise will inevitably be eaten away by such change. Its recent history suggests it is likely to remain at the heart of whatever emerges from the latest financial and economic trauma.

'The Global Financial Centres Index, City of London. Authors: Mark Yeandle, Jeremy Horne and Nick Danev of the Z/Yen Group. It is updated every six months.
Hugo Duncan explains the philosophy of regulation in London in contrast to other centres and describes how responsibility for the running of the market is divided between the London Stock Exchange and the FSA.

The Role of the FSA: How Market Activity is Regulated

The Main Market in London is seen both by investors and companies as the world’s most prestigious listing environment, a badge of quality for those on it and an aspiration for those who are not. At the heart of the market’s philosophy is the principles-based approach to regulation adopted by the Financial Services Authority (FSA) through its UK Listing Authority (UKLA).

Broadly speaking, the UKLA is responsible for maintaining the Official List. Day to day monitoring of trading on the market is down to the Exchange, although it is overseen by the FSA. Good regulation creates protection for investors without overburdening companies with expensive and unnecessary obligations.

Achieving the right balance between investor protection and intelligent regulation is the trick, hence the London market’s popularity over New York and, in turn, the success of AIM, the Exchange’s growth market for smaller companies, as well as the Main Market. As one leading corporate lawyer in the City of London explains: “We are better off with more balanced, principles-based regulation. London still has a material competitive advantage over the US for this reason.”

Until 2000, the Exchange was responsible for the listing requirements for companies, at which point this function was switched to the UKLA. There was another shift of power towards the FSA after the EU Financial Services Action Plan was passed in 2003 to pave the way for a single financial market in Europe. New laws were passed and the FSA was given the power to enforce them in Britain.

The UKLA has three sets of rules governing the Main Market: the Listing Rules, the Prospectus Rules, and the Disclosure and Transparency Rules.

“We are better off with more balanced, principles-based regulation”
All UK companies are subject to Company Law, but in addition, publicly listed companies on the Main Market have to abide by these additional rules, which effectively have the force of law. The FSA has the power to prosecute if any of these rules are broken, particularly relating to market abuse, and ultimately watching over the FSA is the EU.

The Listing Rules determine the eligibility of a company to gain entry to the Main Market. At an EU level there are certain requirements for what companies are obliged to do, both at the time of listing, and once they are on market. The FSA has implemented these in Britain through the Listing Rules, which have been ‘gold-plated’ for Primary Listed companies with more stringent requirements to ensure investor protection and make the market an attractive and safe place to do business.

The Prospectus Rules stem from the EU Financial Services Action Plan’s Prospectus Directive and set out when companies should publish a prospectus, what information should be included, and how they should be distributed. Prospectuses are produced for initial public offerings, secondary raisings, rights issues and takeovers. Under such circumstances, firms have to produce a document in the form dictated by these rules and have it approved by the FSA.
Another EU directive, the Market Abuse Directive, introduced a common EU approach for preventing and detecting market abuse and ensuring a proper flow of information to the market. Key to the FSA’s implementation of this was, according to then managing director of the FSA’s Wholesale Business Unit and now FSA chief executive Hector Sants, to “ensure that UK financial markets retain their deserved and hard won reputations for being orderly and fair”. Offences contained within the rules include insider dealing and manipulation, something the FSA is eager to clamp down on. For years there was, if not quite a laissez faire attitude to insider dealing in London, a far less rigorous polic-

“Our aim is to maintain a regime that concentrates on the right outcomes, while retaining an appropriate degree of flexibility”

ing of it than in the US, something the FSA has changed. After all, the market must be fair for all, for companies and investors alike.

Much of this is covered by the Disclosure and Transparency Rules, which ensure timely announcements to the stock market. These not only include financial updates such as interim management statements, results and annual reports, but also profit warnings, material changes in the shareholder register, share dealings by directors – in fact, anything deemed insider knowledge that the rest of the market should know.

Even while the FSA maintains a balanced approach to regulation, the thresholds it has set for such disclosures are rather stricter than those laid down by the EU and followed in other countries. This is deemed to be a small but very necessary burden on companies to ensure the Main Market is the market of choice for investors.

When joining the Main Market, a company has to satisfy the FSA’s Listing Rules and then apply to the Exchange for its securities to be admitted to trading on the Main Market. The Exchange must be satisfied that a company has met the requirements of the home Competent Authority, and for UK companies this is the UKLA. This is part of the Exchange’s obligation to maintain a fair, orderly and transparent market. In addition, potential issuers must commit to comply with the Exchange’s Admission & Disclosure Standards. One of the many published guides to the market puts it succinctly: “By floating your business, you are putting a long-term value on it and selling it to outside shareholders. So, irrespective of your ability to meet the UKLA’s requirements, if the investment community does not value your business as highly as you do then the flotation may not be a success. Ultimately, the ability to meet the market’s commercial expectations is all-important.”

The role of investor relations is therefore key in developing a company’s value proposition.

So the Main Market is made up of companies that must comply with both the rules laid out by the FSA and the Exchange. Sally Dewar, managing director of wholesale and institutional markets at the FSA, sums up the role of the UKLA: “We are committed to ensuring that the UK retains its current position as a successful international market. Our aim is therefore to maintain a regime that concentrates on the right outcomes, while retaining an appropriate degree of flexibility, enabling us to consider and respond effectively to developments in the markets.”
The black boxes are taking over. In the old days when trading was conducted on the floor of the London Stock Exchange itself, executing a deal could take several minutes. Now the Exchange has recently announced plans for a new service that will allow deals to be completed in less than a millisecond.

The drive to deliver such extreme speed is the Exchange’s response to a revolution in how shares – and other asset classes – have been traded over the last 10 years. It is a revolution powered by stunning advances in computer power and technological innovation, resulting in a process called algorithmic trading.

There are several forms of algorithmic trading. In one, software programs based on highly sophisticated algorithms are capable of spotting and exploiting profitable pricing anomalies that exist for mere fractions of a second. In the second, the algorithms are used to execute a trading strategy devised by a human being. The software will decide the best time to buy or sell, depending on the strategic constraints it has been set. In another, the software will be used to work out the best ways of slicing up large share deals to keep them hidden from the rest of the market.

But the general upshot has been to make trading quicker. And as speeds have increased, so trading volumes have rocketed.

The result is that stock exchanges have been forced to up their own technological game to provide much more liquidity and capacity. In short, they have had to become much more efficient to exploit the lucrative opportunities that computer trading provides.

The London Stock Exchange’s business philosophy is to establish leadership in international issuances by providing leading-edge technology to support neutral, highly liquid execution, while developing an extensive suite of associated data products. What does this mean in practice in terms of market development and product innovation? **BY ANDREW JOHNSON**
A further impetus has come from the European Union’s 2007 Markets in Financial Instruments Directive (MiFID), part of the Financial Services Action Plan. This provided a harmonised regulatory framework for new trading venues to compete with traditional exchanges. The Exchange now faces competition from a growing number of alternative trading platforms, including Turquoise, launched by a collective of investment banks, and Chi-X, which is controlled by electronic broker Instinet.

Meanwhile, other major exchanges have sought to become more efficient by becoming bigger, with the New York Stock Exchange merging with Euronext, the operator of the Amsterdam, Paris and Brussels bourses; and Nasdaq tying up with Scandinavian exchange OMX.

Many believe the global winners and losers will be decided by how effective their respective technologies are.

The Exchange’s initial response to the combined challenges of computer trading and the threat of increased competition was set out in a technological roadmap outlined in 2003, which culminated in the launch in June 2007 of the cutting-edge trading technology that is TradElect.

The roadmap was first developed in response to US work on trading systems and the realisation that the Exchange’s existing execution system was fine, but that it would not allow the Exchange to compete and develop new business streams in the future.

TradElect replaced the technology underpinning the Exchange’s Stock Exchange Trading System (SETS), which had been operating since 1997. SETS started by being able to execute trades within 600 milliseconds, which came down to 140 milliseconds. The aim of TradElect was to bring execution speeds down to fewer than 10 milliseconds, which it achieved not long after its introduction. Latency has come down to five milliseconds since launch, and sub-three milliseconds is now being targeted.

In September, the Exchange announced what might prove to be the culmination of the drive to speed: sub-millisecond access to London’s markets through Exchange Hosting. This works by letting firms site
The Exchange is already offering a range of different asset classes on different platforms

their own computers within the Exchange’s own data centre, removing the need to operate over a network.

Hand-in-hand with increasing execution speeds were systems to provide information, such as share prices, much more quickly. The launch of Infolec in 2005 brought the speed with which information is provided down to two milliseconds.

TradElec has also transformed the ability of the Exchange to handle huge volumes of orders. Improvements have seen TradElec’s capacity quadruple between August and October 2008, from 5,000 orders a second to 20,000 orders per second.

These technological improvements have driven an explosive growth in UK equities trading. The Exchange is now seeking to capitalise on the volume growth by reducing the tariffs it charges.

Chief executive Dame Clara Purse said that when the new prices were launched it would allow the Exchange to “capture the important growth arising from the major shift towards algorithmic trading in UK equity markets” by providing incentives for those bringing more liquidity to the stock exchange.

TradElec is also proving attractive to other exchanges. The Johannesburg Stock Exchange in South Africa is using the system, while Oslo Børs and the London Stock Exchange agreed a strategic partnership in December 2008, which it is envisaged will see Oslo Børs eventually replace its existing trading system with TradElec.

Meanwhile, following the merger of Borsa Italiana and the London Stock Exchange, Italian equities have migrated onto TradElec, with the belief that this will drive significant growth in trading volumes in Italian equities, partly by giving them access to London’s network of member firms in addition to those in Italy.

Experts say it is too soon to say what impact MiFID and the rise of alternative trading platforms might have. Initially, it was feared they would take liquidity away from the Exchange, hitting revenues and profits. The rise of competitors in the US cut the New York Stock Exchange’s market share of equities trading from 90 per cent to 40 per cent.

But the reality in London and Europe appears to be much more complex. The rise of Chi-X, for example, has provided a further source of pricing anomalies for one type of algorithmic trader to exploit. The Exchange has noticed that it is doing more trading in the stocks busy on Chi-X. The presence of two separate platforms trading the same stocks has increased total liquidity.

Separate trading platforms also make it easier for buyers and sellers of huge tranches of shares to hide their transactions and avoid moving prices. The process has given rise to the term ‘dark liquidity’ as opposed to the ‘lit liquidity’ that drives normal share trading.

One of the ideas behind Turquoise was to allow investment banks to trade such large tranches between each other without the deals becoming known – so-called ‘dark liquidity’. The Exchange responded with plans to launch its own dark pool of liquidity, called ‘Baikal’. But rather than create one single, off-exchange trading platform to enable secret deals, the plan is to take advantage of cross-border trading and the growing number of new platforms to slice up large deals across 22 different ‘liquidity pools’ across Europe. As part of Baikal, the Exchange is planning to introduce ‘smart-routing’ technology that will automatically find the best places for the deals to be done.

Another major source of future development will be for exchanges to offer a broader range of asset classes, either on their equity execution platforms or separately. This will be driven by the fact that a deal can only be executed so fast. Once the sub-millisecond level is reached, then exchanges are bumping up against what is currently possible under the laws of physics. Inevitably, everyone will offer sub-millisecond execution speeds and gain no competitive advantage. New ways of beating the opposition will have to be found. Again, technology holds the key.

The Exchange is already offering a range of different asset classes on different platforms. The merger with Borsa Italia gave it control of MTS, Europe’s biggest platform for trading government bonds. It is also offering derivatives trading and access to commodity markets through exchange traded commodities.

However, the group is planning its first move into a single, multi-asset platform this year when it launches a combined market for equities and an equity derivative called a contract for difference (CFD). It will initially involve only FTSE 100 Index constituents. It means CFDs can trade against equity orders, allowing better pricing and liquidity of each. It will also open up CFDs to investors barred from trading in over-the-counter products.

The Exchange has also made it easier to manage the risks involved in trading by offering a choice of central counterparty services through clearing houses LCH.Clearnet and SIX x-clear. This service means traders will have only one risk position to manage, rather than worrying about the individual organisations on the other side of every trade made.

For all these developments, the pressure will still be on to keep pace with the ever-more sophisticated black box operations being developed by the Exchange’s customers. The future will be driven by the need to develop systems that can handle ever more complex trades across a huge range of different asset classes, across different geographies and including both hidden and open trades.
CATERING TO THE CORPORATE LIFE CYCLE

ROBERT LEA explains how companies have moved from AIM to the Main Market

or some it is all about continuing to grow.

“The board now considers, having regard to the company’s market capitalisation reserves and resource base, operations and production profile, the Main Market to be a more appropriate platform than AIM for the continued growth of the group,” said Yogeshwar Sharma, the chief operating officer of Hardy Oil & Gas when he announced the explorer’s move up to the Main Market of the London Stock Exchange.

For others it is all about finding new investors.

Of the delivery of his fast food chain to the Main Market last year, Domino’s Pizza executive chairman Stephen Hemsley explained: “Due to the higher number of institutional investors who regularly trade in companies admitted to the Official List, the company will be better placed to achieve improved liquidity.”
Or as Bob Holt, chairman of Mears Group, who made the same move says, it is all about a “higher profile with investors” and “an increased access to capital”.

Until the financial crisis engulfed markets in 2008, never had so many companies been announcing their intention to move onwards and upwards.

In 2007, a record number of stocks moved from AIM to a listing on the Main Market. The 12 companies that stepped up in that year almost matched the total number of 13 who made the move in the preceding five years. The previous 12-month record was seven in 2001.

The companies that made the move also happened to be among the junior market’s largest stocks by market capitalisation. With a three-year financial record needed to qualify for a listing on the Main Market, they also tend to be those companies that have been on AIM for a significant length of time, during which they have built up a track record and a level of transparency and requisite level of governance.

According to capital markets specialist Alexander Keepin, a partner at lawyers Charles Russell, achieving a listing on the Main Market can create for AIM companies a virtuous circle of profile, of investor confidence and of liquidity.

“The attraction of the Main Market predominately centres around the ability to attract investors, thereby gaining access to capital and to enhance liquidity in the company’s securities,” says Keepin.

Increased profile should lead to greater coverage by research analysts, he says, and better research should enable a wider constituency of investors to make a decision on investment. The increased levels of regulation and of corporate governance requirements also means institutional and private investors should have greater confidence in companies and are more willing to invest.

By the time an AIM company decides it is time to move up, it is likely to be of the size that should gain it eligibility to the FTSE 250 Index, which will prompt passive investment from index tracker funds and, therefore, greater liquidity.

It is a fact that many institutions and the mandates of funds limit investment in AIM stocks or in baskets of AIM stocks (or indeed any stocks below a certain liquidity threshold), while tracker funds, for instance, can only invest in Primary Listed companies on the Main Market.

AIM itself is not shy that companies are feeling the need to graduate. When it was originally

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**Increased profile should lead to greater coverage by research analysts**
“It can be a big step for a company moving to the Main Market”

launched in 1995, it promoted itself as “an entry to life on a public market” and was seen very much as the stepping stone for a private company on its way up to the Main Market.

As it happened, the traffic initially went the other way, with smaller companies on the Main Market seeing AIM’s more flexible approach and ‘lighter touch’ as more attractive.

AIM still markets itself as a magnet for the “young, fresh, entrepreneurial, growth-oriented businesses” which need to raise capital – and increasingly a magnet for international companies from a diverse range of sectors, who can access London’s investment community of not just investors, but advisers and industry research houses.

But rather than simply using it as a stepping stone, Philip Secrett, corporate finance partner and AIM expert at accountants and advisers Grant Thornton, believes companies moving from AIM to the Main Market are now seeking to differentiate themselves.

“In the past, a larger company on AIM was a big fish in a small pond,” he says. “AIM now has almost the same number of companies quoted on it as the Main Market. It has become a very big pond. What companies are looking for is visibility, recognition, differentiation.

“AIM has been very successful, but with that has come challenges and certainly some companies on AIM have issues. By moving to the Main Market, an AIM company is telling investors it is aiming for the gold standard.” But there are, of course, potential drawbacks in a move on to the Main Market.

Irrespective of whether any new money is being raised or shares being issued, the company must produce a full prospectus with the attendant cost – in money and management time – that will entail.

On average, the simple, tangible financial cost in preparation varies, but can run into several hundreds of thousands of pounds. As opposed to a company on AIM, a company on the Main Market will have to prepare a Business Review, a statement of capitalisation and indebtedness, pro forma historic financial information, accountants’ reports on cashflows and letters of comfort. Specialist companies, say, in the mining and exploration industries, may also need to provide detailed expert reports on their production track record.

Within that process, if the company is seeking a Primary Listing, it will need to make sure it is compliant with the UKLA’s more stringent and significantly longer Listing Rules and with the corporate governance principles that overlay the market.

At the end of that, there will be a substantial vetting process by UKLA, the listing authority. And when the company takes up its listing on the Main Market, management will need to be aware of the tighter rules on acquisitions, disposals and fund-raisings.

Keepin, the author of A Practical Guide to AIM, says: “The move from AIM to the Main Market is often perceived as a natural development as a company grows and matures.

“However, the attraction of the potential increase in its shareholder base and the company’s attraction to a wider pool of investors should be carefully weighed against the one-off costs involved in making the move and the management time and costs of complying with the increased regulatory burden to which the company is subject in the future.”

As Secrett says: “It can be a big step for a company moving to the Main Market, but the big cultural step is the step that it has already taken from private company to public company on AIM.

“AIM gives a company a track record, it shows whether it is suitable to step up to the Main Market, it beats into management what their responsibilities are. AIM is a good training ground for a public company.”
**APPLICATIONS OF THE PLAYERS**

**GARY PARKINSON** explains how London market information is disseminated, who uses its systems and in what numbers

**WHO ARE THE TRADING AND INVESTING CUSTOMERS?**

On one day in the middle of September 2008, a record 1.6 million trades were carried out on the London Stock Exchange.

That’s approaching 54 trades for every second the market was open for business. The value of the securities changing hands that day was £15.7 billion. Three days later, on 19 September, fewer trades were executed but their value topped out at almost £22.5 billion, another record for the Exchange. Trading has declined sharply since then as the global economic slowdown gathered pace. But the adverse conditions also underline its strength. Its liquidity and stability are particularly appealing to customers and give it a significant edge over the competition.

Those who trade on the Exchange’s markets fall into four broad categories. As well as investment banks and retail stock brokers, the Exchange has more than 400 member firms, including 80 international member firms, from 39 countries. Then there are a growing number of specialist proprietary traders that are also paid up, though low-profile, members of the Exchange. These tend to be private funds and firms that chase computer-generated profits using algorithmic trading strategies, making money from a very great number of small trades.

Each firm pays an annual membership fee based on the number of ‘relevant’ staff it employs. These are the traders, directors, researchers and corporate finance teams that are actively involved with investments traded on the Exchange.

Membership not only brings access to the Exchange’s trading and information systems, it also provides a certain degree of confidence that those conducting business with each other will be abiding by the same rules and standards of conduct. Crucially, members can trade via the Exchange’s trading platforms – the most well-known of which is the Stock Exchange Electronic Trading Service, or SETS, which was established in 1997.

SETS is essentially a matching engine that marries buy and sell orders from across the market. Banks and brokerages can trade shares on SETS in the overwhelming majority of the Primary Listed securities on the Main Market, as well as Exchange Traded Funds (ETFs) and Exchange Traded Commodities (ETCs).

For those less liquid shares, the Stock Exchange Electronic Trading Service - quotes and crosses trading platform (SETSqx) allows the buying and selling of shares with typically only one, or no, market maker. It works by electronic auctions four times a day combined with standalone quote-driven market making. Member firms each maintain an order management system that allows them to plug into SETS. If electronic trading platforms are the engines of the stock markets, then information is their fuel. And the Exchange offers members a rash of information services that it says helps transparency and liquidity in London’s markets.

Rupert Armitage, a director of the stockbroker Shore Capital, says: “It’s crucial to get fast and accurate information because, with the internet age, there’s so much information out there, so many different data sources, that investment professionals need it that much quicker if we’re to stay ahead of the game. As a market maker you can’t
For traders using algorithmic strategies, speed is all-important. The opportunities they chase may only present themselves for a split second.

make proper prices if someone knows more than you do, earlier than you do.”

The Exchange provides real-time prices, company news and other information to 139,000 terminals installed in more than 100 countries around the world.

Since 2005, real-time price information has been disseminated by Infolect, which the Exchange describes as its “ticker plant”.

One way or another, anyone trading Main Market securities uses Infolect. Real-time data generated by trading activity is fed into Infolect and then transmitted to fund managers, banks, brokers and the like, either directly by the Exchange itself or through data distributors such as Reuters and Bloomberg.

There have been a couple of recent developments to speed up the time it takes to transmit this market data to members. The Exchange’s ‘Performance Channels’ went live in June, and allow Infolect data to be transmitted down 100 mega-byte cables running beneath the City in under a millisecond. Three months later, ‘Exchange Hosting’ enabled firms to locate algorithmic trading boxes within the Exchange’s data centre itself, in close proximity to the Exchange’s computer servers, again providing sub-millisecond access to Infolect data. For traders using algorithmic strategies, speed is all-important. The opportunities they chase may only present themselves for a split second.

Private investors, who may have less need for speed, can still take real-time prices from any one of the Exchange’s licensed vendors. Or share prices are available for free, though delayed by a quarter of an hour, through the Exchange’s online prices service.

For the bigger picture, historical and reference data are provided to help investors and financial professionals check the Exchange’s official trading record and analyse the activity on its markets. These give corporate event information, historical price data as well as statistical and trading reports.

The Exchange’s Regulatory News Service, or RNS, is one of the company news services available which allows firms to communicate with investors. RNS delivers market sensitive information for many quoted companies to a global audience of dealer terminals, databases and financial websites, such as FT.com and Yahoo. This regulatory news division allows investors and brokers to weigh a company’s performance, build customer contact databases, identify early investment warnings, develop financial models and analyse competitors.

On top of this, the Exchange’s Market Reports Service is a daily report focusing on the market dynamics of a company and its peers. It is used by management as a timely update of any information affecting a share price, and to cut the time and costs of consolidating this data in other ways.

It gives an intraday open, high, low and closing price; two-year historic closing price; and tracks peers and indices for comparison. A share register analysis is also provided – showing any holding of half a per cent or more – as too are broker recommendations and forecasts, and key company financial figures.

Participant Trading Data, delivered at the end of each business day, gives tick by tick trading data filtered for that particular participant. It shows trades involving a member firm to assist in end of day reconciliation and settlement, and an analysis of trading.

The Exchange’s Corporate Events Diary is an online calendar for tracking upcoming corporate events affecting UK securities traded on the Exchange.

This offers advance warning of Stock Situation Notices, such as share splits and when a share will go ‘ex-dividend’, allowing users to keep up to date with corporate events, anticipate the pricing impact of key events, and gear up front and back offices ahead of company announcements. The Exchange is also the joint owner of FTSE, the firm that calculates the official stock market indices that track equity and bond markets around the world.

The wall of money referencing these indices in the UK alone is eye-watering. More than £199 billion of UK assets under management in pension, investment and insurance funds weighs itself against the FTSE 100, FTSE 250, FTSE Small Cap and FTSE All Share indices.

Making that money work will keep the Exchange’s members busy throughout the current crisis and beyond. ■

Gary Parkinson is editor of BBC 5 Live’s Wake Up To Money.
The insurance companies and pension funds control the big pools of capital in London. Who are they and how has their investment approach evolved in recent times? **BY GARY CORCORAN**

THE LONG-ONLY FUNDS

Asked once what it was that made the City of London special as an international financial centre, a former Governor of the Bank of England replied without hesitation that it was the availability of capital. The fact that English was the language of business mattered, as did the time zone, and the vast pool of advisory, markets and banking talent. But while all these were necessary the essential thing was the capital. Ultimately people use a financial centre because that is where the money is. Take that away and the business will gradually dwindle.

London is uniquely well-placed in this respect by both accident and design – the accident being that through its recent history the bulk of the UK’s savings have come to be aggregated in relatively few very large pools, the design being that since the financial centre originally came into being on the back of trade with the British Empire, it has always had a thriving, internationally oriented fund management community.

Key players in this today are what are known as the long-only funds – the pension funds, the investible resources of the insurance companies, the investment trusts and the retail funds concentrated in the mutual fund industry, with the pension funds alone accounting for around £1,000 billion of assets.

The key here was not the creation of the funds themselves – enlightened employers had begun before the Second World War to provide such funds – but the significant extension of the concept to cover a substantial slice of the UK workforce in the 1950s, and the switch. This coincided with the realisation by the manager of the Imperial Tobacco Pension fund, a man called George Ross Goobey, that people use a financial centre because that is where the money is. Take that away and the business will gradually dwindle.
that the returns if the funds were invested in equities rather than bonds would provide significantly better pensions. Thus it came about, as others followed his lead, that the UK had a massive accumulating source of capital for equity investment.

Clearly the very existence of these pools of capital was a benefit for the London Stock Exchange, but it was in fact specifically, as well as generally, important. It was a feature of most pension funds and indeed insurance companies that great emphasis was placed on the security of the invested assets. Only securities listed on a recognised exchange were deemed to be suitable, which in practical terms in those days meant the Main Market of the London Stock Exchange.

The growth of the long-only funds therefore had a direct effect in enhancing the liquidity and depth of the market and creating a demand for new issues.

This role and linkage has continued to evolve. In 1991, a well-known British businessman, the publisher Robert Maxwell, was discovered after his death to have extracted money from his employee pension funds to finance his wider business ambitions. Subsequently, legislation was enacted to improve the governance of schemes, but a wider issue was the pressure from institutional investors. This led to the formation of a committee (under Sir Adrian Cadbury, a leading industrialist), which sought to add to the protection and security of pension funds and other investors by drafting a code of best practice on how boards should be structured and companies managed. This was the Cadbury Code, which, with additions down the years from committees chaired by Sir Ronald Brait, Sir Richard Greenbury and Sir Derek Higgs, has become what is known as the Combined Code of Corporate Governance. Compliance with the Code is mandatory for companies with a Primary Listing on the Main Market. The long-only

The growth of the long-only funds had a direct effect in enhancing the liquidity and depth of the market and creating a demand for new issues.
investment funds therefore have had a significant influence on the governance and boardroom process of listed companies.

This influence continues to this day, in particular through the investment committee, which operates under the umbrella of the Association of British Insurers, a trade association. This monitors corporate activity, co-ordinates shareholder responses and sounds alerts when it considers shareholder interests are threatened or wider principles are at stake. Companies use it to sound out shareholders on proposed initiatives before they are set in stone and it, in turn, will quietly lobby company boards on issues which give it concern. Occasionally these discussions get polarised and spill over into the public domain – but the vast majority take place away from the public gaze and significantly enhance understanding between boards and their leading shareholders.

Another advantage of the ‘long-only’ structure in London, from the perspective of companies seeking a listing, is the concentration of power. It is often said that fewer than 50 people control the bulk of the money in London. While that figure is hard to verify, it is the case that those seeking capital can very quickly have face-to-face meetings with most of those who are in a position to provide it. Structures are relatively flat and decision-making rapid, so companies can learn quickly where they stand, whether a given proposal is acceptable and if not, how it might need to be modified to make it so.

It helps, too, that most of the industry is geographically concentrated in central London. There is fund management elsewhere in the UK, notably in Edinburgh, but compared to the geographic dispersal of the United States, where leading asset management groups are spread across the continent, access is easy. Many of the continental banking groups also house their fund management activities in London, and it is a feature of many recent mergers and acquisitions that the key issues have been fought out in front of the London-based investment community, even when the participants are foreign-based – as with Mittal’s acquisition of Arcelor, in the biggest deal the steel industry has ever seen.

In recent years investment techniques have become more sophisticated and, as they have matured and regulation has evolved, the needs of pension funds have become more complex. There has been a huge growth in benchmarking, where portfolio performance is measured against the performance of the market as a whole or sectors within it. There has been an increase in the use of passive investment – now accounting for around 30 per cent of pension funds under management, where the objective is to replicate the performance delivered by the market as a whole or again some specific part of it. And laterally there has been the growth of Exchange Traded Funds (ETFs), specialist investment vehicles which reflect the performance of these underlying indices and which allow investors to gain exposure to the performance of a sector or asset class – for example, commodities – by the purchase of the relative ETF. Judicious buying and selling of ETFs provides a simpler and less expensive way for funds to maintain their balance of exposure to different asset classes and has greatly increased the range of tools available to fund managers. But the point is that none of this would be possible were it not for the presence of the Main Market, which has given the index providers the raw material they need to provide transparent and robust indices based on the prices reported by the market – and in which the long-only fund managers can have confidence.

Gary Corcoran is editor of Portfolio Adviser, an investment industry trade magazine.
GARY CORCORAN looks at the mutual fund industry in terms of the funds under management, the leading firms and the investment approach

THE MUTUAL FUND INDUSTRY
he mutual fund industry in the UK used to be of little interest to anyone other than the extremely wealthy. These were the days when those who had money to invest would use a stockbroker to buy and sell stocks for them. Not any more. The number of stocks being bought and sold has multiplied a hundred times, gone global and is now available at the touch of a button to everybody, not just to stockbrokers; and it is no longer just stocks being bought, nor is it just the extremely wealthy who are showing an interest.

The mutual fund industry that we know today kicked off in the 1930s with the advent of unit trusts, the whole idea of which was to allow an individual to invest in more than one stock at a time. They are also referred to as collective investments. The very first open-ended unit trust set up in the UK was introduced by M&G on St George’s Day in 1931, copying an idea from the US that was deemed successful given that it had gone through the Wall Street Crash relatively unscathed only two years earlier.

The investment trust industry – something that is peculiar to the UK only – is considerably older, with the first product launched by Foreign & Colonial (known today as F&C) in 1868. The key difference between these two types of investment is that unit trusts are open-ended, issuing and cancelling shares themselves, but investment trusts are closed-ended and floated on the Main Market, and secondary trading in shares is conducted on the appropriate trading service. Generally, unit trusts are more commonly sold to retail investors via independent financial advisers (IFAs), whereas investment trusts must be bought and sold on the stock market via a stockbroker. Both have their supporters and their detractors, though it would be fair to say that it is unit trusts that hold sway with the majority of individual, man-on-the-street retail investors.

Until the 1960s, it was life companies who dominated the investment world, running huge pension schemes in either with-profits or non-profits funds. Things changed when they started introducing unit trusts through financial advisers, either IFAs or their own sales force.

Nick Wells has more than 30 years’ experience in the industry and is now the product and communications director at Artemis. He explains: “Commission levels were different as unit trusts were a lot more aligned to stock market investments rather than life products. In the early 1960s, with Abbey Life, then Hambro Life, you had unitised funds and that is where the big break came, as they could offset the commission levels against corporation tax.”

Wells adds that the commission on the original unit trusts was the same as for small equity baskets, 1.65 per cent compared to the life companies paying 5 per cent. Deciding which to sell was, he says, “a no-brainer”.

Without doubt, the 1980s saw the introduction of the mutual fund industry that we recognise today. The life companies were left behind and it was the turn of the mutual fund managers to come into their own. Some of the founding companies, like Save & Prosper, have fallen by the wayside – being swallowed up by Flemings, which then became part of the giant JP Morgan. Others, such as M&G, floundered and made way for US giants like Fidelity, and household names such as Henderson, only to bounce back to be one of the largest, most respected firms in the industry today.

At this time investors only had a few hundred funds to choose from – when Fidelity first launched in the UK it only had a handful of funds to offer – with total assets under management in the region of £100 million invested in unit trusts.

Today there is closer to £450 billion across the range of unit trusts in as many as 16,000 onshore funds. Many of these funds are hangovers from the days when life companies’ investment products, sold by commission-hungry sales forces and IFAs, dominated the management of individual investments.

The introduction in 1986 of Personal Equity Plans (PEPs) by the then Chancellor Nigel Lawson – and their subsequent iteration as Individual Savings Accounts (ISAs) in 1999 – was a major influence in increased share ownership by individuals. It is also arguably responsible for the introduction of mutual fund houses to a far wider audience in the UK.

Life companies found their reputation among investors in tatters, following the separate pension and endowment scandals. The failure of
Mutual funds investing in equities, bonds and cash could be the future

Equitable Life was another nail in its coffin.

Justin Urquhart Stewart, marketing director at Seven Investment Management, says: “Those firms that had a big unit trust operation, that already had a sales force, could walk past the life companies and start going directly to the clients. As soon as that happened, people either wouldn’t know what a tax wrapper was that the insurance companies were offering, or couldn’t see the value of having it.” Investments were now being seen as a standalone product alongside life assurance, pensions and general insurance. The big change was who was offering it.

The door opened for those mutual fund houses that had the budgets to carry out huge poster campaigns that promoted an ISA as an investment product rather than a tax wrapper – far less sexy – and investors questioned their need to go to a life company. They were attracted by the newer fund houses that had no ‘baggage’.

While access to mutual funds increased, they were still heavily based on stock, or equity, investing. Any bond investment was limited to gilts and Treasuries, and while commercial property funds were available, they were still the preserve of the institutional investor, and still were until the early to mid-2000s. The introduction of corporate bonds pre-dated this by around ten years.

In 1985 the European Commission introduced its Undertakings for Collective Investment in Transferable Securities directive, more succinctly known as UCITS regulations. The intention was to allow fund management companies to remove barriers to supplying their funds outside their own country through the use of a ‘passport’. After more than 20 years this is still yet to happen, and is unlikely to in the foreseeable future given the different sets of tax rules in place, as well as a degree of stubborn parochialism. However, what UCITS III (UCITS IV was scheduled for February 2008 and we are still waiting for an amber light, let alone a green one) does allow is for mutual funds to use derivatives, index-trackers and funds-of-funds.

This has widened the investment approach available to individual investors immensely, with the types and number of products available increasing, as are the number and type of mutual fund provider.

The move from the big players (Fidelity, Schroders etc) to boutiques (Artemis, Neptune, Thames River etc) was partly as a result of the new regulations and partly a natural progression and a conscious move away from institutional-style investment operations that benchmarked a particular index; or simply harboured a desire for greater control and creativity. Dick Turpin, managing director at Artemis, explains: “The guys who set up Artemis wanted to put their heads on the block and say: ‘This is my decision and I’m going to stand by it and it will be reflected in my performance. If I get it wrong it’s down to me’ instead of being told they could have 2 per cent above a benchmark and be 3 per cent overweight in a particular stock.” It no longer made sense for this new breed of fund manager to hold a stock they fundamentally did not believe in.

Turpin adds: “There is also the belief that you can’t do everything. Our focus is fundamentally on UK and European equities; Thames River Capital started as an emerging markets specialist; Neptune is still essentially an emerging Europe player; Perpetual – arguably the first boutique – and Jupiter when they kicked off were mainstream UK equities.”

Any industry post-1980 will have experienced change directly linked to improvements in technology. In the mutual fund industry, technology advancements allowed independent providers and life companies to give investors direct access to funds through a shared technology platform. Skandia was the first life company to trade in this way, while CoFunds and FundsNetwork are the two largest independent providers, each offering more than 1,000 funds to retail investors.

Jonathan Willcock, managing director of global sales at M&G, describes these types of platform as “one of the most fundamental driving forces in the UK and Europe today”.

He adds: “The advent of fund supermarkets [where a variety of funds can be purchased from many different management groups via the internet] in the 1980s and 1990s allowed IFAs to access all the fund groups through one platform. It saved them huge amounts of paperwork and time and gave them access to better portfolio management tools. They could also use the technology to automatically send their clients one consolidated statement of account.”

Today, Legal & General and Axa are two other life companies that have put together a range of mutual funds available through a technology platform. And with the current volatile market conditions seeing investors return to what they are comfortable with, then mutual funds investing in equities, bonds and cash could be the future.

In many ways, collective funds and the Main Market are joined at the hip. Investment trusts and UK-REITs must be listed on it to get the tax benefits. Elsewhere, there are rules limiting the proportion of non-EU-regulated securities that UCITS funds can hold, and unit trusts also largely focus on Main Market securities. It therefore remains as true as ever that a healthy Main Market is an essential pre-condition for a successful collective investment industry.

Gary Corcoran is editor of Portfolio Adviser, an investment industry trade magazine.
More institutional money is making hedge fund managers grow up fast.

BY STUART FIELDHOUSE

LONDON’S HEDGE FUNDS GET SERIOUS

These are rough times for the hedge fund industry, and collapsing markets and the shortage of credit have forced many to close their doors. But the general view is that this is an overdue culling of the weak and many of the worst affected were marginal firms tempted in by the easy profits of the boom years. These managers have found it much harder to perform and many have been badly caught out when conditions changed. It is true, too, that some of the big funds have also made mistakes, but these are expected not only to survive, but to emerge stronger from the experience.

Although the hedge fund industry was born and matured in the United States, London has become the home to more than 80 per cent of Europe’s hedge fund groups, and many of these, including the likes of Marshall Wace, RAB Capital, Lansdowne Partners, GLG and TCI have become multi-billion dollar giants with interests in a variety of markets.

Since 2001, however, we have seen a sea change in the way London’s hedge funds operate and to whom they report. Ten years ago, a typical hedge fund’s clients would be composed of private banks, high net worth investors and family offices. Their clients were rich individuals who could afford the typical asking price of at least $1 million to invest with them. Today, that picture is very different, with almost 60 per cent of hedge fund assets globally coming from institutions, including pension funds, endowments and banks.

We have even seen some already established investment managers, including Henderson, New Star and Gartmore, opening their own in-house boutiques to meet the demand from their existing customer base for hedge funds. In addition, the larger hedge fund managers have become highly institutionalised businesses in their own rights, managing several different investment strategies and resembling their more established ‘long-only’ mutual fund cousins in the way they operate.

Hedge funds are, however, a very diverse bunch. Not all of them trade equity markets, and not all equity hedge funds pursue the popular long/short strategy, which allows them to profit from falling share prices by borrowing stock. But hedge funds, both in the UK and beyond its shores, have become an increasingly powerful force in European money markets, and despite their secretive natures and smaller asset base...
profiles of the players

Not all hedge funds rely on intra-day trading to make a profit

when compared to traditional fund managers, still seem to end up in the business headlines on a regular basis.

One of the reasons for this has been the activist stance taken by some funds (notably Christopher Hohn at TCI), a habit that seems to have crossed the Atlantic from the US. These funds have been able to derail proposed mergers and even depose seemingly unassailable CEOs by organising enough shareholders to exert sufficient pressure on management to effect changes. Hedge funds are not the wrecking balls that they are frequently made out to be by politicians (and more recently senior clerics): an activist hedge fund manager will usually only turn to other shareholders when he feels that management is not paying him any attention. His proposals are often the consequence of much serious research about a listed company and the markets it does business in, and will include suggestions that could potentially help a company to make more money. Unfortunately, some businesses take the view that shareholders, like little children, should be seen and not heard, and this can cause sparks to fly when an activist hedge fund manager starts acquiring their stock.

Not all hedge funds rely on intra-day trading to make a profit, either. Many follow a buy-and-hold culture that is based on fundamental, original research, frequently generated by talented teams of in-house analysts. The only difference with mutual funds is that hedge fund analysts are looking for both buy and sell ideas, in order to generate short trades for the manager. And a cursory examination of most long/short portfolios will reveal that the bulk of London-based long/short managers tend to stay net long, explaining why returns have not been as rosy this year as previously.

“Hedge funds are more likely to carry out a high level of detailed analysis on a company,” says Barry Marshall, CEO of BidRoute, the automated auction service for London-based equity trades, which went live last year. “Lots of long-only fund managers rely too heavily on their brokers for research.” Marshall was previously the chief operating officer at Gartmore, one of the earlier London-based firms to launch dedicated long/short equity funds for their clients.

Another important source of liquidity for London’s exchanges are the so-called ‘stat arb’ (statistical arbitrage) funds, those that follow an investment strategy that is guided by buy and sell signals generated by a programme. They are characterised by their short holding periods and by the large amounts of money they can bring to a trade. On a low volume day, the activities of one or two of the major stat arb players can move prices quite significantly. Global macro funds, which have attracted the ire of central bankers and regulators in the past and have been accused of punishing fragile currencies, stock-markets and debt securities, are a high profile part of the stat arb gang.

The advances in trading technology over the last few years have meant that large, multi-billion dollar funds have been granted greater flexibility in the way they split up orders and place them in the market. Many are now using several brokers in order to manage the costs of their portfolio management effectively and cloak their activity in the markets. It comes as no surprise that revenues from hedge fund prime broking activities comprised an increasingly important share of turnover for the investment banks prior to the recent crisis.

“Hedge funds are now more open about trying new ways to execute deals, and they are being more efficient in the way they deploy their [trading] infrastructure,” says BidRoute’s Marshall. His firm is one of the technological applications competing for a share in the lucrative stat arb trading budget. He sees a market for systems that will help big hedge funds to allocate trades discretely and cost-effectively in London
and elsewhere. In the wake of the EU’s recent MiFID directive, which requires investment managers to seek out the best price for their trades, hedge fund managers with large institutional client bases are keen to show that they have been able to source competitive deals.

In the wake of the current banking crisis on Wall Street, it is likely that stat arb funds will devote more time and money to seeking out direct market access solutions that will allow them to bypass the ailing banks. The demise of important hedge fund prime brokers, like Bear Stearns and Lehman Brothers, is re-shaping the landscape, particularly for those managers that also relied on their brokers for a degree of financing to provide them with additional leverage on their trades.

It is also worth mentioning that the London Stock Exchange has played a key role in helping hedge funds to raise capital. A number of leading fund managers have chosen to list their businesses (Man Investments, arguably one of the biggest hedge fund providers in the world, is now a FTSE 100 Index company) or their funds on the Main Market. The listing of hedge fund firms like RAB Capital is a milestone in this industry's evolution, as it marks the point at which boutique investment management houses came of age, and could IPO with realistic prospects.

In addition, managers have tapped the market for cash by listing their investment schemes as closed-ended funds. Major managers like Brevan Howard now offer investors access to their strategies via traded companies, sometimes when the core fund is closed to new investment. This seems to have gone down well with the investment community, which appreciates the additional liquidity and transparency listed funds bring, as well as the effort the manager has expended on complying with the regulatory and corporate governance standards required under the FSA’s chapter 15 Listing Rules for closed-ended funds.

“A Primary Listing brings with it the highest standards of corporate governance,” says Soondra Appavoo, the managing director of PSource Capital, which successfully placed £30 million in shares in the PSource Structured Debt fund. The fund has since more than doubled its assets under management.

Appavoo says the Exchange’s move to make it easier for funds to list has helped to give it an edge in the eyes of hedge fund managers, and he is confident that, as market circumstances improve, managers will be back for more, thanks to the lure of the permanent capital a listing can bring. “I’m not saying this is an alternative fundraising vehicle; I’m saying this is a better fundraising vehicles,” he argues. The traditional open-ended structure adopted by hedge funds has proved to be a double-edged sword in the current trying times, as too many redemption requests force managers to liquidate positions. These problems are alleviated for managers with funds admitted to trading on a public capital market.

For those alternative investment managers looking to appeal to the more sophisticated investor, the launch of the Specialist Fund Market by the Exchange has recognised the appetite for an appropriately structured, peer group capital market facility at the heart of London. Although new admissions have been quieter recently, Appavoo confirms there is a pipeline of new funds waiting to join once investor confidence returns, and is himself looking forward to the next chapter in the evolution of London’s hedge fund fraternity.
HUGO DUNCAN explains how an overseas company with a Primary Listing of equity on the Main Market should approach the different categories of London investor.
“The market does not like surprises,” says Graham Webster, corporate finance director at Daniel Stewart. “Investors are like elephants – they never forget. Once you lose the confidence of the market, it takes years to rebuild credibility.”

Overseas firms in particular should take heed of this warning. Without a strong track record of investor relations in London, and with management based outside the UK for long periods of time, market sentiment can quickly turn.

But this is simply something of which to be aware, rather than afraid. After all, floating on the Main Market is not an end in itself but a means to an end, that end being to have your company’s securities traded in one of the most, if not the most, prestigious capital markets on earth. Central to this is getting things right, not causing surprises.

“The golden rule for directors of a quoted company is effective communication,” says Webster. “There are two facets of this which are the ‘rules’, legal and regulatory requirements with which you must comply; and ‘market practice’ – a set of principles, which although not compulsory, will help to attract investors and generate liquidity in your shares.

“The principles are designed to ensure a level playing field between both existing and potential investors with regard to information on each company on the market. All market participants should have equal access to information and directors are individually and collectively responsible for ensuring that this information is communicated to the market.

“More important is the effective presentation of your company to the market. The smaller you are, the harder you will need to work at communicating and selling your story to raise investor interest and liquidity in your shares.

“You will need to be upfront, clear and timely with information. The market does not like surprises. If not, at worst you could be breaking the law. At best, you will have angry investors who lose faith in the company and its management.

“The result is selling of your shares and a downward pressure, or even the collapse of the share price.”
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The golden rule of reporting is to be timely, consistent and open. The market does not like surprises, even nice ones.

Firms must also disclose in a timely fashion major new developments within the business or markets, significant changes in trading or outlook, and various other matters such as board changes or a director’s share dealing.

So who makes up the market, and who are these investors? Broadly, the market includes fund managers (running pension, insurance, charity or mutual funds), private client brokers, research analysts and the financial media, among others. It is the company’s job, together with its stockbroker and financial PR adviser, to ensure expectations of the market accurately reflect the actual trading and financial position of your company. If it does not, it is the sometimes painful duty of the company to set that straight.

Webster explains: “Analysts will publish their views and recommendations on a company’s performance and their coverage is an essential part of attracting investment in the shares. Following results or significant announcements, key directors should be prepared to set aside time to meet with shareholders, analysts and the press and answer their questions. This provides valuable feedback to the directors regarding areas of interest or where they can improve their message.

“Companies should also consider ‘investor days’ where analysts and investors or potential investors are invited to visit the company. Media coverage is very useful for encouraging the interest of private investors, which helps provide liquidity. All these activities require significant commitment, especially for management based outside of the UK.”

Just like understanding the sector in which their business operates, companies must appreciate and understand the structure and dynamics of their investor base and frame an investor relations strategy tailored to each specific investor, whether it is a retail investor or a large pension fund.

Among the institutional investors, there will be investors representing funds with many different aims. A company that occupies a specific index, such as the FTSE 100 or FTSE 250 indices, or an index for a specific sector, will attract tracker funds, which invest in companies in an index to track its performance. Special situations funds look for specific opportunities, such as a sector that is undervalued, companies ripe for takeover, companies on the acquisition trail, or companies on a turnaround strategy.

Income funds invest in companies paying dividends, while specialist funds may be looking for firms that are ethical. Private client funds represent an underlying client base of private clients.

So, ‘target your marketing’ is Webster’s advice to foreign firms, to make sure you are speaking to the investors best suited to your company.

“If you don’t pay dividends, don’t target income funds. If you have only recently commenced payment of dividends, it is unlikely you will have income funds on the register, so you should target them for your future marketing efforts. Is your business international? Should you target overseas investors within those markets?

“Also, don’t forget that most fund managers are responsible to their own clients for their investment decisions. If you let them down, they in turn are letting down their own clients, and they don’t like it. This also applies to research analysts, whose reputations depend upon the accuracy of their research.”

As such, overseas firms can expect questions of all shapes and sizes.

In terms of technical accounting issues, the market will want to know if exceptional items really are exceptional and can or should be ignored to understand the true trading position of a company.

There will be questions about corporate governance, such as board structure, controversial appointments, disagreements and the independence of non-executive directors. While grand old British firms with years of experience in the London market may be able to adequately explain certain areas of concern, it will be more important for an overseas company to attempt to do so, particularly if it is Primary Listed in London but does not do much business here.

The market community will also be interested in dividends – should they be higher, why does a company not pay them, should a company pay them? Firms must also be consistent. If a company presents a level of information in one set of results, it must be reflected in subsequent sets of results. If not, the market will ask: “What are you hiding?”

Webster says: “The key to being a quoted company is to be proactive. The bottom line is, being a quoted company is a significant financial and resource commitment. That being the case, exploit its benefits to the full and make use of what the market has to offer.”
It’s a complex business

What route will you take to raise capital?

KPMG in the UK can work alongside our global network of country specialists to assist you with bringing your business to the UK. We can advise on planning a successful IPO, help to reduce the risks and provide valuable local knowledge.
Achieving success in turbulent conditions

Raising capital is a complex business and even more so when you are operating across geographical and cultural barriers. KPMG’s research shows that many companies underestimate the time and resources required for a successful IPO and even more are taken by surprise by the ongoing demands of being a public company.

Depending on the route you take and where your company is based, the issues you will face could include:

- Preparation and audit of IFRS financial statements
- Being ready for due diligence
- Compliance with unfamiliar corporate governance expectations
- Improving your business planning and forecasting
- Ensuring your management information is sufficient to enable you to comply with the ongoing reporting requirements
- Speeding up your year-end reporting

Our pre-IPO readiness check can help you identify which of these or other issues could impact on your business and our UK Capital Markets team can provide you with the specialist help you need.

By working with member firms from KPMG’s global network of 123,000 professionals in 145 countries we aim to make the process of raising capital as painless as possible and let you focus on what really matters – growing your business.

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Your gateway to London.

The PricewaterhouseCoopers Capital Markets Group works with companies and investment banks on London capital markets transactions helping them on a range of issues. From preparations to becoming a public company and selecting the right market to reviewing financial reporting procedures and corporate governance arrangements to GAAP conversion projects and undertaking financial and business due diligence investigations, our team will provide advice that is tailored to your needs.

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Who are the advisers that a Main Market company needs to recruit to guide it through the process? ANDREW CAVE looks at the role and responsibility that each takes.

THE ROLES OF THE ADVISERS

A listing on the Main Market is the culmination of what is in effect a due diligence process by the regulator (the Financial Services Authority) and the London Stock Exchange. Achieving and maintaining a listing involves several types of advisers with different skills.

The advisers in the listing process
Market commentators frequently use the term ‘listing’ to mean ‘traded on a stock market’. In fact, ‘listing’ has a specific regulatory meaning and a significant due diligence process attached. It is this vetting process that is the key to unlocking the opportunities a listing on the Main Market brings, and naturally choosing suitable, high-quality advisers is one of the most important steps towards flotation. The substantial legal and regulatory, financial and marketing considerations involved in joining the Main Market mean it is necessary for companies to appoint a team of experienced advisers to guide it through the process. So who are they and what role and responsibility does each take?

The sponsor
Companies considering a Primary Listing (the ‘gold standard’ route to the Main Market) will need to
GBA has organized several IPO conferences and Forums across China and achieved great results, especially during the China IPO & UK Inward Investment Forum in September 2008 during the 5th CISMEF. Together with our partners Seymour Pierce and Axiom Capital, we are currently assisting 7 Chinese companies with their plans to list on the AIM and PLUS markets from 2009 onwards, and 230 other Chinese companies with capital and profile-raising projects in the UK. At the same time, we have started to match Chinese companies with potential UK partners and also providing the next gateway for the 6th CISMEF and the upcoming 2009 China IPO & UK Inward Investment Forum.

GBA specialise in investment and finance (assist both UK and Chinese government to attract foreign funding via recommendation of investment projects), project management, and creating successful business models for clients and high profile partners to generate mutual interest.

GBA is the professional new generation coordinator who orchestrates company’s inputs and monitors the IPO process, providing high quality and trust guarantee services to our clients and partners.

We offer clients specialized services including:-
- IPO and Inward Investment
- Capital Connection and Project Match
- Overseas Company Search and Due Diligence
- Overseas Government Support
- Fast Market Entry Strategy
- Project Management
- Legal and Business Advice in China
- Business Representative and Virtual Assistant
- Business Trust Licence

“All industries have their economic and life cycle... every financial crisis can give birth for the next business generation. Utilising the concept of exchange and share, rewards can be maximised with limited resources.”
- Grace Bian, Managing Director, GBA

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The Innovative IPO Coordinator
Global Business Associates (GBA) provide profitable business opportunities during global financial crisis to unite and increase international cooperation via merger and acquisition, resource planning and corporate regeneration, in order to create a brand new innovative economy in an uncompetitive healthy market.
appoint a sponsor. Sponsors take a central role in the flotation, advising a company on a wide range of issues, which can include the appointment of other professional advisers. An investment bank, stockbroker or other adviser, such as a corporate finance house or accountancy firm, can take on the role, as long as they are approved by the UKLA to do so.

Sponsors’ duties include assessing a company’s organisational structure and capital requirements and advising on the composition of the board, the most suitable method of flotation and the flotation timetable. They also help co-ordinate the activities of other advisers and advise on the pricing and underwriting of shares in equity issues.

For some transactions, the UKLA requires the company to appoint a sponsor who will provide the issuer with specific expertise drawn from its involvement in previous transactions, helping to streamline and standardise practices.

The corporate broker
The broker is a company’s main interface with the stock market and potential investors. It advises the company seeking a listing and its sponsor on market conditions and the likely level of demand.

The corporate broker actively markets the shares or depositary receipts to potential investors, and advises on the best method of flotation, the size of the issue, timing and price. It also puts in place arrangements such as underwriting and stock placing agreements.

If the sponsor is an integrated house that offers both investment banking and stockbroking services, then the sponsor and corporate broker can be the same firm. Some brokers have particular sector expertise, for example in technology. They are also ranked in league tables of leading research houses.

The broker is a company’s main interface with the stock market and potential investors.
Seeking a listing on the Main Market is all about cost versus benefit. No other form of capital raising also provides the benefits of profile raising and secondary market liquidity that comes with a listing.

**The corporate lawyers**
Most flotations involve two sets of lawyers; one to advise the company and its existing shareholders and the other to advise the sponsor. The lawyers draw up the agreements surrounding the flotation. They are responsible for the due diligence process, which involves verifying statements in the prospectus and other documents. Lawyers also oversee changes to companies’ articles of association and directors’ contracts and prepare the ‘verification’ questions used to confirm that all statements in the prospectus can be justified as fact. The two sets of lawyers work together on agreements between a company, its sponsor and existing shareholders on issues such as underwriting and tax. They may also draw up share option schemes.

**The reporting accountant**
A company looking to list on the Main Market must have a reporting accountant, responsible for reviewing and auditing its finances so potential investors can make an informed decision about its shares. Accountants may also act as the sponsor to an issue, though sponsors may wish to appoint a different firm to ensure the highest possible levels of detachment and independence.

Accountants issue two types of reports – long form and short form – in a flotation process. The long form report is a detailed financial and management history of the business, which is not published but provides the management and sponsors with the information needed to draft the prospectus. This serves as the basis for the short form report, which is published as part of the prospectus. The accountants will also usually prepare a report for the sponsor on the company’s projected working capital position over the 12-18 months following flotation. They may also advise on tax implications of a flotation or specialist tax advisers can be appointed to do this.

**Other advisers**
Companies listing on the Main Market may also appoint financial public relations consultants, though there is no regulatory requirement to do so. Other advisers can include registrars to manage the share register; chartered surveyors or valuers to assess property values; security printers, actuaries, receiving bankers to handle share applications in a public offer; and insurance brokers to check that all risks are adequately covered. For companies with business models which can not be valued in terms of cashflow and instead are trying to exploit higher to value concepts such as scientific development (biotechnology, drug development) or planning to exploit mining rights for example, expert reports may be required to qualify the investment opportunity and help potential investors to better understand the risks. And for companies issuing depositary receipts, a depositary bank is required to manage the programme on a regular basis.

**The costs of a listing**
Listing on the Main Market is a major investment that is likely to cost at least £500,000 in professional fees. This figure can rise significantly for a sizeable listing when the costs for insuring a successful flotation through underwriters who contract to buy up unused allotment of shares are taken into account. However, companies may be able to fix some of their costs, such as accountancy and legal bills, at the start of the process.

The UKLA and the London Stock Exchange also charge fees to list companies and admit their securities to trading. Once listed, companies have an obligation to disclose price-sensitive information to the market through a Regulatory Information Service, such as RNS, which is paid directly by companies to their preferred service.

While the total costs vary depending on circumstances, they tend to amount to between 4 per cent and 8 per cent of the total proceeds of the offering. Costs are usually paid out of the proceeds of an offering.

Ultimately, seeking a listing on the Main Market is all about cost versus benefit and while the process may involve much time and many third parties, no other form of capital raising also provides the benefits of profile raising and secondary market liquidity that comes with a listing.
Foresight reveals itself in the hour of need

What makes ww&p a leading source of legal services in Switzerland? Certainly the expertise of our attorneys – a cornerstone of our business. Also our long experience in selected industries – which allows us to understand our clients’ needs and objectives. But more than that, it is the culture of our firm that has made us a leading source of legal services.

Find more about our philosophy and our services on www.wwp.ch
UNDERSTANDING THE IMPORTANCE OF COMMUNICATIONS

JAMES MOORE looks at the essential role that effective communications play
To many, the term ‘PR’ still conjures up images of champagne and long lunches. Put ‘financial’ in front of that, however, and it is a different ball game – just ask Northern Rock. The former building society that had once been Britain’s fastest-growing mortgage lender had been forced to call on emergency funds from the Bank of England. The story leaked to the BBC and was made the lead item on its News at Ten programme. The result? The next morning, queues of worried savers converged at Northern Rock branches on high streets up and down the country in an attempt to get their savings out as quickly as they could.

What became the first ‘run’ on a bank in living memory left the taxpayer with a multi-million pound bill as the Government was forced into guaranteeing Northern Rock deposits ahead of its nationalisation.

This, of course, was an unusual situation, but there have been many others when financial news has triggered a minor disaster. The role of the financial PR can appear to be nebulous, but at its most basic it is to try to prevent this from happening. The financial PR sits between a company and its external audience, the media, the institutional investment community and the private investor community. Its role is to tell the company’s story and communicate its message. Partly what a PR does is promotional – aiming to ensure the company stands out from the many seeking to secure the media’s attention and helping to develop the relationships it needs. Partly it is advisory, to ensure a public company puts its ‘best foot forward’ when speaking to its external audience. But perhaps the key role is ‘being there’ when a crisis strikes and putting the record straight – and with today’s media having gone global, a rumour on a financial bulletin board can be flashed around the world almost as quickly as one can say ‘Google’.
Investors: retail and institutional

The old cliché held that when your cabbie started to talk shares, it was time to get out of the market. It’s one of those old City sayings that shows just how sniffy the professionals are about retail investors.

But those retail investors can be a vitally important part of any company’s shareholder base. Just ask Norwich Union (NU). What is today Aviva was created when the former succeeded in pulling off a nil premium merger with CGU – itself a combination of Commercial Union and General Accident. The deal was controversial with some institutions and with a vocal group of private investors. At the time, it seemed as if it was very much touch-and-go as to whether the merger would succeed, not least because a counter bidder could easily have come out of the woodwork.

To get the deal through, NU also had to achieve the support of 75 per cent of its shareholders because the merger was being accomplished through a scheme of arrangement. This, therefore, required the company not just to achieve the support of its retail investors; it had to ensure they registered their votes. That is because the company had legions of retail shareholders who had retained the free shares they were allocated when the life insurer changed status from a mutual, owned by its with-profits policyholders, to a plc with a Primary Listing on the Main Market.

NU, therefore, had a twin communications strategy – institutional shareholders were catered for through roadshows and the one-to-one conversations they had come to expect. But a great deal of effort was also taken to court retail investors, with targeted press coverage and roadshows of their own.

The retail shareholders proved to be an ace for NU – while a vocal minority opposed the deal, the majority voted for it, creating one of the world’s most powerful insurance groups and proving the benefit of looking after both sets of shareholders. Thus, the company demonstrated the importance of communicating effectively with both groups of shareholders and being alive to their particular needs.

Analysts: buy side and sell side

They are often similar people, with similar backgrounds, and there is considerable movement between the two, but communicating with the buy side and sell side presents subtly different challenges for any company.

The sell side are analysts employed by investment banks to publish research on a variety of companies. With their research, they aim to generate commissions from the buy side – institutional fund managers and the like. This is done by producing innovative research with the aim of providing trading ideas that, they hope, will see the buy side engaging the investment banks that employ sell side analysts to execute trades for them.

Because of this, many sell side analysts behave more journalistically than a buy side analyst might.

This is because the latter are employed by fund managers to research companies. What they write is not usually openly published, being available only to the managers at their firm. They can therefore be considered more like investors for communication purposes, with what they write having a strictly limited circulation.

Sell side analysts, however, are often seeking an angle to get attention for their research so that it is noticed and generates business for their employer. The more independently minded of them will ask tough questions, focusing closely on a company’s figures and looking to make their forecasts as accurate as possible. Research by sell side analysts is also often made available to journalists for use in their articles and even where it is not, it can usually easily be obtained by journalists. This, then, is the crucial difference when communicating with the two types of analyst. The buy side is not for publication, the sell side is.

Shareholder analysis

‘Know your customer’ is one of the key mantras of a successful business, but ‘know your shareholder’ is arguably just as important and presents an important communications challenge.

For a successful and mature quoted company, it is important to have a wide mix of shareholders. This facilitates liquidity, prevents a shareholder or group of shareholders from having too much influence and provides a broad base to call on should the company require funding for activities such as acquisitions, or, in today’s colder climate, to fund activities such as paying down debt.

The second is particularly important given the increasing influence and prominence of activist investors such as hedge funds at a time when share prices are low, and vulnerable companies can fall prey to assault.

Even large companies are not immune – witness the upheaval caused at businesses such as ABN AMRO or Deutsche Börse by the hedge fund TCI, acting in concert with other activists.

At the basic level, an income-seeker’s interests are quite different from those looking for capital growth. Then there are specialist funds, which concentrate on specific sectors based both in Britain and abroad.

However, deeper analysis can reveal trends within funds. Managers have different ideas on what sort of companies they like and by developing their knowledge of this, companies can develop links with investors who have a good knowledge of their business, understand the challenges they face and are willing to support them in their goals.

Analysing what shareholders are looking for in the companies in which they invest can pay real dividends if companies are prepared to put in the time and effort required to develop a communications strategy aimed at them, and to make the effort to go and see them.
At New World Resources we respect tradition and invest for the future. We understand the need for efficiency and we recognise the opportunities for international growth. We are aware of our responsibilities to our people and our environment. That is why we invest in new technologies and strive for innovation. The investments we make today will help to secure the future – of energy, of industry, of our customers, partners and of the communities where we operate.
RICHARD SCHWARTZ provides an overview of market developments

If, as William Pitt once said, “The parks are the lungs of London”, its financial markets are its lifeblood. Since its founding in 1801, the London Stock Exchange has come to occupy a pivotal role in global finance. Initially conceived to provide a location for the trading of British government debt, by 1914 one-third of the public capital available to investors anywhere in the world was listed and traded on the London Stock Exchange.

Over the past century, as financial market activity has expanded across the globe, the Exchange has retained its global reputation. According to a recent TABB Group report on European Equity Trading, the Exchange, the Deutsche Börse and Euronext together comprised almost 60 per cent by value and 62 per cent by trading turnover of all European equity market activity in August 2008.

The Exchange remains the most international equities exchange in the world, providing access to Europe’s largest pool of liquidity. Its centrality derives both from the companies that choose to float on the Exchange’s markets and the investors providing liquidity to the market.

**Companies**
The Exchange provides a range of alternatives to companies wishing to float. The Main Market alone covers some 42 sectors, with counters varying in size from fledgling growth companies to global multinationals. Its international flavour is reflected in the choice of routes to market, which recognise that there is a need to balance the requirements of investors for disclosure and transparency with the circumstances (including domicile) of the companies concerned. A Primary Listing indicates compliance with the highest standards of regulation and disclosure in Europe, the payoff being access to the widest pool of investors, and thus liquidity. A Secondary Listing follows EU Directive standards and is more appropriate where institutional investors only are sought. A Primary Listing does not require a company to give up its home listing, nor does a Secondary Listing imply that the firm is also listed elsewhere.

**Investors**
The potential capital pool available to these companies includes a vast array of institutional and...

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retail investors and their associated vehicles: Primary Listed companies in particular have access to the broadest investor base, including 5,000 pension, insurance, mutual funds and investment trusts; Individual Savings Accounts and Personal Equity Plans held by retail investors; 240 institutional funds explicitly benchmarking the FTSE UK Index Series; as well as 60 tracker funds that are obliged to have exposure to Main Market companies in the relevant FTSE UK index. In addition, over the past few years, a range of alternative stock market-related investments has been introduced, such as Exchange Traded Funds, spread betting and contracts for difference.

Trading
While access to such a liquidity pool is no doubt a prime attraction for the firms that choose to list on the Exchange’s Main Market, the loyalty of investors depends on efficient trading mechanisms to support their investment strategies.

Here the Exchange excels, with established order book and quote-driven trading facilities supported by low-latency platforms to enhance algorithmic and other high-velocity trading activity. Its trading platforms are designed to maximise liquidity, from premium fully electronic order-driven trading platforms for liquid UK and international securities, through to quote-driven market maker platforms for less liquid securities.

In June 2007, the Exchange introduced TradElect, a new electronic trading platform. Shortly after its launch, latency – the time lag from client order to execution – had been reduced from 140 to 6 milliseconds, while capacity had increased tenfold.

In September 2008, £302.8 billion worth of equity trading was carried out during the month, an increase of 24 per cent on September 2007, while the total number of trades increased 63 per cent to 27.1 million. The combined average daily value traded in equities across the Group’s markets (those of the Exchange and Borsa Italiana) increased 12 per cent year on year to £13.8 billion, while the average daily number of trades increased by 48 per cent to 1.2 million. By October 2008, latency had again been halved.

Member firms have been trading on the order book, known as SETS, since its launch in 1997, and investors are increasingly able to trade alongside them through broker-sponsored Direct
LIQUIDITY IN THE MAIN MARKET

While access to such a liquidity pool is no doubt a prime attraction for the firms that choose the Exchange’s Main Market, the loyalty of investors depends on efficient trading mechanisms to support their investment strategies.

Market Access (DMA) – an attractive option for traders seeking speed of execution and keener pricing than might be available from a third-party market-maker.

Retail investors, meanwhile, are traditionally executed by a broker through a retail service provider (RSP), an automated quoting system similar to a computerised market maker. Brokers will normally request quotes from several RSPs and trade on the best price. RSPs take on the best execution responsibility owed to a typical private investor and will always, at least, match the best bid and offer displayed by the Exchange.

MiFID
The European Commission’s Markets in Financial Instruments Directive (MiFID), was introduced in November 2007 with the aim of improving transparency and competition across EU financial markets.

In October 2007, in response to MiFID, SETSmm, an electronic order book supported by continuous liquidity provision from market makers, was combined with SETS to create a single platform for the trading of the constituents of the FTSE All Share Index, Exchange Traded Funds, Exchange Traded Commodities and 180 of the most traded UK and Irish AIM securities. Partly spurred by TradElect, electronic trading volumes on SETS recorded 82 per cent growth in the most recent financial year.

In addition to straight DMA, firms on both the buy-side and sell-side are increasingly making use of algorithmic trading capabilities to reduce the market impact of large institutional orders and to capture trading alpha through high-frequency strategies. In the first quarter of 2008, for example, average daily order book cash equities trading for the combined UK and Italian markets grew 17 per cent to 916,000 trades.

In addition to the low-latency TradElect platform, a new high-speed delivery mechanism for the Exchange’s Infolect data offers clients using algorithmic trading models clearer information during periods of high activity. Called Performance Channels, the service delivers market data on trading activity at high speeds. It provides firms using algorithmic trading models with greater visibility of the spikes and events that occur during periods of high trading activity.

To address the related issue of network latency, the Exchange has introduced Exchange Hosting, a co-location service that offers sub-millisecond access to TradElect and the Infolect market data feed. This effectively eliminates network latency from overall round-trip trading times.

Pricing
With the advent of multilateral trading facilities (MTFs), a new form of trading venue introduced by MiFID, much has been made of the ‘maker/taker’ model of liquidity pricing adopted by these initiatives. That pricing model is not new, however. Since the inception of SETS in 1997, the Exchange has charged liquidity providers far less than ‘aggressive’ or liquidity-taking traders, thus helping to fuel liquidity. The past five years have also seen a progressive reduction in tariffs. From September 2008, the Exchange has moved further down this path, offering credits for liquidity providers on a tiered basis and removing order execution and order management charges. As a result, the Exchange’s tariff offers the lowest net fee and largest credit of any venue in Europe for clients that achieve upper bands for both liquidity provision and liquidity taking.

The Exchange is also introducing its own MTF. Baikal will combine algorithms and smart order routing with a non-displayed, or ‘dark’, liquidity pool. It will be a broker-neutral venue, offering access to securities in 14 countries and provide smart order routing to liquidity in at least 22 trading venues, along with liquidity-seeking algorithmic strategies, anti-gaming controls and surveillance tools. Real-time post-trade reporting will be offered through the Exchange’s Infolect data feed. The MTF will include a pan-European clearing and settlement solution with aggregated trade booking of Baikal-matched and smart-order-routed business.

From non-displayed institutional liquidity through to small retail orders, the Exchange will continue to enhance its trading and decision-support facilities to ensure that it remains the venue of choice for the widest possible range of global investors.
Driven by new European Union legislation that abolished stock exchange monopolies, a host of alternative trading venues have appeared in Europe to compete with the primary exchanges. **BY JOEL CLARK**

**THE ALTERNATIVE TRADING EXPLOSION**

Since it first began several centuries ago, the trading of shares in Europe was nearly always restricted to the primary exchange on which a particular company happened to be listed. A Vodafone trade would be matched on the London Stock Exchange; a France Télécom trade would be matched on Euronext; a Deutsche Telekom trade would be matched on Deutsche Börse in Frankfurt.

Today, each of those three companies, and a great many more, can also be traded on a number of new trading platforms, known as Multilateral Trading Facilities (MTFs). Built with sophisticated technology to deliver competitive prices and speeds, MTFs have begun to compete with Europe’s primary exchanges in the trading of securities.

The technology to build rival exchanges has of course existed for many years, but what has brought about the change is the effort by the European Union to try to create a single capital market for Europe by having all the different exchanges within the Union compete with each other. This involved removing the restrictive rules that made the emergence of new competitors difficult, and the main vehicle for this was a regulation passed by the European Union on 1 November 2007, known as the Markets in Financial Instruments Directive (MiFID).

Several years in the making, MiFID’s aim was essentially to integrate the European capital markets, facilitate cross-border trading and improve the quality of service given to the end-investor.
LIQUIDITY IN THE MAIN MARKET

When MiFID came onto the horizon in 2005, some market participants realised that it presented a business opportunity to create competitive new trading platforms. In the United States, such platforms, known as electronic communication networks (ECNs), had already begun to see some traction, with sizeable chunks of liquidity shifting away from the New York Stock Exchange (NYSE) and Nasdaq towards innovative ECNs, such as BATS Trading, Archipelago and Brut. Accordingly, platforms were developed by Europe and by the end of 2008 several were operating in competition to the London Stock Exchange in particular and with other markets in Europe in narrower areas.

The likes of Chi X, Turquoise and more recently Nasdaq and BATS – soon to be joined by Equiduct – were pressing hard to see if what had happened in the United States could be replicated in Europe.

To some extent, the new entrants spoiled their case in the early months of their activity with tenuous and not wholly credible claims for market share gains. But that said, there is no doubt that Chi-X and probably Turquoise have established notable volumes and have probably also quite significantly expanded the market.

The more interesting point, though, is that while the first mover, Chi-X, has clearly done very well, and does indeed probably have in excess of 15 per cent of the market – at which level its boss Peter Randall says the business breaks even – can the others expect that level of success? If the other firms have similar cost structures, can they all realistically expect to get a similar market share and make a decent profit?

The excitement about the launch and the arrival of competition seems to be obscuring this fundamental point. The business model may work for some, but it remains hard to see how it can work for all.

It is tempting to believe that the hidden strategy of some of these firms may be not to expect to make money, but to gain sufficient market share to panic some incumbent – the Exchange most likely – into buying them out, which is after all what happened in America. But the Exchange seems too smart for that. It prefers to compete and in the autumn of 2008 threw down the gauntlet to the newcomers by adjusting its tariff structure to target their kind of customer.

The Turquoise story is also intriguing. Part of its launch plan put on its investment bank shareholders the obligation to make markets on the MTF. This raised eyebrows because the market making model is generally thought to be on the way out – investment banks don’t like risking their capital, so why build a business on a failing model? It is widely suspected, however, that the market making obligations are a relatively short-term device to commit users to the market and create an identity of interest. They are unlikely to be a long-term feature of the platform.
The other significant issue for observers of the evolving scene is the fundamental change in the nature of the firms doing the business. An assumption that the customers were traditional pension funds and insurance companies would be off the mark. An assumption that the big players were hedge funds and the in-house trading desks of investment banks would be closer, but still largely wrong because the credit crunch has put paid to them as a force. Today, the really important customers are a new breed of firm – new to these shores anyway – called electronic liquidity providers. These have hugely powerful systems – so fast they can grab stock and match bargains on the exchange before anyone else.

They don’t buy or sell shares on behalf of distant owners, or indeed as principals themselves. They

The platforms are paying the players to use their systems, which is a complete reversal from the old system

don’t make markets. They just buy and sell – and in effect get paid by the exchanges and MTFs for doing so. If they provide liquidity, the exchange pays them. If they take liquidity, they pay the exchange or MTF and they make money if they provide more than they take. In other words, the platforms are paying the players to use their systems, which is a complete reversal from the old system, where the users paid a fee to the exchange when they dealt.

It means that the battle between the exchanges and MTFs is in fact a battle to attract and retain the business of the liquidity providers. Chi-X scores because one of the biggest, Getco Europe, is a shareholder and that certainly seems to have helped it move so far so fast. The Exchange’s counter-attack is based very much in trying to ensure that such players are drawn to their market as well. It is all about who gets the high-volume traders.

Time will tell how the battle evolves. The challenge for the Exchange is not so much its higher legacy costs in the face of nimble newcomers. Rather it is the extent to which it can legitimately play the newcomers at their own game, without alienating its traditional investing institutions and users. But the challenge for the future is rather different. When you think about it, why can’t people just buy and sell to each other direct, like they do on eBay?

Joel Clark is staff writer at Risk Magazine.
The move to electronic trading and the SETS order book has created a huge increase in transaction activity over the last decade. **Richard Schwartz** looks at developments to date and what this means for the market.

A Sound Platform for Volume Growth

In 1997, the daily average number of UK equity bargains on the London Stock Exchange’s markets was 52,962. By December 2008, it was 734,000 – an increase of almost 1,400 per cent. This spectacular rise can be attributed to two overarching developments. On the one hand, the increase in the broad availability of electronic trading tools globally over the past decade has had a significant impact on trading velocity and turnover, with the rise, in particular, of high-frequency trading strategies. Perhaps more important, however, the Exchange itself has ensured that its own trading infrastructure remains ahead of the curve and is therefore able to absorb increased demand. Coupled with that is an expansion in the breadth of listed securities that can be traded on the Exchange, including depositary receipts through the International Order Book, the world’s most liquid trading platform for that type of security.

The groundwork for this rapid expansion in volumes was laid in 1997 with the launch of SETS, combining electronic order-driven trading with integrated market maker liquidity provision, delivering guaranteed two-way prices. Since then, a number of milestone developments have reinforced this growth. The successful merger with Borsa Italiana and the launch of TradElect in 2007 were two such factors. The equity order books of the two Exchanges (which now make up the London Stock Exchange Group) recorded a combined 263 million trades in 2008, an increase of 25 per cent on 2007.

TradElect meanwhile helped facilitate the 82 per cent growth in electronic trading volumes on SETS recorded in the latest financial year. One hundred of the busiest trading days ever have occurred since the introduction of TradElect, and nine out of ten of these peak days saw more than one million trades a day. This new system provides significantly increased capacity and improved latency – the time that elapses between an electronic order being placed and executed. This enables customers to trade at much higher frequency and with greater certainty of execution.

**The trading environment**

The quality of these infrastructures has allowed the Exchange to respond effectively to the
extraordinary market volatility that has been a feature of the global equity markets since late 2007. The conditions evidenced over that period have contributed to further volume growth on the Exchange. In 2008, for example, the total number of trades on the equity order book of the Exchange grew 39 per cent to 186.5 million – the 2007 total was exceeded by mid-September 2008.

This growth is evidenced across the diverse range of trading services that the Exchange offers, notwithstanding the launch of alternative trading venues since the introduction of the Markets in Financial Instruments Directive, in November 2007. These services are set out in the table above.

International Order Book
The increase in trading volumes for international equities on the Exchange has been particularly striking. The International Order Book (IOB) serves to bring additional liquidity to the trading in London of depositary receipts (DRs) in non-UK companies. These are negotiable certificates that represent ownership of a given number of a company’s shares and can be listed and traded independently from the underlying securities. They are a well-established vehicle for institutional investors who are seeking exposure to foreign companies without the complexities of having to trade and settle in each firm’s home market. At the same time, DRs offer companies a path to raising capital abroad, and the opportunity to raise their profile on the global stage.

The IOB offers easy and cost-efficient access for traders looking to invest in fast-growing economies, for example, in Central and Eastern Europe, Asia and the Middle East. The service is based on an electronic order book similar to SETS but with the added option for member firms to display their identity pre-trade by using Named Orders. All trades are settled bilaterally between participants and settlement takes place in either Euroclear Bank or the Depository Trust and Clearing Corporation, as specified by the Exchange for each depositary receipt. In 2009 a central counterparty service will be introduced to the IOB for the most liquid securities on the service. This will allow participants to benefit from full counterparty risk protection, enjoy post trade anonymity and experience improvements in straight through processing when trading in the these securities on the order book.

Trading on the IOB continues to increase with new records regularly being achieved. In 2008, turnover on the IOB increased by 24 per cent year on year to $552.8 billion, while the volume of shares traded grew from 13.3 billion to 21.8 billion, an increase of 64 per cent.

New initiatives
Several new initiatives have also been announced recently to further extend market access for the Exchange’s customers.

Member Authorised Connection (MAC) is a service provided by the Exchange’s member firms to latency-sensitive customers that are not members of the Exchange. MAC enables non-member firms to connect directly to the Exchange’s
centrally cleared order-driven markets under an authorising member firm’s trading code. As this is a direct technical connection between the MAC customer (non-member firm) and the Exchange, orders submitted to the market do not pass through the usual Order Management System of the authorising member firm.

Another new service is Exchange Hosting, a connectivity service that provides sub-millisecond access to the Exchange’s matching engine and market data. By allowing member firms to locate their servers within the Exchange’s own data centre, customers get the fastest access to the Exchange’s trading and information systems.

In 2008, the Exchange also announced plans to create a pan-European multilateral trading facility (MTF) named Baikal, for the execution of non-display orders. This will provide market participants with an unrivalled trading service for European equities, being the first to combine an innovative dark liquidity pool with sophisticated algorithmic trading functionality.

The future

Future enhancements to TradElect will see the introduction of new order functionality such as the ability to enter hidden limit orders, helping traders and investors to minimise market impact. Subsequent developments will include introducing hidden pegged orders and anti-gaming functionality to the Exchange’s electronic order books. In addition, participants will be able to connect to TradElect via a FIX interface for the first time.

In mid-2009, the Exchange is also planning to introduce a new solution enabling participants to trade Exchange Traded Contracts for Difference (CFDs) on the same liquid, centrally cleared order book as the underlying equity. This will be the world’s first combined cash equity and CFD order book and is designed to allow market participants to trade CFDs in an innovative way while also deepening the liquidity pool for equities.

Borsa Italiana and the London Stock Exchange are working to integrate their systems to deliver increased levels of performance, improved tradability and access across asset classes and markets for all of their customers. The first phase of this integration has been completed with the migration of the majority of Italian equities onto TradElect, with other Italian instruments set to move later in 2009.

Going forward, it will be those exchanges and MTFs who continue to seek new trading products and performance enhancements that will achieve greater market efficiencies, increased volumes and improved liquidity. Only those who strive to adapt their strategy to satisfy the varied needs of their customers and meet the challenges of rapidly changing market conditions will remain competitive. 

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THE EVOLUTION OF TECHNOLOGY AT THE LONDON STOCK EXCHANGE

Technology and market efficiency are, now more than ever, at the very heart of what it is to be an international stock exchange. Having completely revamped its core technology with the creation of the TradElect platform, the London Stock Exchange is now working on a number of enhancements to make sure the system continues to compete with other trading venues.

BY JOEL CLARK

The trading of securities is no longer measured in minutes or even seconds, as it was just a few years ago. It has become an arms race, in which the most successful investment firm is the one that can see an opportunity in the market and take advantage of it in a matter of milliseconds. In an environment of increased volatility in share prices, coupled with the emergence of alternative trading venues, the speed at which a trade can be completed has become absolutely critical. The pressure on exchanges to provide robust, fast technology has never been stronger as their customers seek to cut out any unnecessary delay, or latency, in the trading process.

The London Stock Exchange, like its competitors across Europe, has been heavily focused on building and enhancing its underlying technology for more than a decade. For any company listed on the Main Market of the Exchange, that technology is now more crucial than ever in ensuring that shares continue to be traded and prices remain competitive. Since the major launch of a new underlying trading platform, TradElect, in mid-2007, activity on the Exchange order book has mushroomed, attracting very fast electronic trading firms that are becoming increasingly crucial in today’s market. Without doubt, it is technology that gives exchanges their cutting edge in increasing volume, maintaining market efficiency and, ultimately, attracting new issuers.

Ever since the deregulation of the financial markets in 1986, also known as ‘Big Bang’, which transformed trading from being a face-to-face business to one conducted from dealing rooms via computer screens and telephones, technology became a big consideration for stock exchanges as they prepared for the total automation of trading. The Exchange shut down its traditional ‘open outcry’ trading floor in 1986, replacing it with the Stock Exchange Automatic Quotation system (SEAQ), followed in 1997 by the Stock Exchange Electronic Trading Service (SETS), its first electronic order book, able to deal with much higher trading volumes at high speed.

When the Exchange became a public company in June 2001, a host of internal changes and new appointments brought in David Lester as chief information officer, a new position created to combine the management of the Exchange’s technology and information services divisions. Having previously been part of the Accenture team that built the SETS platform in the 1990s, Lester’s new remit at the Exchange would be to completely replace the technology to deal with the changing demands of the market.

As trading volume in the US market shifted towards innovative electronic communication networks that offered higher speed and capacity and more complex functionality than the incum-
bent exchanges, Lester realised that SETS, ground-breaking as it had been at launch, would not be able to sustain the Exchange as similar changes took place in Europe. So it was that in 2003, he conceived the four-year ‘technology roadmap’ that aimed to enhance the Exchange’s technology to accommodate faster transactions and greater agility.

That strategy saw the release of a new market information dissemination platform, Infolect, and culminated in the launch of TradElect in 2007. “The main success of TradElect has been its ability to allow customers to trade at record levels and in record volumes,” reflects Lester. “Our 100 busiest days ever have taken place on the TradElect platform.” And on 25 separate days, more than 1 million trades passed through the system – a volume that was unheard-of previously.

Major performance technology improvements naturally had to be incorporated into TradElect to enable such record volumes. Trade execution latency was initially cut from 140 milliseconds to six milliseconds and the Exchange’s capacity increased to 5,000 continuous messages per second – a facility which has not even been half-used on the Exchange’s busiest days. Since the Exchange acquired Borsa Italiana in 2007, it has been working to integrate the Italian markets and in November 2008, the migration of Italian equities onto the TradElect platform created a major boost to liquidity in London. “Our Italian member firms in particular will benefit from improved system performance and the opportunity for new algorithmic and technical trading strategies,” explains Lester. “It will also make the London Stock Exchange Group the biggest single liquidity pool in Europe, with more than 500 member firms.”

Presenting the Exchange’s annual results in May 2008, CEO Dame Clara Furse said that TradElect had “revolutionised the speed and capacity of our technology platform and has taken our service quality to new levels”. But revolutionary as the platform was, neither Furse nor her colleagues are blind to the fact that the technology challenge continues. Since TradElect was launched, the advent of the European Union’s Markets in Financial Instruments Directive (MiFID) in November 2007 has brought with it a host of new multilateral trading facilities (MTFs) that have sought to
compete with the Exchange through the use of very fast, high-capacity technology. Although TradElect certainly set new standards in latency and capacity, the emergence of the MTFs, led by Chi-X and Turquoise, has challenged those standards and driven the Exchange to enhance the platform faster than it might originally have planned.

In 2008, TradElect’s latency was further reduced to 4.6 milliseconds and Lester hopes to make it sub-millisecond during 2009 – a goal towards which most international exchanges and MTFs are currently working. Capacity was also enhanced to deliver 12,000 continuous messages per second and this will continue to increase with further updates to the system. In September 2008, the Exchange introduced exchange hosting services, whereby those very speed-sensitive trading firms (usually hedge funds) that seek sub-millisecond access to the market, can physically co-locate their own servers inside the Exchange’s data centre, so eliminating any network latency. It is estimated that for firms using those services – now widely offered by exchange and MTF alike – an extra 1.5 milliseconds of latency in trade execution and market data transmission times can be cut. That may seem insignificant, but to the high-frequency algorithmic traders that are becoming important in today’s market because of their ability to transact high volumes and enlarge the overall liquidity pool, every millisecond counts.

While 2008 saw much enhancement to TradElect, there is much more innovation planned for the coming year. In 2009, the Exchange plans to introduce a new interface to the platform, based on the FIX protocol, an industry-driven messaging standard for the electronic communication of trade information. With the arrival of electronic trading, FIX has enabled firms to access new markets and trading venues in a far more efficient and cost-effective way.

“As these increasingly important open standard interfaces are adopted by both sell and buy side, we want to ensure all existing and new trading customers can connect directly and easily to our order books,” explained Purse when the plans were revealed.

Aside from the continual performance enhancements and the integration of the FIX interface, a further step in the evolution of TradElect will be the integration of cash equities and contracts for difference (CFDs) onto a single order book, planned for later in 2009. The trading of CFDs, essentially a derivative where the seller pays the buyer the difference between the current value of an asset and its value at contract time, is currently done bilaterally in the UK, without the benefit of a central exchange to manage the risk. By integrating the trading of CFDs onto its main order book, the Exchange hopes to bring greater efficiencies and risk management to the product, thereby allowing more investors to participate in the lucrative practice, which is crucially exempt from UK stamp duty.

The Exchange has focused not only on TradElect, but also on its information services division.

“We will be including CFDs on the same order book as the underlying equities, so that the orders can interact,” explains Lester. “The major advantage of combining the two products on the same book is that it will boost liquidity and price formation.” He adds that the technology is already developed to integrate CFDs, but the Exchange is currently working with a number of prime financing partners who will manage any mismatches that might occur. When it launches in 2009, it will be the world’s first integrated CFD and equity order book, says Lester.

To remain competitive and attractive to its customer base, the Exchange has focused not only on TradElect, but also on its information services division, which provides real-time prices, news and other financial information on its listed stocks. As part of the technology roadmap, the Exchange launched Infolect in 2005, an information dissemination platform with an end-to-end latency of just two milliseconds. “Delivering data quickly provides greater execution assurance, because there is a reduced window for the data to be out-of-date,” says Lester.

To that end, the Exchange launched ‘performance channels’ in mid-2008, a facility which delivers Infolect data over 100-megabyte lines and cuts network latency within London to less than a millisecond. As on the trading side, the milliseconds are crucially important in accessing market data and more than 40 of the Exchange’s largest customers have already taken advantage of the performance channels.

Technology and innovation have certainly driven the development of the Exchange’s trading and information services over the last decade, and that development is set to continue in the coming years. As the Exchange is well aware, speed, capacity and innovative functionality are some of the most important factors that today’s traders seek when looking for an exchange on which to execute an order. But those assets, crucial as they are, need also to be combined with reliability and liquidity.

“In isolation, speed and throughput and other individual measures are meaningless – of greater importance are purpose, utility and value,” says Lester. “We believe that for the vast majority of business we offer the best all-round platform in terms of speed, resilience and liquidity.” □

Joel Clark is staff writer at Risk Magazine.
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