



European Market Structure in the Post Mifid World

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Regulatory Landscape & Trading Implications

Mifid

1. Harmonization of regulatory landscape
2. Encourage competition and transparency—MTFs and Trade reporting
3. Framework for Best Execution

Soft Dollars & Unbundling

1. FSA clarifies use of commissions for provision of EMS/OMS/Connectivity services
2. Proliferation of CSAs

Code of Conduct

1. Unbundling and interoperability of clearing & settlement services
2. Transparency of Fee schedules



Effect of Regulatory Landscape

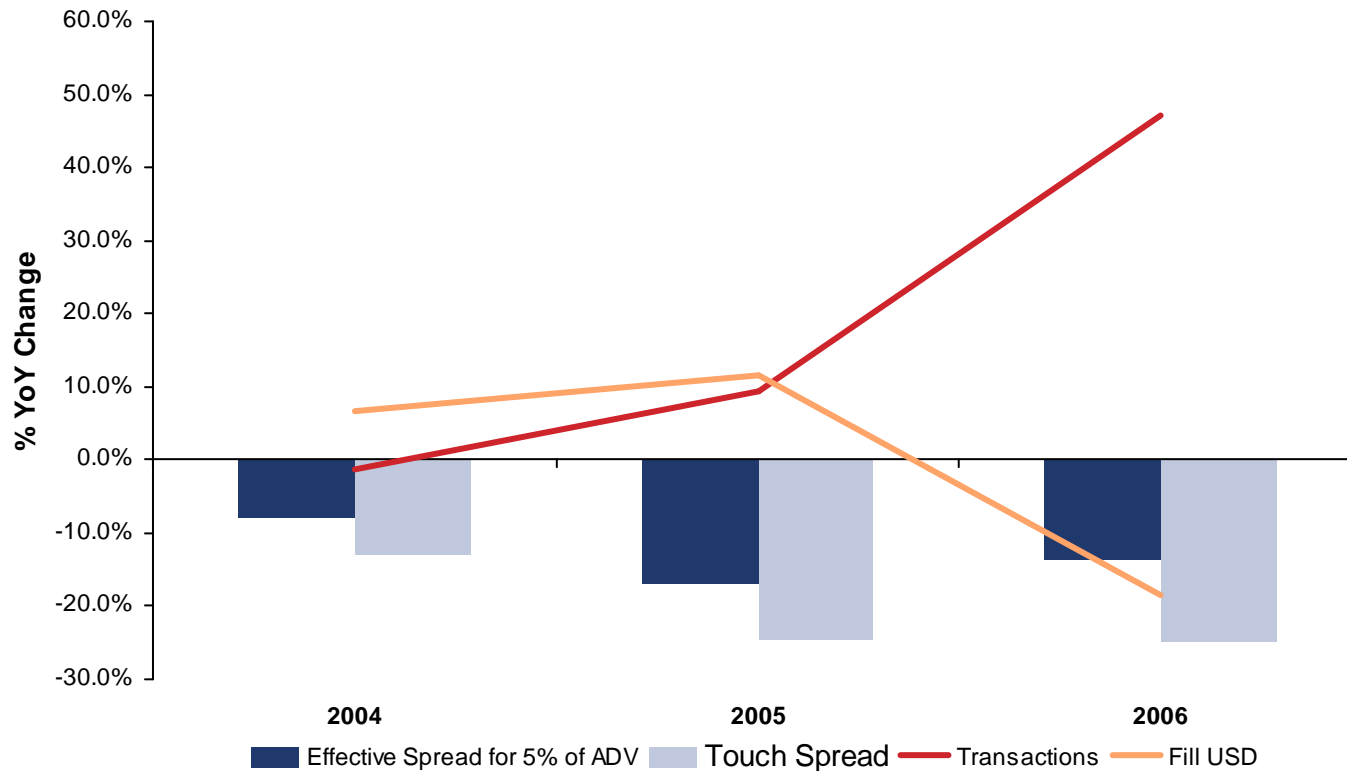
- Multiple liquidity venues—fragmentation already exists in OTC/Block space, but new entrants likely to win market share from incumbents
- Increased transparency and availability of new market data services (i.e. OTC post trade reports and retail sized pre trade information)
- Competition should result in fee reductions for execution, clearing & settlement
- Execution commissions may no longer serve as payments for OMS/EMS/connectivity services for FSA regulated investment managers



Potential Implications of Regulatory Evolution

- Importance of technology (i.e. connectivity, smart routing, etc...) with greater differentiation among providers
- Ultimate move towards a European Best Bid/Offer that recognizes a consolidated tape and will evolve best execution rules and metrics
- Overall volumes grow—high frequency players can further optimize their models as costs come down
- Some vendors and consumers likely to charge/pay fixed amounts for provision of services. FSA regulated investment managers will need to consider whether to pay for provision of services

Overall Market Quality



- Spreads narrow, average fills fall, and trade count balloons, but becoming more difficult to trade an order for 5% ADV

Source: Goldman Sachs internal analysis

Turquoise & Other Players

Turquoise Rationale

- Increase competition versus the regional monopoly structure by providing a viable and innovative alternative to pool Pan European liquidity
- Reduce the overall explicit cost for execution, clearing and settlement
- Create an independent company with dedicated management and proper governance

Turquoise Principles and Model

- Pan European cash equity trading with specialized functionality for both small and large orders
- Transparent order book that can interact with other, non displayed order types
- Low latency, functionally rich platform with a competitive fee structure

Other Players in the Market

- Chi-X—Instinet platform already live and demonstrating solid, early growth
- Posit—ITG's legacy periodic crossing network expanding to real time “dark” matching (i.e. non displayed)
- Liquidnet Europe—US ATS making inroads in Europe for buy-side only block crossing
- BOAT—Consortium initiative for trade reporting & market data solutions as a result of MiFID and completely separate from Turquoise

Executive Summary

- Market structure changes will require the relationship of vendors, buy & sell side firms to evolve and increasingly rely on technology, market share and industry expertise
- Competition from new liquidity venues and the expected impact on fees should unlock latent liquidity in the market and increase overall volumes and value traded
- “Organized Fragmentation” will result from these new venues competing with traditional exchanges and will likely have a negligible impact on execution quality for algorithmic and other electronic order flow
- Internalization by brokers will continue to grow as will the development of new business models to enhance a trader’s tool kit (i.e. block matching, “dark pools,” and automated/increased capital commitment)
- The resultant trading landscape is not just a sell side phenomenon since all market participants need to understand the impact of this evolution and how to best position your firm/desk for this new environment

Key Questions

- Are the tools on my dealing desk (i.e. OMS and EMS) connected or committed to access alternative liquidity pools?
- Will my primary executing broker relationships access the full range of liquidity destinations for all types of trading (dma, algo, PT & Cash)? What is their strategy and available pool of resources?
- Will my internal market data systems and best execution policy incorporate new sources of activity that execute away from the traditional exchanges (i.e. OTC)?
- What impact, if any, will this post MiFID world have on my internal benchmarks (i.e. VWAP)? What is VWAP?
- Beyond technology readiness, do my traders understand the likely implications of these market structure changes and are they ready, willing and able to capitalize on them?

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