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**Subcommittee on Intellectual Property, Competition and the Internet**

**Hearing: Competition and Consolidation in Financial Markets**

**Testimony of Gary Katz,  
President and CEO, International Securities Exchange**

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**Introduction**

Good afternoon Chairman Goodlatte, Ranking Member Watt, and Members of the Subcommittee. Thank you for the opportunity to testify before you today on behalf of Deutsche Börse Group regarding the proposed merger between NYSE Euronext and Deutsche Börse.

My name is Gary Katz, and I am President and CEO of the International Securities Exchange, also known as ISE. I would like to first provide you with some background about ISE and how I came to represent Deutsche Börse here in front of the Committee today.

I co-founded ISE in 1997 along with David Krell, a long-time executive in the options industry, and two E\*Trade executives. Our vision was to launch an all-electronic options exchange to introduce competition to the U.S. options industry. At that time, stock options were traded in an open-outcry environment with very little competition among the four existing floor-based options exchanges. The vast majority of options products were singly listed, meaning that different products were traded on different exchanges. Without competition, the industry was inefficient. Exchange fees remained very high, the quality of the markets was poor, and, as a result, many retail and institutional investors had a negative view of the options industry, and growth remained stagnant.

In founding ISE, we embraced change and looked to deliver a new model for options trading that would vastly alter the competitive landscape, encourage greater participation in the market, and engender efficiencies for all market participants.

After becoming the first new securities exchange approved by the Securities and Exchange Commission in 27 years, we launched our market, the first all-electronic options exchange in the U.S., on May 26, 2000. Following our launch, ISE grew very rapidly because of the value we delivered through electronic trading, our innovative new market structure and fee model, and our highly competitive, transparent markets.

In March 2005, ISE became the first U.S. securities exchange to complete a public offering. Then in December 2007, ISE was acquired by Eurex, the derivatives arm of Deutsche Börse, and with that transaction, we became part of a leading global exchange organization.

As President and CEO of ISE, I hold positions within the Deutsche Börse governance structure as a member of the Executive Boards of Eurex and Eurex Clearing. Likewise, my ISE co-founder David Krell, who is the non-executive Chairman of ISE's Board, serves as a member of the Supervisory Board of Deutsche Börse Group.

## **ISE Experience as Part of the Deutsche Börse Group Portfolio of Exchanges**

As an entrepreneur, there is always trepidation in giving up ownership of the business you have built from scratch. Of course, I had those feelings when ISE became publicly traded and then again when Deutsche Börse acquired ISE.

I can assure you, however, that ISE's experience as part of the Deutsche Börse Group has been overwhelmingly positive. Having access to the global scale and resources of this world-class organization has better positioned our business for future growth in an increasingly competitive market environment.

At the same time, much about our business model has remained unchanged. ISE continues to be a U.S.-registered securities exchange. We are still regulated by the Securities and Exchange Commission just as we have been since our registration 11 years ago. The SEC must approve any changes or modifications to our exchange rules, just as they do with any other registered securities exchange in the U.S. In practice, this means that any changes regarding new products, fees, exchange functionality, or market structure must be filed with and approved by the SEC. Likewise, the membership requirements of our exchange remain the same: only U.S.-registered broker-dealers are permitted to be ISE members.

With respect to the day-to-day matters of running the ISE business, our integration with Deutsche Börse was a seamless process. In the exchange business, a seasoned and expert team is your most valuable asset, and implementing a strategy that allows your business to grow and improve its competitive position is the best job security a management team can offer to employees. That belief was proven true in ISE's integration with Deutsche Börse, and the Deutsche Börse merger with NYSE Euronext provides the same opportunity for the respective employee teams. In general, key business lines will remain in the present locations while gaining additional global growth potential. A significant portion of the cost synergies will be driven by rationalizing technology and market operations and, where appropriate, consolidating clearing services and risk management capabilities.

The revenue and expense synergies that ISE realized from our partnership with Deutsche Börse only made us stronger. For example, ISE has been able to draw on the vast technology resources at Deutsche Börse to jointly develop a completely new trading architecture for ISE's options exchange. In April of this year, we successfully launched the new platform, called Optimise™, and, as a result, we are well-positioned for continued growth in the ever more competitive U.S. options industry. As competition continues to intensify among U.S. exchanges, fee compression and declining profit margins are realities of our business. However, the scale and synergies offered through combinations such as the one between NYSE Euronext and Deutsche Börse create efficiencies that can offset some of this pressure and enable value to be delivered to both shareholders and customers.

Given the broader focus and diversity of NYSE Euronext, the benefits of the proposed combination with Deutsche Börse are on a much larger scale. This merger will create an

exchange group with a large domestic and international footprint that will become a more important and formidable entity in the financial services industry's intensely competitive global exchange sector. Building on the strength of the combined entity, we will be strategically positioned to jointly expand into emerging markets and new asset classes and to implement a strategy that allows our business to thrive. This will strengthen the competitive position of both New York and Frankfurt as financial centers, to the benefit of the U.S., European and global capital markets.

### **Competition in the U.S. Options Industry**

The options market is more competitive today than it ever has been. In the 10 years prior to ISE's launch announcement in 1997, industry growth was stagnant: average daily trading volume of equity options contracts grew only 3.4% on a compounded annual basis over that timeframe. Since ISE's launch and the injection of competition into the industry, the growth trajectory tells a very different story: average daily volume in the industry grew over 18% on a compounded annual basis from 2000 through 2010. In that timeframe, the number of exchanges grew from four to nine. There are no signs that competition in U.S. options will abate. In fact, a 10th exchange, the Miami International Stock Exchange, recently announced its intention to launch an options platform in 2012.

It is also important to note that there are already several examples in the industry of one exchange parent operating multiple options platforms, each with its own unique exchange license. Operating multiple exchanges under one roof enables the parent company to offer greater customer choice through different market models and pricing structures. For example, CBOE Holdings, Inc., owner of the largest U.S. options exchange by market share, operates both the Chicago Board Options Exchange and C2. NASDAQ OMX, the second largest, operates the NASDAQ OMX PHLX exchange as well as the NASDAQ Options Market (NOM). And, of course, NYSE Euronext operates both the NYSE Arca Options exchange and the NYSE Amex Options exchange.

The scale and scope of the combination of Deutsche Börse and NYSE Euronext will enable each individual exchange to draw upon the resources of the parent company to deliver a more competitive offering to customers. At the same time, we recognize that each of the three options venues – NYSE Arca Options, NYSE Amex Options, and ISE – provides a targeted value proposition to clients, and, as such, we expect to maintain three U.S. options exchanges within the new group structure. We will also seek to benefit customers by consolidating as much of the technology and market operations as possible in order to deliver maximum efficiencies for our clients.

In the options industry, this intense competitive dynamic has resulted in the highest levels of customer service, the greatest transparency, and the lowest commission rates in its history. Competition has helped “grow the pie” so that more than 16.7 million equity options contracts are traded across the industry on an average day, representing approximately 1.7 billion shares of

underlying stock. This growth is phenomenal when compared to the average daily volume only eleven years ago of 2.7 million contracts.

This level of growth also supports a virtuous competitive cycle by attracting new entrants who continue to challenge the existing exchanges to deliver innovation to the marketplace.

### **Conclusion**

The combination of NYSE Euronext and Deutsche Börse creates a platform for growth. It combines two of the most successful exchange groups to create the world's premier global exchange group and the largest and most iconic venue for capital raising and equities trading.

By bringing together two strong, innovative teams, the combination will strengthen market infrastructure and create a global platform for customers to access liquidity and manage financial and counterparty risk, thereby enhancing the stability and integrity of the global financial markets. The combined group will also have the financial flexibility to invest, grow, and innovate to meet the demands of the global marketplace and reinforce the future growth of the business within the U.S., Europe and globally.

We believe the combination of Deutsche Börse and NYSE Euronext will deliver significant benefits to market participants, strengthen the foundation of the capital markets both here in the U.S. and globally, and promote a global benchmark regulatory model while preserving national regulatory roles. The balanced governance structure of the combined group will preserve the franchises, expertise and talent of both Deutsche Börse and NYSE Euronext while strengthening New York, Frankfurt and our other key locations and financial centers. And most importantly, our customers will benefit from the global scale, product innovation and operational and capital efficiencies that our combination will deliver. Simply put, the combination of Deutsche Börse and NYSE Euronext offers unique short and long-term benefits for all of our constituencies – shareholders, employees, regulators, and, importantly, our customers, the retail and institutional investors.

Thank you for the opportunity to testify before you today. I am happy to take your questions.