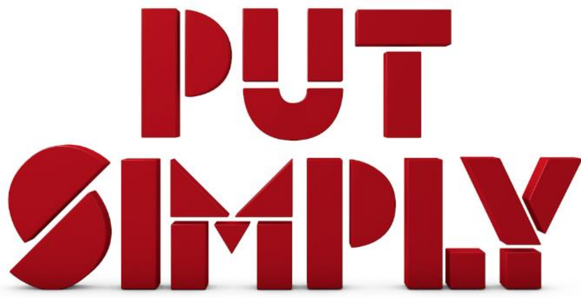

Jersey Finance
Delivering Insight • Driving Innovation

Stock Exchanges: Past and Future

Exchanges grew out of commodity trading, which included agricultural products and other raw materials and increasingly involved the use of sophisticated contracts.

This evolution of commodity-specific exchanges saw the creation of the London Metal Exchange, markets focused on 'futures' (financial contracts giving the buyer an obligation to buy an asset, and the seller to sell an asset, at a set price at a future point in time), on options (a derivative contract that gives an owner the right to buy or sell securities at an agreed price within a certain time period) and derivatives.

A brief history

Early 1600s:
The Dutch East India Company is the first company to issue bonds and shares to the general public.

1600s:
Amsterdam becomes known as the birthplace of the stock market.

1693:
The first UK government bonds were issued.

1694:
The Bank of England is set up. Companies began going public by selling stakes to the general public.

London's first stockbrokers were barred from the old commercial centre, the Royal Exchange. Instead, stockbrokers conducted business from coffee houses in an area

known as ‘Exchange Alley’. Stockbrokers would go to ‘Exchange Alley’ to find out what stocks were listed and the latest commodity prices.

1801:
The London Stock Exchange (LSE) is founded.

The stock exchange today

Today, the general public will think about a stock exchange in terms of large, well-known companies having equity (typically in the form of shares) listed and traded on the likes of the LSE or the New York Stock Exchange (NYSE).

However, debt securities, such as bonds, may be also brought to market. Exchanges often have specific rules for listing and trading these different types of securities.

Larger exchanges may have specialist markets focused on particular ‘products’ or junior markets where, not only the rules, but the level of regulation differs based on the types of issuers and securities and the profile of the investors.

For example, the LSE has a main market and it also has an Alternative Investment Market (AIM), with the latter established to provide a more viable option for smaller to medium sized companies, rather than just multinationals, to access capital via the stock market. Ultimate oversight of the main market is carried out by the UK’s national financial services regulator, the Financial Conduct Authority (FCA), via the UK Listing Authority (UKLA).

On the other hand, oversight of AIM is carried out by the LSE in conjunction with the issuer’s Nominated Advisers (‘Nomads’) and hence it is considered to be ‘exchange regulated’.

In the case of the main market, securities are admitted to the Official List (of the FCA) and as such, are considered ‘listed’ (and traded) whereas those approved to AIM are not admitted to listing but simply admitted to trading. In either scenario, the securities of issuers would be considered to be ‘quoted’.

Regulation of stock markets in the EU

The European Union (EU) originally classified different venues as regulated markets or Multilateral Trading Facilities (MTFs). A regulated market is run by a market

operator which is authorised by, and operates under, the regulations of the national financial services regulator. An MTF is a self-regulated trading venue operated either by a market operator or an investment firm. LSE's main market is considered to be a regulated market, but AIM is an MTF. Similarly, in Ireland, Euronext Dublin has a Main Securities Market, which is a regulated market and there is the Global Exchange Market (GEM) which is exchange regulated and therefore, is an MTF.

TISE is a regulated market, although it is not an EU regulated market as it sits outside the EU/European Economic Area.

The EU has introduced the Organised Trading Facility (OTF) into the mix.

Like a regulated market and an MTF, the OTF also brings together multiple third party buying and selling interests in financial instruments. However, OTFs can use (a degree of) discretion when matching buyers and sellers. Equities cannot be traded on OTFs. The OTF was added to the formal EU trading framework to increase transparency and trading in markets where transactions had typically taken place Over the Counter (OTC); not on the exchange ('off-venue').

OTC transactions take place more informally, typically through dealer networks. The market contracts are bilateral (meaning, the contract is between two parties) and historically, details of the transactions have not necessarily been published publicly.

Developments in technology have impacted on the range and types of markets that have seen rapid growth in OTC transactions. That said, the lack of transparency, especially on pricing and the increased exposure to risk means that OTC trading is not preferred by all investor groups.

The future of stock exchanges

The principles behind the operation, benefits and success of exchanges remain largely unchanged from their origins. Even though technological advances, including the blockchain, are radically changing the way listing and trading is done. The framework of the marketplace, the asset classes and as such, the types of issuers and investors are all changing thanks to technology.

Jersey is at the forefront of responding to these developments. It continues to facilitate flows of capital globally, whether through TISE with its office in Jersey, digital currency exchanges regulated in Jersey or as a location to establish vehicles which list on other global exchanges.