

# E-trading comes of age

A new study by *Best Execution* and *GreySpark Partners* shows that the buy-side are embracing electronic trading but the sell-side needs to adopt a much more holistic approach to win the business.

E-commerce no longer just applies to the trading end of the spectrum but needs to be across the entire investment life cycle if banks want to maintain their edge, according to a new report, *Trends in e-commerce and electronic trading* published by *Best Execution* in association with *GreySpark Partners*. The biggest challenge for the sell-side will be to switch from a product and asset class centric approach to a client focus in order to deliver the best platforms across functions and divisions.

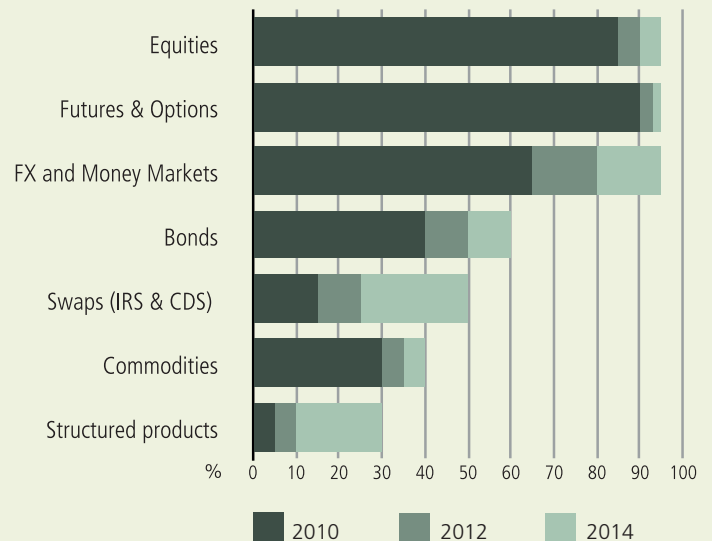
Building an integrated client-focused e-commerce offering though is no easy task. In fact, the survey, which canvassed 50 buy and sell-side firms, reveals that only three out of the top ten investment banks have been able to create a dedicated e-commerce organisation straddling all asset-classes. This is mainly because the business model in most sell-side firms is silo-based with divisions focused on only one asset class. As a result, e-trading systems have been developed separately and independently from each other.

There have been initiatives within the industry to unify systems within each organisation, but they have not been successful. Breaking down cultural and political barriers to build client and not product-centric organisations has been difficult, which is why many firms still operate half-a-dozen portals or vertical offerings that try and provide everything through the same interface. A common solution is a series of e-portals and single dealer platforms, managed per business silo and based on different technology implementations. The one exception is research, which tends to cut across asset class boundaries.

There is no doubt though that e-commerce has come into its own, covering all asset classes, albeit to varying degrees. According to *Best Execution* and *GreySpark's* research, e-commerce ranges from a mere 10% in credit default swaps (CDS) to a more meaningful 85%

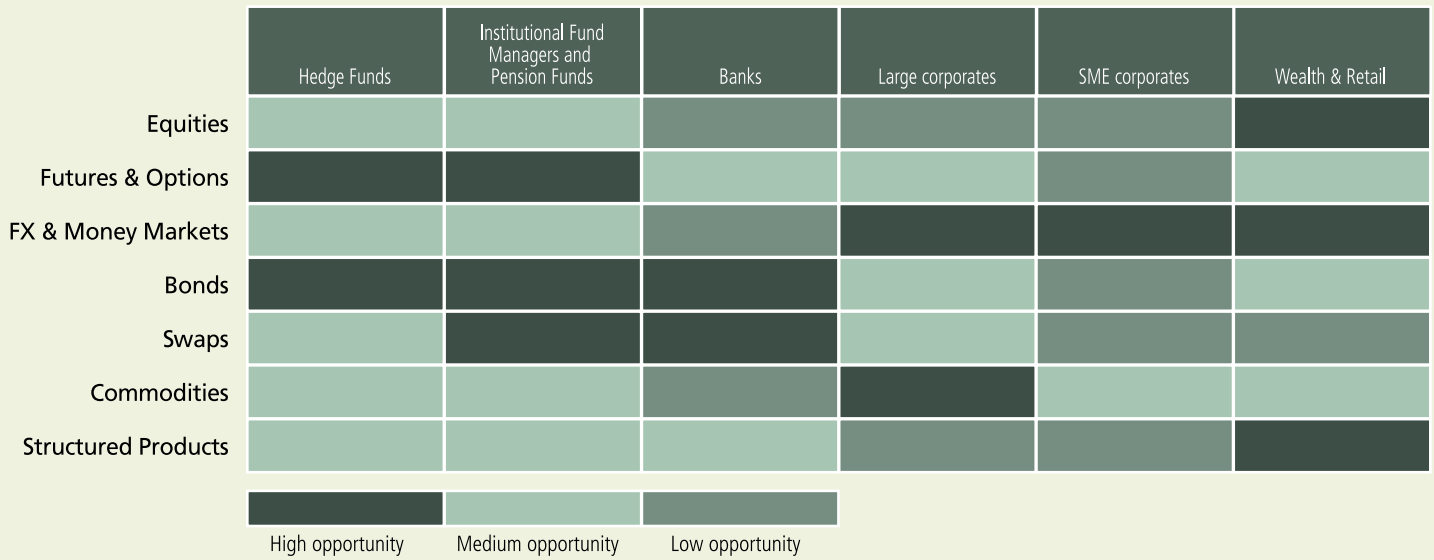
in listed futures and options. A growing percentage of the more liquid part of the OTC market, particularly foreign exchange, is also on board and an upward trajectory is forecasted for the future. The report shows that more than 60% of FX is traded electronically and this is expected to climb to over 90% by 2014 (see *chart 1*). Fixed income instruments such as bonds, on the other hand, are also proving fertile ground for the development of electronic trading. E-commerce activity is expected to reach 60% in three years time from its current 40%, while swaps should also experience a significant surge, jumping from today's low of around 15% to 50% within the same time frame.

**Chart 1:** Current importance of e-commerce and expected growth



Looking ahead, the study reveals that the highest e-trading opportunities will remain with listed futures and options, bonds and swaps due to the continued demand from hedge funds and institutional investors. The growth in FX e-trading will be mainly driven by large corporations, small and medium enterprises and wealth and retail investors (see *chart 2*).

**Chart 2:** Expected growth in e-commerce. E-commerce opportunity – by product and client segment



**Chart 3:** E-Commerce from a client's perspective:  
 A: Preferred e-commerce channel – Flow products  
 B: Preferred e-commerce channel – Derivatives and structured products

■ 1st preference ■ 2nd preference ■ 3rd preference

**A**

Products	Hedge Funds	Institutional	Banks	Large corporates	Small corporates	Wealth & Retail
Multi dealer platforms	2nd	1st	1st	2nd	3rd	3rd
Single dealer platforms	3rd	3rd	2nd	1st	1st	1st
FIX & direct APIs	1st	2nd	3rd	3rd	3rd	3rd

**B**

Products	Hedge Funds	Institutional	Banks	Large corporates	Small corporates	Wealth & Retail
Multi dealer platforms	3rd	3rd	3rd	3rd	3rd	3rd
Single dealer platforms	2nd	1st	1st	1st	1st	1st
FIX & direct APIs	1st	2nd	2nd	3rd	3rd	3rd

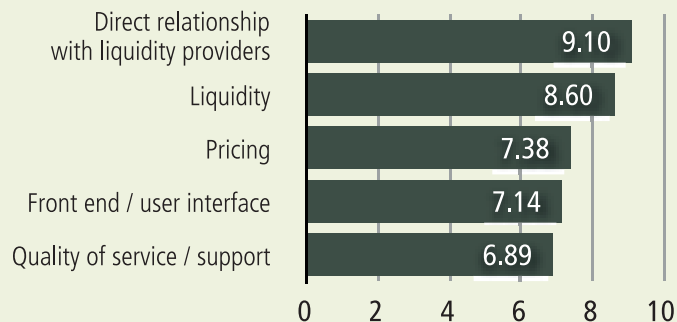
As to the venue of choice, there continues to be an ongoing debate between the merits of the single- versus multi-dealer platform. However, as the study shows the death knell of the single dealer platform has been greatly exaggerated. Channel usage, though, depends on a firm's particular requirements, trading styles and instruments traded. For example, hedge funds and proprietary trading firms tended to favour FIX and direct API connectivity across the product range while banks and institutional investors opted for the multi-dealer platforms for flow products such as spot FX, cash and bonds. Single dealer platforms though were their preferred choice for the more complex instruments including swaps, exotics, and structured products. In addition, both small and large corporates as well as wealth and retail prefer single dealer platforms (see chart 3).

According to the study, the main attractions of the single dealer platforms were the direct relationship with the liquidity providers followed by the liquidity itself, pricing, front end/user interface and quality of service and support (see chart 4). By contrast, multi-dealer platforms were ranked high for their latency, best execution compliance, liquidity, prices and pre-trade functionality (see chart 5). As for those taking the FIX and direct API route, best execution and compliance came last while lower latency and algorithmic trading followed by prices and quality of service were high on the checklist (see chart 6).

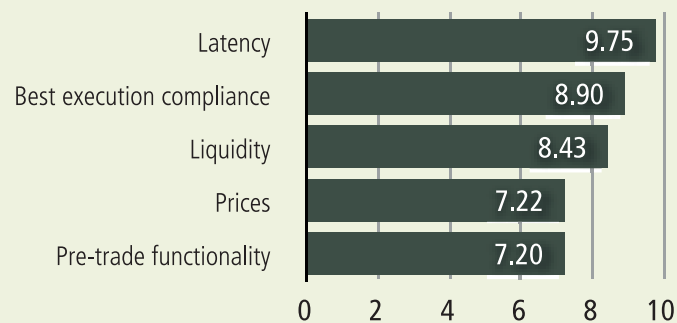
Not surprisingly, regulation in the US, UK and Europe has and will continue to be a key driver behind the development of the electronification of markets. MiFID and Reg NMS have made their mark but the trading landscape is set to change even more dramatically once the final blueprints of Dodd-Frank, the MiFID review and the European Market Infrastructure Regulation are approved. At the moment, regulators in each region are debating and discussing the finer points and while there are differences between the US and European reforms, there are common links particularly with the OTC market.

The overall aim is to push as many OTC instruments onto exchanges and through central clearing houses with mandatory reporting to trade repositories. This will not only increase transparency but mitigate counterparty risk. For example, CDS Indices, Interest Rate Swaps (IRS) and FX options, will be executed through a bank by voice or electronically on a platform, and then cleared at a central counterparty. It will not happen overnight and

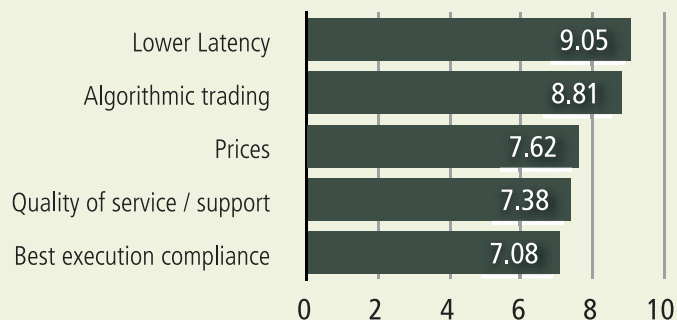
**Chart 4:** Top 5 reasons to select a Single Dealer  
(Note: 10 - the most important, 0 - the least important)



**Chart 5:** Top 5 reasons to select a Multi Dealer  
(Note: 10 - the most important, 0 - the least important)



**Chart 6:** Top 5 reasons to select FIX API.  
(Note: 10 - the most important, 0 - the least important)



regulators are still determining which contracts will be eligible but the goal is to move around 90% of voice transactions onto electronic platforms.

For brokers, there is not only the opportunity to enhance and develop their e-commerce capabilities but also to capitalise on the new market for clearing facilities. The client faces only one clearing broker with a capability to provide netting for margin across multiple assets and clearing houses. According to the study, if a broker can capture this business through its e-commerce offering then they are likely to remain loyal. It found that client-clearing broker relationships tend to be “sticky” and once appointed, institutions do not change.

However, if the price is not right, the buy-side cannot be reeled in regardless of how alluring the e-commerce shop window looks. In fact, our survey shows that 84% cited competitive prices as one of the top reasons to use a platform across all asset classes and client segments. Functionality is also key and, at the bare minimum, they expect platforms to offer a wide range of services including client static data, instrument static data, repository functions, market data distribution, core pricing and analytics and client pricing and negotiation. Credit checking, trade processing, risk management, clearing and settlement, trade repository as well as financial and compliance reporting are also must-have services.

The ability to electronically trade multi-asset classes is also a factor and the sellside have slated it for future technology investment, but it was not currently rated as a high e-commerce priority. Our survey indicates that it comes sixth on the list for those trading on single-dealer platforms and tenth for those firms using multi-dealer platforms. Change though is afoot as institutional investors have regained their confidence as well as their risk appetite. The buy-side are once again venturing out of their comfort zone and casting their nets wider to search for higher yields in the current low interest rate environment. They are also increasingly looking at risk across a wider asset class spectrum and the opportunities for hedging.

Just as electronic multi-asset class trading will grow in importance, the same can be applied to the user experience, which also came down the list as reasons for choosing an electronic platform. Our study shows though that expectations are shifting and that institutions increasingly will want the electronic tools and services

found in the home to be translated into their workplace. To date, this has not been the case because most systems on the sellside are still working according to earlier standards. They have been developed around an internal data model or processes of underlying legacy systems rather than being designed around the way users work. However, enhancing the user experience can become one of the key differentiators among platforms with similar functionalities, enabling brokers to break away from the pack.

Although the sellside will have different approaches, there is no doubt that technology will be the driving force behind the new upgrades and products. Brokers will also need to automate more processes in order to achieve the economies of scale required to remain competitive. This is not a new concept but it has taken on new meaning in today's world of increasing total volumes traded and narrowing spreads. The key indicator is “cost per ticket” for a transaction, which relates to the processing costs such as execution, clearing, settlement, staff, IT, legal and third-party services. Since the profit and loss realised on each transaction is directly proportional to the width (or narrowness) of the bid-offer spread, brokers need to ensure that they are effective and efficient in reducing those costs.

If you are interested in purchasing the full report “**Trends in e-commerce and electronic trading**” please e-mail [surveys@best-execution-world.com](mailto:surveys@best-execution-world.com) or call Ian Rycott on +44 20 7415 7169.

*GreySpark consultants are a London-based consultancy working with investment banks, hedge funds and asset management firms to deliver real solutions that work. Covering all asset classes, GreySpark engage directly with the trading, risk, operations and technology departments within their clients' organisations. In particular, the GreySpark team brings deep expertise in: Electronic Trading; Risk and Trade Management; and Data Management.*

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