AN EVOLUTION IN TRADING

REGULATION THAT AFFECTS THE TRADING AND CLEARING OF DERIVATIVES IS TRANSFORMING THE WAY THEY ARE TRADED. DANIEL MARCUS GIVES A PROVIDER'S PERSPECTIVE

The G20 recommendations on financial regulatory reform have started to fundamentally change the shape of global financial markets. Even though the intended legislative changes have not – in almost all circumstances – come into force, the spectre of such a seismic shift is already influencing strategic thinking among market participants. And treasurers are not only interested in where they can trade a product, but also which platforms they can rely on to provide them with reference price tools for debt issuance, as well as other capital-raising or funding activities.

The key elements of regulatory change that affect trading platforms are the potential mandatory electronic trading and clearing of certain derivatives. In response to this, market infrastructures are analysing the opportunities and threats that such change presents and taking a view as to how best succeed in this new world. The challenge is made more interesting by the fact that traditionally many OTC derivatives have been traded by voice either bilaterally (for example, bank to bank) or via intermediaries (such as inter-dealer brokers), who create liquidity pools and match interests. As a result, platform providers must consider multiple issues if they are to succeed in this more automated world. The following are two key elements:

Before the present tide of regulatory change swept the globe, the transition from the voice world to the electronic world was slow. But the pace of change is accelerating against a backdrop of regulatory reform and technological advancement

LEADING-EDGE TECHNOLOGY

The speed and resilience of the technology required is dependent on the derivative product type. For example, in very low-latency, standardised markets, where there are 24-hour global offerings such as FX spot, top-grade, consistent, low latency, resilient technology is required. Accordingly, whatever the product type, the choice of provision is vital – do you use in-house technology where you benefit from the intrinsic control and value of the technology, or do you outsource where you can leverage off specialist providers? However, a trading screen is only as good as the prices on it.

"LIQUIDITY BEGETS LIQUIDITY"

In general terms, the accepted view is that if you have significant interests on a platform, more people will interact with the platform. This is a virtuous circle because the more trades that are completed, the more liquidity will be fuelled. More trades mean higher revenue and a greater ability to reinvest in technology solutions.

So how do platforms achieve liquidity? In our case, not only have we designed our technology to be hybrid, so allowing voice brokers to interact and help feed the base liquidity pool, but we have also partnered with suitable liquidity providers. We have encouraged them to create markets by providing firm bids and offers so that the depth and quality of the platform is increased.

The process of building a market tends to require significant upfront investment and returns can be slow, which means patience is required. The pace of transition from the voice world to the electronic world is accelerating against a backdrop of regulatory reform and technological advancement. The real proof of concept for any platform provider is not just the volume it trades, but whether there is recognition by the market of its pricing data as a reference pricing tool by end users, such as treasurers, for the purposes of raising capital and investment strategy.

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