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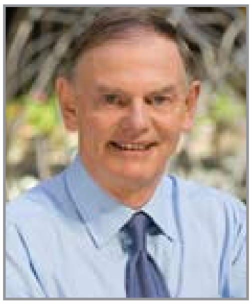
FPL Canadian Electronic Trading Conference 2008



By **Robert Smythe** and **Mark Waugh**, Stratix Consulting

The Fourth Annual FPL Canadian Electronic Trading Conference, which took place on May 5th and 6th 2008 at the Hilton Downtown Hotel in Toronto, was a "sell out" event attracting over 400 participants.

To put this in context, an equivalent event in the US given its 10-1 size advantage would involve 4000 delegates. The SIFMA Technology event in the US is probably a reasonable comparison, hence comments that the FPL Canadian Electronic Trading Conference could be seen as the equivalent of a "SIFMA North".

The Conference started with a standing room only pre-Conference FIX Primer Workshop in the morning led by Jim Northey (LaSalle Technology Group), with support from Scott Atwell (American Century).

The main Conference had 14 sessions with 65 speakers running over a day and a half. There were many positive comments received from delegates regarding the quality of the conference.

> *I've had our US director of operations bending my ear at great length about your show in Canada, which he has just attended. Ecstatic is not the word, you have a fan for life. All the exhibitors he spoke to were similarly impressed by the quality of attendees and the standard of organisation.*
>
> *Managing Director – Automated Trader*

The conference addressed five major themes:
- Globalization
- Changing Buy-side, Sell-side Relationships
- Market Fragmentation
- Managing the Flow of Trading Information
- Regulatory Impacts

There was also increasing focus on transaction networks and post trade settlement processes.

Globalization and Changing Buy-side, Sell-side Relationships

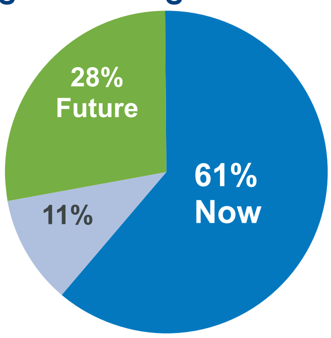
Investment Managers Pursuing a Global Strategy

A research study by the IBM Financial Markets Industry

Institute for Business Value identified that 61% of asset managers who were interviewed are currently pursuing a global investment strategy and 28% plan to do so in the future. This will have a major impact on services provided by broker dealers, and the networks and systems required to link dispersed parties, not to mention more complex clearing and settlement processes.

Diagram 1 AM Global Strategy

Asset Managers Pursuing a Global Strategy



IBM Financial Markets Industry Institute for Business Value

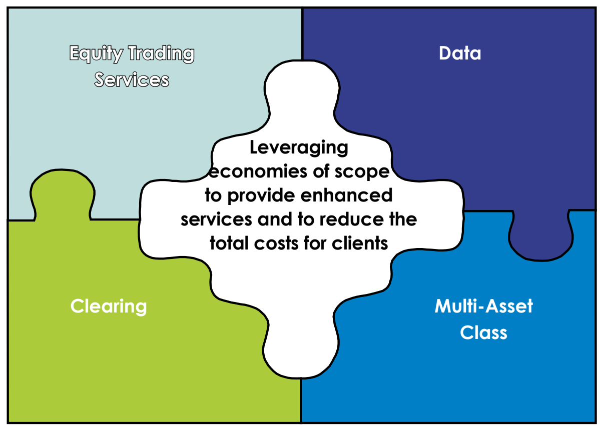
Exchanges Merging Globally and Within Countries

Speakers from ISE/Eurex, NYSE Euronext and NASDAQ OMX addressed the impact of international mergers and the transformation of their business models. Discussion covered how traditional exchanges, with their broad offerings and generally older technology, could compete with the more nimble, newer entrants. Multi-asset trading capabilities, faster technology, competitive pricing and broad product offerings were seen as effective ways to compete.

It was cited that, in Europe, traditional exchanges remain market leaders but Multilateral Trading Facilities are capturing market share and some price formation is moving away from exchanges. Exchange revenues in Europe are concentrated with less than 10% of listed companies representing over 90% of turnover. Major challenges in Europe are the 30 rulebooks, absence of common clearing and settlement process and a lack of cross-border interoperability.

Representatives from the Toronto Stock Exchange and the Montreal Exchange discussed how they are currently competing with newly emerging Canadian competitors in the Canadian marketplace, while at the same time, reaching out to the global marketplace to also compete with global competitors. An interesting component of the TSX MX merger revolves around the Canadian Derivatives Clearing Corporation, owned by the Montreal Exchange. How this asset is utilized in the future could result in further clearing and settlement efficiencies.

Diagram 2 Exchanges Leveraging Economies of Scope

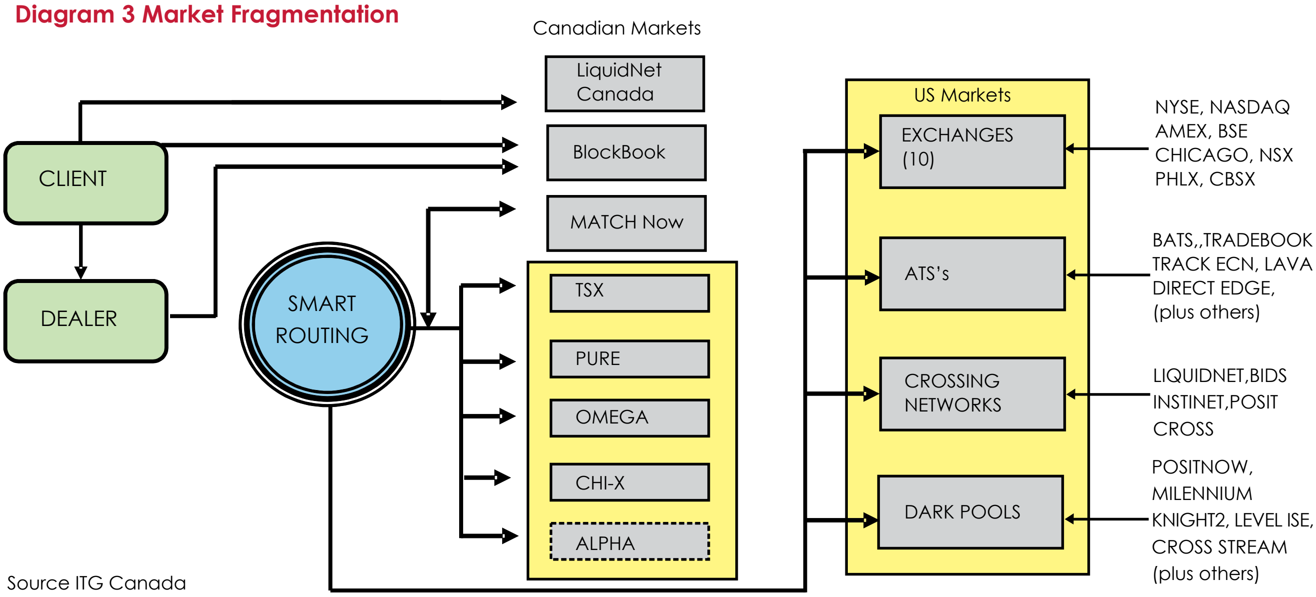


Source TSX Group Presentation

Addressing Market Fragmentation

Market fragmentation, both in Canada and globally, continues unabated. In Canada, ATS's have less than 2% of market share.

Diagram 3 Market Fragmentation



Source ITG Canada

In the US, TABB Group estimates that regional exchanges and ECNs have a 25% market share vs. 37% for the NYSE and 38% for NASDAQ.

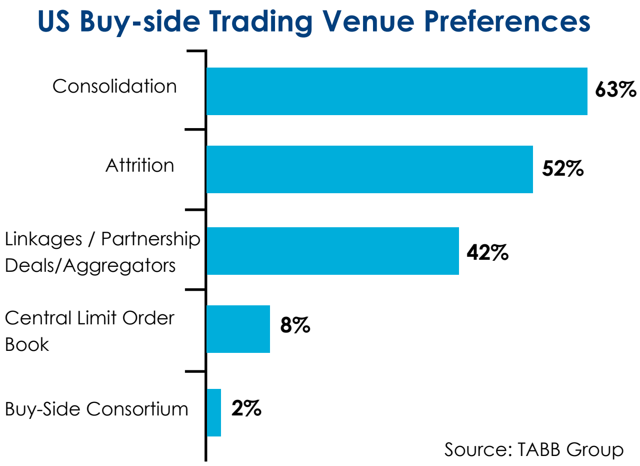
TABB Group also identified that traders used to pick a venue with the greatest chance of execution and stick with it, while today they need to be everywhere all of the time, leading to a requirement for smart order routing.

Buy-side Trader Preferences

According to TABB Group, the buy-side believes fragmentation has gone too far, making price discovery and liquidity sourcing too complex. In Canada with no "central data consolidator", price discovery processes continue to evolve. There is some thought that information vendors can provide this data eliminating the need for a central data consolidator.[1]

The buy-side sees best execution as more than best price, and must include factors like cost of execution, ability to source liquidity, speed of execution and value of ideas.

Diagram 4 US Buy-side Trading Venue Preferences

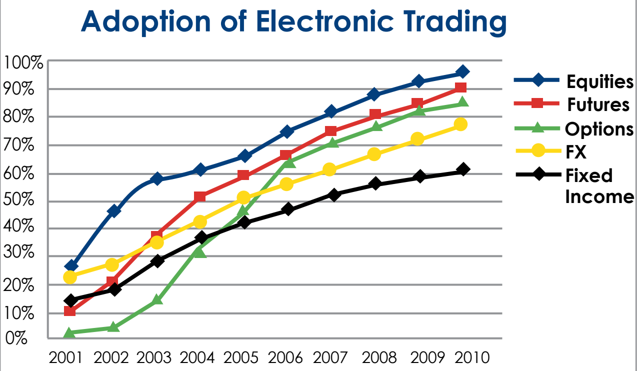


Source: TABB Group

OMS/EMS

OMS/EMS continues to be a topic of interest. The increasing adoption of electronic trading, and the growing use of algorithms, increases the need for these systems. The demarcation line between these two systems is graying, as OMS and EMS vendors increase functionality. Mergers between vendors, and the acquisition of vendors by broker dealers, are changing how these systems are being offered.

Diagram 5 Adoption of Electronic Trading

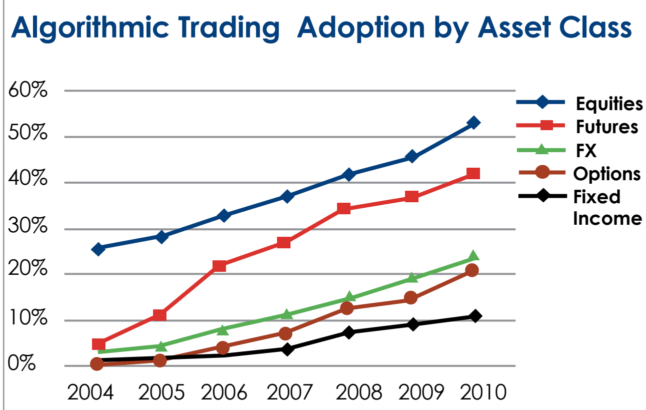


Source: Aite Group Estimates

Algorithmic Trading

Adoption of algorithmic trading in the US has grown rapidly and the same phenomenon is now underway in Canada. Key growth areas are asset classes beyond equities. As global trading increases, linkages to FX trading have also increased. There was general agreement that use of algorithms could result in a 4 bps performance improvement. Panelists also talked about the ability of their algorithms to handle interlisted securities, and to seek out liquidity in dark pools. ITG estimated that trading in both the US and Canadian markets could add a 0.8% bps performance improvement and accessing dark pools could increase this by another 0.6% bps.

Diagram 6 Adoption of Algorithmic Trading



Source: Aite Group estimates

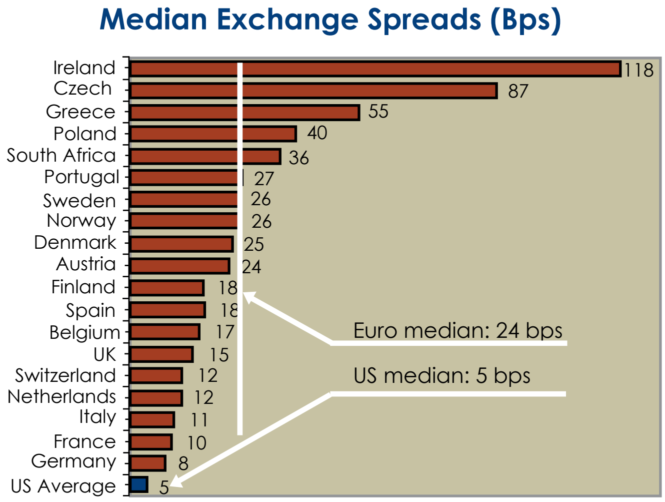
In Canada, Regulation Services (RS), the overseer of all trading activity, has recognized the impact of algorithms on markets. They require parties using algorithms to exercise the same degree of fiduciary responsibility over algorithms, just as they would for any trader using a keyboard. A common challenge identified across the panel was the disconnect that can exist between the trader using the algorithm and the developer of the algorithm.

Trading Beyond Canada

While MiFID has focused on improving trading in Europe, there is still room for significant cost improvements in trading, clearing and settlement processes. Credit Suisse indicated

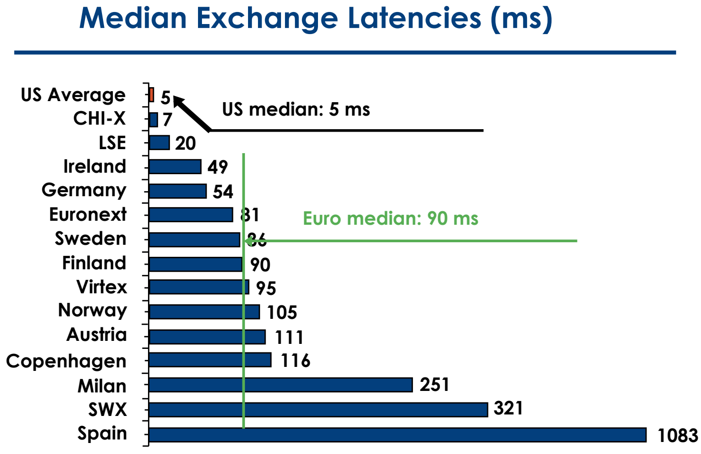
(1) *The Ontario Securities Commission Trade-through Protection, Best Execution, Access to Marketplaces and the Consolidation of Data Supplement to the OSC Bulletin April 20, 2007 Volume 30, Issue 16 (Supp-3) (2007), 30 OSCB*

Diagram 7 Median Exchange Spreads



Source: Credit Suisse

Diagram 8 Median Exchange Latencies



Source: Credit Suisse

that median European spreads are five times higher than in the US and median latencies are eighteen times higher.

The exchange spread in Canada is 8 bps, which is at the lower end of the scale and equivalent to Germany.

Managing the Flow of Trading Information

Three panels with a broad range of international participants looked at:

- How FIX, FpML and Swift are working together to define a joint investment roadmap
- The ongoing implementation and evolution of FIX FAST
- Optimizing networks to reduce latency

All these initiatives are key to the development of the most efficient trading processes.

Investment Roadmap

During the conference, FIX Protocol Ltd (FPL) announced that it has been working with FpML/ISDA, SWIFT and ISITC to provide clear direction to messaging standards usage by mapping the industry standard protocols FIX, ISO, and FpML to the appropriate business processes across the major asset classes. This establishes the groundwork for one common financial messaging standard, ISO 20022, while maintaining the existing independent protocols.

This is a major step forward and is the result of cooperation and contribution from all parties.

FIX FAST

The CME and NASDAQ identified the innovative ways that they are utilizing FIX FAST to reduce costs and improve performance. It was reported that the use of FIX Fast by the CME has reduced the number of messages required to transact their business from 29,000 to 8,500 messages per second and also reduced required network bandwidth from 25 to 8.5 MBS.

NASDAQ OMX is moving forward with a new integrated delivery platform based on FIX and FIX FAST. This platform will manage trading, market data and clearing operations. Program trading will utilize the FIX FAST protocol.

Network and Processing Latency

This year, a significant number of network, specialty hardware and transaction processing software vendors participated in the conference. They identified how to establish global connectivity, reduce latency and manage complex event processing.

Achieving high performance requires a low latency architecture and a seamless orchestration of processing components and services. The ability to monitor performance and continually optimize processes were also identified as key ingredients.

Responding to Regulatory Impacts

The conference sessions with a regulatory focus looked at:

- Changes to the Matching on Trade Date Initiative
- Changing Soft Dollar Practices
- Operational Risk

Trade Matching on Trade Date

Canada is a leader in enhancing equity post trade processes because of its focus on moving to trade matching on Trade Date (T). The objective was to have 70% of domestic trades matched by midnight on T, by June 30, 2008, increasing to 95% in 2010.

As of March 2008, 78% of trades are being matched by noon on Trade Date plus 1 (T+1) and 35% on T (up from 3% in 2004).

Despite this progress the industry has concluded that it will not be able to achieve 70% trade matching

on Trade Date by the end of June 2008. As a result, there would be considerable exception reporting overhead.

After consultation, the regulator agreed to extend the 70% matching on T exception reporting date to June 30, 2010. Up to this date, an exception report must be filed if less than 90% of trades are not matched by Noon on T+1. While the exception reporting parameters have been modified, the principal of matching trades on T has been retained.

Soft Dollars

The panel session on soft dollars was well attended, with many questions coming from the audience; a clear indication that this is a front burner issue. In Canada, regulators have published a draft rule, with the comment period having just ended on April 10, 2008. Many of the comments received, address concerns around the valuation approach, the disclosure process and the length of time to transition to the new regulatory regime.

At the heart of the issue are accounting processes associated with which services are included, how they are valued and how they will be tracked. The US has taken steps to delineate between effecting securities transactions and the provisioning of research. Canadian regulators appear to be proceeding with an eye on the evolution of rules in the US.

Some robust discussion surrounded the issue of "value for performance", and methods to track and value services.

Risk Management

The panel session on operational risk and electronic dealing discussed how global industry initiatives and evolving practices are linking these areas, and addressing inefficiencies.

Markit , a leader in derivative valuations, presented improved industry processing metrics that resulted from the creation of the Operations Management Group (OMG) in the US with a mandate to drive fundamental improvements in front-to-back Over-the-Counter (OTC) derivatives processes.

Citigroup and Financial Intergroup Advisers identified ways to measure operational risk related to capital markets. Candeal (provider of on-line access to debt marketplaces) itemized how electronic execution reduces operational risk throughout the lifecycle of a transaction.

FPL Canadian Electronic Trading Conference 2009

The establishment of multiple marketplaces in Canada is substantially increasing the use of FIX. As investment horizons expand beyond Canada FIX Protocol is becoming the preferred way of communicating with the rest of the world.

An initiative to establish an Americas Canada Committee is proceeding. This will supplement the achievements of the FPL Canadian Electronic Trading Conferences in enhancing the use of FIX in Canada.

Planning for the FPL Canadian Electronic Trading Conference 2009 is already underway, so stay in touch with these initiatives by regularly visiting **www.etradingcanada.ca**.

Any thoughts on this or other articles?
Please send any comments, refering to this article as Vol 2 Issue 6 AM4 , direct to Edward at edward@fixglobal.com