

Inside Market Data

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FRAGMENTATION

SPECIAL REPORT



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Taping Fragmented Markets Back Together

A few years ago, the London Stock Exchange and Euronext tried competing for trading in stocks listed on each other's markets. Then, neither was able to steal share from the other. But 2007's Markets in Financial Instruments Directive regulation changed that, enabling the creation of new trading venues providing execution in stocks listed on exchanges across Europe.

The move has resulted in lower trading costs by introducing competition to an area previously controlled by large, domestic exchange groups. At the same time, firms seeking to exploit the benefits of these new venues have faced the administrative burden of sourcing data from multiple new venues—even if most multilateral trading facilities initially make their market data available free of charge—to create a definitive “European Best Bid and Offer” price to govern their trading and smart order-routing.

But fragmentation isn't just a European issue. Canada has also seen an influx of new trading venues competing for market share, while many also see potential for competition between markets in Asia Pacific. Even though these markets lack a common currency or regulatory framework, some say that venues with high-frequency trading platforms might attract traders ready to arbitrage latency between different platforms, while the Association of Southeast Asian Nations is already building a trading link between four exchanges, with the aid of NYSE Technologies.

In an article in this report, Fidessa's Andrew Barella notes that—like the Asean marketplaces—Europe does not have a single currency (since the UK still trades in pounds sterling) or regulatory regime. Europe also lacks a single clearing and settlement mechanism and a “consolidated tape” of equity market data, which are both present in the US, where equity trading is fragmented between a combination of exchanges and ECNs. A consolidated tape is a bone of contention for many, who feel that the fragmentation created by regulation should have been accompanied by a mandated tape of pan-European data to enable affordable access to information from the new marketplaces. Even Canada already has a consolidated tape, operated by exchange group TMX.

If a regulator is mandating fragmentation and best execution, should it not also mandate a definitive source of data for best execution? ■



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Fidessa, Reuters Expand Fragmentation Tools

UK-based data and trading technology vendor Fidessa is planning to expand its Fragmentation Index to the US and Asia for trading firms to incorporate liquidity fragmentation data into their smart order routers, while Thomson Reuters has rolled out new analytical tools to help Japanese firms deal with liquidity fragmentation as the Tokyo Stock Exchange's new Arrowhead trading system drives wider adoption of high-frequency trading strategies.

Fidessa launched its Fidessa Fragmentation Index in 2008 to identify fragmentation of European equity trading from the Markets in Financial Instruments Directive, which led to the creation of a range of new, pan-European multilateral trading facilities (*IMD*, Nov. 24, 2008). The index shows how fragmented trading in a stock or index is, based on how many venues a firm must visit to find the best price. Steve Grob, director of group strategy at Fidessa, says the vendor will probably bring the index to the US in the first half of 2010, to provide an index of equity trading fragmentation across US exchanges and ECNs, before rolling it out to address growing fragmentation in Asia later this year. Grob says that Arrowhead's lower latency is expected to attract high-frequency trad-

ers and encourage fragmentation between the TSE and Proprietary Trading Systems (PTSs) in Japan—along with the pending Chi-East dark pool joint venture between Chi-X and the Singapore Exchange and regulatory changes in Australia designed to open the market to competing trading venues—is likely to spur fragmentation in the region, which market participants must quantify to achieve best execution.

And because the PTSs may not be able to achieve a significant share of their domestic market, they may well take “a more pan-Asian view,” and start trading stocks across key market centers such as Tokyo, Singapore, Australia and Korea, Grob adds. Meanwhile, Thomson Reuters adapted its Equity Market Share Reporter and Best Execution Service to support Asian data at the end of last year, to help local participants track the share of trading in any given stock executed across competing venues, and has rolled out the product to global broker-dealers and execution venues that are using it both for internal analysis of market share and for promotional purposes, officials say. In addition to EMSR Asia, Thomson Reuters has also added Asian market data to its global Best Execution Service, which allows firms to run best execution reports to monitor the quality of their

trades and fine-tune execution policies. “In terms of venue choice, you need to have access to reliable data to identify the most viable liquidity venues, which is important in guiding smart order routing and best execution policies,” says Stephen Wilson, global head of exchange-traded instruments at Thomson Reuters. The launch of the TSE's Arrowhead platform at the start of this year is expected to stimulate trading volumes on the exchange, but market participants also expect greater liquidity fragmentation as trading volume rises on rival PTSs such as SBI Japannext, Kabu.com, Instinet's CBX Asia, and the upcoming Chi-X Japan. Mark Wheatley, head of Japanese equity trading at Bank of America Merrill Lynch, says that speed differences between Arrowhead and other platforms—along with other factors such as PTSs capturing more volume and TSE's new Flex Full feed making it easier to spot arbitrage opportunities—could create potential for inter-market arbitrage.

“As latency evens out among the competitors, it could become a lot easier for firms to move their flow around different venues, and that can lead to liquidity fragmentation,” says Sang Lee, managing partner at research firm Aite Group. ■

Avenues: Data Utility Will Combat MiFID Abuse

A UK-based group of specialist consultants dubbed the Alliance of Independent Advisors to Financial Markets—or “Avenues”—has called for the creation of a centralized utility to deliver a pan-European “consolidated tape” of market data from European exchanges and trading venues, to assist in monitoring market abuse.

Brian Taylor, a founding member of Avenues and managing director of UK-based BTA Consulting, says the proposed new utility would address a disparity in European financial markets, where a pan-European trading infrastructure currently relies on different national regulators to detect abusive market practices. “The primary driver for this [centralized

utility] is to level the playing field. Currently, there are different levels of surveillance responsibilities for different types of venue-so regulated markets have to do the most, and others less so,” Taylor says. “Surveillance should not be a competitive issue. It should be a standard issue done centrally by a utility which would undertake market abuse detection on behalf of all venues.”

According to Avenues, fragmentation of European trading data resulting from the Markets in Financial Instruments Directive has made it “almost impossible” for regulators to ensure fair markets, given the proliferation of multilateral trading facilities, dark pools and systematic internalizers since the

launch of MiFID, as “the total trading is not visible to any single party at any single time. The Financial Services Authority does not have a single set of eyes because it does not have access to the order books of the different markets in real time,” Taylor says. “We are talking about huge volumes of data which may not be consistent and need to be bought together and normalized to detect patterns,” Taylor says.

However, scrutinizing a consolidated tape will not prevent market abuse unless there is a regulatory requirement to trade at the price on the tape, Taylor says. “Unless the components that make up best execution are regulated, [a consolidated tape] will just be a partial solution,” he says. ■



CESR Calls for EU Consolidated Tape

The Committee of European Securities Regulators has joined calls for a pan-European “consolidated tape” of trade data that would consolidate executed prices from exchanges and multilateral trading facilities for stocks traded on multiple venues, to increase transparency in the region.

Addressing an event organized by Deutsche Börse in January, CESR chairman Eddy Wymeersch said that the introduction of the European Commission’s Markets in Financial Instruments Directive (MiFID) has helped to reduce the cost of trading in Europe, but that market participants would still benefit from improved data quality, which could be achieved by a US-style consolidated tape of data. Wymeersch told attendees that market

forces had still not succeeded in creating adequate post-trade transparency, and that a consolidated tape would help to address this issue, adding that the development of such a service is all the more crucial given the increasing levels of high-frequency trading taking place in the market, which necessitates accurate information to guide trading decisions.

He also noted that the absence of a consolidated tape in Europe has made it difficult for regulators to understand exactly how much trading takes place on dark pools, and suggested that the market could also benefit from a consolidated quote feed of pre-trade data. “Why not bundle all lit orders, on exchanges and MTFs, and examine the development of an efficient consolidated quotation system?” Wymeersch said. ■

Reuters Survey: Buy Side Demands Cheaper, Better Data

Buy-side market data consumers are calling on European exchanges and trade reporting facilities to provide real-time trade data as a standalone subscription product, to allow the creation of a cost-effective consolidated tape of time-and-sales data, according to research from Thomson Reuters.

The survey of around 30 buy-side firms revealed a need for better quality and more granular European data, and the ability to access consolidated trade data across multiple liquidity pools at a lower overall cost, says Andrew Allwright, business manager of MiFID solutions at Thomson Reuters.

According to the report, buy-side firms struggle to meet the cost of real-time subscriptions needed to obtain a full view of pan-European stock trading, because real-time time and sales data is only available as part of Level 1 or Level 2 feeds. While those polled consider current fees reasonable for a montage of real-time executable quotes, they argue that fees charged by exchanges and trade

reporting facilities for aggregated trade data should be significantly lower. “We have had initial discussions with one of the larger exchanges, and this is something that they are considering,” Allwright says.

In addition to lower fees, buy-side data consumers are also calling for improved quality and granularity of data, through the introduction of better quality control procedures by trade reporting facilities, more detailed trade flags to identify the type of trade being executed, and timestamps that allow users to see when a trade was actually executed, even if its trade report was delayed in accordance with MiFID rules. “All the trade reporting services, except for Markit Boat, do not provide an execution timestamp—just a reporting timestamp,” Allwright says.

Finally, the research also recommends increased adoption of standards around how quote-and-trade data is consolidated, and how analytics such as volume-weighted average price are calculated. ■

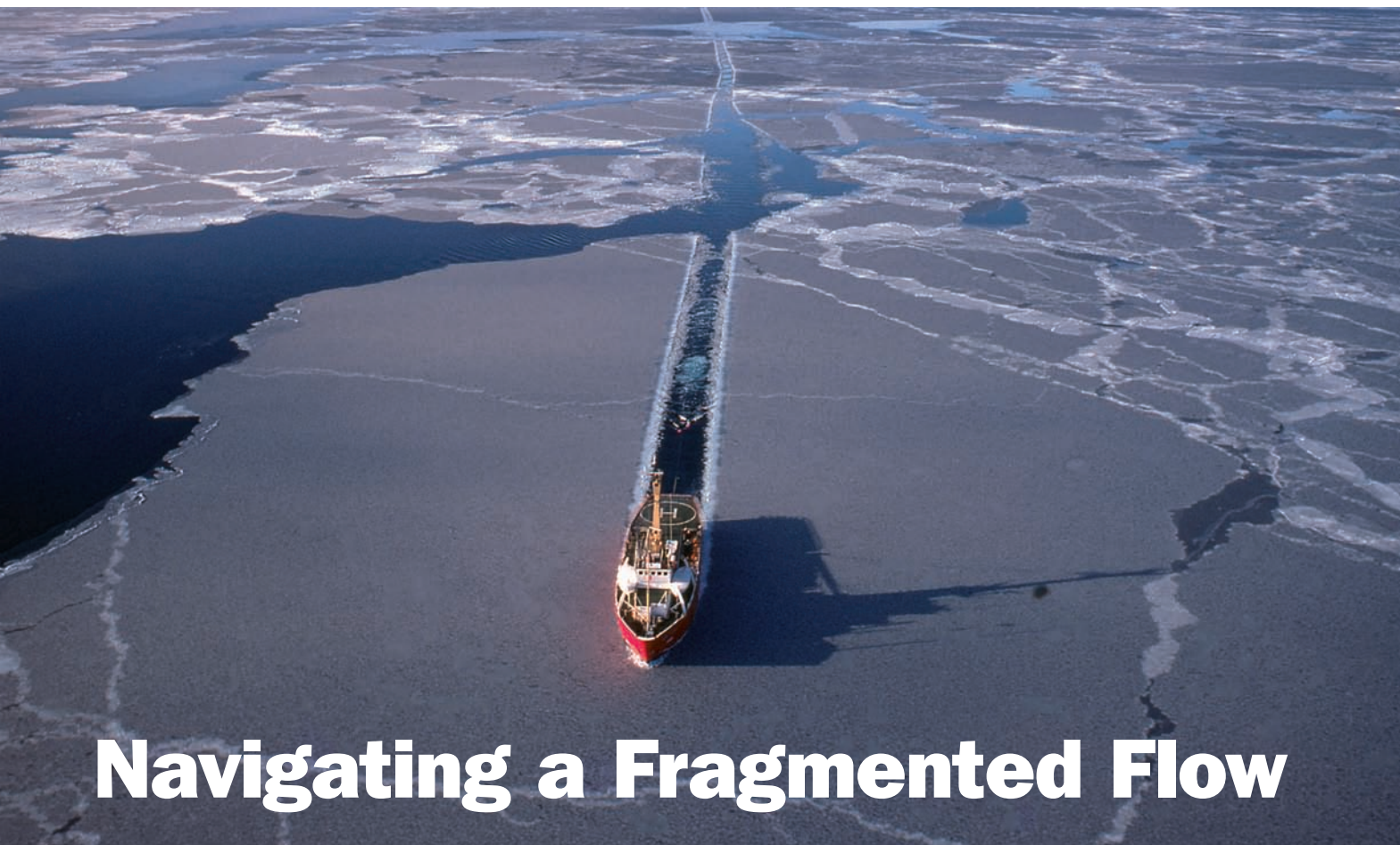
CFA Institute Urges EC Data Review

The European Commission should address concerns about the cost and quality of market data by introducing a US-style consolidated tape when it reviews the impact of the Markets in Financial Instruments Directive (MiFID) this year, according to research from the CFA Institute, a global association of qualified Chartered Financial Analysts.

According to a survey of roughly 1,700 CFA charterholders, two-thirds of respondents believe the cost of data access has increased since the introduction of MiFID in November 2007. These increased data costs have been driven by the need to invest in technology to source low-latency data from multiple venues to feed into smart order-routing systems, which has given an advantage to larger institutions with the necessary capital to invest, says Rhodri Preece, policy analyst at the CFA Institute in London and author of the research.

A US-style consolidated tape would therefore help to address data quality while promoting a fairer market by making consolidated data more easily accessible, he adds. Similarly, roughly two-thirds of respondents are concerned about post-trade data quality, stating that trade reporting obligations have been negatively impacted by fragmentation, as the current regulations are vague in defining who is ultimately responsible for fulfilling post-trade reporting obligations, which can lead to confusion, missed trades and double-counted trades, Preece says.

The research also included a study of whether MiFID-inspired market fragmentation may have impacted bid-offer spreads and market volatility. While the research found that price volatility had clearly increased since the introduction of MiFID—possibly from market volatility induced by the financial crisis—the study found that average bid-offer spreads had in fact fallen since MiFID. The report suggests that one explanation for narrowing spreads is “the existence of greater competition amongst trading venues,” which “may encourage liquidity suppliers to post narrower spreads to attract order flow,” along with increased uptake of high-frequency and low-latency trading strategies. ■



Navigating a Fragmented Flow

New regulations and execution venues have caused equity trading to fragment between multiple marketplaces, regardless of their place of listing. But has fragmentation delivered on its promise of increased competition and lower costs, or has it merely increased the challenges and burden facing end-user firms and their trading strategies?

IMD: What impact has fragmentation of trading had on different marketplaces around the world, and how is this affecting the market data industry in the current economic environment?

John Schwall, global head of product management for global equities, RBC Capital Markets: Liquidity fragmentation has had a profound impact on developed markets, particularly in those markets with a common regulatory framework whereby an implicit or explicit requirement exists to access that liquidity. We've seen the proliferation of smart order routers, the adoption of venue maker/taker pricing models, liquidity-seeking algorithms and the evolution of high frequency trading strategies. We've also seen dramatic growth in trade, quote, and quote cancellation volumes.

As a result, there has been an on-going need for technology investments throughout the market data infrastructure to handle the increases, from networks and networking components to market data gateways, trading systems, and trader desktops. In fact, the historic market volatility at the beginning of the eco-

nomie downturn has proven that some firms need even more technology investment.

Miranda Mizen, principal, Tabb Group: The fragmentation of liquidity has been accompanied by a huge rise in volume (particularly of unexecuted orders) and demand for customization and variety. Market participants today need greater granularity and choice when it comes to what data is required, what sources are to be used, the frequency of update and the delivery mechanism. For example, fund managers seeking a reference price for an investment have very different data needs from their traders executing their orders, or from smart routers, algorithms and black box models.

Rhodri Preece, director of capital markets policy, CFA Institute: Fragmentation, spurred by competition between trading venues, has coincided with a reduction in trading fees. Greater competition has also led to reduced latency. These developments have had some positive effects on liquidity, witnessed by



the narrowing of bid-offer spreads in several markets globally.

At the same time, fragmentation of liquidity has coincided with a fall in average trade sizes across venues. Fragmentation has also diffused data on prices, volumes, and trading interest, via the multiplication of data originators (such as exchanges and multilateral trading facilities). Fragmentation of data has made it difficult for vendors to collect, consolidate and disseminate accurate market data in a timely fashion. This can have adverse implications for market transparency.

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Andrew Barella, global head of market data services, Fidessa: Fragmentation typically brings opportunities as well as challenges. By its very nature, fragmentation is often associated with the emergence of new venues, which means more sources of market data. This is often associated with a drop in trade sizes but a rise in volumes as the high-frequency traders move in to exploit arbitrage opportunities. This all drives market data rates up and brings issues such as disparate symbology to the fore. These challenges need to be met head-on with the provision of intelligent workflow tools that allow people to operate effectively in the new trading landscape.

Gavin Quinn, associate director, JWG: There has been a veritable arms race of technical and business innovation, but much of this has been confined to liquid equities, futures and options markets and foreign exchange in a limited number of countries. This has led to increased specialization and competition, changes in the supply chain, trading techniques, number and distribution of data sources and consumers. For a relatively small number of organizations, the more important question has become not where they are sited in relation to the markets they work, but where their servers are located relative to where other (exchange) servers are located.

IMD: Is fragmentation producing the results intended by regulators and market participants of better and cheaper market data, or has it created confusion, more data, and more expense for end users?

Quinn: I don't think that the regulators or market participants' objective was to create cheaper market data—if so, I am sure there were other ways that they would have attacked the problem.

“Liquidity fragmentation has had a profound impact on developed markets, particularly in those markets with a common regulatory framework whereby an implicit or explicit requirement exists to access that liquidity... We've also seen dramatic growth in trade, quote and quote cancellation volumes.”

John Schwall, global head of product management for global equities, RBC Capital Markets

There has, however, been a fundamental shift in demand, including lower latency, “dirty” data, better cleansed data, more detailed data, full order-book data, volume data, more historic data, more decimal places, more granular timestamps and richer data. Because of this, it was in some ways easier for the newer MTFs to create the infrastructure to deal with the new demand, but they lack the liquidity to make this compelling, although in doing so they did kick-start an arms race where the larger existing exchanges rapidly moved away from years of complacency and under-investment in an attempt to catch up with the young turks.

There is more data, and while it may not be useful or cost-effective for everyone to see every tick and quote on every stock, there are those who will spare no expense because they want to own and control as much data as possible. Demand for market data can be limited by geography, asset class, the liquidity of each security, and the aims of the buyer. These firms who want all of that data form a relatively small but extremely forceful part of the holistic market for this data. Because of these changes, increased volume and velocity of data, more venues, more formats, more consumers all with different requirements, longer histories, etc., it has become a more complex business if the user requires it.

Schwall: It probably depends on your side of the argument regarding high-frequency trading. Clearly, there is liquidity being added to the market, and that's a good thing in terms of increased market data and available liquidity. Yet, some strategies being deployed to add that liquidity also result in higher quote cancellation volumes, which comes at a cost—both in terms of needing to support the market data and the implicit cost of information leakage caused by “disappearing” quotes.



John Schwall
RBC Capital Markets

Preece: The provision of market data was left to competitive forces under MiFID. To date, the industry has yet to come up with a cost-effective solution to the provision of consolidated pre-trade and post-trade data. Existing commercial offerings have

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Rhodri Preece, director of capital markets policy, CFA Institute

also not yet provided investors with sufficiently timely and comprehensive information. Moreover, the latitude afforded to investment firms under the MiFID trade reporting provisions has created problems related to the accuracy and consistency of reported trade data, which further complicates the provision of consolidated data. Data quality and control is an important issue that must be addressed in order for future consolidated data offerings to be effective.

Barella: The fact that the concept of “best execution” is still so widely open to interpretation highlights the fact that the market still has some way to go to assimilate the true intentions of MiFID. There are most certainly additional sources of market data in a fragmented world, along with more trading venues to visit to find liquidity. From a European perspective, while the cost of trading has come down, this has been offset by the cost of the technology required to access this new liquidity and the additional burden of operating in a more complex clearing and settlement environment. This is why the market eagerly awaits the next round of MiFID regulation. Exactly what “MiFID 2” holds for the marketplace remains to be seen.

Mizen: Regulators are primarily focused on the creation of equitable markets but the quality of market data is fundamental to the integrity of the marketplace. Post-trade data is in the European spotlight at the moment as they struggle to create a tape of record by bringing together data which has a variety of sources, formats, costs, codes and reporting standards. Market data needs to be accessible and affordable, and this means traditional licensing and pricing models need to change, but it also means creating pricing models that are tightly coupled with usage.

IMD: How can firms decide which venues to source data from in a fragmented market? Must they subscribe to all sources of data on a security, or can they apply a formula to be selective about the venues they subscribe to?

Quinn: First, select your firm—it would depend upon the size of the firm, its geographic aspirations, which asset classes it chooses to play in, specialize and concentrate upon, client

demand, costs, regulations, etc. For some firms, there is a positive advantage in gathering every scrap of data that they can, and in looking for patterns and correlations. But for others, it would be a costly administrative burden that would never be used. Likewise, some firms will be driven by the minimum standards of compliance, risk management, etc., while others would see this as a necessary cost that must be paid to allow them to fulfill their needs and those of their customers and investors.

Are we concentrating myopically on the Direct Market Access low-latency, high-frequency market of liquid equities, or are we considering market data in the round? While a highly important and influential part of the market, only a relatively small number of buy-side and sell-side firms demand that level of sophistication, and even then it does not really exist in many areas.

Preece: Obtaining access to all venues that a security is traded on can be costly, particularly for smaller players. Firms can specify which venues they will source for transacting client orders under their execution policies. In many cases, information will be sourced from (and orders will be sent to) the primary exchanges, which benefit from being the incumbent price discovery venues. However, fragmentation is eroding this advantage. Ultimately, reliance on the exchanges may not be sufficient to obtain best execution for clients.



Rhodri Preece
CFA Institute

Barella: The research labs at Fidessa created the Fidessa Fragmentation Index (FFI) and Fragulator (www.fragmentation.fidessa.com) tools, which are designed to help both buy-side and sell-side participants make sense of fragmentation across the European markets. By providing the hard facts and intelligent insight into the world of fragmented liquidity for all the key European indexes (all the way down to individual stock level) firms can see where liquidity really exists across all the available venues.

This kind of information not only allows firms to form an opinion as to which venues they should subscribe to, but also how to interact with the various venues at a trading level. Firms need to be selective about where they connect, based on their particular requirements and what they are trying to achieve. Clearly, though, firms also need an efficient workflow and trading solution in place to facilitate best price discovery, smart order routing and all aspects of trade management through to settlement across these venues. Without a truly comprehensive and integrated system in place, the question of which venues to connect to can become rather academic.

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ROUNDTABLE



Miranda Mizen
Tabb Group

Mizen: Regulation and competition are the key drivers. In the US, there is a more stringent consideration of which quotes must be taken into account under Reg NMS, but there is choice on how you view and access sources and venues. In Europe, best execution is the driver and this crucially includes clearing as a consideration. Brokers can be and are selective about which venues they consider, but this is both a question of competition and in flux, and they face the increasing

scrutiny of the buy side. For as long as the market structure is still forming and new venues are launching—whose success is not assured—there will be greater selectivity in Europe.

Schwall: A decision around the type of market data received from different venues is typically a function of the trading strategy and/or business of the firm. Generally speaking, most firms will subscribe to the full breadth of market data, either via direct exchange feeds or an aggregator. While sell-side firms need market data for making routing decisions to any venue that could be considered part of their best execution policies, other firms (e.g., electronic liquidity providers and high-frequency traders) may only subscribe to market data from those venues that may influence their trading strategies. Rather than being selective about venue subscriptions, some firms may opt to reduce market data message volumes through parts of the infrastructure via different methods of quote conflation. This may be an option for those firms and trading strategies which are not dependent on tick-based order-routing decisions.

IMD: As trading in a security fragments, what impact does this have on the value of data from different venues, and are these changes being reflected in the price charged for data by trading venues?

Mizen: As liquidity fragments, the importance of the “primary” exchange changes. At Tabb Group, we have seen this in the US and are now seeing it in Europe. Increasingly, liquidity needs to be measured by stock and not just by overall venue, as liquidity does not disperse at the same rate across all stocks. This makes the granularity of choice and pricing more important, otherwise the cost of data effectively rises.

Schwall: For sell-side firms and long-only institutions, fragmentation results in challenges and costs associated with accessing multiple liquidity sources and the need to consume and pay the costs associated with receiving market data from additional sources. For data recipients interested in arbitrage trading strategies, fragmentation and the resulting market data feeds can translate into profit-making opportunities. However,

the costs of market data are not reflected in the liquidity imbalance that may exist in certain securities.

“From a European perspective, while the cost of trading has come down, this has been offset by the cost of the technology required to access this new liquidity and the additional burden of operating in a more complex clearing and settlement environment.”

Andrew Barella, global head of market data services, Fidessa

Quinn: The pricing of data from different venues varies widely depending on membership, liquidity, speed, depth/ detail of service, the liquidity of the venue and their desire to encourage ever-greater liquidity. Given the variety of offers from so many venues and vendors, it is often invidious to try directly comparing them.

Perhaps of more interest would be to compare the changes and the wider demand for market data. The time-value of data has changed dramatically—no longer will vendors claim that three or four seconds is real time—and the value of historic data has risen markedly (people were far too profligate in the past). However, there is a danger that we become fixated on highly-liquid equity markets and high-frequency trading, when there are many markets, asset classes and consumers that are largely unaffected by these changes. The result of fragmentation in equity markets has encouraged the rise of co-location and ultra-low-latency feeds of “dirty” data. The cleansed and truncated data terminal market has also been overhauled, and then there is the new market for historic full order-book data for building and honing, back-testing and regression testing of algorithmic and quantitative models for both trading and risk management.

In the space of a few years, demand has developed for far more detailed data, full market data, and “dirty” data as well as cleansed data, while “real time” has been re-defined and speeded up, and historic data is no longer limited to closing prices. This is not all due to post-MiFID fragmentation or arbitrage opportunities, as it required other technological improvements such as analytic software, infrastructure, databases and new players on both the buy side and sell side for this to happen.

The question also seems to concentrate on transparent and liquid markets, whereas there are many asset classes where the data is either derived, synthesized or made up—sometimes for self-interested mark-to-market purposes. If one looks across the global market, there are many areas where a lack of transparency is caused by many different factors: convention, rules, lack of actual or perceived liquidity, lack of widespread interest, the bilateral nature of some trades, many of which are distorted by different credit criteria, etc. These, along with speed and accuracy, should perhaps create more and different price points.



Barella: Pricing pressure has increased dramatically, particularly as many new venues charge much less—or not at all—for their data. However, the “value” of data is subtly more complex than just data fees for individual stock pricing. Issues such as where most of the liquidity really sits, what is considered the “base” price, what is used as the official close, and who provides reference data such as corporate actions, are some of the other factors that need to be considered in assessing the overall value of the data. As the market matures (or flattens), I would suspect that venues will try to promote the “value” of their data and seek out additional revenues from it—particularly from any previously free-to-air market data.

Preece: As liquidity fragments and alternative trading venues grow in prominence, the value of information from those venues rises. This may give alternative trading venues greater pricing power over their market data. However, at the same time, greater competition between venues can have a downward effect on fees. So the net effect is often that competitive forces check the pricing power of trading venues.

IMD: Does fragmentation necessitate a consolidated tape of data for each fragmented marketplace?

Barella: Necessitate a consolidated tape, and an “EBBO” for that matter, from a regulatory perspective? No. Is price aggregation needed to determine best price prior to trading and to facilitate post trade analysis? Yes. Is a consolidated tape in Europe now needed in order to provide transparent insight into the market? Yes, I believe it is.

Preece: A recent survey of CFA Institute members found that 65 percent supported the introduction of a consolidated tape under MiFID, reflecting the view that investors currently find it difficult to obtain a complete and clear picture of prices and trading interest across markets. A consolidated tape, along with a consolidated pre-trade quotation system, “centralizes” liquidity and connects markets by providing a single place for firms and clients to access independent pricing information, thus lowering costs to investors. A consolidated tape would

improve market transparency and facilitate the accomplishment and measurement of best execution, thus delivering real benefits to investors.



Gavin Quinn
JWG

Quinn: Should the question be how many consolidated tapes are required (as there are already a number of them, which are not all the same)? The question implies that there is a single version of the truth—but, as there are so many ways of getting to that point, is it likely that everyone would agree with the various methods that could be applied? Is there value in consolidated tapes for all asset classes, or are we just thinking of equities (and indeed probably a

relatively small number of the equities from the universe of equity prices available)? Is there value in a tape of currency data? If so, would you distinguish between deliverables, synthetics, etc.?

Schwall: One of the biggest benefits of a consolidated tape is the ability to achieve and demonstrate conformance to a best execution policy. However, Europe is an example of a market that is clearly fragmented and there is not a regulatory mandate for a consolidated tape. Meanwhile, fragmentation will likely continue as more European brokers establish their dark pools as registered multilateral trading facilities.

Mizen: The US has a mandated consolidated tape, and the revenue from this is shared by the exchanges. Europe is developing its own equivalent method of producing a tape of record, but will not follow the same path. While the need for comprehensive and robust market data is prerequisite in any marketplace to support best execution, risk management and market surveillance as liquidity fragments, this does not translate easily into a one-size-fits-all consolidated tape. ■



SPONSOR'S STATEMENT

Dealing with Data in a Fragmented World

Fragmentation of trading, whether driven by regulators or market forces, has increased competition between different trading venues, but has also increased the challenges facing firms trading these markets when it comes to obtaining data for order-routing and compliance purposes. By Andrew Barella, global head of market data services, Fidessa

Fragmented liquidity, fragmented market venues, fragmented places of settlement—we live and operate in a fragmented world. This is nothing new. Markets have always had an element of fragmentation, but drivers such as the introduction of new ECNs and alternative trading systems in the US in the 1990s and the Markets in Financial Instruments Directive's transparency rules in Europe have accelerated both the pace and complexity of fragmentation. As such, the need to overcome and deal effectively with a fragmented marketplace is both a business and a technological challenge.

The challenge is to consolidate these markets in a coherent way that enables an efficient and compliant trading operation, while cost-effectively minimizing operational risk, from price discovery to settlement. The corresponding pre-trade, trading and post-trade processes must also operate in a tightly integrated manner.

Firms must decide which venues to consider for liquidity discovery and achieving best execution. These decisions will initially be driven by a firm's trading profile, but a coherent and consistent view of the market concerned—as well as the venues where trading actually occurs—is also a necessity.

Tools like the Fidessa Fragmentation Index (FFI) and the Fidessa Fragulator

provide a free insight into the fragmented European world, and track the degree of fragmentation of index and individual stocks across traditional and alternative trading venues. As figure 1 shows, fragmentation across the major European indexes continues to increase, with the FFI for the FTSE 100 now at a value of more than 2.3. Thus, to effectively trade the constituents of this index and achieve best execution, firms should be looking to execute across at least two venues—those where most of the liquidity now resides.

As soon as an FFI value breaks above 2, this means that a firm must visit multiple venues to achieve best execution, since that stock is no longer deemed to “belong” to its primary exchange. The FFI shows that we are now starting to see more liquidity move to new, non-primary venues. In a recent one-week period, for example, 47 percent of trading in Hiscox took place on the London Stock Exchange, while three other venues accounted for between 7 percent and 35 percent of the remaining volume. This shows how brokers now have an increasing obligation to seek out liquidity across the fragmented marketplace to achieve the best price. I suspect that as venues expand the breadth of coverage they offer in order to compete, we will also see increasing frag-

mentation of liquidity in other key European indexes.

and offer) price and a consolidated tape of latest prices from all the regulated stock exchanges. There is also a single clearing and settlement service operated by the DTCC and, of course, a single currency. Europe, in contrast, has none of these things, so there are many more operational and technological challenges to overcome.

So, what are the key factors for efficient operation in a fragmented marketplace—especially one where many “rules” are open to interpretation and market forces?

Activities such as price discovery, pre-trade analytics, smart trading, post-trade analytics and compliance (for both best execution and market abuse) are just a few key areas that are affected by a fragmented marketplace. An integrated, coherent and holistic approach is critical to the long-term viable success of a business.

Market aggregation and price formation (a European Best Bid and Offer) is critical to price discovery and the decision of where to trade in a fragmented marketplace. Activities like smart trading, smart order routing and algorithmic trading rely not only on a consolidated or benchmark price, but also on an integrated and consolidated view of volume, market impact analysis and best execution reporting.

Should the market find solutions to the problems itself or should the regulatory bodies prescribe? That debate will run and run, and “MiFID 2” may even deliver!

Maybe in some areas the industry needs help. For example, a neutral, Europe-wide symbology masterfile would enable the industry to lower the costly burden of integration and realize more of the benefits that MiFID set out to achieve.

Today's challenges are not just technological. They are more about adapting to an ever-changing market landscape and evolving regulations while delivering targeted business workflow solutions in a coherent manner that leverage value across an entire trading operation. ■

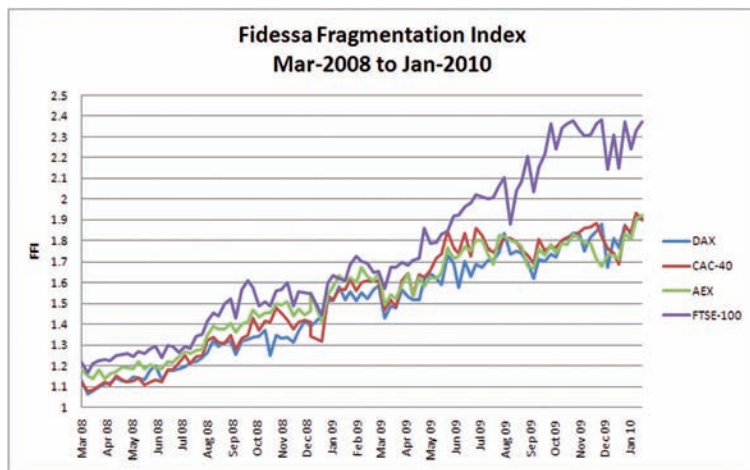


Fig. 1: The state of fragmentation for leading European indexes.

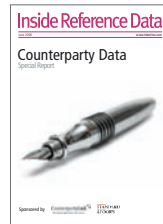
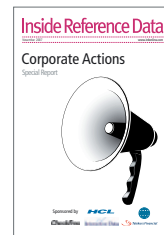
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