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OPEN PLATFORM

A Pivotal Role

Without technology, there would be no modern securities business management.

In the late 1980s, the role of technologists within brokerage firms was one of addressing problems identified and prioritized by business managers based on tactical economic considerations. As technologists gained experience and the front office adopted more technology in the 1990s, a shift occurred as technology began to be used to deliver a competitive edge, especially with institutional clients. However, one thing that has not changed over the last few decades is the eternal question: Should firms build their own solutions or contract with vendors serving specific products?

Over the next five years, brokerages will need to take a more dramatic, enlightened and calculated approach in answering this question.

Business and technology teams will need to look beyond product-specific tactical solutions, which have generally been home-grown, to a much more strategically focused and multi-product set of solutions that includes active vendor review and integration. This multi-product approach ensures that mission-critical needs are deliverable in a timely fashion.

New Challenges

After dealing with Y2K, the introduction of the euro and decimalization, the securities industry is much more demanding and competitive. Regulatory issues drove many technology initiatives in recent years, but new techniques and capabilities in the technology have led to a new dimension in the technologist's role in the evolution of the securities business.

With much of that experience behind us, it is clear that the active involvement of chief technology officers (CTOs) and their technology managers working with more informed line managers is critical to successful business progress.

Over the last two years, and for the next several years, the pace of change and the challenges that it represents will touch nearly every aspect of the securities business. Running the gamut from market structure changes, such as Regulation NMS in the US and the Markets in Financial Instruments Directive (MiFID) in Europe, the regulatory influence continues to be felt and mandates wholesale change. These changes, due to their pervasiveness, will affect all customers, brokers, exchanges, ECNs and other liquidity providers. The regulations will also foster the need for technology solutions that will enable firms to continue to develop more sophisticated capabilities, provide more documentary evidence of execution quality and improve cost efficiency.

New technology, and the technologists who manage its implementation, will require more rigorous planning in order to meet clients' diverse and global needs.

The industry has already seen execution trading aggressively embrace the adoption of newer techniques, such as electronic access by institutional and retail clients in the forms of direct market access (DMA) capabilities and algorithmic trading.

It may have started with trading US equities, but now this capability is used for international equities as well as listed options and futures. Foreign exchange (FX) and fixed-income markets are also embracing the changes enabled by standards, such as FIX, to accelerate electronic trading.

Hot Opportunities

As exchanges pursue strategies to promote their continued viability, and ECNs continue to evolve as Regulation NMS implementation nears, the dark pools, or automated trading system (ATS), phenomenon continues to mushroom.

Will each organization need to build its own "smart router" to navigate through a series of dark pools and then exchange public quotes? What will best-execution statistics look like and how should brokers document their decisions?

The technology in this arena may need to be built, bought or outsourced depending on a variety of priorities. This is a technology decision with definite business implications and overtones.

Beyond this variety of choices for seeking liquidity, brokers continue to see an increasing variety of execution options used to control order flow by program trading desks, block trading desks, sales traders' DMA options and algorithmic strategies. Even institutional and retail clients are reserving the right to use these strategies.

The broker's challenge is to support a range of clients with services that give them the latitude they require while enabling the broker to optimize all order flow overseen through best-execution and transaction cost analysis (TCA) tools.

Brokers are competitively challenged to charge a variety of commission rates for these options and monitor client profitability. These tools must provide compliance oversight, enable evaluation of their performance and provide their clients with data that hopefully shows increasingly improved results.

The Rise of Hedge Funds

The hedge fund community continues down the path of multi-asset-class strategies more actively year on year. As they do, they apply more and more quantitative techniques and electronic trading means to meet their need to act quickly to take advantage of market disparities. These strategies may primarily call on their prime and executing brokers to enable them to execute a variety of asset-class strategies individually or in concert.

Beyond that challenge, some hedge funds are adopting multi-asset-class front-end execution management systems that enable them to pull the trigger on these strategies based on complex analytics and broad-based market data feeds.

Technology's role has evolved from initial problem solving to leading-edge capabilities that make newer strategies possible through their power and cost-effective delivery.

Due to this reality, brokers must examine their products, people, operations and technology to rationalize the range of services they intend to offer to a client base with diverse needs and appetites.

This is no small task, especially where tactical decisions for the current month, quarter and year can overshadow the need for investments in technology and people.

The brokerage business—especially the trading and sales portions—needs to be viewed with a "total cost" mentality and analyzed from an expense and revenue perspective. Perfecting tools and services to meet the most demanding clients' needs must be subsequently leveraged with all accounts to effectively scale the costs into the model.

Technology and the collection of data for analysis must be brewed together to link front-office and operational information by client, by sales trader and by market to create a comprehensive picture of revenues collected, processing costs incurred and net revenues retained. The cost per trade—long sought by most and effectively determined by few—must be conquered in order to have effective client profitability and internal product margins tracked, managed and factored into the overall product mix of the brokerage community.

Now, as never before, the industry and its technologists face the challenge of acting as both arms-length vendors for their users and evaluators of external third-party products. An ongoing commitment to test new products, cultivate vendor partners and create an interchangeable or componentized best-of-breed environment needs to be pursued in an organized and ongoing fashion. The challenge of the future is to seek the most cost-effective, timely and multi-product solution set available.

It is highly unlikely that any organization has the personnel to create and implement all of its own solutions cost-effectively and in a truly competitive timetable. Technologists must embrace and perfect this evolving role as equal members of the management team to truly serve the overall best interests of their respective organizations in the future.

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