

GROWTH

## The Advance of IOI Distribution Solutions



*By Paul Scott, Director, FIX CITY*

**IOIs (indications of interest) in a stock, play an essential role in the search for liquidity in securities for buy-sides and in the provision of liquidity for sell-side firms. However, in the large and increasingly fragmented global market, the efficient management of IOI messages can be a major challenge.**

IOIs enable brokers to keep their clients informed of trading opportunities by providing an opening, but not binding, indication of interest in shares to support negotiations with buy-side firms. IOIs also allow buy-side firms to see which brokers have liquidity in the securities they want to trade, decide where to place orders and help demonstrate best execution. However, finding the most appropriate brokers to trade with is not always straightforward. With more than 300 sell-side firms in the US alone, delivering hundreds of thousands of messages

throughout the day, on a daily basis, to around 500 US buy-side firms, effectively managing the sheer volume of IOI messages is crucial. This is particularly important as the number of IOI messages grows and increasing numbers of firms trade on a global level, accessing liquidity from domestic markets and overseas territories.

While some large brokers have developed proprietary technology for the creation and sending of IOIs, the majority use vendor tools to create IOIs from orders they

receive. When the IOI has been created brokers use vendor distribution systems to carry the IOI to their clients. These vendor solutions have typically charged per message to broadcast the same IOI messages to a large number of buy-side clients, encouraging large volumes of messages in order to maximize profits. However, this approach can be expensive and can clutter buy-side systems with irrelevant IOI data.

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Buy-side solutions revolve around either vendor solutions, which carry and present IOIs to the buy-side trader, or the use of the FIX Protocol to allow the IOI to be sent into the buy-side's Order Management System (OMS). Traditional vendor solutions offer little in the way of filtering, that is, technology that allows buy-sides to manipulate the view of IOIs they receive by various attributes including specific securities, geographies or sectors. As a result, new and innovative solutions, offering a more cost effective and intelligent way of delivering and utilizing IOIs, are transforming the pre-trade operations of buy- and sell-side firms.

For example, the latest solutions offer per-destination pricing and targeted IOI distribution. This pricing structure can be more cost-effective as it does not penalise brokers for their IOI distribution. Brokers can cancel IOIs when they have traded that stock and replace IOIs when the amount or price has changed without financial penalty. This means IOIs are more likely to be kept up-to-date and ensures buy-side dealers are immediately informed of changes.

### Targeted messaging

While per-destination pricing models allow brokers to send traditional IOI broadcasts to large numbers of dealers, they also allow targeted messaging or 'narrowcasting' of IOIs to small groups or individual destinations. Finely targeted IOI distribution can be used to quickly identify potential trading partners, maximising the chance of securing orders.

Brokers are able to 'narrowcast' the distribution of their IOIs, targeting individual organisations with much shorter expiry times, knowing that if the targeted buy-side firm is interested, the IOI will be matched with an order, and responded to. However, if the broker doesn't receive a response or match, they are then able to cascade messages through their client list, without incurring additional costs.

### Fishing – the IOI legacy

In the past, the reputation of IOI distribution solutions has suffered because of the misuse of IOIs by brokers 'fishing' for business, that is, sending out IOIs for stocks that they didn't have orders to support, in the hope of winning that business and then finding the stock to fill the orders.

Due to the propensity of 'fishing' in the US, some buy-side players began to question the reliability of the IOI data they received. As a consequence, many buy-side firms preferred to rely on trade advertisements (TAs) as opposed to IOIs, to determine whether a broker was active in a stock.

TAs are used by brokers to advertise their completed trades in individual stocks. They provide a useful barometer of market activity as they reflect actual business conducted. Just as TAs identify which brokers have recently traded in a particular security, they are also useful in the search for the most unusual, or illiquid, securities.

The latest vendor solutions offer the ability to view TAs and IOIs in correlation. This functionality can help to highlight when a broker might be 'fishing' for business – for example where they have sent an IOI for a stock, but have subsequently failed to advertise completion of the trade, by following the IOI message with a TA.

### An end to hide and seek for IOIs

Traditional IOI distribution solutions offer limited functionality for IOI selection. Nowadays, IOI screening technology gives buy-sides the ability to focus on what is most important to them. By filtering IOIs on specific securities, geographies, sectors or attributes, they can significantly enhance their ability to streamline incoming IOIs and improve pre-trade efficiency. By carefully targeting IOIs at selected clients, brokers are able to increase the likelihood of them being turned into orders.

The latest IOI distribution solutions also enable buy-side dealers to proactively watch IOI activity in selected securities. Dealers can be alerted when liquidity appears for stocks in which they have specified an interest, without the

need to refresh or search manually, enabling them to concentrate on their core trading activities. This functionality significantly improves dealing desk performance as it allows them to concentrate on the trades themselves, without the headache of trawling through irrelevant pre-trade messages.

### The role of FIX

The wide-spread adoption of the FIX Protocol and trading tools in the US has led to greater levels of automation and straight-through processing for buy- and sell-side firms. The FIX Protocol has largely replaced the need to develop proprietary systems, providing system interoperability and reducing integration costs.

FIX has also aided the efficient distribution of IOIs. FIX compatible IOI distribution solutions can be easily integrated into an existing FIX infrastructure with no additional hardware or software.

This compatibility is aiding the growth of a global trading community with many firms using a single global FIX architecture to send messages between countries, without the need for additional connections. As a result, IOI distribution solution providers that use the FIX messaging standard are establishing global offerings and providing access to a global community of buy- and sell-side firms. US brokers increasingly have connectivity to buy-side firms in Europe, and vice versa.

**A FIX IOI feed enables firms to run complex trading models based on IOI data...**

### The direct route – OMS integration

The US market has seen a proliferation of buy-side OMS in recent years. Streamlined distribution via OMS is now achievable as buy-side firms are able to receive IOIs directly into their OMS. However, with the large volume of IOI messages being sent on a wide spectrum of securities, this can be an additional burden for the OMS. The latest IOI distribution systems can deliver IOIs via a consolidated FIX feed that will intelligently filter on stocks of interest. This is an important development, as although many OMS have the functionality to receive IOI and TA messages; few buy-sides have connectivity to their complete broker community and it is not the job of the OMS to maintain historical data. A FIX IOI feed enables firms to run complex trading models

based on IOI data, to raise orders on the back of IOIs using their OMS connectivity, and reduce errors caused by re-keying data.

However, the melding of IOI distribution solutions and FIX-enabled order management systems is in the early stages of development. Buy-side firms would greatly benefit if they were able to receive IOIs targeted specifically to them, and, through an IOI solution linked to their OMS, be able to see these against their orders that an IOI was available. They could then nominate to send the order via FIX back to the broker, referencing the IOI that had been sent. Unfortunately, this capability only exists in an ideal world. In reality the IOI is rarely targeted so narrowly, so the buy-side dealer could end up exposing their position after the broker has already traded with someone else. Currently, the ability to link IOI distribution solutions into the OMS allows dealers to search for liquidity directly from their order blotters, or load the stocks from their blotters into their specific watch lists. As IOI distribution solutions continue to evolve however, the level of integration with OMS – for increased pre-trade efficiency – is expected to increase.

### The next generation of IOI solutions

New IOI distribution solution providers have rapidly grown their user community by offering lightweight, scalable and easy to use solutions. For brokers without FIX connectivity, IOIs can be inputted via a web interface and viewed by buy-side dealers. Browser-based solutions require no minimum hardware and are invaluable for smaller brokers that have yet to implement FIX.

Gone are the days of IOI solutions that are difficult to integrate, time consuming and that offer limited functionality. The latest solutions have significantly advanced the delivery and presentation of IOIs so brokers are able to target messages and develop effective IOI distribution strategies. Today's IOIs are more reliable and significantly streamline the buy-side dealers' search for liquidity, improving the efficiency of dealing desks and significantly reducing costs. **FIX**

### **Any thoughts on this or other articles?**

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