

## FIXAsian Roundtable

19 February 2004,  
The China Club,  
Singapore

In February, nine of FIX Asian's leading lights got together at the China Club in Singapore to discuss 'FIX past, present and future'. The group held a long, lively discussion ... we reproduce just a snippet of the evening's conversation here ...



Brook Teeter



Chris Biscoe



Kent Rossiter



Kevin Milne



Francis Lee



Dan Tan



Michelle Yeoh



David Klinger



Michael Tan

**Chris Biscoe (CSFB):** Thank you all for coming and thank you to CSK and to Reuters for sponsoring this event. This is the third FIX Asian roundtable; and having gathered a pretty broad group of industry representatives together for this event, I am curious to know what everyone thinks the industry is going to look like in ten years' time?

**Kent Rossiter (Allianz Dresdner Asset Management):** I think sales traders and sell-side dealers provide a very valuable service. If you didn't have the sales traders, then there would have to be a lot more resources on the buy side. I cannot handle a huge amount of orders on a DMA basis where my traders are actually hitting a bid or lifting an offer a hundred different times for one single order. That's why we rely on sales traders to give the proper instructions to the sell-side dealers.

We get serviced by many different brokers and its never the same broker who has the story first. We are always going to need these brokers to give us the information; something that a DMA engine wouldn't be able to do.

The other side is that a lot of the big brokers are coming up with programs that can trade for you, whether it is a VWAP? target or any number of other benchmarks. I am wondering if ten years from now there will be the little guy on the street who actually beats the system because he can see when a system is programmed and moving the market in one direction. So he just waits patiently, aware of the systemic nature of what is happening. I think that could happen, when the order gets too far away and you don't keep watching them.

Actually, I think that is where my own traders add the value just by watching and being patient. Some brokers use one-third of the market volume every day and they just keep doing the same thing. You can either get ahead of them or keep pace.

**Brook Teeter (E\*TRADE FINANCIAL):** So you think we are a long way away from having artificial intelligence that can replicate what sales traders do?

**Kent Rossiter:** Well, it's not like there's 'one' uniform type of artificial intelligence, like one identical broker in the whole market. The brokers are all developing their own, highly specialized artificial intelligence. At the end of the day, we are trying to replicate what a sales trader can do for a dealer, but I don't know how successful it will be. Probably it's going to take more than ten years. It may work very well on balance for index-related purchases, baskets, or small maintenance-like trades, but maybe not as well for harder single stock situations.

**David Klinger (CSFB):** Yes. I think that these things are tools and all they're designed to do – like FIX – is to increase efficiency. So if you received an order to buy 50,000 Cheung Kong over the day, then it's very hard to add any value; these automatic trading systems add value because they do a reasonable job of automating the simple execution aspect of trading, nobody has to watch them and you can focus on the harder orders and bigger orders. The sales trader and execution dealer can look at the market and give you the sort of feedback that you will say is valuable. For example, what's

happening on the breaking story? What's new in the market, and those sorts of things?

I don't think algorithmic trading will ever replace that. All it will do is actually free people from the clerical aspects of trading so that the value-added actually becomes more focused and specialized. If you look at what sales traders, and most traders in general do, half of their day is spent doing reasonably menial stuff: sending orders out, giving instructions – not a huge amount of value-add. Then there's the other side, where they are actually doing the value-add, which is watching the market, taking a view, holding, etc.

So if you can use the technology to make people more productive and take away the more menial part of the job, then I think the value proposition becomes much more compelling. *NB from editor: a lot of value added and repeating here.*

**Chris Biscoe:** As a broker I can't help but agree. However, algorithmic trading is already beginning to replace human intuition and experience in the markets. We've done it. I know one hedge fund that's New York-based that has three T3 lines serving its data requirements – all of this in order to feed into its central processing system, their brain. That's an enormous amount of data, and what they are doing is to try to take an immense amount of data and compress it into discrete trading components that help give them an edge.

There is a subsection of our industry that's already decided algorithmic trading can make them a lot of money. Whether they're right or not – they're very large, but I think their margins are very small. It's the LTCMLong tTerm capital management model, finding nickels between the cushions.

But to me, as more and more of us adopt that model, the market becomes skewed and I would imagine you're going to see a lot more volatility in a market is going to be a lot more erratic as engines try to emulate human behavior, and humans try to then interact within those engines.

**Michael Tan (Morgan Stanley Investment Management Company):** I think everybody is talking about the day when machines will replace dealers executing trades. I share Kent's view in that there would still be a need for a sales trader, a human being at the end of the line to pick up the call, to do the trade, partly because I think humans add that element of unpredictability in the way we trade. That element of unpredictability gives the market its vibrancy, and that's what keeps the market alive. There may come a time when sales traders become just managers of systems, but we would still need their background in being able to trade – to intervene if necessary.

**Chris Biscoe:** But are we changing our focus in the industry? It seems that maybe not even five years ago, there was a lot less emphasis on the prints you got over the course of the day: we are now able to measure intra-day trades and apply them to real-time benchmarks in a way that we certainly could not do, because the systems were not there. Does that change the way in which not only traders, but also portfolio managers look at the process of buying and selling in the market?

**Michael Tan:** I think managers are getting more input from the market on the direction, trends and flows. Therefore, it is likely that the managers would want to use the system more. We could see a true straight through processing line from the time a decision is made all the way to the settlement, that is all done electronically.

You could see that kind of scenario, but what happens if you have too much information, then what do we do with it? Are you going to have another machine to manage all that information? Where does it end?

**Brook Teeter:** I agree. I don't see the whole idea of sales traders and the added value that a human provides to the whole process going away any time soon. From a systems point of view, what can the industry do to help facilitate all this data flow and myriad of information, and how can we make the systems better for both buy-side traders and sell-side dealers?

**Dan, from Reuters, you have obviously been in the data business a long time. What have you done with your systems to help facilitate and make easier to decipher some of this information?**

**Dan Tan (Reuters):** It is still back to the very basics. It's the ease of use and the connectivity to the community, providing the right size and segmented data with relevant analytics and trading capabilities. The community, either the buy- or sell-side must be able to connect to their business partners and global counterparts globally electronically at a reasonable cost. With Reuters Institutional Order Entry, you can trade with more sources – you can reach a wide range of brokers, exchanges, crossing networks, automated trading systems and electronic order modules. Over 400 Institutions and Broker/Dealers rely on Reuters Institutional Order Entry to successfully execute trades to institutions worldwide. Our system enables institutions to download single or basket orders for delivery to any participating broker; set limit orders and easily import files from modeling or portfolio accounting systems.

**Michelle Yeoh (Reuters):** For a long time, we thought that providing raw data to the end-user was good enough. We

have now started streamlining it exactly to how the person requires it. Take for example, news. Although the coding is still Reuters, it specifically tells you that this coding is really meant for a particular market segment, e.g. equity or fixed incomes. There is some form of streamlining by Reuters; first of all we try to understand what you do day to day and what you require and when you require that piece of news. For example, say in the morning you require only this segment of the news, that impact the market or asset of your interest you can selectively display this on your Reuters screen in the morning itself. This is one example in which we use technology to enhance our data, but basically it is still pure raw data; it's just the way we intelligently display it.

Another example is, from the same piece of code or data you can easily connect to Reuters Institutional Order Entry system, which allows users to trade electronically with a range of brokers, exchange and crossing networks. With a network linked to virtually all major institutions, Reuters takes advantage of its unique positioning in the industry to offer widespread connectivity between institutions and brokers. Reuters' design allows clients to easily access any existing broker on the network from their Reuters workstation or PC. With each order, a single click allows for selection of a broker. Once sent, orders are quickly delivered to the broker of choice

**Brook Teeter:** Kevin, you have been surprisingly quiet, what are your thoughts on the future of electronic trading?

**Kevin Milne (formerly Macgregor):** I think when you ask the question, 'what's going to happen in the next 24 to 36 months?' it is really an easy answer. When you start to get to five years, it becomes a bit more vague and when it comes to ten years, it becomes fundamentally more interesting.

I think in any economic structure, especially a financial economic structure, there are three key vectors for change: fear, greed and regulation. In the short term, you look at fear and greed and I think what we've seen in terms of progress, if we can assume it to be progress over the past five years in this place, everything has been driven by fear and greed, and it's the model of the buy-side and the sell-side.

The buy-side asked for lower commissions, fast restitutions to the sell-side into developing automated execution services, and direct access, because they just can't afford to have US\$300,000 of sales trader answering every telephone call.

In my view, and it's a personal view, over the next ten years, fear and greed will become less important and regulation will actually become more important.

The regulators are now starting to look at the industry. The technology has run ahead of itself to a degree. There is the technology, as Chris rightly points out, that will basically get rid of everybody's job around this table. There are ECNs, ATSS, direct market access mechanisms, benchmark execution services, advance execution services. All of that stuff is out there.

But the reality is that the buy-side is not ready for it, the buy side is unequipped for it, and the buy-side doesn't understand most of it. There may be isolated pockets of that, but there isn't a true understanding of it. I came from a three-hour meeting this morning with a fund manager who says, 'Yes, I want to do this, but I'm not worried about the electronic trading yet because that's probably not going to take off.' Now, that's in Singapore, which is one of the most advanced electronic market places in Asia, and this is a big firm. So to a degree, I think over the next ten years, one driver is going to be the regulators that are starting to look at the whole market structure and how stuff happens. Regulation comes to a point in most markets that we have to look after the investor; we have to make sure that the client doesn't get screwed. The bulk of the regulation in place in the US, Asia, the UK and Europe recognises the fund manager as being the clients.

The new regulation will recognise that the fund manager isn't the client and the fund manager is actually the pension fundholder; it's me providing for my future. And in terms of screwing people over, fund managers have a much, much greater opportunity to strip me than a broker ever would. So I don't want to be protected from the brokers, I want to be protected from the fund managers. I want to be protected from market-timing abuses. I want to be protected from inefficient and expensive processes.

I want to understand why, when I want to move my pension fund from place A to place B that my transfer value is 75% of my net contributions. That to me, as an investor, does not make sense and a lot of the regulation that is put in place is going to support that view. I think that will fundamentally change the market structure. It will force fund managers to become more responsible, they will not be able to abdicate best execution responsibility to their broker; they will have to assume that responsibility themselves. They will be forced to look at new execution vendors, but they will want to do it on a cheaper basis. The only way you can do it cheaper is to do it electronically.

So the sales trader, by definition, could only be used for those trades in which you can add any value because the only way that these guys on the sell-side and other execution

venues can provide you lower cost-effective trading services is to cut out some of the costs and those would be staff costs.

So to a degree I think you've got to be careful what you ask for, because you might just get it. I think the focus in the next ten years is going to be a fundamental change in sharing the responsibility in the fund management sector. The brokerage sector has been squeezed incredibly over the past ten years and it has created fundamental changes on the sell-side in terms of how they look at things, how they do things, how they operate. The next ten years are going to be focused on the buy-side.

**Francis Lee (CSK Software Singapore Pte Ltd.):** I felt that the fund managers are not very open to using technology. It seems to me that ... fund managers are always – at least those that I spoke with – are very closed, [believing] that “we are in fund management ... we analyse stocks, we analyse equities, we provide our judgment, how we invest the money. We make money to beat the index. When it comes to technology, when it comes to electronic trading, don't talk to me about it, it's none of my problem.” It's the brokers problem. What are your opinions ? If you agree, Why is that so ?

**Kent Rossiter:** But for fund managers' actual position of being an investment manager, that's certainly true. There are probably only a couple of people at only some of the many investment management companies who really understand the business and they might not have the ear of upper management to get the changes to put in place. So I would agree with a lot of that, yes.

**David Klinger:** My experience would be that it's really driven by individuals. Internally within a brokerage shop, you have a handful of people who want to do their stuff and most people are like, ‘You know, I like the way it's being done now, I don't want to change it’ and it is exactly the same with fund managers. You have a few people who sort of see the light bulb going on and say, ‘This is how we've got to go and this is how we've got to grow the business’, but a lot of people are set in their ways. They like doing it, they like what's always worked; they don't have to think about. It's a lot of extra work to go and get all this technology installed.

**Kent Rossiter:** It's a huge amount of extra work. Once again, easily 90% of the people in our industry would rather just go with the status quo.

**Chris Biscoe:** What we're talking about is trimming the fat. Do you agree that the industry can regulate that fat off and

still preserve itself in the form that still looks recognizably like what we have now?

**Kent Rossiter:** I think that is something we have to be careful of; you can become over-regulated. Let's take the example of ECM activity in the US. America has always been tough on new issues, but five years ago if you had an IPO in America you could actually get information from the broker.

Right now, brokers are scared to divulge anything beyond the name of the company. Getting information on any deal is extremely complicated. Even if it's public, in a prospectus, the only way you can get it is in a hard copy. US brokers won't send it. They just have to tell you to refer to the prospectus.

So you are trying to make a smart decision about investing in a company and you can barely find any information about the company because you don't have the prospectus. But you might be interested in the deal. How can any broker send out 50,000 prospectuses to every potential client? This is the type of thing that is over-regulated.

**Chris Biscoe:** So are we seeing electronic trading as a revolutionary force that is trying to replace an old system that is outdated and no longer functioning the way it should?

**Kevin Milne:** I think that is a means to an end. I've been involved in FIX for about a year now. When I first joined somebody asked me, ‘how do you figure out whether FIX is successful?’ And I said, ‘the first time you know a FIX implementation has been successful is when people stop talking about it’; it is just a means to an end and the ability to communicate trading information, be it orders, executions, information, advice, whatever. As soon as you can communicate that in a secure audit-trailed way then that's fantastic. That's what FIX will enable you to do.

**Chris Biscoe:** We have this other triumvirate of factors that seem to be having a profound impact on the direction of electronic trading: We are coming out of a vicious bubble – one of the worst we've seen in a long time. Consequently, we're seeing a high degree of regulatory scrutiny. The increase in regulation, coupled with a changing funding model, forcing execution to be separated from execution and the explosion of electronic trading seem to be causing the industry to be almost schizophrenic in the way it reacts to a changing environment. What seems certain is that the cost structures currently supported by our industry, in particular the brokerage industry and the way in which research is funded, are fundamentally unsupportable in today's low commission environment.

Electronic trading is putting up its hand and saying, 'I'm an answer to that' but of course it's not. It isn't yet a facility. Electronic trading cannot and will not address the question of the economics of research and how it is funded.

I walked through a client's office three days ago and was just astonished by the number of trees that had been killed by all of our firms in order to put research reports on their desk every day. So how do we come to some sort of valid resolution, and is there any way to do it peacefully? Electronic trading will only make the schism more apparent, but is not, in itself, an answer to the problem.

**Dan Tan:** As so many people want to provide for the fund managers' needs, from vendors to the brokers, so it may be that now they have ended up being overwhelmed by all this research and other supporting services. So the value of it is really dropping in that sense.

**David Klinger:** Well, that's sort of what Paul Myners came out with in his report in consultation paper 176 that the FSA put out. Are you guys, the fund managers here, seeing pressure to justify your brokerage commissions, by actually splitting up what you want to pay for research, and what you want to pay for executions. Are you seeing that in a day-to-day sense in your organisations here?

**Kent Rossiter:** in a very minor way. It's not widespread. I've talked to a few of your fellow brokerage firms. Some of them will pay for what they call executions, but for the most part, your bread and butter is still going to be the standard full service rate paid by investment managers.

**Michael Tan:** But a lot has to do with the way the broker selection process works. Do you select a broker based on his research, his trading, or his operational capability? Do you want to be transparent in all the information as it is currently accepted, revenues are amalgamated so a broker could not attribute which part of his revenue comes from trade execution or other areas. So that part is still grey; but as Kevin is saying, maybe regulations may open that out one day.

We also have to remember that clients and regulators may want a say in this. This is the whole issue of unbundling that the market has been whispering about.

**Francis Lee:** Electronic trading cannot completely replace the human touch in trading. However, it could only introduce a more efficient and cost-effective medium to enhance the productivity of brokers and fund managers alike. It minimizes the time spent in dispute handling, order execution,

matching and reconciliation activities. It puts more time in the hands of the sales traders for value-added client servicing to take place. Most importantly, it brings down the cost of operations and overall it makes investing less expensive. Can't wait for the day to come!

**Dan Tan:** What are the current criteria for selecting brokers? Is it simply efficiency?

**Michael Tan:** It depends on the fund managers. If a fund manager is mandated mostly by benchmarks, then it is likely that the heavier weights will be given to research, but for fund managers that are more hedge-fund-oriented, there will be more executions, fresh ideas, those kinds of things. So it all depends.

**Chris Biscoe:** I think the hedge funds don't have fundamentally different selection criteria. It has come down to price and performance whereas, it is figuring out some soft mechanism for pricing in research. Can the industry support a model for research that is based on some sort of hard commission?

To me, that's where the rubber hits the road in this whole discussion: is electronic trading driving open all these other issues about the way in which we are all compensated, the way in which we function and it seems very normal to us, but clearly from the outsider looking in, like the Myners' report, it seems like something is wrong here.

**Kent Rossiter:** Again, obviously the US back in the early '90s went through a lot of this painstaking process that seems to be going on in London right now with the unbundling, with the FSA, the CP176 report. They got through it. You wonder now whether the same thing is going to happen in London again. I do not know if that means more education, if fund managers need to explain to their clients why they are getting this research or why the research is necessary in general. Again, perhaps the whole thing will just blow away? ... **FIX**

*The discussions continued for another couple of hours ... Many thanks to all who took part. The Asian FIX committee will be arranging future roundtables.*

*If you would like to sponsor or participate, please contact Edward Mangles at [edward@fixglobal.com](mailto:edward@fixglobal.com).*