

# The expanding role of FIX

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**Charles River Development is an active member of FIX Protocol Ltd's European working committee and a forerunner in implementing FIX for fixed income. As such, both TradeWeb and MarketAxess selected Charles River as their first order management system (OMS) collaboration. The following is a discussion on the expansion of FIX – beyond Equities and beyond Fixed Income.**

As investment managers continue to look for ways to gain maximum efficiencies from their trading cycle – from decision support through to trade settlement – the FIX Protocol is poised to be a winner. Today, as an industry, we conduct a considerable portion of global equity trading via FIX, and the success of that model has already helped to spur use of the FIX Protocol for other trading activities. Over the past year, we have seen FIX trading increasingly permeate the world of fixed income. However, unlike the equity markets, where access to liquidity sources was the primary motivating factor, it seems that the push for the adoption of FIX for fixed income stems not only from the desire for liquidity, but also from the desire to take advantage of the efficiencies offered from straight through processing (STP). Today we are seeing investment managers actively trying to be more efficient in terms of how they connect to liquidity sources, regardless of security type. Therefore, as electronic accessibility improves and usage increases, it is only natural that FIX will continue expanding in two major areas: 1) FIX will branch out to handle

additional instrument types (currencies, derivatives, etc.) and 2) more phases of the post-trade cycle (allocations, confirm/affirm processing).

## **FIX for foreign exchange**

As FIX expands across different instrument types and liquidity venues, investment managers will no longer be forced to search for liquidity manually; managers will be able to electronically trade liquid instruments and smaller orders that require little to no manual intervention. Electronic trading allows easy, simultaneous interaction with multiple sources. The implementation of FIX not only provides managers liquidity access that is efficient, but also allows their organizations to take advantage of a centralized approach to dealing. For example, investment managers can track and manage all securities trades in one central internal source through an order management system (OMS) that supports all currency and security types. The OMS allows managers to centralize their trading operations and external

communications and, using FIX, route trades to multiple dealers or other sources of liquidity. This electronic interaction aids the back office because both parties capture all the details of the trade electronically as part of the execution process – the result is a reduction in manual errors, an improved audit trail, and a streamlined workflow. We are just starting to see this interaction for fixed income trading. As investment managers become comfortable with the method (as have the equity managers), volume will rapidly increase. As this volume increases, and as cross-border electronic trading becomes prevalent, a corresponding requirement for foreign exchange (FX) trading is likely to develop.

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Use of the FIX standard for FX trading is still in its infancy. Despite the fact that FIX has supported elementary FX trading since v4.0 and a number of institutions and brokers have been trading FX via FIX for some time, adoption has been slow. That is beginning to change with the FIX Protocol Organization's recent (December 2003) formation of a FIX Foreign Exchange working group. FX managers are concerned with increasing trading costs and shrinking margins now more than ever, and FIX is a viable solution. The adoption of FIX provides several benefits to FX managers, including:

- Access to a larger liquidity pool;
- The ability to centralize FX dealing within the OMS (which centralizes FX dealing for the instruments being dealt);
- Faster time to market, which reduces exposure to fluctuating interest rates; and
- Increased volume, which can translate into better rates.

To make FIX for FX a reality, OMS systems will have to be able to interface with both traditional FX market makers and the myriad of new FX electronic trading venues. In addition, the industry will need to develop a standard, simple workflow that will work for both environments.

FIX must support three primary transaction types for success in the world of FX trading:

- Spot trades;
- Forwards;
- Swaps.

Spots and forwards should be easier to implement than fixed income securities because it will be easier to identify 'securities' using the EBS (Electronic Broking System Ltd) format of 'CCY1/CCY2' and a value date. In addition, the FX trading environment generally uses a simplified workflow. Much like fixed income, FX trading only requires a price to complete a trade and with infinite liquidity, there are few (if any) partial fills.

Implementation of FIX for FX does not seem to require anything additional beyond the needs of the equity world. Investment managers should be able to piggyback off the standard equity FIX infrastructure; however, the ability to get FX quotes from market participants is a consideration.

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Before we see widespread adoption of FIX for FX, a number of issues need to be resolved. These issues are mainly because, until now, there has not been any standardization in FX trading and the use of ECNs for FX trading is new.

- Allocation level trading versus block level trading – Should the OMS send pre-trade allocations to the ECN and then the ECN roll them up into block trades?
- Allocation netting versus block netting – Should the OMS have the ability to net all trades (buys and sells) per currency pair at the allocation level, and send a single trade per allocation through to the counterparty? Or, should the netted allocation trades be further rolled up to a single trade for the currency pair, which means that the counterparty will receive a single block level trade and a number of allocations which can be either buys or sells for that currency pair.
- Initiating the trade – Should the OMS send FX trades to the ECN as each FX trade is generated at the OMS,

or should the FX trader make the decision as to when to send his/her FX trades? If the latter, the OMS will net all of the trades before sending it to the counterparty.

- Allocations – How should allocation and settlement details reach the counterparty? As pre-trade allocations, or as post-execution allocations?

To resolve these issues, the new FIX for FX working group will attempt to move the industry towards a limited number of standardized workflows. Hopefully, they can leverage the infrastructure and experiences of their predecessors in equity and fixed income.

### **FIX for allocations and the path towards STP**

Just like FIX trading messages (orders and executions) need to be tested and certified with trading counterparties, so do FIX allocation messages; each counterparty might have slightly different message formats or workflows. In addition, depending on the execution venue, the recipient of the allocation message could differ from the original target for the source order.

The utilization of centralized trading venues (such as TradeWeb or MarketAxess) can assist in standardizing messages across many sell-side brokers. Instead of having to implement and test with many counterparties, the trading venue acts as a hub and provides a centralized point for implementing a FIX allocation workflow. However, these trading venues will not cover all brokers with which a buy-side manager might want to interface, so there will still be a need to interface with individual brokers directly. While there is widespread use of central post-trade utilities (Oasys, Oasys Global), there are still many parties not using such systems and the systems do not cross all investment types. As a result, the use of FIX allocations as a standard mechanism for supplying post-execution information provides even greater value.

When it comes to equity FIX allocations, the current industry landscape still calls for interfacing with many sell-side brokers. The scope of this work can be prohibitive for buy-side clients. However, help might be on the way from two sources: central utilities (such as Omgeo and Swift) and OMS vendors. Once Omgeo and Swift start supporting FIX, they may be able to take on the role of a central hub for equity post-trade processing. OMS vendors will add value by

providing the connectivity with those parties and, in the case that an investment manager does not subscribe to those services, the OMS will provide connectivity with brokers directly by implementing the necessary messages and enabling the corresponding workflows.

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The next evolution of FIX for settlements should include standard workflows for the settlement instruction enrichment and the affirmation processes. It will be necessary to have tools for tolerance matching and exception processing. Today it is a challenge for the three main players of a trade (manager, broker, and custodian) to maintain and access the most up-to-date settlement instructions for a trade. This challenge, along with the need to streamline affirmations, will only grow as the industry moves more and more towards an end-to-end FIX solution.

### **Summary**

- 1) Enabling centralized operations,
- 2) better and easier access to liquidity, and
- 3) the reduction of errors due to the elimination of manual processes, are just a few of the benefits of implementing FIX to achieve STP. While challenges remain, one need only look at the success of FIX in the equity markets to see the benefits of implementing an automated approach to trading that covers the entire trade cycle. **FIX**

*Charles River Development provides financial technology and consulting services to the global investment management, banking, pension, and insurance industries. The company is known for its market-leading OMS, the Charles River Investment Management System (Charles River IMS), which is a comprehensive, integrated suite of portfolio management, electronic trading, order management, and real-time compliance tools for all security types.*