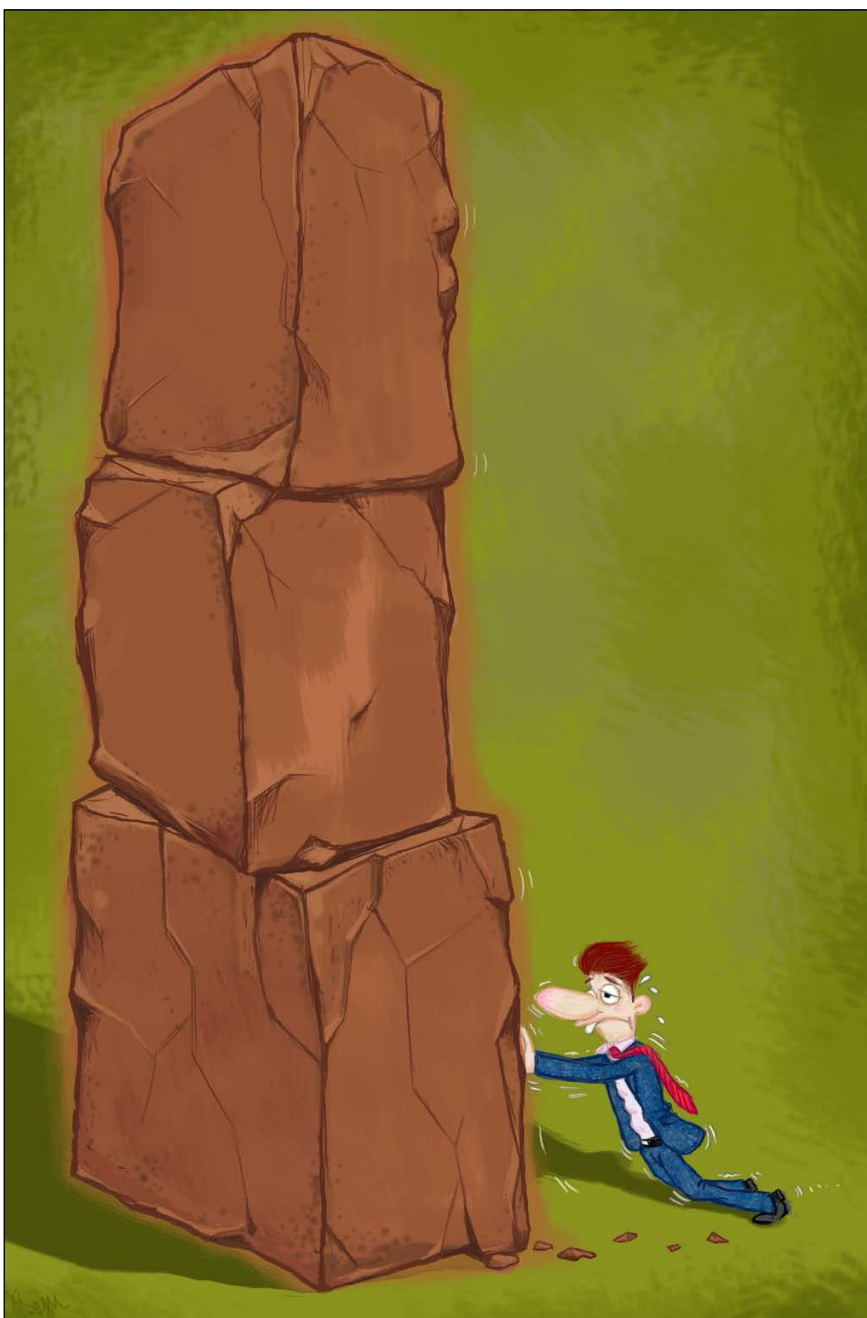


Tackling the Block in the IOI landscape

The value of Indicators of Interest (IOIs) is being questioned and the growth of new distribution mechanisms has actually heightened the concerns with several key problems remaining for the industry, contends Tradeweb's Robert Warshaw.



Problems abound

Dealers are not getting the return from IOIs that they would like. Buy-side firms are becoming more reluctant to interact directly with IOIs because they do not necessarily represent block capacity and there is immediate information leakage. So, while they remain important as guideposts for order management, IOIs are losing their power to drive trades.

The distribution of IOIs is also evolving with a significant increase in direct distribution from specific trading venues -Alternative Trading Systems (ATSs) and algorithms. Regardless of the nature of the distribution, the question is whether block-sized IOIs can increase the likelihood of creating a satisfactory trading experience for both sides.

The biggest problems with the current model are:

A) Uncertain rules of engagement.

Dealers offer IOIs as an invitation to trade while buy-side firms want IOIs to be a promise that a trade will occur if they expose their order. Because there is uncertainty around broker intent, buy-side firms are using IOIs for information purposes but with less willingness to accept the invitation to trade.

B) Unreliable targeting of messages.

Buy-side firms only want to see relevant IOIs on which they can execute. Because dealers cannot know all order flow, too often the buy-side gets buried in irrelevant messages or misses out because the broker has assumed they are not interested in a symbol. This hurts the broker and client.

C) Difficulties in evaluating IOIs.

Even with some of the new representations of IOIs that are appearing on buy-side desks, it is very difficult to determine the comparative merit of one IOI versus another, and to the market.

D) Information leakage.

Many clients are reluctant to react directly to an IOI because

it means showing their hand to the dealer without certainty of response. Good IOIs help set the parameters of a good negotiation. Bad IOIs act as fishhooks to reel in a customer with less welcome consequences. Distinguishing between the two is not always easy.

E) Market fragmentation.

IOIs can come from distributors, direct from dealers or through dark, really grey, pools. Some are integrated into Order Management Systems (OMSs) while others are not. They can be in the form of traditional IOIs viewed through third party displays, FIX IOIs integrated into OMSs, EMSs, IM messages etc. The complexity and fragmentation have increased the difficulty of determining contextual relevance.

Unresolved, these problems will increase the trend that IOIs influence but do not drive order activities.

Fixing the problems

There are plenty of issues but the good news is that vendors, such as Autex, are coming up with innovative ways to move the market forward to a more sustainable model for the industry. The overriding trend has to be to ensure that IOIs provide more intelligence about trading opportunities and more certainty that a direct response will result in a trade within expected trading parameters.

Among the areas of opportunity are:

A) Leveraging FIX to embed IOIs in workflows.

While FIX formatting allows IOIs to become part of the order and execution management processes, a more sophisticated organization of IOI flows can be implemented to strengthen the connection between current IOIs and order decisions. FIX tagging can play a part in this. This is a necessary starting point to increase the usability of IOI flow. Then real-time display, rather than occasional lookups, of current relevant IOIs both are possible and highly valuable because relevant IOIs can be displayed when they matter most within the workflow.



Robert Warshaw,
Managing Director, Tradeweb

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B) Increasing relevancy through improved targeting.

Driving IOIs to buy-side firms based on their actual order intent rather than a guess at their activity is essential. IOIs that are targeted based on actual order flow are two times as productive as regular IOIs, a study performed by Tradeweb, which owns Autex, found in 2009. Improved targeting also allows IOIs to be blocked more effectively against same side contras.

C) Improving the quality of the IOI.

The primary complaint against IOIs – even Naturals sometimes – is that they do not represent reasonably priced, available inventory. As a result, dealers are in the market potentially moving prices to fill the order that was generated as a result of an IOI. IOIs must behave more like orders or automated links to orders, using FIX-formatted invitations to talk to FIX-based order flow. Ultimately, dealers may need to commit to price and size in some form of actionable IOI for buy-side firms to increase the responses' rate.

D) Intelligent routing of IOIs.

The goal is to have the IOI flow find the order rather than having the order manager chasing down IOIs. Even if the IOI is not in a

FIX format, IOI routing systems need to be able to interpret FIX-based flow to provide timely links between IOIs and orders.

E) Better contextual analysis.

In combination with their other order market information, over time, buy-side firms have a lot of information about the probable efficacy of an IOI. By itself, an IOI may not provide reliable indication information but, in the context of current and past IOIs, as well as previous execution information, it can reveal significant information. An IOI can represent a customer order being worked by a dealer or the willingness by the dealer to trade their own balance sheet. Ironically, both result in significant price risk for buyer and seller. Both, the dealers through better timing, certainty and precision; and the buy-side through better display and analytic tools – can contribute to a more beneficial alignment of needs and outcomes, the ultimate goal of any marketplace.

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