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## WELCOME TO FIA EUROPE INFONET



The relationship between vendors and their clients in the derivatives space has become critically important, as highlighted during FIA Europe's most recent InfoNet, covered in this report. Whether it be in their role in providing solutions for transaction reporting, or functionality for algo tagging, vendors have had to work increasingly closely with their trading and clearing member clients to deliver the tools necessary for them to meet new regulatory obligations.

Nowhere is this clearer than in the coming implementation of MiFID II requirements. As a number of speakers at the last event pointed out, those vendors who are most closely engaged in the regulatory process, gaining knowledge and interpreting rules, will be best placed to deliver the most relevant products and services and benefit from the new environment.

While the pressing issues around MiFID II and EMIR may be at the forefront of everybody's minds at the moment, there is also a need to look further ahead at the other advances that technology providers can deliver. Disruptive technology and a range of fintech startups have already given the industry new applications to consider.

Next month's InfoNet will look at the innovation taking place, largely on the back of adopting of new technology, in processes and products for the cleared derivatives industry. The growing amount of resources being devoted to nurturing fintech innovation by a range of banks, exchanges and consultants is testament to the importance these startups are expected to play in the future of financial services.

So, on the one hand the industry is increasingly dependent on its vendors to enable firms to comply with a range of regulatory obligations. On the other, new vendors are increasingly dependent on the industry to nurture and fund their growth. Neither side can survive without the other.



Emma Davey  
 Director: Membership and Corporate Affairs, FIA Europe  
 edavey@fia-europe.org

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## THE INFONET TEAM

### Emma Davey

**Director: Membership and Corporate Affairs, FIA Europe**  
edavey@fia-europe.org  
+44 (0)20 7090 1348

### Bernadette Connolly

**Corporate Events Manager, FIA Europe**  
bconnolly@fia-europe.org  
+44 (0)20 7090 1334

### Philippa Hanman

**Marketing and Communications Assistant, FIA Europe**  
phanman@fia-europe.org  
+44 (0)20 7621 2811

### David Setters

**Contango**  
david@contango.co.uk  
+44 (0)7710 271291

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## A REPORT ON THE 23RD FIA EUROPE INFONET

# TRADING AND TECHNOLOGY



### MODERATOR

**ST** Sam Tyfield  
Partner, Vedder Price

### SPEAKERS

**RB** Richard Bevan, Global Head of Electronic Trading, Exchange Traded Derivatives, UBS Investment Bank

**HJ** Hugo Jenkins, Managing Director, FIA Europe

**PM** Paul Marks, Global Head of Electronic Trading Product, Futures, Clearing and Collateral, Citi

**AR** Andy Roberts, Global Head of eSolutions Support, Société Générale Newedge

*The listed derivatives industry's vendors have always played a critical role for the front, middle and back office. Today, intermediary firms increasingly rely on their vendors for compliance with existing and future regulatory obligations and the relationship that firms have with their vendors is becoming ever more critical, particularly with respect to MiFID II.*

*The panel at this InfoNet looked at how that relationship has evolved over time and how firms are able to comply with increasingly demanding due diligence obligations that they have in respect of their vendors, and could kitemarking, for example, help? The perennial question of vendor regulation was also addressed. Sam Tyfield, Partner at Vedder Price and chair of the panel, kicked off the discussion by asking whether intermediaries, such as GCMs and FCMs, viewed themselves as vendors.*

**Andy Roberts** Absolutely. A vendor is someone who provides a service to another party. We, obviously, require a service from ISVs, and similarly, there are exchanges who provide a service to us. We then provide a service to our clients. There's a whole chain of service provision, so, yes, GCMs are a vendor requiring vendor services from other parties.

**Paul Marks** There is a slight differentiation between vendors that are regulated and vendors that aren't regulated. From an FCM perspective we're a regulated entity and while our vendors can provide us with trading

services, platforms, hosting services, they don't provide us with regulated resources or regulatory frameworks. That's where we come in.

**Sam Tyfield** What role do regulated vendors play in the tripartite relationship between unregulated vendors, regulated vendors and the client of the two?

**PM** It's not a strictly a trilateral agreement. There's a clear distinction between the services an FCM subscribes to from a third-party provider and the agreements that we have with our clients. In some cases vendors also have agreements with clients. This is particularly relevant with multi-broker platforms. However, it's still the FCM as a regulated entity that's held to account. While a vendor can provide a screen to a user, it's the FCM that is held responsible for ensuring the compliance of that platform and that the users are compliant. From a Citi perspective we see that our role is to ensure that we provide a leading product in every channel. We continue to invest significant resources into the global regulatory agenda to ensure that all of our products conform. The way we look at it is that we provide our clients with products that they can rely on for regulatory security.

With regards to vendor selection you can put in place measures to ensure you pick the partners that understand regulation. This is becoming increasingly valued. Investment firms now go further than just looking at service providers to provide technology. The due diligence



“It would be helpful if there was a clearer framework that defined how you are certified and how you become algo compliant.”

**Andy Roberts, Société Générale Newedge**

process and the kind of thought leadership that firms are looking for goes well beyond what you'd have seen five years ago.

**ST** So if it is the case that you are looking at the right vendors for your clients to use and putting the onus upon yourselves to decide who are the wrong vendors, what criteria do you apply to them?

*The panel pointed out that kitemarking is currently being debated actively by the industry, but it is a question of who would most benefit. Vendors could use a kitemark to show customers that they have a certificate, which says their system works. Equally, a firm purchasing these types of software would be able to identify those vendors with the appropriate kitemark, in much the same way as they recognise the conformance testing that vendors go through with exchanges to show confidence that their system works. But it is ultimately up to the firms, as regulated entities, to do their own due diligence on their vendors.*

**AR** The German algo flagging regulation of last year was a great example of what happens when a new

regulation comes in. It was poorly understood to begin with and FCMs and ISVs were not properly engaged. It was delayed by the regulators and then much later when people realised it was going to come into force, a huge amount of effort was applied at a late stage.

All the members then went to the ISVs to ask what they would do about it? I'm sure that there are differences between what FCMA and FCM B thinks. Similarly some vendors were very well engaged in it and understood it as we understood it, while others were barely engaged with it, to the point that we scraped through on the last day with them. It would be helpful if there was a clearer framework that defined how you are certified and how you become algo compliant. I'm not sure that regulatory knowledge should be a factor in selecting a vendor. An FCM should be comfortable in the knowledge that his vendors are providing him with adequate security and that you're trading safely within defined boundaries. Then you can, obviously, look at the competitive advantage of functionalities etc.

**PM** I'm not a big advocate of kitemarks. You've got ISO 9001 but it was actually designed for manufacturing, not for software development. The interpretations of those standards are different and, therefore, you can't really rely on certification to be a standardised mark of quality. There is also SAS 70, which is an audit standard and, therefore, performed by external auditors. This focuses more on process controls and systems controls as well as IT security. So that holds a bit more weight but it's still only an audit standard and the output needs interpretation.

**AR** Manufacturing has been around for centuries so the framework will be robust. Electronic trading on the financial markets is much newer and, therefore, it's adapting and growing at a pace.

**ST** Can kitemarks applied to stringent standards in the development of software or a manufacturing process be usefully and genuinely applied to the interpretation and implementation of regulation?

**PM** It's very difficult because the FCM is accountable. If there was a problem and you were pulled up by an exchange or the FCA they may ask what due diligence you performed. If you said that you relied on a kitemark they would probably say it doesn't hold up. So it's a tool, but one of limited use from a regulatory risk perspective.

**AR** I don't think that having a kitemark absolves

you of responsibility. It just shows that we collectively, FCMs and ISVs, agree that this platform is now suitable and fit for purpose. It's got a kitemark there for if there's something wrong. Otherwise it just becomes a case of who is going to get caught first and then everybody else shouts at the vendor to fix that before they get caught.

**PM** If you setup a kitemark it has to be within a relevant standard. As I said, ISO 9001 was originally designed for manufacturing. We don't have a true ISO 9001 standard designed explicitly for software production. It would take a lot of time to get everybody to agree to a standard and if something goes wrong, in my opinion, it's still of limited use from a regulatory risk perspective. So I've invested in developing the right questions to ask. I've invested in the best practice that is my due diligence framework. I'm therefore much more focused on getting the right answers and probing for the evidence than necessitating a kitemark.

My other fear is that if you have broad kitemarks then you're going to reduce competition in the vendor space because it will make it more difficult for new entrants to come into the market by raising the barrier of entry. We've already seen a lot of consolidation in the vendor space and in the industry as a whole, so we need to be able to keep ourselves nimble to innovate. We need to help people come into this industry, not build further obstacles for them to overcome.

**ST** Is there a role for trading venues to make it a four-party relationship within the setting of the kitemark standards or defining what is and what isn't compliant?

**AR** The vendors are already conforming to exchanges so they have to have a level of certification or they won't allow you to connect. It seems strange to have a level of conformity with exchanges, but not with the regulation. There seems to be some disparity there.

*The panel then discussed interpretations of regulations, which vary from vendor to vendor, FCM to FCM and even among lawyers. One example is in the area of best execution. Firms have to have a best execution policy that is fully understood and adhered to. Some vendors believe they merely provide the execution system, and that best execution is the firm's problem. Others feel they can potentially differentiate themselves by producing something to help firms capture the relevant data needed.*

**ST** What kind of contractual protections would you be looking for with respect to vendors who are marketing themselves as being on top of the regulation and compliance issue?

**AR** That doesn't exist at the moment so it would need to be fathomed out. When we did the algo flagging some of the vendors were very heavily engaged and you can see that they have departments that were looking solely at this. We were talking directly with developers who were trying to give their interpretation. There was a huge differentiation and we run a lot of different vendors so it was very onerous to make sure that we completed.

Ultimately the threat is there. If a vendor isn't compliant, you will have to stop trading on that venue. But if there was to be a kitemark, I still think you would need to ensure they couldn't be responsible for unlimited fines applied by a regulator.

**PM** If I had a choice between one vendor who had a kitemark and another that didn't, but who really understood what's coming down the track and were committed to working with me, collectively, for our mutual benefit, I'd go with the vendor with the vision over the one who's got a rubber stamp every day.

It comes down to innovation and competition. Vendors who have invested heavily in the compliance and regulatory space will benefit significantly from the changes of MiFID II. Those that are further behind the curve will generally struggle because even though they may meet the letter of the text and scrape over the line at the eleventh hour, they may not comply in the way that FCMs want them to and FCMs may, therefore, have to plug gaps manually to fulfil their obligations. If you can't fully automate regulatory processes it will significantly increase your cost of compliance.

**ST** While FCMs may lead the understanding of the regulations and what compliance means, is there a role that vendors can, should, or will play in framing financial services regulation?

*The panel felt that regulation should start by looking at the customer and then what is needed to help that customer achieve their desired outcome. FCMs compete to provide innovative services that carry a customer's order to a regulated venue. Regulation then starts looking down at the bits that make it happen but has to stop at some level. The*

*best approach is to regulate that top level and then to let that top level decide how things work underneath. While vendors can be part of that debate, they should not necessarily be part of the regulatory processes themselves. Ultimately, though, greater clarity of the regulation is what is required.*

**ST** Regulation places quite a weight of responsibility lying on the FCM's shoulders and if your client's DEA members are trading venues or HFT or otherwise end up directly regulated, then they get a share of the responsibility too, but you're the last regulated access to the market. It's all on your shoulders.

**PM** There's still room for vendors to become more involved in the regulatory process and to engage with trade associations and regulatory working groups. Vendors are still very much on the fringes and involvement is the exception as opposed to the rule. If vendors invest more in proactive self-regulation they'll stave off the threat of enforced regulation. There is a threat of vendors being regulated in some form and so it's important that they do raise the bar to avoid that eventuality. A regulatory outcome would be bad for everybody.

**ST** It's probably not so very far away. The Fair and Effective Market Review was issued on the back of the Libor and the FX fixes. And the market practitioners' professional body responded to the consultation by saying that future regulation should be framed by regulators talking to vendors. This would seem to be a change of culture. In the meantime, if we're trying to stave off regulation, what is it that makes a good ISV?

**PM** You need to look at componentisation of the problem. If you look at solving problems in vertical silos it slows you down and restricts your choices. If you break the problem down into smaller chunks and look for people that are really plugged into what's going on around the world then those are the vendors that you want to work with. We feel that we have a successful track record of picking vendors across a wide range of technologies at an early stage. We then partner with them as they become very successful players in the market.

**ST** If you are looking at things in silos, will regulation stifle innovation in those individual areas?

**AR** There are areas such as algorithmic trading where there should be great innovation and trading

activity. There are also areas where there shouldn't be so much innovation and ensuring that you're regulatory compliant is not particularly exciting but, obviously, very essential. But, it's more than just compliance with regulation. The vendors have got a long history and huge experience in these markets. You don't just send a message to an exchange and get something back. There's a whole suite of characteristics that have to be sent with each message and that need to be understood. Its complex and not something that can be created very quickly. So I don't think it's regulation that's stopping that, I think it's the industry that's so complex.

**PM** If you cannot break down problems into digestible chunks, you will be going up the regulatory escalator while it's coming down and you're just going to stay still. You really have to be able to take a step back and break problems down into their component parts to get to the top of that escalator. You can then work out what you want to build in-house and what is commoditised and can be outsourced to reduce cost.

In parallel to that: clients are looking for deeper and broader relationships with their banks. We can't just look at this from the point of view of a futures broking business any longer. The needs of our clients are much broader and more complex. They want to consolidate the number of relationships. So that's where we can focus our intellectual property and internal development.

Citi, for example, has a technology innovation centre. It is focused on cranking out great core technology components that can be leveraged across all asset classes. Bitcoin is a great example with the block chain and how that could be used to reduce costs of transaction processing and collateral movements. There are lots of other new technologies that can be harnessed on the desktop that give traders seamless experiences across mobile and desktop platforms.

Other industries are harnessing all this new technology. But in ours, too many are stuck in vertical silos so, with the regulatory challenges, it's sometimes hard to get above the parapet to start making progress again. This is something we need to remain focused on as this has historically been a really innovative and dynamic industry.

**AR** Doesn't that go back to why it would be better to have a kitemark and then everybody would exert the same effort to meet that standard, while you could





“You have to decide what camp you are in. Is regulation a cost and a challenge and a pain, or is it an opportunity?”

**Paul Marks, Citi**

spend more development hours doing better things? Rather than everybody creating a way to make the same regulation.

**PM** My personal view is that trying to agree and then conform to a kitemark would do completely the opposite and weigh everybody down.

**AR** I think it would make it much cleaner. Once you've got that stamp, you can spend time, effort and money doing something more interesting.

**PM** You can do that without a kitemark. I don't want to wait for say four years until we have a kitemark to then start on innovation. I want to innovate now. I want to invest upfront in the regulatory process and work with selective strategic vendors, regulators and with trade associations to map out what the future looks like and build to that now.

**ST** In an ideal world an FCM would welcome an approach from a small, start-up fintech firm, which had disruptive technology to help him in his business, as long as he either had a kitemark or you trusted that he understood the financial services business.

**PM** There's a lot of buzz about disruptive

technologies but for me it has been around forever. Looking at the vendor space in the futures space now versus five years ago there are players that have already disrupted the market. MiFID II will be hugely disruptive to the market in a whole new way because those who've really thought about their technology and have componentised their technology are going to be much more dynamic in being able to manage change. Those who have rigid legacy technology will find it much more difficult to change and add value at the same time.

You have to decide what camp you are in. Is regulation a cost and a challenge and a pain, or is it an opportunity? If it's an opportunity you'll do well. If it's a challenge and it's a pain, and you're waiting for someone else to come up with a kitemark, you're going to be at the end of the queue. Everyone's going to have moved on and taken the opportunity by the time you get there.

**AR** We're all trying to meet the same regulations. So vendors should be working singly to provide it. Our requirements should be the same, subject to some interpretations, as everybody else's.

*The panel then discussed the future of smart order routing for the OTC market. As one speaker pointed out, with OTC derivatives, the same product can be traded in a number of different places. A broker has to consider best execution as a requirement and develop the front end to enable differentiation.*

*“In the equity space it's almost entirely the other way around. There's no differentiation for a broker in the frontend, but when you look at the venues, you have dark pools, lit exchanges etc. It's how you handle those venues that makes you different.”*

*A good broker will measure the 'toxicity' of venues. That means how much information it is giving away to high-frequency players, for example.*

*The SEF space has not reached that level of sophistication but, as that develops and players become more sophisticated, brokers will start competing with their smart order routing.*

**PM** Looking at this on a holistic level the market structure is not ready to support a truly viable agency model. Clients are looking for liquidity. They're predominantly looking to carry on their business, and as some put it, give me what I had yesterday, but a compliant

solution. The centre of gravity has to shift for there to be a viable market and that means a viable economic ecosystem. We need the transaction fees for the FCMs, and for the vendors to be able to make money and we are not quite there yet.

**ST** What will be the driver for it to become offered to clients?

**PM** It comes down to liquidity, so in some products there might be sufficient liquidity for that sort of model but you're building a whole new system, vendors building technology, FCMs building technology and all to serve a very narrow segment of the market. So unless something changes and the opportunity broadens across a wider pool of products, we're not going to see a real big swing in that direction. Put another way, you can choose not to do it and it's not a problem.

**ST** What is the trigger point for you feeling that you have to do something?

**PM** You can develop a product concept but choose not to take it over the line. If you have limited investment dollars, you have to decide how you want to spread your bets. You can cast some of those bets with vendors. It's about covering the roulette table, and everything that's going on in the industry. Do you want to bet on new venues or on convergence of OTC and ETD? Do you want to bet that the whole market's going to move to horizontal clearing and that we're going to need smart order routers for listed derivatives? You can only bet on so much. It's a case of working with your vendor partners to help give you more coverage. Vendors effectively give you more leverage in terms of how you can apply your bets.

**ST** With respect to consolidation and barriers to entry, we know that the number of FCMs is falling but what would be the consequences of the number of ISVs falling?

**PM** You would end up with fewer FCMs because only so many FCMs could afford to build everything in-house. A concentration of vendors would make the concentration of FCMs smaller and smaller. The biggest FCMs can start building in-house tomorrow but most of the people out there can't do that.

I've noticed that there's an emergence of what I call wholesale outsourcing. That is packaging up technology with regulated resources to provide an end-to-end service to clients. That would be giving them a trading platform,



“The vendor is in partnership with the GCM and between them they have to make sure that the software is adequate.”

**Andy Roberts, Société Générale Newedge**

the risk tools, the allocation modules, a true full-service offering. That has to be provided by an investment firm as opposed to a vendor because a vendor is not regulated.

It's pretty complex to deliver, but the fact there's such a demand really shows you how the cost of compliance is increasing and that today people can't afford the total cost of ownership of deploying their own trading systems. It's not just about having a screen. You've got to support the traders and do the surveillance. You've got to do the setup. You've got to have the control. And you've got to comply with MiFID II when it comes. It's getting harder for providers to deliver an offering to accommodate this space.

**ST** Can we move on to market data? What are the issues there?

**AR** Market data is a very complex and costly area. We have hundreds of screens across hundreds of clients. As markets start to introduce market data charges we require that vendors can actually permission the market data system in the same way that the vendor charges it, or otherwise we run the risk of a client being overcharged where we can't un-permission certain products because

it's in a different category. That doesn't exist per se across all vendors and all markets. So we end up with this situation where clients are paying for market data that they don't want. It's an unfortunate outcome for everybody, but there's no option at the moment. The vendor's responsiveness to the market data changes is essential just on a cost basis.

**PM** From an end customer perspective there's a drive to push single user netting as a concept. It's great to see that ESMA seem to have taken that feedback on board and I hope that that gets seen through into the final versions of the MIFID II text.

In order to achieve that, however, you need two things. One, the end customer needs the reports of its data consumption in a standardised format that means it can do its reporting easily and then benefit from netting. You also need the granularity in terms of the market data reporting codes for the various exchanges so that you don't have to spend hours each month manually working out market data reports. Vendors need to understand where the market's going and what's likely to be required in 2017. Those that do can help build these solutions that will make everyone's life easier.

And this is where there's room for standardisation, not necessarily kitemarks, and for people to come together. Those who are at the forefront will define the standards and everybody else will generally follow. This is definitely an area where we'll need to see some development and more pro-active engagement from vendors.

**ST** I'm interested in the collaborative element again that keeps cropping up. Is a collaborative relationship something you can have with a large number of vendors? We're talking about the systemic risks of a smaller number of vendors, but are the things that we're looking for going to result in fewer vendors anyway?

**PM** The unintended consequences of MiFID II could well drive further consolidation because there are people that understand what's about to happen and will get in front of it. The trade associations have done an excellent job through the consultation process to get connected and to solve these problems. But you've got to want to be part of solving for the future as opposed to waiting for someone to come and clarify it for you.

**ST** And outputs, back into market data, we're mainly talking about trade reporting. Regulators change their

minds on a fairly regular basis and simple things like what format in which they want the reports to be submitted or the fields that they want filled in. What role would you expect vendors to have in making sure that they were on top of that or would you expect them just to build what they're told?

**AR** Again the specifications are provided. The vendor is expected to provide the platform that meets those specifications. If they're subject to last-minute change, yes, there's obviously, the work that's got to be done, but the vendor is in partnership with the GCM and between them they have to make sure that the software is adequate.

**ST** So, what if they're not compliant? Because they're in partnership with you, it's your problem as much as theirs.

**AR** Well, obviously, there's been some breakdown in terms of whether there was enough time provided? Was the vendor engaged early enough? Was there enough effort, manpower put on it? Was it escalated properly? But, ultimately, if you're not going to pass, it's probably too late in the day to switch to another provider anyway.

If you've got a vendor who was in compliant the chances are lots of other people have the same vendor who was in compliant. We got very close in the algo flagging case where some vendors weren't going to comply and we were speaking regularly to the regulator of that particular point and we were just upfront and said, "we've got some issues here". And to be fair they were fine. They said, "keep us updated". If it had gone on too long there probably would have been a problem, but as it was it was just transparent and well managed between all of us.

**ST** The reason things went slightly smoother in Germany in terms of negotiating with regulators than it might otherwise have done is that there were so many who weren't bothering at all, that if you were trying and still getting it slightly wrong you were still better than quite a lot of others, so they were prepared to be a little bit lenient.

**PM** There's only going to be limited tolerance. If, for example, you're having challenges with MiFID II and go to the regulator with 15 pages of non-compliance then I'm not sure they're going to take a sympathetic view. I think that we're also going to see exchanges and regulators continue to increase their fines for non-

compliance to send a message and to show that they're holding participants to account. Let's be honest, we don't currently have a great public opinion around our industry and so there is a clear political desire to show that if people break rules, that there will be significant consequences.

**ST** It's not just breaking rules that is an issue, it's helping others break rules, which brings us on to the case of Navinder Sarao [the trader arrested in connection with the 2010 flash crash]. He was initially described as an HFT shop and then he was a point and clicker and, finally, there seems to be some sort of consensus that he bought an algo or had a vendor help him adapt an algorithm at some point in his audit check to allow him to point and click. So we have a possible scenario where you have a vendor who is unregulated helping a man who, as far as I'm aware, is unregulated.

**PM** It depends what the role of that ISV was and in what capacity they're acting because if that was the member's platform and the client has gone to the ISV provided directly for some sort of custom algo tool, then that potentially puts the FCM in a poor light with the regulator from a control perspective. This was always an area that we were quite concerned with, around making sure that we could clearly draw the barriers around where our systems end and where the client's systems start. Making sure that we avoid a situation where clients could build their own algos within our systems.

**ST** So again you're going to become less and less willing to work with clients who are using ISVs and other vendors of whom you do not in the broadest possible sense approve. So we're back to the tripartite relationship.

**PM** Not tripartite, it simply means we are responsible for our system. So it's either going to be a fully endorsed, supported platform, or it's not going to be supported. The client needs to manage any relationships with its own vendors for its systems in a completely independent manner. I believe that there are other factors in these sort of alleged market abuse cases. There are obligations for FCMs too when onboarding new clients. You have to do due diligence around the client's track record, competency and disciplinary history. These cases are undoubtedly going to sharpen politicians' resolve to ensure that there are no exemptions to the scope of DEA user regulation, that all algos are properly tested and that the DEA providers are responsible for those algos.

**Member of the audience** I have a question about complexity, silos, innovation and then moving through to output data. The recent ESMA consultation on transaction reporting seemed to recognise that there was no way of identifying what was being traded and that lack of standardisation was a key issue.

Is there any sense that something's going to happen between now and 2017 in terms of firms working together to come up with something or would it make it easier if vendors provide a solution that would work with all of you, rather than saying, "we're going to have to hand make a simple solution for every single firm in the market to deal in a totally non-standardised environment"?

**PM** I don't think we'd want to create a kitemark but, we'd work as an industry to create common standards. I think the reason why there's been no real focus in this space is because the current ask is huge in terms of the level of data that needs to be captured at the point of order entry and then passed through to venues and all the way through to transaction reporting.

At the moment we're talking about end user identifiers, date of birth, passport numbers, of the people that are making the investment decision as well as the people executing the trade. We're talking about algo tags for both of those as well and if trades were bulked in terms of multiple client orders aggregated together, they need to be tagged with the number of clients of orders that were aggregated and passed through. So the complexity of solving that is huge, and there's a hope that at least some of that scope is reduced. However, until we know what the final specification is it's very hard for people to get together and work out a standard. Ultimately, the regulators are going to be prescriptive in saying here's the value, in terms of the tag for this field that everybody needs to use to conform to their standard.

So there will be a standard there. Where we'll probably have to work together is how systems will communicate because it's pretty clear the data has to persist all the way through the chain. This is where the challenge is going to predominantly lie, as opposed to with the data itself.

**Member of the audience** Going back to the 'flash crash trade', it seems very strange that between the risk manager of the third party NCM, the FCM, the exchange and the regulator, it's taken us five years to work out his 189 crimes. What are your views?



“There are always going to be some bad actors out there, and there are different systems and different controls.”

**Paul Marks, Citi**

**PM** There are always going to be some bad actors out there, and there are different systems and different controls. That’s why generally MiFID II is designed to increase standards to ensure that these sorts of things don’t go undetected and action is not taken for a long period of time. If you have real-time surveillance for market abuse, that nature of activity should be flagged and escalated in a timely manner.

There is another point here in terms of where MiFID II is going because the LEI is becoming mandatory. This will need to be on a trade at the point of execution or you can’t trade. One of the concerns I’ve heard from regulators in the past is that sometimes when they find someone and clamp down and tell the FCM to turn them off, the client just moves to another FCM. So, part of the problem could be that the data isn’t there to pin the problem down.

Maybe you have an entity performing abusive practices doing one leg of the trade with one FCM and another leg with the other FCM. How is anyone really going to be able to ultimately piece that together? It’s very difficult to do that without an LEI on all of the orders. With MiFID II, the data model is such that it essentially allows people

to piece the full picture together. Abusive activity will be much easier to detect the data sets that they’re asking for under the new regulation. Obviously, this relies on the regulators and exchanges being able to take that data and interpret it, but you have to assume that that’s going to be the case and hence that’s why they’re asking for it in the first place.

**ST** If you saw somebody doing that is it not just a question of kicking them off, but also kicking off the ISV who might have helped them build the algo?

**AR** Obviously, being collaborative in underhand behaviour then there should be no doubt, but the guy probably wasn’t fully aware. I can’t believe they would risk their reputation on one home trader.

*An audience member asked about transparency from software vendors and how to ensure they adhere to standards themselves. The response from the panel was largely positive. One speaker said that it came down to three elements: “One is, does a vendor have a quality system in place with procedures? Two, is it a good quality system? And three, are they actually following it?” While digging down into the code would be laborious, there are nevertheless questions firms can ask of their vendors, such as: how do you manage your quality standards? Where do you keep the procedures? How do you test? Who signs off? Where are these things evidenced? Do you have design reviews? Do you have a separate function that audits that you follow your quality standards?*

**PM** If you get to the point where you’ve got to look at vendors’ code, you may as well build it yourself. That’s, again, why we’ve advocated that reviewing source code is not something that FCMs are really positioned to do or have the capability to do in an economically viable manner. In that eventuality we’d have to simply choose not to do the business.

**ST** A few years ago, a group of FCMs, trading firms, trading venues and ISVs did talk about escrowing source code and I don’t think anybody around the table actually saw any benefit of that.

**PM** We use escrow for a slightly different reason. It’s generally used for protecting a firm in case a vendor goes under. In that eventuality escrow provides a mechanism to take over the running of the service and provide rights to the source code.

**Member of the audience** Specifically around ISV consolidation, you started out talking about how you have multi-decade experience of working with vendors. You're worried about ISV consolidation, but if that consolidation gets to be the point where there is pricing pressure put on, your immediate instinct is to build it in-house even though there's an acknowledged multi-year transition period to get to any alternative solution. In the context of disruptive companies and disruptive technologies, why the instinctive response to build in-house rather than work to improve the diversity of the ISV landscape?

**PM** The key here is the componentisation, so you don't necessarily use just one vendor. You've then still got some pricing power and in terms of a multi-year roadmap I don't think it would be as long as you think. If the firm has the right strategy the components are already in place and the building blocks taken from one asset class and applied to another quite quickly.

Having a good diverse pool of vendors is important. As that starts to get squeezed it becomes a problem and then there comes a point, if you think it's going to get squeezed

very tightly, you've got to kick-off your strategy to build everything internally. But you don't really want to get to that point. It's great that we have vendors as it gives both us and our clients choice. It gives us all flexibility and it means there's more dynamism in the market. If consolidation gets pushed too far you can't just help create a new ISV in the market. So in that eventuality it becomes a key differentiator to build all technology in-house again.

**AR** Quite often a bank isn't just ISV or just internal. They will still run components of both. So there's a lot of internal politics about whether you're moving that way or whether you're moving towards the internal built systems. If the squeeze is on the ISVs the political stance behind using your own internal stuff just grows. It's not that you're starting from scratch. There's already a reasonable component there.

**PM** To cover the disruptive point, we want to use these technologies. We want to see how we can apply these technologies within our stack. So we focus on how can we develop and incubate ideas and concepts that give us optionality if various scenarios play out.

## MarketVoice magazine

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**ST** The disruptive technology development industry is not helped by the fact that quite a lot of the developers and the leaders in that space don't have a really strong background in financial services. So they're thinking about problems in the financial services sector from a technological rather than a financial services point of view. It's the building of the relationship thing is important and it is really no surprise that brand new fintech firms who've got some venture capital funding might not get a seat at the table with the largest FCMs.

**PM** I disagree because investment firms are aware of the problem that it's difficult to sign-up with a company with a staff of three people. So what they've done is set up incubation programmes so that it's almost like a firm within a firm that takes those technologies, develops them, brings those assets and applies them. It also gives something back to the financial technology provider as well because they learn about the applicability of their technology in a financial environment.

**Member of the audience** Given that our industry has seen certain ISVs getting bigger, either by buying others or by developing a pretty good platform based on a specific capability like equities, do you have a concern about putting all your eggs in a small number of ISV baskets?

**AR** As the trading ISVs consolidate there needs to be a look at their resilience, their durability and maybe even a concept that there is differentiation between GCM one, GCM two, GCM three all running on the same platform. I'm not saying they have to go through different ISVs, but there needs to be a level of technological segregation, be it data centres, hosting, telecommunications, or the software lines. It is a concern. But it's not just the size, it's the fact that the model now is hosted, so more and more of the onus is on the ISV to provide a service not just a software. Yes, it should be looked at quite closely.

**PM** I think it comes down to disaster recovery and contingency planning, so understanding what you need to do in those situations. What backups have you got?

If you're a big firm and you're supporting the whole business from one core platform you need to have back-up options. So you really need to make sure that vendors can continue to compete in the market. You have to find a way to try and help new entrants to find their niche and to educate them so that there are other options out there. Otherwise, if you are just driving everything to a handful



“We've heard from certain exchanges and CCPs about their desire to forge closer relationships with buy-side firms. Do you think that has actually got legs?”

**Hugo Jenkins, FIA Europe**

of players, that eventually leads to the point again where you have to build everything in-house. Essentially full circle and right back to the beginning where everyone has their own platform and the client has several different platforms on their desk in case one of them goes down.

**Hugo Jenkins** Looking at some of the changes, or potential changes, to business models in relation to the disintermediation of FCMs. We've heard from certain exchanges and CCPs about their desire to forge closer relationships with buy-side firms. Do you think that has actually got legs and the vendors can help facilitate that, for example?

**PM** If anything our relationships with our clients are getting broader and deeper, not shallower, especially with the most important ones. You need to consider who's going to put the skin in the game. At the end of the day it's the FCMs that provide the back stop to the market and the FCMs that have to do all the due diligence on the customers. Based on what I've seen I'm not sure the exchanges are going to have the appetite to start doing all of that regulatory work.

**ST** If you're not there, somebody has to bear the responsibility that you're already bearing and can you see the trading venues doing that?

**PM** I guess the trading venues have got a pretty good return on equity at the moment and I am not sure that they will really want to drive that south by committing significant additional capital to default funds.

**HJ** MiFID II as we've discussed, involves and includes a whole raft of additional regulatory burdens for firms such as yourselves. I was wondering whether you think that those regulatory burdens could potentially present more opportunities for firms such as yourselves to provide white-labelled market-access solutions to brokers who don't want to take on that regulatory burden?

**PM** Yes, that's really the wholesale outsource model that I was talking about earlier. Absolutely, there's a big appetite for that. However, we'll have to look very closely at the MiFID II text to see exactly what our obligations are under that and review that model to make sure that it still stands up. But I don't think the regulators want to push everybody in the market to face just a handful of players. I think that they appreciate the specialists don't want to build their own platform but still have an important role to play for servicing smaller clients. So I think they're going to try and come up with a model that can continue to accommodate this type of setup.

**HJ** Are you all going to be in that game?

**R** It's being looked at. The 'FCM-out-of-a-box' is a big potential area that needs to be fully understood.

**PM** It's a very big lift so you need a lot of resources, scale and fire power to deliver this sort of service. It's not easy or simple to do by any means.

**Member of the audience** I remember about a dozen years ago, so pre-crash, one of the major American firms, not one on the stage, used to hold a vendor meeting every six months inviting all the vendors that it would see as partners and tell them all in one meeting, what they were planning, how their plans had moved, which building wasn't being done, etc. So rather than being hit by vendors all the time wanting meetings around individual silos, they would tell them all everything in half an hour. Is that something you do? And something you would consider positively?

**PM** It's something I do on a one-to-one basis, but I don't generally want to get everybody in the same room



“If you're not there, somebody has to bear the responsibility that you're already bearing – can you see the trading venues doing that?”

**Sam Tyfield, Vedder Price**

because the objectives are going to be different. I would also want to respect the mutual confidentiality agreement that I have with each vendor as it's a two-way relationship. I'm hopefully giving them an edge in the area where we've agreed we're going to work together. So sharing that with everybody would really just be taking away the value that they get back from us from the non-monetary side of the relationship.

But certainly we always talk regularly to our vendors and we're very focused on helping them in terms of their processes, controls, procedures as well as implementing metrics to measure their performance and help them improve. We will continue to work and invest in the ones that take on our feedback and show willingness to improve and innovate. The ones that are not listening or potentially don't care we'll move down the list and invest our time and effort elsewhere.

**AR** It takes time and effort, we don't treat all of our vendors the same, and some are very vanilla, out the box. They provide a very simple service. It's a screen. We administer it. We provide it, done. Others are key vendors and we have a very clear roadmap and deliverables that we track. We can't treat them all the same. It's just not fair.



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## FIA EUROPE NEWS & EVENTS

### RESPONSES TO REGULATORY PAPERS AND POSITION PAPERS

- May 2015** FIA Europe and ISDA submitted their joint response to the green paper, together with a joint ISDA/FIA Europe position paper on “lowering the barriers to capital deployment in Europe” – a vision for derivatives markets in the Capital Markets Union.
- May 2015** FIA Europe sent a letter to UK CCPs regarding non-default loss allocation rules.
- March 2015** FIA Europe has submitted its response to the ESMA Addendum Consultation Paper on Transparency.

### NEWS

- April 2015** FIA Global issued recommendations for assessing and managing risks that arise from CCP clearing.
- May 2015** CEO Simon Puleston Jones spoke in Brussels on 29 May at the European Commission’s public hearing on the EMIR review. The panel session covered the extent to which the risk mitigation techniques provisions in Article 11 of EMIR have helped to drive standardisation and reduce discrepancies/disputes between counterparties.

### NEW MEMBERS

We are pleased to welcome the following new members:

- BTG Pactual Commodities LLP
- ICIS
- Freepoint Commodities Europe
- Jyske Bank A/S

### FIA EUROPE’S CLEARING IN A DAY, FRANKFURT – AN INTRODUCTION TO DERIVATIVES CLEARING

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### 2015 POWER TRADING FORUMS

25 JUNE, 17 SEPTEMBER, 13 NOVEMBER

### 2015 COMPLIANCE & REGULATION FORUMS

26 NOVEMBER ~ J.P.MORGAN

### FUTURES FOR KIDS CALENDAR

3 JULY – GOLF DAY

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### UPCOMING INFONET EVENTS

#### INNOVATION - PRODUCT, PROCESS AND PLACE

9 JULY 2015 – GROCERS’ HALL

Senior management from FCMs, exchanges, clearing houses, proprietary trading firms, vendors and end-users discuss their latest issues. Further information available shortly.

#### THE PRE- AND POST-TRADE ENVIRONMENT

20 OCTOBER 2015 ~ GROCERS’ HALL

#### STATE OF THE INDUSTRY – THE OUTLOOK FOR ETD BUSINESSES

JANUARY 2016

For more information on all events, including sponsorship opportunities, please contact Bernadette Connolly on [bconnolly@fia-europe.org](mailto:bconnolly@fia-europe.org) or +44 20 7090 1334

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