Below The Waterline – Overdue Efficiencies With Open Security Identifiers

Stuart Breslow, CEO/CIO RealTick

Much attention has been given to market structure changes over several years and how these have impacted the trading environment. Most have focused on the resulting initiatives around new liquidity venues, fragmenting liquidity and the world of price discovery and market structure.

Regulation ATS and Regulation NMS in the US, combined with the introduction of MiFID in Europe, have been the primary drivers – as regulators strive to create an optimum environment for better market efficiency, investor protection, and greater competition, with new liquidity venues emerging such as ATS, MTFs and dark pools.

However, market efficiency is often analogous to the proverbial 'Iceberg' – like many aspects in the financial markets much of the market efficiency and related benefits are in the detail and often achieved below the water line, with powerful drivers delivering daily capital market efficiencies as well as broader macro objectives.

A good example of this is the Financial Information eXchange (FIX) protocol. Started in the early 1990's, FIX created and began a process of standardization for sending electronic messages and trade communication across the broker and investor community. FIX accelerated the ability for software to be developed for electronic trading of financial instruments globally. FIX's adoption led to greater market efficiency and cost savings for the industry as a whole, as market participants reduced the number of proprietary protocols and transmission methods they used in electronic trading. It was without doubt one of the most important initiatives adopted by the trading community that drove greater access and volumes in equity electronic trading over the past decade – with greater efficiency and certainty coupled with a lower level of errors and cost for the industry.

Now consider market data, arguably the life blood of the financial markets used by traders, investors, brokers, liquidity venues and regulators. In similar fashion to FIX, the world of instrument symbology and identifiers lies deep below the waterline, but their efficient use is equally impactful across the capital markets and its functioning.

Currently there is a multitude of security identifiers, spanning global and regional markets, exchange and over the counter markets including RICs, Bloomberg, ISIN, SEDOL, Valoren, CUSIP, WKN, Quick, to name some of the most common. Across just the listed markets for equities, listed derivatives and fixed income, there are several million financial instruments, each with potentially hundreds of fields of information that are used. The number of tradable instruments continues to grow daily. In many cases an instrument will also trade on multiple liquidity venues – in part as a result of regulatory changes promoting greater competition. For the industry, this presents increasing complexities and challenges around the maintenance and management of multiple and differing instrument symbologies.

Why is this important? Because each time an electronic order for a security needs to be passed across trading applications and markets, or between buy-side, vendor, broker and exchange there needs to be a cross referencing of data to ensure we are all referring to the same unique instrument. The security identifier or symbol needs to be translated to the required symbology for the destination and then back again for the completion of the full trade cycle. There is little or no interoperability and as a result the process is costly, inefficient and potentially error prone at the daily operational level for all participants, while making reporting, transparency and market surveillance less efficient than it could be.

The recent announcement by Bloomberg to make their symbology available as open-source, and NYSE Euronext's announcement to distribute the Bloomberg symbols as part of its datafeed, is a positive step towards opening the debate in this area for more efficient electronic order routing and one of its central requirements. We believe this represents the potential direction in a process, similar to the steps in the adoption of FIX, which could lead to greater standardization and result in benefits for the buy-side, brokers, vendors, liquidity venues and regulators alike.

In Europe the trading landscape has drastically changed following the introduction of MiFID, as new venues have fragmented market liquidity, price data and reporting. While competition and new venues have helped drive down direct dealing costs, benefiting investors, the lack of transparency, coupled with relatively high cost of fragmented post trade data are focusing regulatory attention on ensuring that 'best execution' objectives (as mandated in MiFID) are not hampered. A European consolidated tape, in some form, seems necessary and inevitable following CESR's recent consultation papers on proposed changes around transaction reporting. The industry can help itself and investors by getting ahead of this, moving in an appropriate fashion to adopt standards, such as common and 'open-sourced' symbology to support best-execution objectives, in conjunction with the next phase of CESR and 'MiFID II' deliberations on post trade transparency.

As a result of the historic lack of a standard global security master, RealTick has maintained its own market symbology (security identifiers) since inception in 1985, sourcing exchange data directly as part of our Execution Management System capability. As a trading hub for the routing of electronic order flow between investors, brokers and liquidity venues, we have to ensure that we support and provide all the common symbology used by clients. This differs greatly across clients, who have often built in house systems or utilize third party systems with differing identifiers. We are certainly not alone with this challenge, as it is shared by all intermediaries serving the electronic trading community.

Often it is what you cannot see below the waterline that can have the biggest impact. We applaud Bloomberg's move to 'open-source' their security identifiers, and strongly support NYSE Euronext's intention to distribute these codes, and we look forward to continuing to work towards promoting greater market efficiencies ourselves in this regard. We would encourage other market participants to take a lead in this area by 'open-sourcing' other commonly used, yet proprietary, symbology, thereby making it easily available for greater standardization, wholesale interoperability and overall capital market efficiency.

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