

With a greater ability to design how your trading front-end system looks and the leveling of functionality across vendors, the battle over trading front-ends may be fought over what is behind the screens. **By Daniel P. Collins**

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# WHAT IS BEHIND YOUR FRONT-END?

A COUPLE WEEKS AGO, an e-mail was received from an individual who was researching electronic futures markets. He wanted to know if *Futures* had or knew of any projections on when electronic markets would overtake and eventually eliminate open outcry markets. Coincidentally, the answer was provided almost a year ago by an officer of a large electronic trading firm who suggested the Chicago Board of Trade (CBOT) floors would be closed by the end of 2000 (see "Going Electronic," *Futures*, November 2000). Now we know, of course, that answer was premature as the floors still are active and some electronic trading start-ups are shutting their doors and slashing staff.

Beyond that, several of the front-end trading systems who were banking on the death of open outcry are now figuring out ways to take advantage of the value-added services they can provide clients by also porting their system to outcry pits via electronic clerks (ECs).

While open outcry may not last forever, it is ironic that the competition among front-end trading systems, spurred on by the belief that Chicago's open outcry pits would bow to the electronic revolution, may now be won by whoever can offer the most efficient access to those pits in the meantime.

Tom Theys, chairman of Patsystems, an order routing and front-end trading system, is one who readily admits his firm was banking on the death of open outcry. However, Theys now sees significant potential business in providing European customers access to U.S. grain markets, linked through Patsystems' software and routed to ECs in the Chicago Board of Trade's agricultural floor.

The onset of ECs and its effects on front-end business models demonstrates the fluid nature of the business and the need for agility and flexibility to meet customer needs. One difficulty in understanding the business of trading front-ends is grasping exactly what those firms do. There is always a vague reference to providing solutions. Some folks aren't sure if they are

independent software vendors (ISVs), routing systems, direct access brokers, trading front-ends or all of the above. The vendors combine software, back office, risk management, brokerage and even clearing capabilities and have entered the fray from each of these different perspectives. Perhaps their claim of offering solutions is because the problems keep evolving. It is not a simple question of talking to the top 15 widget manufacturers and finding out who makes the best widgets at the cheapest price.

**BEHIND THE SCREEN** ISVs not only offer traders front-end trading systems but also order routing to a number of different electronic exchanges. For many providers, that connectivity is the heart of what they are selling.

"We want clients to think of us as Intel inside," says Scott Shellady, COO of Patsystems. Shellady compares it to the gold rush of 1849. "We aren't mining the gold; we are selling the shovels."

While most front-end providers claim tremendous flexibility in their built-in functions, with most allowing clients to greatly customize their screens, the competition among ISVs and routing systems is turning into one based on market access, pre-trade risk management, quality control and the viability of the companies themselves. Theys points out that with the commitment involved, it is important for a futures commission merchant (FCM) to know that their technology provider is going to be around for a long time.

"The front-end is important, but even more important is the backbone of the architecture and the possibility to deliver open systems to our clients," says Jeff Patrick, marketing manager of GL Trade.

Several ISVs note that they allow people to write directly to their application processing interface (API), bypassing their front-end screen.

"We want to be the technology behind what they distribute," says Steve Monieson, vice president of Trading Technologies. "In the same light, we feel that our front-end screens themselves are a very powerful tool."

An example of this is how data service provider CQG has developed its own front-end and has arrangements with numerous ISVs that connect CQG screens to the ISVs routing software. This allows FCMs and their customers to select the data provider and routing system they prefer as well as conserving desktop real estate.

"At some point the amount of bells and whistles an ISV can offer is going to level off. Everyone is going to be able to offer the same level of service from a front-end trading perspective. What is going to differentiate them is support and the number of exchanges that they have on board," says Fimatrade Managing Director Christian Altmayer. "Those ISVs that can provide the best support, continue to keep up with competition and add as many exchanges and products are going to be the most successful."

While much commonality has grown among front-end systems, some providers believe there will be a second generation of front-end technology that end-users can choose from.

"The market at the beginning of the year was a race among vendors to refine and stabilize the primary components involved in order execution and management," Monieson says.

Trading Technologies is developing an "Auto Spreader" function that allows traders to create a nine-legged spread. For example, this will allow traders to spread between the Nasdaq, S&P, Dow and FTSE.

Interactive Brokers' Vice President of Operations Laura Schueneman notes that her firm offers a "best execution" feature to its customers. Best execution picks the exchange that offers the best price on a commonly traded contract. While that has mainly been a tool for equity option traders, Schueneman notes that, with the onset of BrokerTec and multiple-listed futures contracts, that will become more important.

Interactive Brokers is not alone in that capability. A common theme among ISVs is the ability to connect to every market out there and provide customers tools to spread across different exchanges and different markets.

**ISV VS. BROKER/FCM** For some, order routing is a business and for others it is a business expense. Patsystems, GL Trade, Trading Technologies and others market their front-ends and connectivity to FCMs and institutional traders. On the other hand, Fimatrade, Xpresstrade and to a certain extent Interactive Brokers are primarily in the brokerage business. There are advantages and disadvantages to each business model.

Brokerage firms and FCMs offering their own networks note that it is a complete trading solution.

"Our core business is and will always be clearing and execution services," says Fimatrade's Altmayer. "The success of Fimatrade's platform as an ISV is not solely dependent upon our ability to sell screens. Because Fimatrade owns the system, we control the direction and speed of development. We are not at the mercy of a third party that may not want to go to many of the smaller markets."

Xpresstrade has as an online trading service for self-directed retail traders.

"Nobody knows our customers better than we do," says Xpresstrade Principal Dan O'Neil. "So who's in a better position to design and build the system that we make available to our clients?"

Interactive Brokers places itself between those ISVs that developed their systems to market to FCMs and institutional traders and electronic brokerage firms. It developed its systems for institutional clients and now is marketing it to retail customers.

They says that many large FCMs started out developing their own systems and found out there was a lot more involved than they originally thought. He notes that the process is lengthy and expensive and the expenses don't stop once the system is in place.

"There are two to three upgrades a year. Multiply that by 10 exchanges," They says. "To support it, maintain it and distribute it is a real big business. Our approach [was to] do that for everybody else who wants to write their own front-ends and they can use our API, risk systems, exchange gateways and all our back office interfaces."

**SPECIALIZATION?** With so many markets and ways to trade, a question faced by many is whether to serve the whole market or find a certain niche where they can thrive. One aspect where there won't be specialization is in markets served. Every routing system provider emphasizes the necessity to access as many markets as possible whether they are marketing to FCMs, institutional traders or retail traders. The only exceptions are those that limit themselves to electronic markets.

A question faced by electronic markets, both >

## We can do that too

Trading Technologies' MD-Trader (market depth trader) has a vertical display of market depth that once was considered unique. Now many front-ends offer similar features.

Price	Quantity
114100	
114075	
114050	
114025	
114000	
113975	
113950	
113925	
113900	
113875	
113850	
113825	
113800	
113775	
113750	
113725	
113700	

- view position
- single-click trading
- market gaps visible
- default quantity
- single-click delete
- static price display guarantees price clicked is price sent
- sweep the book capability

➤ new and old, is who will provide liquidity. Who will take the function of the local trader who scalps the market providing a tight bid/ask with reasonable size? Electronic markets have turned to market makers to fill that role, and several ISVs have developed software to serve those traders as well.

Actant is one ISV that specializes in automated market making on electronic platforms. The company writes software for market makers and other liquidity providers, according to Actant General Manager Joshua Hodge.

Market making is particularly difficult while trading options where you are not providing a bid/ask in one market but across several strike prices on puts, calls and other orders. RTS is an order routing front-end system that specializes in options pricing.

Chuck Dolce, managing director of RTS says his software "recalculates quotes anytime theoretical [options] prices change." RTS also has developed functions to trade baskets of stocks that could allow for a greater opportunity for cash arbitrage in equity indexes, Dolce says.

With the advent of individual equity futures, the importance of a front-end provider being able to give end-users access not only to those markets but also to the underlying cash markets is greatly intensified. After all, equity futures and narrow-based equity index futures have the potential to create a huge basis trade market.

They says Patsystems is linked to all the stock market exchanges because of equity futures.

"We want to be able to execute into single stock futures [markets] but we also want to make sure we have the underlying market as well," They says. "From our screen, you will be able to trade the future and the cash outright."

**WHO WILL SURVIVE?** Along with the death of open outcry, the other assumption many people within the industry held a year ago is that there would be a great deal of consolidation among ISVs and front-end systems as users settled on the best in the field. Well, that hasn't happened yet either, though it undoubtedly will. The full scope of what these ISVs do is not entirely defined yet, and the rules are continually changing.

A hint of what the future may look like for ISVs may have been provided by the recent partnership of Refco and EasyScreen (see *Trendlines, Futures*, September 2001.) The agreement opens the door to Refco's institutional and massive retail customer base, according to EasyScreen Vice President Stephen Parris. Parris notes they also entered into an agreement with E-Speed that enabled E-Speed's cash bond traders a futures outlet through EasyScreen's network. Parris believes those partnerships strengthen their position among ISVs.

They says that the consolidation he sees happening is by FCMs choosing their technology providers. He notes those firms with a global perspective will prefer to have one solution.

While winners and losers will be determined to a certain extent by those with the best technology, an old-fashioned idea like customer service will also play a role.

"The front-end provider that can offer the most products and best functionality will be the dominant player, [but] if a provider can't support their multitude of products they might as well not offer them," Altmayer says. "Traders want a single access point to all major markets that is quick, reliable and supported by individuals who can quickly identify the problem.... If you are not flexible you will not succeed."

GL Trade's Patrick agrees: "The casualties will be those who aren't constantly adapting themselves to changing market conditions, staying abreast of newer technologies and keeping close to their customers to ensure they understand each individual customer's business requirements."

## The guts behind the glory

While order routing firms are proud of their screens, the ability to offer common functions and customization makes what is behind the screen most important.

### GL Trade

### Interactive Brokers

### Patsystems