White Paper
Single Dealer Execution Platforms
Why they are strategic in an uncertain world

Adsatis

Paper written by Adsatis in association with David Bullen (freelance consultant)

INTRODUCTION

Single-dealer platforms (SDPs) are nothing new. However, until recently most have been focused on research distribution and providing clients with additional services such as analytics, post-trade affirmation/confirmation and valuation. Only a very few broker-dealers had added execution capabilities, the most notable being Deutsche Bank's Autobahn and Barclay's Barx systems. The years 2009 and 2010 saw several other top broker-dealers embark on their own single-dealer execution builds. These included Morgan Stanley's Matrix, RBS Marketplace, Citi Velocity and Morgan Direct with other dealers also starting to invest. However, all of these efforts have run into the headwinds of regulatory change that have made many doubt, curtail and even cancel their initiatives.

As we move into 2012 and more (and occasionally less!) is known about the manner in which new regulation will impact the fixed-income market execution, many dealers are questioning what their strategy should be and what, if any, investment should be made in SDPs, in particular in the execution platform ("SDEP"). As it stands, it is expected that most flow derivative business will need to be executed via a SEF or MDP. At the same time, it is apparent that a number of dealers are accelerating development of their proprietary execution systems and each month brings an announcement about another dealer's offering. This seems to contradict previous (conventional?) wisdom that the new regulations will make SDEPs redundant.

This article examines this development and sets out the justifications for having, and further developing, single-dealer execution platforms. It also puts forward the case that, for many banks, such investment is an essential business proposition if positioned and executed correctly, in spite of the thrust of the new regulation. We offer this as contribution to the debate that must be taking place in many banks at the present time.

THE BUSINESS CASE

Budgets to deliver SDEPs will vary considerably between banks, so we have considered this by examining the justification of a nominal $1 spent based on our experience in various organisations. We present below 13 reasons to invest, or keep investing, and a running total to see whether it stacks up!

1. **You're spending some of the money anyway!** The existing investment in single dealer systems (i.e. not limited to execution systems but inclusive of distribution of research, trade ideas, analytics etc to clients) is already considerable - most recognise the need to continue providing clients with these services. Likewise dealers will have to provide prices into SEFs, IDBs and MDPs etc. The majority of work to enable this can be re-used or re-directed to populate a SDEP. Functions including administration of trading rights by external parties can be leveraged and re-used to support a SDEP. Provided the dealer chooses the web as a delivery mechanism, the incremental costs of the "final step" of creating an execution website, blotters and ticking price screens etc, are relatively low. Indeed, a small software industry already exists to supply the same technology components that are used to power the premium and pre-existing dealer offerings, although few will admit to this. 20
(= The first 20c in the 1$/€)

2. **Your SDEP programme can become the mainstay of a general efficiency and effectiveness drive in trading and sales areas.** It is widely recognised that trades executed electronically, whether by internal sales people or directly by clients, will contain fewer errors or "out trades". Many dealers, especially those which are the product of multiple mergers, require internal sales and trading teams to use a variety of trade capture systems. The various trade capture rationalisation projects can be curtailed and the investment dollars switched to SDEPs, which can also be used internally by sales people and in-house "trader-trader" trades. **(Total = 25c)** 25

3. **A SDEP helps manage and improve service quality.** SDEPs bring discipline and consistency to what are notoriously difficult subjects for Capital Markets management teams to address. "Is our product GREAT today?" "Are we quoting and market-making as usual, in the usual instrument sets?" "Are the sizes offered competitive?" "Are the bid-offers tight enough to be competitive?" "Have we got that newly auctioned bond or new issue on our screens - 10 minutes, 2 hours or 2 days after the "break?" Building a SDEP, then aligning internal sales and trading practices around it as the default application ensures the business effectively monitors itself. In a multi-dealer system world, the first person to know that a dealer's prices were slipping or uncompetitive is often the clients themselves; not an ideal business situation if there is no natural feedback loop. 35
(Total = 35c)

4. **Capturing in house flows.** SDEP's can lock-in efforts on the internalisation of flow. Large (and even medium sized) firms
constantly struggle with internalising flow and keeping it internalised. In large banks, internal flow can account for 5-10% of
overall activity levels and crucially acts as a market crossing enabler that facilitates external client relationships. In the profit-
maximising environment of a trade floor, artificial rules like "always trade with the house" fall into disrepute very quickly.
SDEPs have an attribute that can help them solve this once and for all. In simple terms, a management policy can be
implemented by a centralised operations/IT/ middle office team which sets the pricing provided to any internal counterparties 40
as the same as the pricing provided to the premium external clients of the banks. This will always be valued and, in the
turbulence of market volatility, is the only arrangement that lasts. **(Total = 40c)**

5. **Brand creation and associated business benefit.** SDEP's create large brand value - witness the Autobahn & Barx case
studies. Large dealers struggle with creating a homogenous, branded workforce within and across sales-trading-research,
across products and across geographies. A SDEP that delivers research, allows trade ideas and analytics to be created, that is
viewed by clients and salespeople *and* provides execution services helps forge a powerful brand across the business. The most 45
notable, historical case study of this was the position Lehman Live achieved for that firm in the mid-2000 era. **(Total = 45c)**

6. **Bringing in retail flow.** Few broker-dealers can ignore retail and small size flow but, equally, few can service it through
traditional high cost mechanisms and still make money. Nearly all dealers focus on large institutional buy-side institutions but
few do so exclusively and often have material opportunities in retail/small transactions. The only cost-effective way to handle
such business is through SDEPs or associated products like single-dealer execution APIs. A correctly constructed offering
providing small size execution services adds zero overhead and has the added benefit of allowing large clients to transact "odd- 55
lots". The quantity of the transaction is a number in a box and computer programmers don't disallow "1 bond" sizes unless told
to do so. Many government bond trading desks routinely execute 0.1 of a UK Gilt which equates to £100 in value. Needless to
say the marginal processing cost really is zero. **(Total = 55c)**

7. **Client profitability measurement and management.** Once most investment bank services are delivered electronically, the
electronic delivery of the service that provides the revenue in flow areas, i.e. execution services, finally allows more scientific
analysis of the entire business. Investment banks are often poor at being able to compile a full picture of the client's use of
their facilities compared with how much revenue is generated. SDEPs will allow dealers to put that picture together much 60
more effectively. Initially, this may be used only for certain challenging clients but the principle will be established and
resulting efficiencies in resource allocation can feed straight through to the bottom line. **(Total = 60c)**

8. **Be in a position to respond and innovate.** The rapidly changing world created by regulatory reform will throw up threats
and opportunities. In order to be able to respond and capitalise accordingly, electronic delivery will be critical. Banks that
don't have their own SDEP won't be masters of their own destiny and won't have the flexibility to respond rapidly. They will be
forced to approach multi-dealer systems to convert on the opportunities they discover. For example, there are many hedge
funds which would respond very favourably to bespoke large volume trading services. MiFID is unlikely to disallow a bank from 65
quoting a single client a $1billion 10 year UST (a bespoke, non-standard size service) but this type of trade will need to benefit
from the bulletproof STP that is the hallmark of any correctly implemented SDEP. Exceptional manual processing on such
important trades, in a world more dominated by STP, is more likely to lead to higher error rates than on vanilla, standard size
trades, as human beings will need to become involved in unfamiliar, infrequently used, procedures. **(Total = 65c)**

9. **Be in Control.** Having your own capability is better than the alternatives. Committing yourself to a non-SDEP strategy will
effectively lead to you recommending to your clients to utilise multi-dealer or exchange type services in order to allow them to 70
get their business transacted. It is very problematic for a sales force to promote venues that they know contain their
competitors' prices, bearing in mind that smart investment banks have ways to "learn" the client base of multi-dealer systems
over the medium term. "Captive" clients become a thing of the past with all the consequences for the broader, relationship
based banking model. In the extreme, dealers will become disintermediated from their clients. **(Total = 70c)**

10. **Guiding clients through future uncertainty**. Who knows what tomorrow will bring? In simple terms, regulatory reform will cause business to be done in different ways. There will be the old way, the way during transition (e.g. swaps in one currency cleared but not another) and the new way (most things centrally cleared). A SDEP positions a firm more competitively, both during the transition and afterwards. During transition, a SDEP can be marketed to clients as a way to manage the complexities. "Just trade with our SDEP and we'll take care of all these complex rule changes for you". In the "everything clears" world there will be many variables on the price of the next trade: clearing fees, whether the client clears with the dealer or out-of-house, the nature of any cross-product margining agreements, back-loaded portfolio or not, etc. Being able to net all these variables into the price of the next trade to the specific client will become the big differentiator between investment banks. Having a venue where you can display that single-dealer bespoke price to a client will give competitive advantage, bearing in mind cross product margining (CPM) and clearing, because it will be the best executable price available to that client at that time, especially if the client has previously traded the majority of their business with that dealer. This will be a virtuous cycle from the dealer's perspective, hence the huge resources the large dealers have expended on building up their clearing, margining and electronic trading offerings.

The variety of trading scenarios will be more pronounced during the transition to, for example, a centrally cleared environment. That transition will also tend to "unglue" old business relationships. Clients will take on new dealers who have solutions that guide them through the maze of changes with the by-line "trade on our SDEP and we'll keep you legal" directing you onto a SEF, should that be required. **(Total = 80c)**

11. **Keeping onside with the regulators.** Having your own shop window helps in the perception of price transparency. Transparency gets high marks with regulators and legislatures. A SDEP is a broker-dealer's shop window on their unique Product. Having a shop window you are prepared to allow the wider financial community to view, (albeit determined by the dealer), demonstrates a willingness to be transparent. How can they do this effectively if they cannot show even their client base the prices they are prepared to stand by and execute at, ANYWHERE on a screen? **(Total = 90c)**

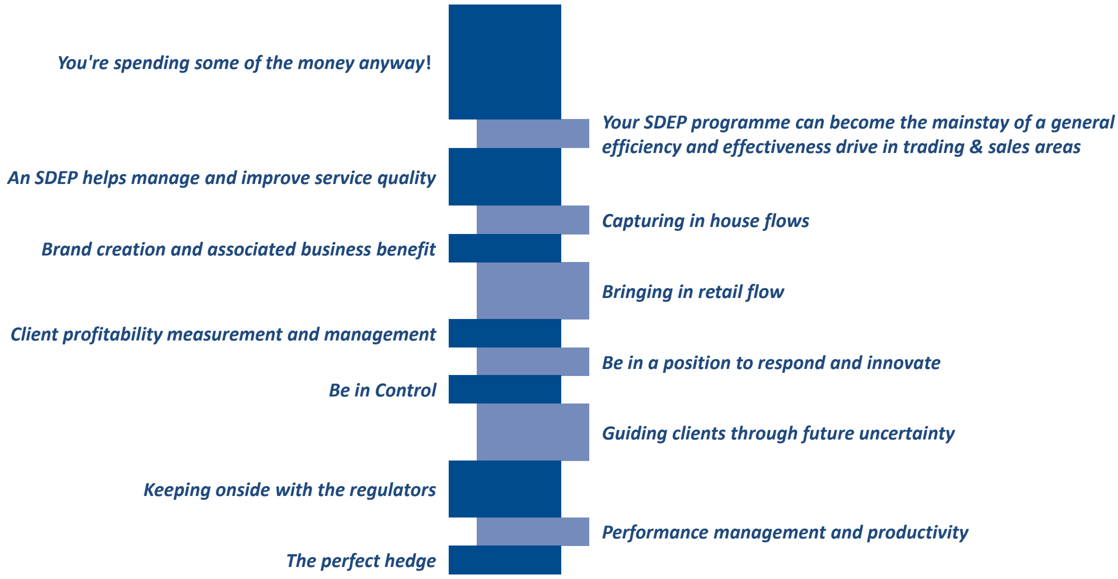
12. **Performance management and productivity.** Web usage statistics can sort the wheat from the chaff and bring your wage bill down. Compensation = if you are able get the sales-trading-research combination really working well through a SDP/SDEP you can start managing the compensation bill - if the SDP is made integral to the work flow. The number of reads of a research document, the use of an analytic engine, the consumption of a trade idea and related executions, the fact that 78% of a traders' real-time offers were outside the market by 1bps, etc. Imagine the management information that would be derived to be able to identify the star traders, key sales people and researchers that bring business to the bank. **(Total = 95c)**

13. **The perfect hedge.** A SDEP is also a hedge. Who knows where the world's problems or regulators will take us? Having the investment in a SDEP behind, rather than in front of, you will undoubtedly position your dealer firm to be more flexible and faster to change than the dealer without the SDEP. In a world where transactions and communication are becoming increasingly electronic it seems obvious that any dealer that intends to be part of the future would want to be able to market its products and services to its own clients through its own channel. **(Total = $1)**

CONCLUSION

In conclusion, it seems clear why large global investment banks are continuing to invest in their SDEPs, even in these ultra-tight budgetary environments. It also seems clear that choosing *not* to develop a SDP and a SDEP is a potential opt out that may risk the long term viability of a bank's business model.

Our 13 points (rather conveniently!) make the budget balance, certainly in terms of justifiable expenditure. However, there seems considerable potential for higher returns from any of these components and we would wager that the banks that do invest (and do this in the right way) will generate returns that far outweigh the cost and will be the banking powerhouses of the next 20 years.



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If you wish to discuss any of the views expressed in this paper or require further information, please do not hesitate to contact us:
michael.birks@adsatis.com

For further information please contact: +44 (0) 20 7663 0800
Adsatis Ltd, Eldon House, 2-3 Eldon Street, London, EC2M 7LS
sales@adsatis.com www.adsatis.com