



# **AN ASIAN PERSPECTIVE**

## ON KEY ISSUES CONCERNING TradeTech TODAY

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# AN ASIAN PERSPECTIVE ON KEY ISSUES CONCERNING TRADETECH TODAY

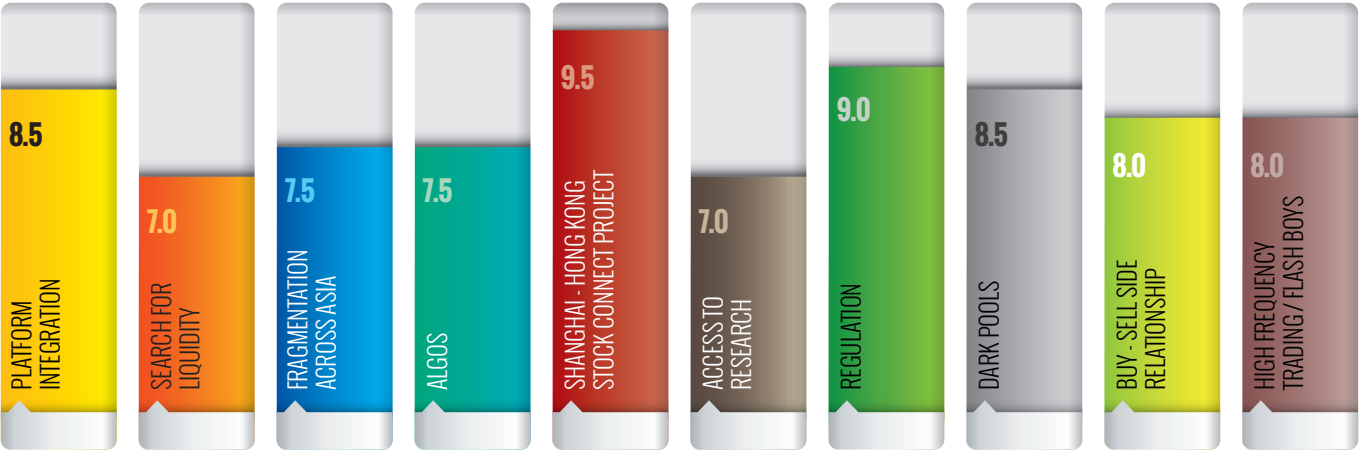
The furiously fast pace of the modern trading technology industry means that companies on both the buy and sell sides of the business need to constantly remain on their toes as their trading environment evolves to incorporate cutting-edge strategies and solutions to both new and age-old issues.

To that end, Worldwide Business Research has conducted dozens of interviews with trading and technology experts in order to gauge the latest opportunities and pitfalls present in the trade tech industry. From forthcoming regulation rules changes to leading research avenues, the most up-to-date concerns and ambitions of trading company CEOs, managing directors, senior strategists and heads of trading and technology have been canvassed and correlated in order to gain valuable insight into the current trade tech landscape.

Particular emphasis has been put on the Asian market perspective as fundamental changes are in motion that are predicted to significantly affect regional trading as well as having global ramifications. Specifically, the long-awaited realisation of the Shanghai-Hong Kong Connect project (due for implementation this October) has generated all manner of interesting considerations as companies and individual traders make their preparations to effectively utilise mutual market access between China and the rest of the world through Hong Kong.

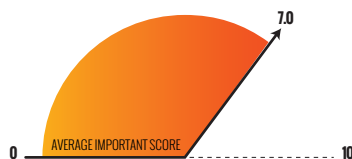
What follows is a rundown of the most pressing concerns and issues faced by traders operating in Asian markets as well as those who are seriously considering entering them to leverage the increasing opportunities that the region offers.

Average importance score out of 10.



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## SEARCH FOR LIQUIDITY

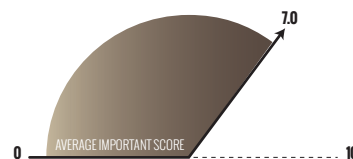


Interviewees have repeatedly underlined how many Asian stock exchanges suffer from low liquidity and higher volatility as a consequence. Some point to the lack of IPOs and insufficient controls on the ones which do enter the market. Without circuit breaker mechanisms in place to respond to substantial drops in value of these often high margin stocks, a number of Asian exchanges are susceptible to high volatility.

The resultant lack of liquidity means that traders are routinely finding it difficult to make block trades, hampering the development of building steady trading relationships with some of the bigger Asian clients. Consequently, many of them have turned to dark pool trading in order to seek out greater liquidity.

However, the greater levels of trading volumes and activity encouraged by the higher volatility of these exchanges are attractive for some traders who aren't as concerned with liquidity. As a result our survey saw a wide spread of importance scores in this area.

## ACCESS TO RESEARCH

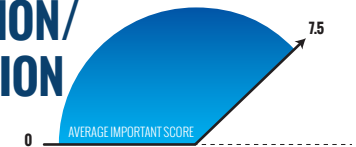


According to our interviewees, a number of new technologically advanced research methodologies of analysing market data have started to penetrate the awareness of firms trading in Asia but not at a particularly fast rate.

The issue on many industry analysts minds is how the segmentation between permissible and non-permissible research will continue and how it will specifically affect Asian markets. Increasingly, this divide is being determined by the likes of the FTA and SFC and the concern remains of whether conflicting regulations will muddy the waters of what is and isn't permissible research.

One buy side head of trading highlighted how the significant monetary and regional differences in various ASEAN territories called for firms to utilise a dedicated research analyst for each market.

## FRAGMENTATION/HARMONISATION ACROSS ASIA



As mentioned, the various rules and regulations of Asian exchanges regarding opening times, settlement, buy in and so on means that trading in multiple Asian markets can quickly become a complex endeavour. While the ASEAN community has made significant efforts to promote itself as a harmonised block, the reality is that it has fallen short of its goal to become a technology enabler. However, interviewees are noticing some promising signs of cooperation between the various ASEAN exchanges and their overriding hope is that this will translate into further standardisation of rules on settlement and other key areas that need simplification.

## ALGOS



Recent regulation efforts introduced by the SFC have had a marked impact on the way traders on both the buy and sell sides view the role and application of algorithms. From the situation only scant years ago where multiple algo trading desks were prevalent, now most traders have significantly cut down on the number of algos that they use. This has been primarily driven by SFC regulations that now require algo providers to be compliant and provide training for

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end user clients so that they properly understand its applications.

However, access to algos is now cheaper and easier than ever before, meaning that they are no longer the sole domain of large firms who could afford to invest millions in development teams. Now firms have the ability to purchase algos from multiple vendors and can enjoy greater levels of customer support along with the reassurance that they are compliant. Still, traders can't afford to blindly trust the algos they use and have to be willing to invest their time to get to grips with the technology to get the most out of it and remain compliant.

Several of our interviewees confidently stated that they believe that there will be gravitation back towards algorithm customisation once the initial adjustment to comply with the SFC is complete. This should hopefully offer firms an acceptable level of choice that can reliably lead them to finding an algo solution suitable for their business needs.



## BUY - SELL SIDE RELATIONSHIP

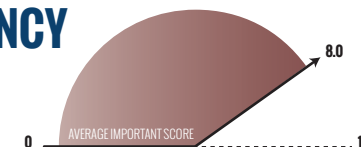


This particular part of our survey was more contentious, with no single prevailing attitude being displayed among the respondents but almost all of them agreed that the relationship between the buy and sell side is important and needs careful consideration.

While some of the respondents were encouraged by increased levels of cooperation and stabilisation between the two sides, a particular sticking point that was repeatedly mentioned was communications. Partly due to compliance issues and partly to a lack of enthusiasm for technological means of communications, many traders operating in Asia are frustrated by the slow dialogue speed that often occurs between the buy and sell sides. One respondent highlighted how brokers will often ask for further information after a request has been sent, with the conversation going back and forth sometimes for days. Obviously, while the conversation continues the funds earmarked for the trade aren't going anywhere and this slow investment speed can ultimately hamper profitability.

While some firms have been slow to embrace the latest technological communications methods, our respondents have noticed a general trend of technological expertise shifting from the sell to the buy side. Ultimately, they believe that this will place more bargaining power with the buy side as the sell side market is cannibalised further by electronic trading.

## HIGH FREQUENCY TRADING/ FLASH BOYS



It's safe to say that the release of Michael Lewis' bestselling exposé Flash Boys has encouraged significantly increased levels of scrutiny towards HFT practices as all manner of US politicians and lawmakers begin to probe relationships between exchanges and HFTs.

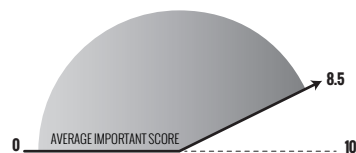
However, a number of our interviewees have noted that while Flash Boys raises some useful, thought-provoking questions regarding the legality and morality of HFT, it also contains a number of highly dramatised and one-sided passages that obscure the full picture. Regardless, many traders believe that HFT will not find the Asian market structure amenable outside of Japan. A sizeable proportion of Asian firms are low latency and attempts by exchanges to make HFT attractive through faster platforms have routinely failed due to prohibitive back end expenses.

In addition, these same traders believe that the accusations of the unfairness of HFT raised in Flash Boys may well scare Asian exchanges away from encouraging the practice, since they are more eager than ever to promote an image of fairness and stability.

However, there is the contending opinion that should new US regulations drive HFT operators away then it's not inconceivable that they may find a new home somewhere in Asia where liquidity is greatly needed.

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## DARK POOLS

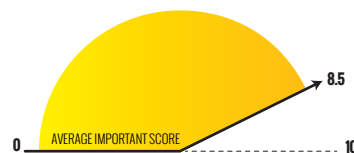


A lot of uncertainty currently surrounds the practise of using dark pools in Asian markets, mainly because of the rapid changes that they are experiencing regarding regulations. This uncertainty has caused many firms that were experimenting with dark pools to stop and wait until a clearer regulatory picture emerges.

The key questions regarding the future of dark pools in Asia revolve around public disclosure as traders want to know exactly how private their DP transactions will be. Still, for firms seeking greater liquidity in Asian markets where it is often hard to find, it seems that dark pools still represent a viable solution.



## PLATFORM INTEGRATION

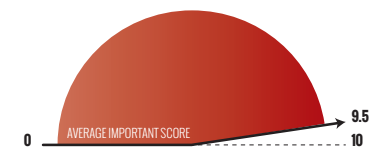


All manner of challenges await companies who are looking to trade across the Asian markets thanks to the often bewilderingly complex overlay of different time zones and often conflicting differences in regulations.

Given this difficult business reality, it is perhaps unsurprising that so many of our interviewees gave platform integration an importance score of 8 or 9. Even companies that make sales through phone or email discussions still rely on electronic trading in order to process them as it is currently estimated that 80% of all sales are electronically routed. Therefore, in order to make the process of tracking and finalising large quantities of sales being conducted in different regional markets, more companies are looking to invest in elegant but simple to use cross-border technology platforms with multi-asset trading panels.

While several solutions are currently gaining traction with companies operating in the Asian markets, it is vital that technology providers in this sphere remember that they need to provide the buy side traders with access to the platform as cheaply as possible. The bottom line matters as much as the speed and ease-of-use offered by the platform's interface.

## SHANGHAI-HONG KONG STOCK CONNECT PROJECT



Despite a number of looming question marks regarding the actual mechanics of how international traders can connect to the Hong Kong and Shanghai exchanges, the prospect of the looser capital flows in and out of China as well as the potential for further mutual market access connections in the future means that everyone is talking about the connect program.

Specifically, it is the lack of clarity regarding daily market quotas that has a number of top industry experts anxious about the whole process. The rules state that each exchange participant or broker needs to show each day that they are not going into negative balance, which creates an issue if a broker has been selling but not buying that day, as it is currently unclear how traders are expected to comply with this requirement without proof that they have the means to buy.

However, despite such inconsistencies and uncertainties, many industry analysts are heartened by the increase in information being released and circulated that should clarify how the exchanges will work. Recently, one of the bigger breakthroughs has been that Chinese mainland



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companies may now share their books with the New York Stock Exchange, easing concerns over further delays and postponement of the connect program.

As all trades will be completed in RMB, this ensures that China's currency will be traded internationally, leading to further reductions of currency controls and restrictions of capital flow. For traders looking to expand into Asia in a big way, this is a golden opportunity that they need to be properly prepared for.

## REGULATION



As previously stated, firms are looking to follow the lead of regulatory bodies like the FTA and SFC regarding intrinsically important issues such as research and the use and sale of algorithms. Many of our interviewees have responded optimistically to the recent efforts of the industry's regulatory bodies. They have noted how the Asian markets they are interested in are now safer trading environments where many of the exchanges are taking responsibility to install a number of safeguards and limits to ward off potential flash crashes.

However, concerns still exist regarding opaque and/or conflicting regulations being issued in the near future. One specific example highlighted by an interviewee involved OTC derivatives regulation coming through around EMIR CCD rules where EMIR has said that European banks can use only certain clearing houses but half the Asian clearing

houses are not yet on their approved list. This lack of international co-operation is particularly worrisome given that China is about to open its market access internationally scant months from now.

Additionally, there are legitimate concerns regarding the ability of the SFC to enforce its rules regarding algo compliance. The sell side is obliged to record that they provided sufficient algo use training to their buy side clients – with certification to prove it – but many of our experts have rightly asked: does the SFC have enough market experience to ask the buy side the right questions to check if they are sufficiently familiar with the algos that they use? If they do not, then enforcement of these regulations will be untenable.

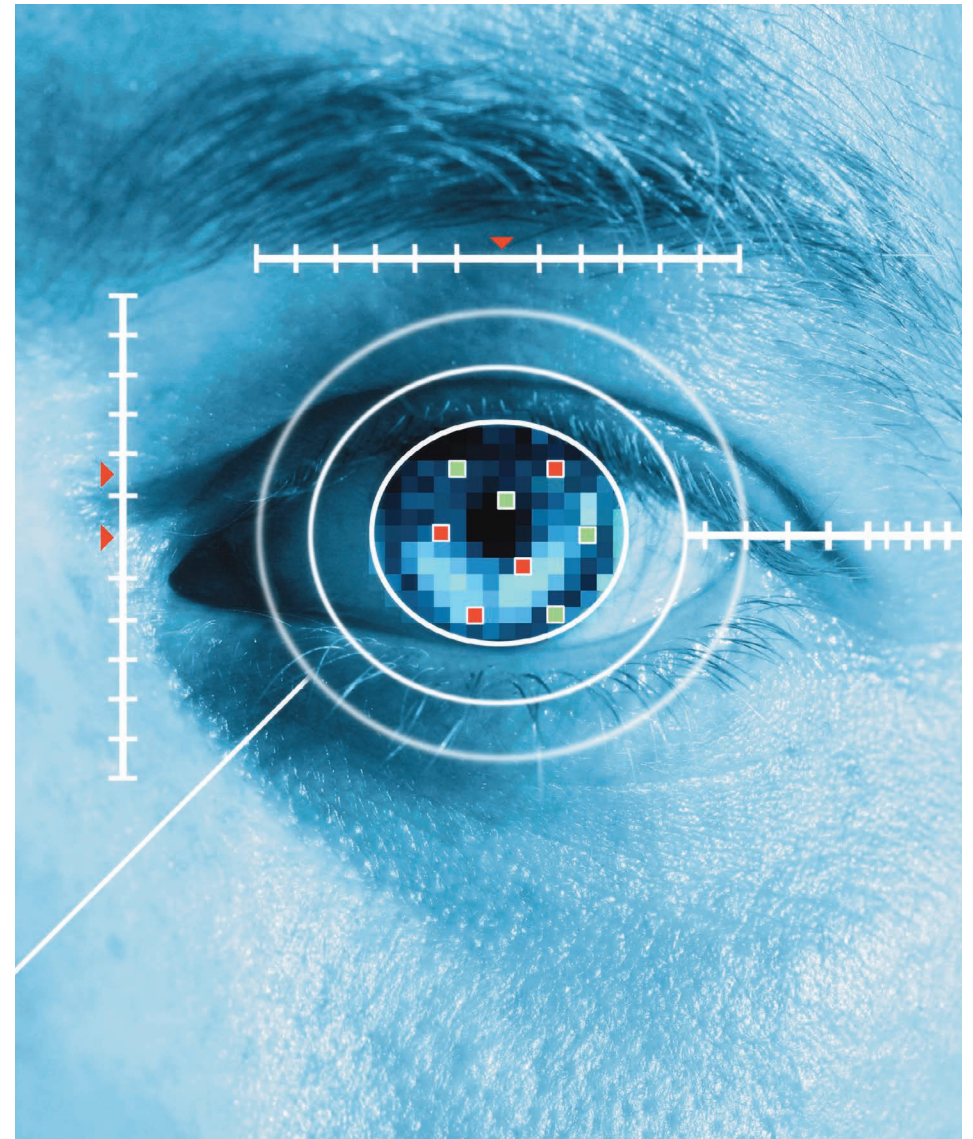
Critically though, so many of our industry analysts keep circling back to the issue that managing the complexity of Asian market regulations always comes at a significant cost. Whether the cost comes from investing in regulatory guidance or simply being caught unawares with resultant fines or barred trading access, regulatory compliance in Asian markets remains a thorny issue.



## GREATER ACCESS, GREATER OPPORTUNITY, GREATER REGULATION

Throughout the dozens of interviews conducted with the leading lights of the Asian trading industry a recurring number of hopes and concerns have surfaced time and again. There appears to be a cautious optimism resonating throughout the region regarding the imminent opening of China's markets to the world (albeit in an initially limited fashion) through the Shanghai Hong Kong Connect Program. Should it result in smooth and stable international trading of Chinese company stocks – not to mention the RMB – then similar connect programs should follow in its wake, providing ample opportunities for all manner of firms in the region.

However, this optimism is tempered by conflicting anxieties regarding the intentions of regulatory bodies both within Asia and without. Our interview respondents believe that the Asian markets need clear, enforceable guidelines regarding dark pool trading, algo use, permissible research, settlement and many other facets of market trading. Greater harmonisation and standardisation of such rules – particularly within ASEAN in order to provide a leading example – would go a long way towards easing those doubts regarding conflicting and unclear guidelines.



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