

Independent execution services

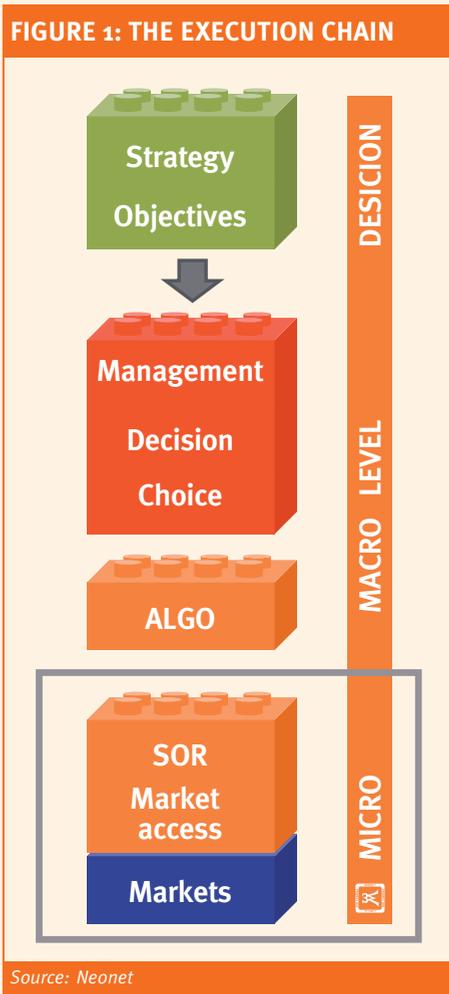
Fine details, sweeping consequences

It all starts with a decision to buy or sell. Neonet’s Jan Jonsson, VP Product Management, explains the minutia of the micro level of the execution chain – which can turn out to be a very big deal indeed.

Depending on the size of an investment and the available liquidity, execution objectives can differ dramatically but they need to be decided before you begin to trade. Your objectives serve as inputs into the macro level of execution and typically involve dividing a big investment decision into smaller, more manageable parts. Each smaller part is then transmitted to an execution venue and will fight with all the other market orders in the order book. This is what we refer to as the ‘micro level’ of execution.

The micro level of execution

The smart order router (SOR) and the Market Access layer works as a finely-tuned mechanism that handles trading in the micro structure of the market. The SOR and the consolidated (aggregated) market data price quotes hide the complexity of fragmentation (many markets



trading the same paper or instrument) so that all markets are presented in a single view for all levels higher up in the execution chain. It handles the immediate and short term execution of small slices of the algorithmic orders, as well as click and trade order submissions.

Benchmarking quality

On the primary market, there is only one best bid and one best offer – “the best bid and offer”. The difference between best bid and offer is called the spread. When multiple venues trade the same instruments, the bids and offers for those instruments can be better or worse than those on the primary market. The best bid and the best offer across all European venues is called the EBBO (European Best Bid and Offer). The EBBO will always be equal or better than the best bid and offer on a

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primary market (better if any of the alternative venues have a better price at any time). To have access to – and execute within the EBBO – is the first benchmark of micro execution.

Benchmarking cost aspect

Alternative venues, such as multilateral trading facilities (MTFs), compete with primary exchanges by offering a simpler, a more transparent and cheaper cost structure of trading. The primary exchanges often have complicated pricing structures that make comparisons difficult. Some MTFs pay for passive flow – cost varying with traded amount, adding to the non-transparent pricing structure. Still, there are ways to compare costs.

The chain is key

Benchmarking the micro level of the execution chain is crucial and can significantly lower costs while at the same time increase the overall quality of execution. When benchmarking against EBBO, the typical net effect is price improvements ranging between one and ten basis points. But in some instances and certain order types, improvement could

FIGURE 2: AN EXAMPLE OF A PRICE COMPARISON BETWEEN NASDAQ OMX SWEDEN TARIFF 1 AND CHI-X:

Amount traded in SEK	OMX		CHI-X		Clearing	Clearing
	Agg (bps)	Pas (bps)	Agg (bps)	Pas (bps)	cost 1 trade (bps)	cost 5 trades (bps)
1,000	75.75	49.93	0.3	-0.2	8	40
5,000	15.23	10.17	0.3	-0.2	1.6	8
10,000	7.79	5.2	0.3	-0.2	0.8	4
30,000	2.83	1.89	0.3	-0.2	0.267	1.33
60,000	1.59	1.06	0.3	-0.2	0.1333	0.65
100,000	1.1	0.73	0.3	-0.2	0.08	0.4
1,000,000	0.43	0.28	0.3	-0.2	0.008	0.04

Executing one order of 30k SEK aggressively in five trades on the primary resulted in a cost of 2.83 + 1.33 = 4.16 bps. Executing the same trade on an MTF resulted in a cost of 0.3 + 1.33 = 1.63 bps. This was a difference of 2.53 bps. The difference will depend on the chosen venues.

Source: Neonet

“In some instances and certain order types, improvement could even be in the thousands of basis points.”

even be in the thousands of basis points. When looking at costs – and specifically for smaller orders – it is also not unusual to see improvements in the tens of basis points, again highlighting its importance in comparison with the price a counterparty is charging.

At Neonet, we strive to deliver a truly transparent and independent execution service with an optimised

balance of quality and cost. Transparent reports like the one illustrated in this document give our clients full control and insight as to how we perform. ■

For detailed reports and statistics please visit www.neonet.com

