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Software vendors globalise pit

ISVs are becoming important players in derivatives, write Jeremy Grant and Alex Skorecki

When Eurex, the world's largest derivatives exchange, teamed up late last year with software company as part of the launch of its new US futures exchange, few outside the industry had heard of it.

But Trading Technologies (TT) and others like it are starting to emerge alongside the exchanges themselves as important players in the global derivatives business.

Their software allows traders to access multiple exchanges on the same computer screen, providing an essential link between users and the exchanges.

Independent software vendors (ISVs) have grown in the past decade as electronic trading has taken over from open-outcry pit trading.

Their role is also growing because exchanges have traditionally not provided an interface between traders and multiple exchanges, only a basic connection to their own market.

The two largest ISVs – Chicago-based TT and Patsystems of the UK – were founded by former traders who defected from the pits, seeing screens as the future.

Kevin Ashby, chief executive of Patsystems, says: "A lot of these companies were created by guys who were working on the floor and who saw electronic trading coming and put their savings – and quite often the savings of their friends – into building a platform."

Pats provides software to about 40 of the world's leading derivatives exchanges and brokers.

At TT, chief executive Harris Brumfield, a former trader in the US Treasury pit at the Chicago Board of Trade, says with traders having access through ISVs to multiple exchanges and their products, "the world becomes the pit".

"A guy sitting in London is all of a sudden in a pit of 20,000 people and has access to all these markets just by moving a mouse around," he says. He adds that ISVs have helped spur trading volume because they offer the prospect of on-screen spreadtrading between products on different exchanges.

Furthermore, derivatives are distinct from other financial markets in that the role of technology is at their very heart. It is not just a question of connecting to the exchange in the most efficient and rapid way. Innovation is also key.

As fast as new trading engines can be invented, traders have to update or die. The companies that develop the software behind these engines therefore become influential and sought-after by the exchanges and the customers of the exchanges – the brokerages.

Orc Software, spun off from exchange owner OM of Sweden, is one of the key innovators, while GL Trade,

a spin-off from Paris-based Euronext, also has clout. But in both cases their target markets are much broader than just derivatives.

While futures trading volume has been growing at record levels in the last two years, competition among ISVs is fierce and profits have been elusive.

"If you add together the turnovers of all the companies in the sector it doesn't actually amount to much. It's an emerging market," says Mr Ashby. He thinks ISVs will see profits once they "get to scale".

"We're moving into an area now, next year and beyond where we'll be extremely profitable. Like any software business, once your R&D is spent, every time you sell a system more or less it drops to the bottom line."

One hurdle ISVs have faced is the rapidly changing technology needs of their biggest customers, the derivatives exchanges, which have forced ISVs to move quickly to win and keep business. Early last year, for example, CBOT said it would switch from a Eurex tradematching engine to one provided by Euronext-Liffe.

Mr Ashby says: "Suddenly, outside of all budgetary control, we had 150 mandates for development, testing and all the effort to roll it out to customers.

"But the positive side is



Mr Harris Brumfield from Trading Technologies

that it's an expensive thing to be able to do, so only companies with scale can do it. It creates a barrier to entry and once you've got beyond a certain size it sustains that size and those barriers."

TT claims to have a customer base of traders that account for more than half of all volume done in US Treasury bond and note futures.

Mr Brumfield highlights the role of former pit traders at TT, saying their expertise has helped it develop software as closely matched to traders' needs as possible. "If you don't have the best product, the brokerages will beat the hell out of you," he says.