By offering solutions specifically tailored to clients on a case-by-case basis, execution consultants can help buy side firms address latency in the trade lifecycle, while allowing them to seek parity in a world increasingly dominated by high-speed "flash" programming. Are the rewards worth the risk of sharing potentially sensitive data with a sell side provider? David Simons reports from Boston.

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GETTING CLOSER TO THE BUY SIDE

ASSET MANAGERS RELY on many different types of strategies and processes, and the demands they place on their internal trading teams can vary wildly. This, in turn, can have a direct impact on the services they require from their providers on the sell side. Yet by settling for a one-size-fits-all solution—or not having better insight into the customisable tools at their disposal—buy side firms run the risk of seriously under-performing the competition.

This scenario has helped raise the profile of a fast-growing niche enterprise known as execution consulting. An advisory buy side service covering a multitude of needs, execution consultants are capable of providing firms with stock ideas and algorithm strategies as well as basic research insight, and can also offer advice about upcoming or existing regulatory issues and how trading processes can be structured to properly comply.

The elements that comprise execution consulting have been around for quite some time. However, within the past year providers have been able to hone in on a central theme: analysing how individual buy side firms can maximise their execution capabilities and, above all, how they can better access precious sources of liquidity. This not only involves determining how a suite of trading products can best be utilised, but often examines wider issues such as market structure and connectivity.

By gaining a deeper understanding of their clients' internal processes, sell side providers have been able to better tailor their product offerings, allowing the buy side to reduce investment latency, and, in the process, recoup "lost" alpha, say consultants. Perhaps most significantly, execution consulting seeks to address issues related to gaming, flash trading other products of an increasingly aggressive, high-speed world that, in some instances, have put institutional players at a severe disadvantage. Can execution consulting help traditional buy side firms redress the balance? Plus, is

The various disciplines of execution consulting have been in place for years, confirms Lee Morakis, head of execution services sales at Bank of America Merrill Lynch. However, like others in the business, over the past year Morakis and his colleagues have begun to see a much greater need for understanding the mechanisms that buy side firms use to execute their orders.

the reward of a more streamlined and competitive execution platform worth the risk of sharing potentially sensitive information with a third party?

An electronic education

Raymond Tierney, chief executive officer and president of global electronic agency brokerage Bloomberg Tradebook, calls execution consulting "something that has always been near and dear to me". He should know. In his 16 years at Morgan Stanley, Tierney served on both the sell side and buy side, the latter coming during a four-year stint as global head of equity trading for the company's Investment Management division. Today, Tierney is working to enhance Tradebook's own execution-support facility, which includes a team of consultants offering guidance on the world of electronic trading and is led by Robert Shapiro, himself a Morgan Stanley veteran, who serves as Tradebook's global head of trading and execution consultation.

If firms have been adept at pushing technology, often they're not nearly as good at providing information about what the technology has to offer, says Tierney. Therefore, one of Tradebook's key objectives is enhancing education around the electronic experience.

"Throughout the course of my career, I always found it somewhat remarkable that we were offering all of these tools, yet few people really understood what the tools did—it was always just a case of 'set it and forget it,'" says Tierney. "Not any more. Not only are sales traders today compelled to know how the tools work, they must also have the ability to distribute these order flows into the different strategies, whether it's liquidity, urgency or size."

Tierney believes that the buy side and sell side are currently at a turning point in their relationship—and as the buy side continues to take greater control of their orders, the sell side is searching for new ways to add value. "It's true that the buy side is no longer dependent on the sell side for execution. Still, I think those that can package and deliver high-quality liquidity solutions to these firms will see an increase in both the top and bottom lines."

The ability to take that discipline across multiple asset classes holds great promise in the years to come, says Tierney. "Just as high-frequency trading has moved across the aisle, the same mechanism will be sought out for the likes of futures, options and FX. So when people are thinking about providing clients with solutions along the lines of an execution

Lee Morakis, head of execution services sales at Bank of America Merrill Lynch. "We've had this enormous growth in electronic trading, particularly in equities, options and FX, and, to a lesser extent, fixed income," says Morakis. Photograph kindly supplied by Bank of America Merrill Lynch, September 2010.

Oliver Sung, head of execution consulting, Bank of America Merrill Lynch, says: "Compared to a straight-out-of-the-box solution, obviously this kind of hands-on approach is something that clients have been very responsive to." Photograph kindly supplied by Bank of America Merrill Lynch, September 2010.

consultant, they really need to be looking at it from the perspective of numerous asset classes. "Greater understanding around market infrastructure and microstructure needs to be brought to bear when approaching clients who are engaged in these different types of businesses. "The point is, product differentiation, education and execution analysis will all be driven by the execution consultant," says Tierney. Accordingly, sell side providers will be forced to adapt if they are to succeed in this field, "because these are the areas that I believe have the greatest potential for execution consultants".

In order to deliver high-quality liquidity solutions to the client base, consultants should have the ability to access the flows within the client's organisation, covering all applicable businesses. "Packaging must be fully transparent and client-driven, with a focus on enhancing the client's implicit P&L, covering everything from information leakage and market impact, to momentum and venue choice," says Tierney. The fact is, a lot of the explicit stuff like commissions, which represent only about 13% of the trade, is pretty much out of your hands to begin with, because market forces drive that behaviour. It's the other 87% that really matters, because that portion is all about the implicit cost savings. So if you can start to find liquidity, manage impact, as well as use the right kind of execution solutions to properly match up with that liquidity, the likelihood of reducing your implicit costs is pretty significant."

Furthermore, says Tierney, consultants must be able to re-classify orders and subsequently channel those executions to the proper venue and/or commission structure, including maintaining a full and thorough understanding of the client firm's electronic offerings.

Consultation disciplines

The various disciplines of execution consulting have been in place for years, confirms Lee Morakis, head of execution services sales at Bank of America Merrill Lynch. However, like others in the business, over the past year Morakis and his colleagues have begun to see a much greater need for understanding the mechanisms that buy side firms use to execute their orders. "We've had this enormous growth in electronic trading, particularly in equities, options and FX, and, to a lesser extent, fixed income," says Morakis. "As a result the sell side has been offering buy side clients a lot of different tailored products to help them respond to this ramp-up in electronic trading."

Rather than continue to seek newer products, however, Morakis found that clients instead wanted a more thorough analysis of the products already at their disposal, so they could decide which ones would provide them with the best execution methodology for a particular asset class, market environment or sector.

"By talking with clients and understanding how their trading strategies might vary from that of another client, we were able to show them the best way to use our tailored strategies in order to perform execution with the least amount of slippage. That's what has really brought this department together over the past year."

Bradley Katsuyama, head of RBC's global electronic sales and trading. "In today's world, however, market-structure insights have become just as valuable to the trading desk as the latest earnings report," he says. Photograph kindly supplied by RBC Capital Markets, September 2010.

By levering three unique disciplines—quantitative consulting through transactional cost analysis (TCA), macro research, as well as market-structure analysis—Bank of America Merrill Lynch is able to provide clients with the wherewithal to trade electronically, as well as more efficiently, adds Oliver Sung, head of execution consulting, Bank of America Merrill Lynch. As part of their menu of services, consultants may perform "deep dive" analysis on a client's current algo arrangement to ensure that overall performance is adequate, making adjustments as needed or suggesting possible alternative strategies. "Compared to a straight-out-of-the-box solution, obviously this kind of hands-on approach is something that clients have been very responsive to," says Sung.

Not only has this analysis led to improved strategies for clients, it has also provided Sung's team with a road map for providing ideas to enhance its suite of products. "We have been able to continually update our anti-gaming regimen based on our analysis to account for the constantly changing marketplace," he says.

While laying the foundation for its electronic service offering launched in May, RBC Capital Markets approached various buy side clients in an effort to determine how to best structure its new platform. "Over and over again, clients were telling us that they felt a lot of the products were commoditised," says Bradley Katsuyama, head of RBC's global electronic sales and trading. "They saw a lot of big marketing, bells and whistles, but very little in the way of explanation. Yet once we started to research further, we found that electronic trading was anything but commoditised—it was all about the way it was being presented. The point is, if you get into a level of unnecessary complexity, trader's will be unlikely to use it."

While running RBC's high touch market making desk, Katsuyama had first-hand experience dealing with the problems and challenges associated with high-frequency trading (HFT). "I saw the flickering quotes, cancellations, and adverse price moves, and was consistently frustrated with the lack of answers," says Katsuyama. "So when many of our top clients outlined the exact same issues, we became dedicated to effectively diagnosing the problem and it started with acquiring knowledge."

The rapid growth of high-frequency trading (HFT), according to Katsuyama, has had the effect of shaking up the marketplace, and, in the process, became a real catalyst for RBC's electronic services platform.

"Suddenly, HFT was this very significant, high-volume competitor, and while many of our larger clients were initially quite opposed to HFT, rather than choosing sides we decided to step back and examine how HFT worked, what the traders' strategies were about, and how we might be able to shift the balance of power back to the institutions. So when it came time to build our client-facing electronic tools, we went out and actually hired individuals with HFT expertise, in an effort to bring some parity to the institutional-client segment of the market. By doing so, we were able to gain meaningful insight into the strategies and technologies surrounding HFT—and that has allowed us to take a very differentiated approach to our service offering."

Market insights

Clients are cognizant of the tremendous focus on micro-market structure, and therefore rely heavily on their broker counterparts to be well researched in this area. "Two years ago, you might have been able to get away with handing a client a TCA report and feeling like you fulfilled your duty as a service provider," says Katsuyama. "In today's world, however, market-structure insights have become just as valuable to the trading desk as the latest earnings report. It's a clear sign that both the markets and the sophistication of clients have evolved."

Filling gaps in electronic trading begins on a much different level—that is, building trust between these two disparate client groups. "There are certain things that a client won't ever divulge to the broker. We have found that once we have established a certain level of trust, clients are quite willing to approach us from an ideas standpoint—they'll bring us into workflow discussions where we learn about the challenges that they're trying to overcome. Coming from the sell side, you get a much different level of appreciation from listening to the people on the front lines who have to deal with these pressures on a daily basis."

One area where virtually all firms wish to improve performance—and where execution consultants can truly add value—is shortening the process chain from investment decision to execution. Research suggests that the delay between a fund manager's decision to invest and the actual market execution of that decision can often cost as much as 400 basis points. A gap this wide can lead to diminished

Raymond Tierney, chief executive officer and president of global electronic agency brokerage Bloomberg Tradebook, states: "Product differentiation, education and execution analysis will all be driven by the execution consultant." Photograph kindly supplied by Bloomberg Tradebook, September 2010.

performance by fund managers. "A lot of people on the buy side are looking to streamline their workflow—and as soon as the order gets into the sell side's hands, the focus is really all about access to liquidity. Through our conversations with clients, we found that liquidity access—or lack thereof—was the number one point of frustration. So that has really become the cornerstone of our approach. Particularly when you consider that HFT represents anywhere from 50% to 70% of total volume, that 'access to liquidity' actually means 'understanding HFT'. However, it's also about being intuitive—we have to be able to sit down with the client and explain why we've built a particular product, here's the rationale based on what we've heard from research and discussions with our clients, and this is what we're doing to address the problem."

Playing the role of advocate goes a step beyond basic consultancy, contends Bobby Grubert, head of US Equity Sales and Trading for RBC Capital Markets. "It requires deeper engagement, greater trust and true transparency. Our consistent focus on viewing every situation through the client's lens has led them to rely on us as a sounding board so that new ideas can be shared and tested in a collaborative manner. This has allowed us to provide customised solutions in a commoditised world."

At the end of the day, says Tradebook's Tierney, the primary goal of the execution consultant is to solve liquidity sourcing challenges for the client, while driving down the implicit costs of trading. "This is effectively a high-touch service in a low-cost world, and in order for you to gain a competitive edge, you'll have to be best in class. It's that simple. However, my general view is that if you can gain mindshare, you'll get market share as well." ■