Risk Broker Rankings 2017

Time to diversify

Anyone wondering what is driving the consolidation trend in interdealer broking need only look at responses to the qualitative questions that accompanied this year's broker rankings.

Our survey of more than 200 bank traders found 27.8% of respondents have reduced their broker fees by more than 20% over the past three years, while 17% reported drops of 10–19%.

As a well as consolidating, brokers are trying to diversify by adding different products and services: "You've got less bank business for various reasons, such as balance sheet and proprietary trading restrictions, so the traditional model is changing," says Dan Marcus, global head of strategy and business development at Tradition in London. "If brokers are to continue to thrive they must be innovative and clever. Partly that means looking at product diversification."

Banks' reduced broker spending may be temporary, though, with nearly 60% of respondents attributing it to a reduction in trading volume, which means they have had less risk to put through the interdealer market.

Elsewhere, banks were divided over whether they expected non-banks to become significant liquidity providers on interdealer platforms – a slim majority said they would (54.5%). Last year's survey of brokers found 78.8% believed non-banks would soon become significant liquidity providers.

Respondents believed non-banks are most likely to add liquidity (37.7%) and increase competition (26.6%). Only 14.6% were concerned they would attempt to arbitrate traditional interdealer market participants, and 10% thought they would make the market more fragile.

Tradition's Marcus doesn't believe large-scale change is imminent: "It's not as simple as just reaching out to an asset manager and asking them to come and trade via an interdealer broker," he says. "Many asset managers operate in ways best catered for by banks. For many years, they have provided a highly efficient service including average pricing and allocation models, as well as leveraging their balance sheet and access to markets."

Away from the broker market, the survey found dealers are getting more technologically sophisticated in the electronically traded over-the-counter derivatives market. Nearly 68% of respondents said they can auto-price trades, while 63.1% can auto-execute. A smaller number (40.9%) can auto-hedge, while just 21.5% can provide execution or order management algorithms to clients.

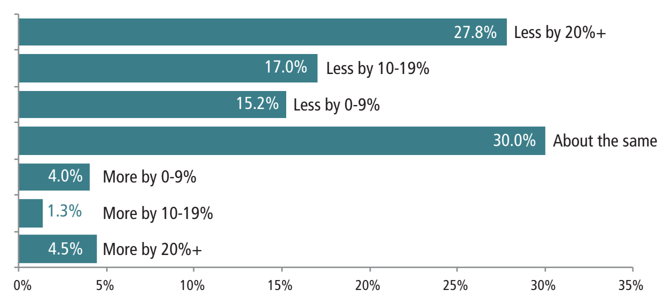
A significant majority (77.9%) say clients are also taking more interest in achieving best execution for OTC derivatives trades. Half of respondents said clients are actively changing their policies to put a greater focus on achieving the best available price, while 27.9% said clients are starting to think about the topic.

With new initial and variation margin rules for non-cleared OTC derivatives coming into force from September last year, and initial margin requirements at clearing houses being factored into pricing, traders say a basis is opening up between certain cleared and non-cleared versions of the same instrument. Just over 53% of respondents say they differentiate pricing between cleared and non-cleared instruments, while 22% expect it to happen within the next year.

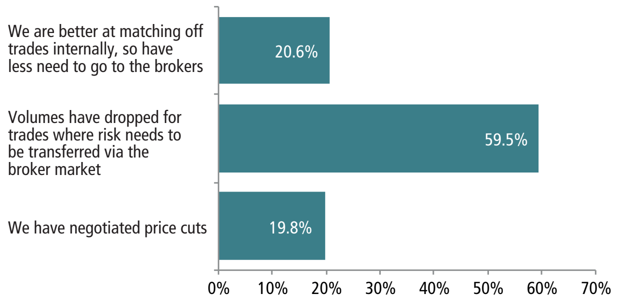
Increasing complexity and new margin requirements have seen volumes of non-cleared derivatives instruments fall by more than half in the past two years, and dealers believe this will continue: 78.1% of respondents believe volumes will fall either at a similar pace (36.1%) or at a slower pace (42%).

Just under 30% of dealers said the decline could be arrested by introducing so-called clean collateral documents, which allow only cash to be posted as variation margin, for instance. A further 18.3% said a more widespread use of compression and netting can help. However 31.1% said the decline in non-cleared volumes is irreversible. ■

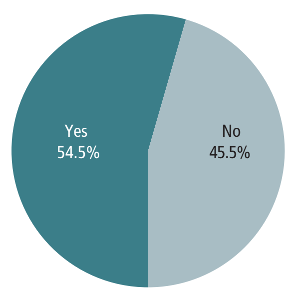
Q1 Is your bank spending more or less on annual broker fees than it was three years ago?



Q2 If your broker costs have dropped, what is the principal cause of the decline?



Q3 Do you expect non-banks to become significant providers of liquidity on interdealer platforms?



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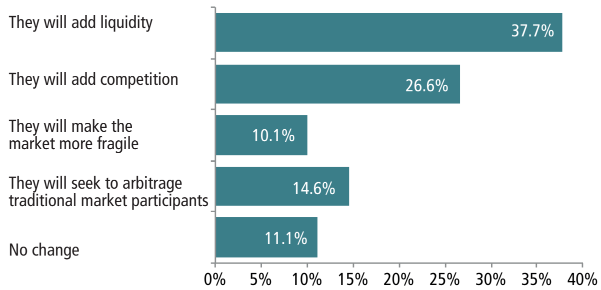
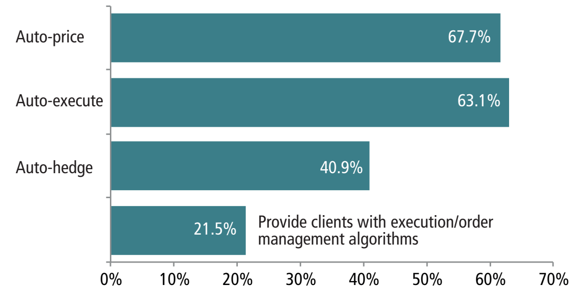
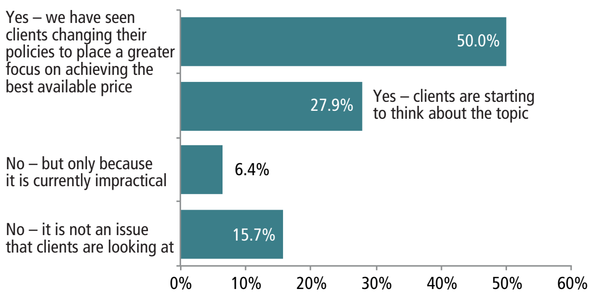
Q4 What will be the most notable effect on OTC markets if proprietary traders (eg DRW, KCG, Virtu) gain access?



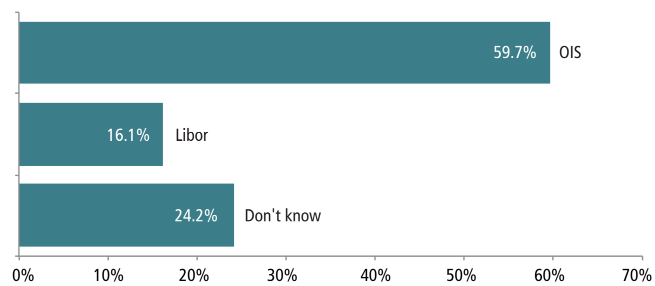
Q5 For electronically traded products, what can you currently do? (select all that apply)



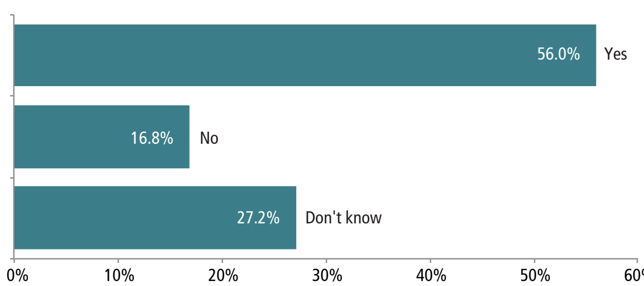
Q6 Are clients taking more interest in best execution for OTC traders?



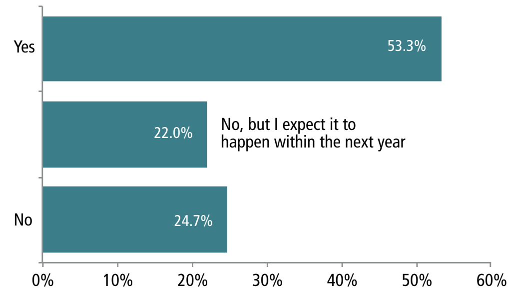
Q7 What rate do you use to discount cash-collateralised trades?



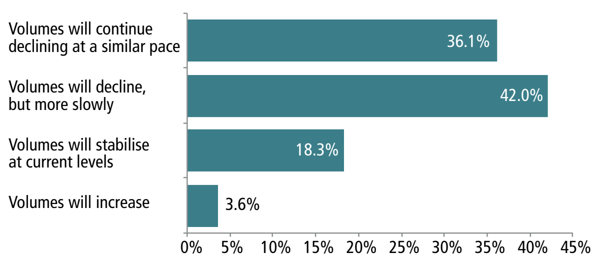
Q8 Does your firm take collateral posting optionality into account when valuing trades?



Q9 Do you currently price cleared and non-cleared trades differently?



Q10 Volumes of non-cleared OTC interest rate derivatives outstanding have more than halved in the past two years. What will happen over the next two years?



Q11 Can the industry do anything to support the non-cleared market?