

Post-Trade, Compliance Desks Seek Tech Solutions

Cheevers & Co. says its innovative software provides transparency into complex trade processing

The burgeoning number and complexity of securities trades is generating a mountain of information that needs to be recorded for post-trade analysis, compliance and risk management, eating up more and more man-hours and potentially cutting into traders' productivity.

This is especially true in the options industry, where reporting requirements are comparatively onerous.

"Regulators want to know when an order was received and when it was executed, and they want those two events to occur as simultane-

ously as possible even if it encompasses multiple asset classes," said Eric White, vice president at Cheevers & Co., a Chicago-based trading firm that specializes in executing the equity portions of complex options trades.

The equities and options industries each have developed separate audit trail system to recreate the sequence of events in the life cycle of orders and more completely monitor the trading practices of member firms. Finra's Order Audit Trail System (OATS) is an integrated audit trail of order, quote, and trade information for Nasdaq and OTC equity securities, and the options exchanges utilize Consolidated Options Audit Trail system (COATS). Since complex options orders typically often involve executing an equities leg, options traders need to comply with both systems.

Member firms are required to electronically capture and report specific data elements related to the handling and execution of orders, including recording precise times of each event.

"The requirement to do post-trade processing intraday is an industry challenge," White told Markets Media. "The work threatens to put a stranglehold on back offices, which can no longer do all the work overnight and now have to process intraday as well."

That view is shared by other market participants. "Compliance officers are struggling to cope with volumes of data from the high-frequency trading world," said Doug Kittelsen, chief technology officer at FTEN, which sells trading infrastructure products to buy-side and sell-side firms. "They need ways to access the data and look for fictitious orders, and lots of mature tools are needed in order to do that."

The need to manage increasingly voluminous data is taking a bigger bite out of the technology budgets of trading firms, many of whom are also shelling out more for high-speed networking and co-location, which are the *raison d'être* of high-frequency trading.

"There's more spend and focus from a risk/compliance/post-trade viewpoint," said Anthony Stanfield, managing director and head of

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global quant trading at TransMarket Group, a proprietary trading firm. "The race to zero (for trade execution) still exists, but there are barriers to entry to the upper echelons of technology."

While prop shops may lament the added time and money costs associated with today's trading environment, it presents a huge opening for software and technology developers who can provide the right product at a reasonable cost.

"There are lots of opportunities for vendors to take the workload off of in-house programmers, freeing them to focus on trading and strategy," Stanfield said. "Off-the-shelf software for risk control and post-trade analysis would ease that burden."

Cheevers was established in 1982 by Kathleen Cheevers as a sole proprietorship. Historically a niche player facilitating equity executions tied to exchange-traded derivatives, the firm, which began with a single seat on the Chicago Stock Exchange, has grown to become one of the largest volume brokers on the CHX, catering to both buy-side and sell-side institutional clients and offering domestic, fixed income and international capabilities.

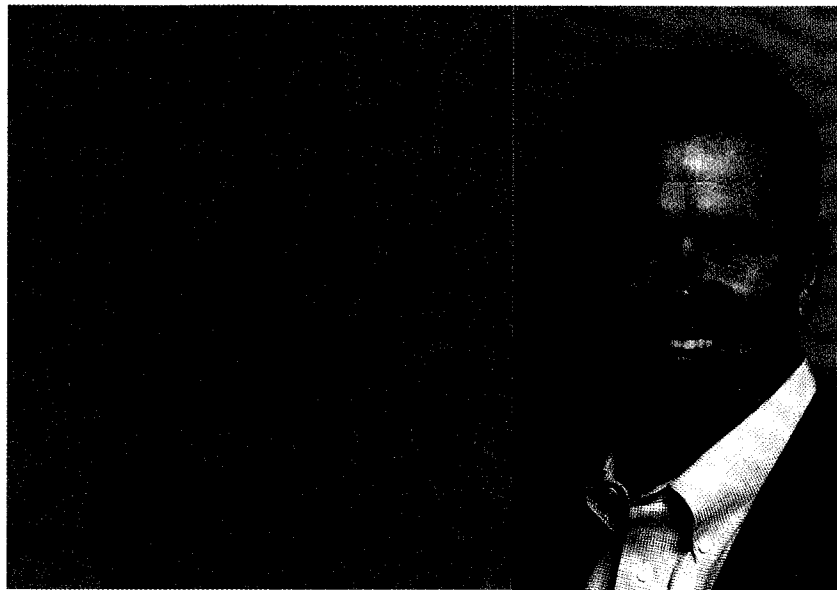
Multi-Step, Multi-Counterparty

Cheevers' mission of executing the equities portion of options trades is especially complicated. "Cheevers' business is more complex than trading stock or options separately," said White. "The combination of the two, plus dealing with multiple counterparties, is unique."

The options trades that need execution involve as few as three but as many as 10 counterparties. Trades originate at a bank where clients seek to establish positions in a stock, index, or exchange-traded fund. These indications of interest are communicated to interdealer brokers who show these indications to their network of liquidity providers and establish pricing levels. Next, those pricing parameters are communicated to options floor brokers who accommodate trading floor interest and determine final pricing for both the options and equity components. The options are then executed by the options floor brokers at the same time the stock leg is communicated to Cheevers and executed.

"Bulge-bracket banks execute orders on behalf of their hedge fund clients; the order then gets split up into an options and an equities portion, each of which involves a liquidity provider and a floor broker," White said. "It's up to us to divide that order up and then deliver information about the trade to the back offices of each of those five counterparties."

Being able to accurately track the timing of each step along the way is difficult, but vitally important as a compliance function. "You need to execute the stock and options components simultaneously,"



White said. "When it's done over the phone, there's time slippage and pulling all that data consumes scarce resources could take days of pulling hand tickets."

Cheevers has developed technology to automate the gathering and distribution of trade information, augmenting the current system of phone and instant messaging. "By implementing this technology, we're creating greater transparency by enabling the back office to log in and view the trades themselves," White said.

The solution Cheevers developed combines trading technology from Mixit Inc. that splits off and directs the equity portion of a complex order for concurrent and compliant execution, with web-based financial management software from Firm58, which manages the processes associated with fees, commissions and payouts.

"Firm 58's web interface allows clients to obtain execution data electronically, enhancing their ability to meet audit and compliance obligations," said White. "In addition, the solution will facilitate the retrieval of execution information for recap, allocation, clearing and billing functionalities."

Previously, Cheevers would have had to segregate and manually blot, or record, information for each party to a trade, using input off handwritten order tickets. "It's a manual, error-prone process," White said.

The new system generates the information automatically. "Firm58 creates a spreadsheet that I can e-mail to Merrill Lynch, Morgan Stanley Goldman Sachs—all the different back offices," said White. "The information is the same that gets sent to the DTCC (Depository Trust & Clearing Corp.) for clearing, so it is virtually error-free." ■