

Buyside seeks intelligent order-routing

Smart order-routing must evolve to address the needs of the buyside and achieve best execution, according to brokers and vendors.

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Users may not be achieving best execution

Smart order-routing technology enables users to execute on several equities venues, including electronic crossing networks, exchanges, alternative trading systems and dark pools.

Smart order-routing emerged as a powerful liquidity-seeking tool to address the best-execution requirements of Reg NMS in the US and to help solve fragmentation of the equities market. When there are more than 40 venues, technology is necessary to execute on multiples of them.

The problem is that what smart order-routing was designed for – hunting down liquidity in multiple venues – may mean it is not helping users achieve their goals of best execution.

Andrew Silverman, head of distribution for Morgan Stanley Electronic Trading, said: “The minute you give your order to a smart order-router you lose control of it. It routes trades at the speed of light, but where is it going – to one venue or to seven of them? Did it leave a footprint?”

Silverman said the only way the buyside can keep control over orders is to understand the routing, processing and technology of sellside counterparts; and to communicate which venues to avoid. “Not knowing means you could be taken into more venues, leave larger footprints, and you might move the market.”

The buyside is looking for more intelligent smart order-routing to the point where the delineation between smart order-routing and algorithmic trading is blurring. The model of a fixed, liquidity-seeking order-router is morphing into a more strategic and customisable type of technology that more closely resembles the algorithms that feed it.

Matt Samelson, senior analyst at consultancy Aite Group, said: “Once the smart order-routing functionality and algorithms were distinct. Now the industry is developing algorithms that do what smart order-routing used to do.”

According to a report by Aite, best execution involves an unspecified combination of price, speed and execution parameters. Traditionally, best execution has been associated with price, but best price does not always constitute best execution, according to the report.

Sometimes, if it is a difficult order, best execution means simply to get the order done at any price, said Samelson. Some algorithms and smart order-routers allow users to put constraints on them, such as excluding certain venues or tweaking the aggressiveness of the strategy.

But most offer only basic parameters, said Samelson. Once your order is entered, execution happens so fast that you couldn't control it if you wanted to, he said.

Joseph Saluzzi, co-head of equity trading at agency brokerage **Themis Trading**, said you need to be careful when allowing your order to be fully automated and handled through a smart order-router.

He said: “Today's markets are more fragmented than ever and the depth of displayed liquidity available is very limited. Smart order-routers work well with very liquid stocks as long as you have defined your parameters correctly.”

Providers of smart order-routing solutions, including software vendors, brokers, exchanges and ECNs, are working to change the perception that their technology is too static.

Because there are so many venues, smart order-routing has become a critical component of many advanced algorithms, according to John Comerford, head of trading research at Instinet. He said the ECN believed its clients should be able to direct their orders as they see fit.

Instinet's SmartRouter allows clients to select the venues to which it would like its orders exposed. Agency brokerage BNY ConvergeX created a suite of products known as TactEx that offer access to dark and light liquidity simultaneously. There are different order types within the suite; one splits an order between light and dark liquidity and rebalances it as parts are executed.

Another only accesses liquidity from dark liquidity sources, said Craig Viani, managing director and head of electronic trading product management at BNY ConvergeX.

The broker is poised to launch one more this summer. Viani said: "Grey is a new order type that sweeps displayed liquidity then disappears into the dark pools when the order is no longer marketable."

Anthony Huck, managing director at brokerage and crossing network provider Investment Technology Group, said that as long as a router was doing what you wanted it to; losing control over the order should not be an issue.

An issue with traditional smart order-routing is that almost everyone has it in one form or another; and everyone is trying to exploit trading patterns or anomalies with more sophisticated systems.

Saluzzi said: "One of the main problems with smart order-routers is that they attract other smart orders looking to take advantage of less sophisticated orders. This is more apparent in the less liquid, small and mid-cap stocks."

To prevent being spotted by another order-router, Themis uses the various ECNs' smart order-routers. He said: "We are constantly changing our venue to reduce our footprint and lower the chance of a predatory algorithm spotting us."

Algorithms and smart order-routers were designed to make a trader's job easier, to execute across several venues and to get the best price, leaving traders free to do more creative things.

Samelson said: "When you use algorithms and smart order-routing you are giving up some control. But these are supposed to be work savers; they are supposed to leverage the traders, not replace them."

Smart order-routing is only one tool in a trader's bag, according to **Saluzzi**. He said: "If you just want to be average and match the volume weighted average price, then solely using a smart order-router in a liquid stock may be for you."

"But to beat the averages, you need to pay attention to a stock. Traders who solely use smart order-routing are not achieving best execution."

You need to be aware of how a stock is trading and where the volume is trading. The best way to do this is old-fashioned tape-reading."