

Xetra

Market quality: The new benchmark for trading venues

Facing an increasingly fragmented equities trading landscape, European investors crave the means to identify the very trading venue which supports their individual strategy best. While cross-venue comparisons regarding market share and liquidity are available, their benefit is limited. To ensure the best possible outcome for a trade, investors have to consider much more: the overall market quality of a specific trading venue. And as important as quantitative measures are, they should not be the only determinants of market quality.

Measuring market quality

As independent research provider LiquidMetrix's 'Battlemap of the Exchanges' shows on a weekly basis, there are several important market quality indicators which are both quantifiable and comparable: spreads at touch, best prices at touch, and the quoted order book depth. Another important factor regarding the quality of a market place is the diversity in counterparties which directly influences a

Michael Krogmann, executive vice president, considers how Deutsche Börse's Xetra electronic trading system rates against quantitative and qualitative market quality criteria.



Michael Krogmann

market's ability to recover from the impact of an order. Thus, the integrity of an order book can only be maintained when the trading venue operator grants equal access for all kinds of investors and does everything in its power to ensure a heterogeneous and pan-European order flow.

The liquidity pool on Xetra reflects the interests of more than authorised 4,500 traders, 250 banks, finance companies and financial service providers

from 18 countries. With the Xetra Liquidity Measure (XLM), market participants active on Xetra own a reliable tool for an objective assessment of their implicit transaction costs right before they have to place an order. XLM reflects these costs – the costs of taking liquidity – by measuring the market impact a specific order size will cause. Since the implicit transaction costs account for up to 80% of overall transaction costs, a rich liquidity pool created by a heterogeneous order flow warrants high execution quality, especially regarding large order sizes.

Deutsche Börse's continuous efforts regarding liquidity provision and pre-trade transparency have been successful: according to LiquidMetrix's research, Xetra consistently offers the tightest spreads at touch and the greatest order book depth. More often than any competitor, Xetra offers the

best prices at touch and in size, making it the market leader in German blue-chip trading. In February 2013, Xetra offered best prices twice as often as the runner-up in the 'Battlemap of the Exchanges', and nearly four times more often than the weakest competitor.

Non-quantitative factors

As important as quantitative measures are, they should not be the only determinants of market quality. In the end, every step in the trading process – from order routing, trading and clearing down to settlement of each and every instrument – is cost-sensitive and may influence the outcome of a trade. In fact, differences in market quality start even before any orders are placed: does the trading venue operator grant equal access for every market participant, no matter what? To which degree is transparency ensured? As a fully regulated exchange, Deutsche Börse offers absolute neutrality and the highest possible level of transparency, pre-trade as well as post-trade – an area where OTC trading facilities are still seriously lacking.

To ensure a high degree of cost-efficiency, Xetra offers straight-through

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processing allowing for multilateral netting and contributes a valuable addition to the systemic risk management of Xetra participants through market integrity. Xetra provides a variety of system-stabilising and risk-reducing rules and security mechanisms all along the complete trading process. To guarantee sensible prices at all times, Deutsche Börse uses the very effective instrument of volatility interruption, introduced in 1999. This security mechanism has proven reliable even in phases of extreme volatility and massive trading activity. During continuous trading on Xetra, carefully conceived recently technical throttles prevent quote stuffing and 'fat finger' errors. Furthermore, trading on Xetra is constantly supervised by the independent Market Surveillance Office guaranteeing fair play and neutrality.

More hard-to-quantify market quality factors include the level of the trading technology and the stability of the trading infrastructure.

To facilitate fast and reliable liquidity provision for market makers, Deutsche Börse continuously improves its low latency trading system maintaining redundant lines and offers co-location services to guarantee fast – and equal – access for every Xetra participant. Another non-quantifiable factor regarding market quality is the market design of a trading venue. Deutsche Börse's market model includes the attraction of liquidity providers – designated sponsors – with the help of attractive incentive schemes to maximize liquidity in most securities. Also, Deutsche Börse creates functional inducements on a regular basis to further improve market quality on Xetra. One of the latest efforts is the so-called top-of-the-book order aiming to increase liquidity in a specific instrument. This new order type has proven to be very popular with market participants and contributes to narrower spreads. ■