John Nixon

REFLECTS ON STRATEGIC ACQUISITIONS, NON-BANKS, SEFS, EXCHANGES AND THE UNIQUE ROLE OF THE FX MARKET

John Nixon, group executive director, Americas, at Icap, retired from the Board on March 31 with 40 years in financial services under his belt. Here, Nixon shares his views on the pre- and post-2008 world with P&L's Julie Ros.

Julie Ros: While at Icap, you were involved in the acquisitions of both EBS and BrokerTec. How did those fit in with the business strategically?

John Nixon: One of the things that I think is important for people to recognise for Icap is that as strong as it is today, the opportunities that were made available to us to acquire firms like EBS and BrokerTec were significantly enhanced by the merger of Garban and Intercapital (Icap) at the outset. Garban was clearly a bigger firm than Intercapital, but Intercapital was a very strong organisation in Europe. Together they were able to leapfrog themselves to front and centre stage as the leading interdealer broker at that time.
If you look at all of the transactions that we've done – BrokerTec, EBS, Traiana and TriOptima – they have been extremely successful and allowed us to differentiate ourselves from our competition and some of our brethren in the interdealer space. But I'm honestly not sure that any of it would really have been able to happen if we had not been able to do that initial merger between Icap and Garban.

JR: What about that merger was special?

JN: It solidified our position as the leading IDB by giving us deep liquidity and market share across multiple asset classes around the world. I think that merger is often forgotten in the history of Icap today. People look at where we are and what we've done and, while we've changed the firm significantly from what it was as an interdealer broker, the beginning of that change happened with that original merger. After that merger, it gave us the ability to have conversations with the bank owners of BrokerTec and the bank owners of EBS in a far more relevant way than if it had just been either one of us on our own, and from that position of strength we were able to grow our electronic and post-trade businesses – all on the back of that merger.

JR: How soon after you joined Icap did that acquisition take place?

JN: In 1998, Icap reversed into Exco to become a public company, and Michael [Spencer, group CEO], asked if I would sit on the board as a non-executive director and help him with his acquisition strategy, and from that came the Garban merger, which then led to the BrokerTec acquisition, which then led to the EBS acquisition. It was one of those situations where you thought you were in for a day a week and you were in for seven days a week very quickly. But there's no question it was a tremendous amount of fun and hard work put together, helping Michael build an organisation from a relatively small interdealer broker in London to a multi-faceted company in financial services.

JR: Icap's strategy in recent years looks more aligned with what some of the exchanges have done – was this intentional?

JN: There's no question that Michael had a vision that the company needed to expand its horizons from the voice broker business to a far more diversified financial services company by owning electronic or post-trade properties. Michael was pretty vigilant about his views that electronic trading had to be part of our solutions and was very dynamic in trying to go out and ensure that the growth of the company was headed in that direction. He was always trying to make sure that the troops recognised that having a voice broking business was an important part of who we were and made sure we didn't lose sight of where we came from and what our pedigree was. But in order for us to be able to build a first-class organisation and compete with the likes of, at the time, a growing group of exchanges, we had to be able to compete by having platforms that would be able to grow in electronic trading similar to exchanges such as ICE, CME or LSE.

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While Michael was always mindful and respectful of the position of our interdealer brethren, he always had one eye clearly watching where the exchanges were headed – where they were investing their money, what they were becoming – and recognised that our traditional competition was going to change over a period of time, and in the long run, while the IDBs would be important competitors, the exchanges and electronic trading platforms would be just as important.

JR: How do you see Dodd-Frank continuing to impact both the OTC and listed markets?

JN: For many, many years, the OTC model and the exchange listed model have grown side-by-side. The OTC market was where people took risk, and the futures market was where people hedged risk. The two of them grew on a percentage basis in a similar fashion. There has been, certainly in the US, in interest rate swaps [IRS], a slight divergence in that history where you've seen bigger growth from CME than you have probably seen from the OTC markets, but most of that has been from changes in regulation than anything else. Those percentage growth rates of futures versus OTC are not as prevalent in some of the other currencies, products, asset classes or even geographies, as they are in interest rate swaps. But there's no doubt that Dodd-Frank and the capital rules associated with Basel III have impacted the interest rate swaps market in the US, and how people put on and manage risk in comparison to what we've seen in the past, which has probably been beneficial to some of the futures exchanges over the OTC platforms.

JR: Do you see that as a dangerous development or something the OTC market needs to mimic or address?

JN: It's hard to mimic and address some of the futures exchanges, which at this stage are protected by some of the fungibility rules afforded to them by the Commodity Exchange Act. The fact that the exchanges built and manage a very successful vertical silo that requires you to buy a future and sell a future on the same exchange and clear at the same clearing house – while with OTC products, you can buy them on one platform and sell them on another platform – makes them very different business models. To a certain extent, the CEA certainly helped the futures markets create monopolies in their particular product base.
If you look at financial products, particularly IRS, but even in FX, CME must have a 98% market share in the products that it's strong in and the OTC markets compete head on head with each other without the benefit of a vertical business model. Whether or not that changes over time is anybody's guess. I don't think it's going to change any time soon, certainly not in the US. Some of the changes that the European regulators are looking at implementing on interoperability might lead one to believe that there's a possibility for change in Europe before you would find change in the US. I think that given the implementation of Dodd-Frank, given the oversight of our regulators such as CFTC, there has certainly been a move from US trading institutions to take risk in the futures market where possible. It's cheaper, it has less variation margin, it has two-day VaR versus five-day VaR, so there are definitely benefits that futures markets provide to market makers and traders in the US, and hence why I think you've seen this outsized growth of the futures markets versus OTC here in the States.

JR: Do you see a future where FX moves to the exchange model?

JN: The FX market at CME, from a futures perspective, has grown significantly over the past number of years, but there is no product in the world that trades more often and across more time zones, in multiple trade tickets, than foreign exchange. Every day, banks get up and talk to their

Nixon has many fond memories of the firm's annual "Charity Day", which takes place every December. The firm donates 100% of its revenues and 100% of its brokers' commissions from the day directly to charities, and to date, has raised $189 million since the first Charity Day took place in 1993.

ICAP raised $12.5 million worldwide during its 22nd annual global Charity Day on December 3, 2014. This is equivalent to 3% of ICAP's full year pre-tax profits. ICAP is supporting around 200 charities globally, having supported more than 1,600 charities since the first Charity Day in 1993.

customers. The number of times they put on interest rate swap positions on behalf of their customers, take positions off on behalf of their customers, or change their US Treasury duration or even have trades to do on behalf of their customers in Treasury products is miniscule in comparison to what happens in the FX market.

The OTC FX market is one of the strongest markets and asset classes there is. I don't see that changing. While futures will always be part of hedging risk – the OTC markets, and FX in particular, are going to continue to be extremely strong when it comes to putting on and taking off risk. Already this year, FX has probably been one of the most important, if not best-performing, asset classes for institutions to be in. While I'm sure there have been many winners and many losers, it has certainly been an active marketplace that is likely going to outperform most other asset classes going forward – how long that lasts is anybody's guess, but it's certainly not going to change any time in the next couple of months.

JR: What do you see as the future of pricing?

JN: The FX markets are pretty efficient quite honestly. FX doesn't use a massive amount of capital on banks' balance sheets; it is a very transparent marketplace generally speaking, and it is pretty liquid, so I actually think that it is quite a healthy market and I don't necessarily see that changing. The FX market is a lot easier for banks to deal in than in corporate bonds, government bonds or derivatives, and there are many more natural end users, buyers and sellers, than in just about any other market in the world. Any organisation, any firm, any bank has FX business virtually every day. That simply is not the case with all the other asset classes.

That said, it may well be that if you look back over the course of the past 10 or 15 years, the cost of transacting and the cost of processing tickets has continued to decrease and it may well be that it has reached a bottom. So we may see the cost of providing prime brokerage services, the cost of using CLS – may in fact go up if the capital requirements of being a PB continue to be increased. So the next move in transaction costs associated with FX may well be up.

JR: The non-banks have been playing a more important role as some banks have pulled back, do you see that as a trend that is going to eventually see them close to par in terms of liquidity provision?

JN: I have to say that there's no question that some of the non-bank financial institutions and market makers have become a far bigger part of the marketplace and my guess is that they'll continue to grow that position. They're going to be more natural providers of liquidity in markets like FX that are very liquid and very transparent than perhaps in some of the less liquid and less transparent markets. They are a very important source of market making in all of our markets today and I have to believe that over the course of the next five years, they will only grow in importance. Will we ever get to a point where the most important market makers are actually non-bank market maker institutions? It's hard for me to see that that would be the case. But there's certainly a possibility that in the liquid products, they will be a very, very big part of that liquidity provision. In the less liquid products, I still think you're going to need the banking community with their balance sheet, to remain an important counterparty for financial institutions on the buy side to transact with.

It's going to be harder for the non-banks to be market makers in corporate bonds than for banks to be market makers in corporate bonds. If the corporate bond market is somewhat broken by the fact that the banks are not warehousing as much inventory as they used to, then I think the model is going to have to evolve, and the model will change to allow both the buy side as buyers and sellers to interact with each other more in the wholesale markets, but they still need the banks to be there to help facilitate those trades. I don't think you can have a corporate bond market that is just simply buy side firms interacting with each other. It's hard to have a corporate bond market where non-financial banks are market makers taking down inventory from buy side, so if there's one marketplace

that truly needs to evolve to an all-to-all where you have all participants trading in that marketplace together, it would be in something like corporate bonds, which requires more balance sheet than a product like FX, futures, equities or even government bonds.

JR: What does fixed income stand to learn from FX?

JN: I think that what Icap learned in FX over the course of the last two years, is that you can't simply be a provider of a central limit order book solution. Banks and customers today will use the central limit order book (CLOB), but there are multiple other ways that customers want to transact in the marketplace. Some of them want to have streamed liquidity from a disclosed source, others want to deal in a dark pool, others want to deal in a matching pool; so if you're going to be a service provider, you need to offer more than simply one trick.

The FX market really probably followed, in some ways, the equities markets, in recognising the importance of offering different methods of transacting. One could even argue that Icap was late in building some of the solutions that we have today with our EBS Direct model, but fortunately because of our distribution, relationships and our position in the marketplace, we've been able to catch up very quickly with those people that were offering services that were different from what we were providing at the time.

I think that bringing the fixed income market of BrokerTec and EBS together has been more about leveraging what we've learned in FX and what solutions have worked in FX and try to bring those to fixed income and even to rates. Whether or not the growth trajectory of the fixed income market for alternative methods of transacting will be as steep as FX is yet to be determined. But in our view, it's very important that we provide those solutions so that we have the answers for our customers, allowing them to execute in different ways. If they choose to use a CLOB, that's terrific, we have one for them. If they choose to use an RFQ or RFS methodology to trade, we have that too. So it's really about giving our customers choice and working with our customers on the types of solutions they want in order to execute with their customers. That, to a certain extent, is why EBS and BrokerTec have been brought back together.

JR: Let's touch on SEFs, since that's an area where the IDBs have evolved in recent years. Do SEFs need mandatory trading rules before they become truly viable?

JN: After the financial crisis, and subsequent to passing Dodd-Frank, the CFTC was dealt a hand of coming up with rules and really, a new market structure that was in some ways necessary and in other ways overly complicated. I do believe that markets are often better off if they have some degree of regulation, but you can have markets that get overly regulated that end up choking themselves. There's no question that the CFTC mandate to try to get more transactions through a clearing house was a well-founded principal, and I think that they've done a pretty good job of pushing that agenda and getting the number of transactions that they have cleared through CCPs.

I also think trade reporting was an important part of Dodd-Frank and certainly the right ask by the regulators and the government to have better insight into trading positions and activity. I was always supportive of the fact that they mandated more trade reporting. We haven't gotten to a point yet where the regulators can truly look at the information they have and deduce anything significantly important – perhaps they can at a very high level, but only at a very high level – so there's a lot of work to be done with the trade reporting data. That's not to say that it can't be done, it just takes time. But you certainly can't have trade reporting solutions if you don't have trade reporting, so you've got to start somewhere and I think that was a good place to start.

I think the introduction of SEF rules was overly prescriptive. I'm not suggesting for a minute that regulating the IDBs and interest rate swaps and regulating any of the platforms was not a positive step. I think they should be regulated, and I think that they should have accountability under a principles-based system. But there are certainly core principles that need to be met. I think where there was possibly a mistake was the CFTC becoming slightly over-prescriptive in implementing more of a rules-based system. To a certain extent, implementing that rules-based system off the back of what had worked in the futures market, and as effective as the futures market is, it is not the OTC market. It doesn't operate the same way as the OTC market, it operates with very, very different counterparties for very different reasons, and trying to have the same rules for futures as we had for OTC, or the same rules that we have for commodity swaps as we have for interest rate swaps, it is just simply unrealistic. There are too many nuances to how these markets operate and in the end, I think the CFTC was right to regulate the market and I hope that they will take a look at the regulations they have implemented and that the final outcome of the SEF rules will be more about a set of principles that SEFs should adhere to in order to operate under a CFTC mandate as opposed to a set of rules.

I also think that in the end, people thought that as the SEF rules came out, there were going to be 25 new SEFs, the world was going to change and a bunch of new platforms were going to evolve. To be honest, the large incumbents in the OTC marketplace pre-SEF are still the large incumbents post-SEF, but they have a more robust regulatory framework around them.

JR: Do you have plans for what you're going to do next?

JN: I'm going to continue to do consulting work for Icap and have recently joined the board of Virtu Financial as a non-executive director. I hope to possibly take one more non exec position with another financial services firm in the not too distant future. I'm still involved on the board of Communities in Schools, a philanthropic organisation involved in student dropout prevention. So between, Icap, the non-profit, and the non exec positions, I hope that will be a good start to filling in some of the time that I would like to spend in the marketplace without taking up all of the time that a full time job used to take.

BIO:

John Nixon has 38 years of international experience in the interdealer broking industry with Icap and, previously, with Tullett Prebon. He served as a non-executive director of Icap from 1998 to 2002 and was appointed an executive director in May 2008. He has been a member of the Global Executive Management Group since 2003 with responsibility, over this period, for business divisions and strategic acquisitions. He represented the Icap Americas businesses to the board, was chairman of the i-Swap business and was been responsible for the implementation of the Icap SEF.

Nixon was inducted into the *Profit & Loss* Hall of Fame in 2011.