acuiti management intelligence

Proprietary Trading Management Insight Report

Q2 2022

Produced in association with

AVELACOM

Introduction

Welcome to the third Acuiti Proprietary Trading Management Insight Report. This quarterly report is designed to provide senior executives at proprietary trading firms with a means of benchmarking sentiment, experiences and attitudes.

The findings in this report are based on a survey of members of the Acuiti Proprietary Trading Management Expert Network, a group of around 100 senior executives from across the globe.

Each quarter members of the network can suggest topics and pose questions to their peers. This quarter questions and topics suggested by the network include ones relating to crypto currencies, salary pressures and trading on the LME. If you are a senior prop executive reading this and are not in the network already, please do get in touch.

The first quarter of 2022 was fraught with risk and opportunity for proprietary trading firms. In this report, we look at the impact that the outbreak of volatility following the Russian invasion of Ukraine had on firms in the market from liquidity to margins.

In addition, we take a look a hiring trends and salary pressures. While the current conditions are bringing opportunity, wages are going up sharply. This, combined with higher margins and costs of business elsewhere, is dampening profits and slowing down the pace of hiring.

Please, as always, feel free to get in touch with any feedback on the report.

Will Mitting, Founder, Acuiti
willmitting@acuiti.io

Table of Contents

The impact of market volatility in Q1 2022

The scale of Russia's invasion of Ukraine on 24 February sent global markets into a tailspin. Volatility not seen since the early days of the Covid outbreak in 2020 erupted with energy and equity derivatives markets at the heart of the volatility storm.

In this quarter's report, we look at how the outbreak of volatility affected markets and proprietary trading firms from liquidity to margins and ask what the medium-term impact of Q1 2022 is likely to be.

Liquidity and volumes

Did you experience any issues with liquidity in any of the asset classes you trade during Q1?

According to the Acuiti Proprietary Trading Expert Network, a group of around 100 senior proprietary trading executives from across the globe who are surveyed each quarter to produce this report, the most intense liquidity issues were seen in Energy and Commodities, which bore the brunt of the volatility. A significant number of respondents also reported major liquidity issues in listed interest rates, equity options and metals.

Margin and clearing

Two major systemic issues were exposed back in February and March 2020 during the period of intense volatility around the initial spread of covid.

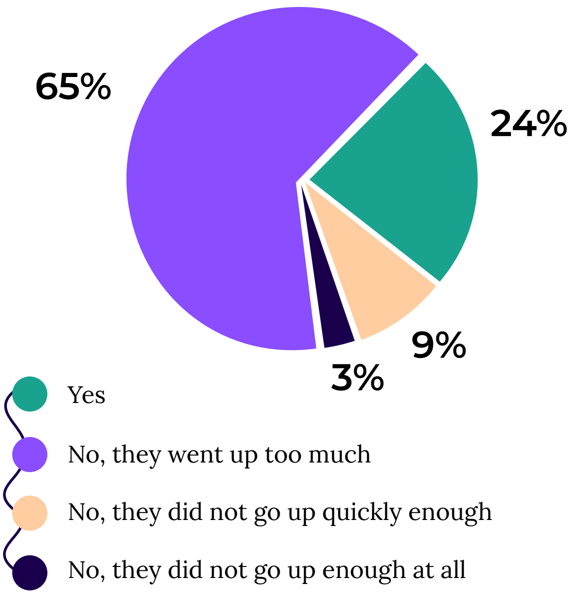
One was the pro-cyclical nature of initial margins calculated by clearinghouses, the methodology of which, at some CCPs, can cause huge spikes in margin calls. The second was that the extreme volumes put immense pressure on the back-offices of sell-side clearing firms.

With regards to initial margin, almost two thirds of respondents thought that the CCP margin adequately reflected risk in the market. However, a quarter thought that they went up too much. Interestingly, though, 12% of respondents said that they did not go up enough or did not go up quickly enough to reflect risk.

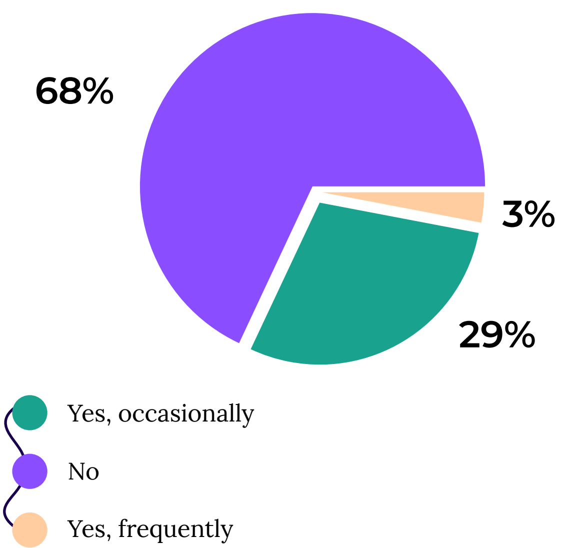
Since the Q1 2020 volatility and pressure on back-office systems, major investments have been made by banks and non-bank FCMs to increase resilience and capacity. However, this report finds that there were still some issues across the sell-side.

Almost a third of respondents reported that trading reports received from their sell-side clearing providers were delayed during the volatility. However, only 3% reported frequent delays.

Do you think that initial margins requested by clearinghouses during the Q1 volatility accurately reflected movements/risk in the markets?



Did your sell-side clearing provider delay the publication of end of day/overnight reports at any point during the volatility?

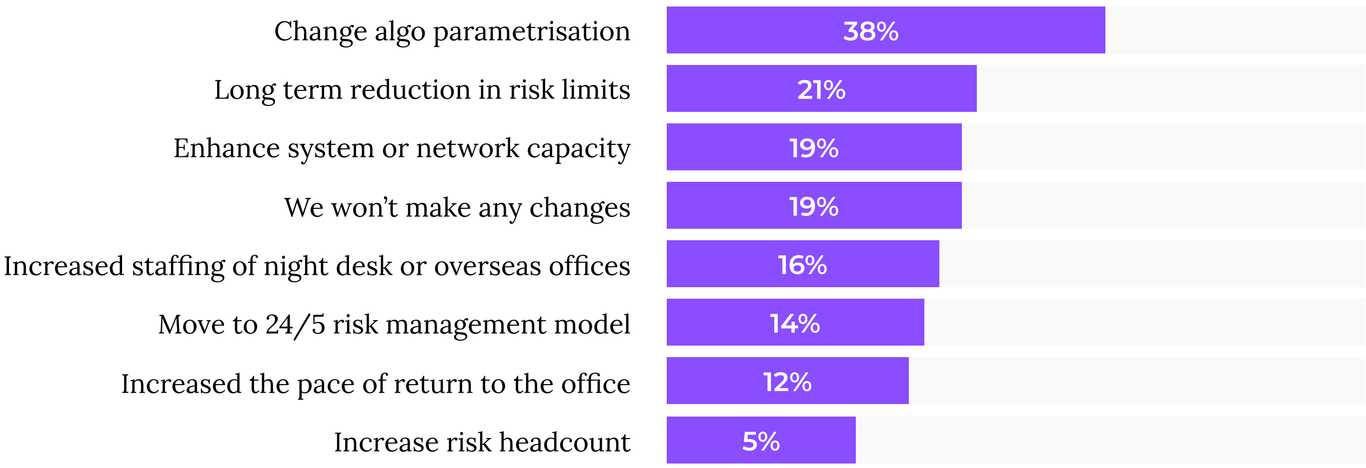


Impact of the volatility

Over 80% of the Expert Network said that their firms were making changes as a result of the volatility experienced during Q1. The most common and obvious change was to algo parametrisation to reflect the performance of the market.

Other common changes are likely to impact profitability. These include long term reduction in risk limits, enhancing system or network capacity and increasing overnight desk staffing and round the clock risk management.

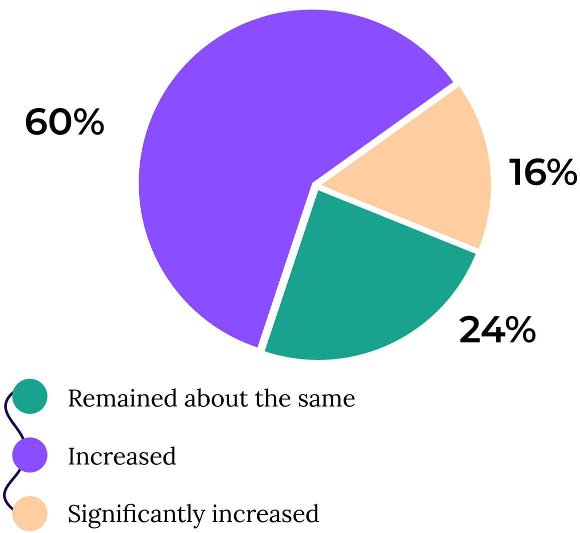
What changes will you make as a result of the volatility experienced during Q1?



A small number of firms reported that they have had to make major changes to their trading strategies. The majority of these relate to a withdrawal from trading on the Moscow Exchange, which was a highly profitable and fast growing market.

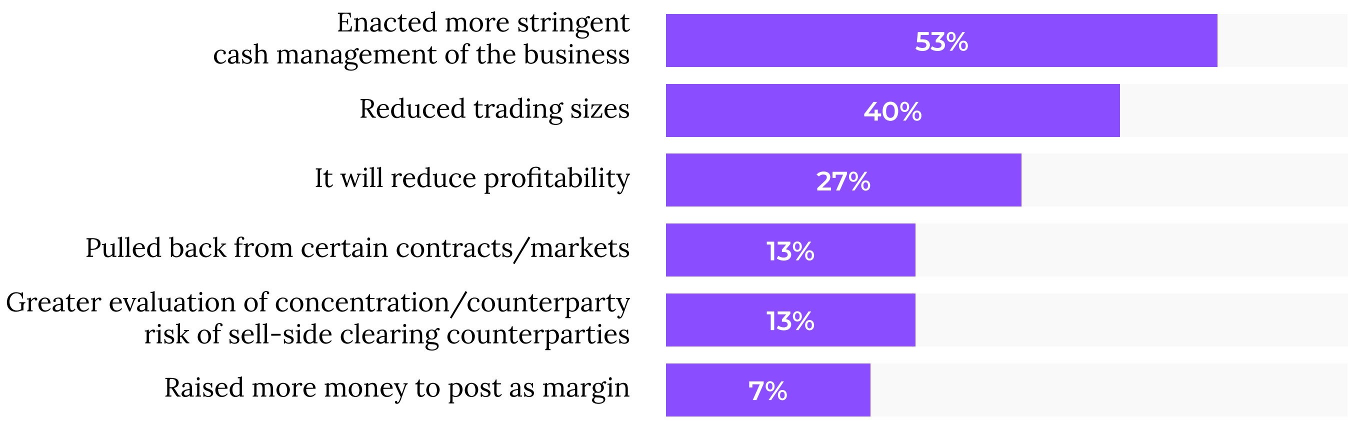
The impact of higher initial margins is also being felt across the market. 76% of respondents reported that initial margins had increased with 16% saying they had increased significantly. The significant increases were reported predominantly by firms that trade commodities.

How much have initial margins changed over the past three months for your business?



Of those firms reporting an increase in margin, over a quarter said that there will be an impact on profitability resulting from the margin increase. Almost half said that they have reduced trading sizes while 13% had pulled back from certain high margin contracts or markets. However, of those that have reduced trading size, 83% said that they only expect do so for a few weeks suggesting that the long-term impact is likely to be muted so long as volatility returns to normal levels.

What impact is the increase in margins having on your business?



“Absurdity” on the LME

Russia produces 11% of the world’s nickel supply so it was widely expected that the nickel price was likely to spike following Russia’s invasion of Ukraine. With LME host to the global nickel futures trade, it was equally likely to come under pressure in the event of a sharp price rise.

However, the events of 8 and 9 March have thrust the LME into regulators’ spotlights and seriously damaged the reputation of the exchange. In early trading on Tuesday 8 March, the price of nickel shot up to $101,000 in an apparent short squeeze of a major Chinese producer.

After allowing the price to rise for hours, the LME halted trading at 8:15am and then shocked the market by busting the trades in an apparent bid to avoid the default of several clearing members on the exchange.

The move was branded “absurd” by members of the Acuiti network. The LME is not a major venue for proprietary trading firms owing in part to its physical delivery and unique contract designs.

However, over the past decade it has onboarded several firms, many of whom are part of the Acuiti network. Of those, half said that they would either reduce their trading on the exchange or stop trading entirely as a result of what happened in March. However, half of the firms said that they would continue to trade despite their shock at what happened. The LME has said that it “sought to act in the interests of the market as a whole”.

Crypto Derivatives

Cryptocurrencies have taken the trading world by storm and proprietary trading firms have been among the main beneficiaries.

For this report, we asked firms that were trading cryptocurrencies about their activities with regards to crypto derivatives.

Of the proprietary trading firms within the Acuiti Expert Network that were trading cryptocurrencies, around 90% were trading crypto derivatives.

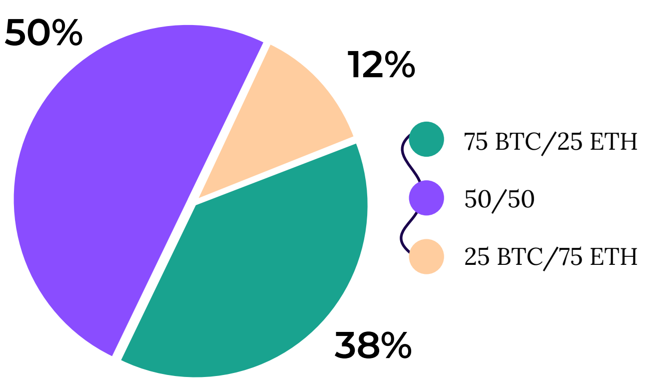
Market structure for crypto derivatives venues is evolving in two streams: native exchanges, which are often based offshore and tend to be regulated outside the main jurisdictions and the traditional exchange world.

The latter is today dominated by the CME following the temporary withdrawal from the market of CBOE and lack of liquidity to date of bitcoin and ether derivatives on other traditional markets. In the native world, liquidity in futures is split over several venues. In comparison, options liquidity is concentrated on Deribit, which is home to over 90% of trading volumes.

Of those firms trading crypto derivatives, 45% were trading on the CME and native exchanges and 55% were trading solely on native exchanges. None were trading just on CME.

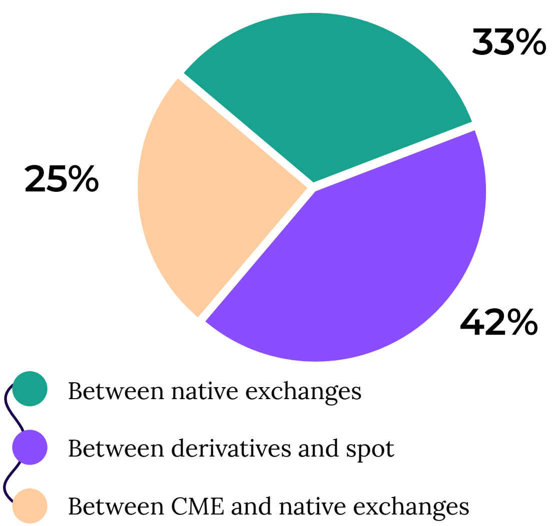
Currently, the listed derivatives markets for crypto is dominated by Bitcoin (BTC) and Ether (ETH) with no other liquid listed contracts.

Approximately what split of typical trading volumes do you have between BTC and ETH derivatives?



Half of respondents said that trading volumes were split evenly between BTC and ETH with 38% allocating more to BTC and 12% more to ETH. This remained broadly constant in Q1 with just 8% having changed their allocation, increasing ETH.

What do you think has the best arbitrage opportunity for crypto derivatives?

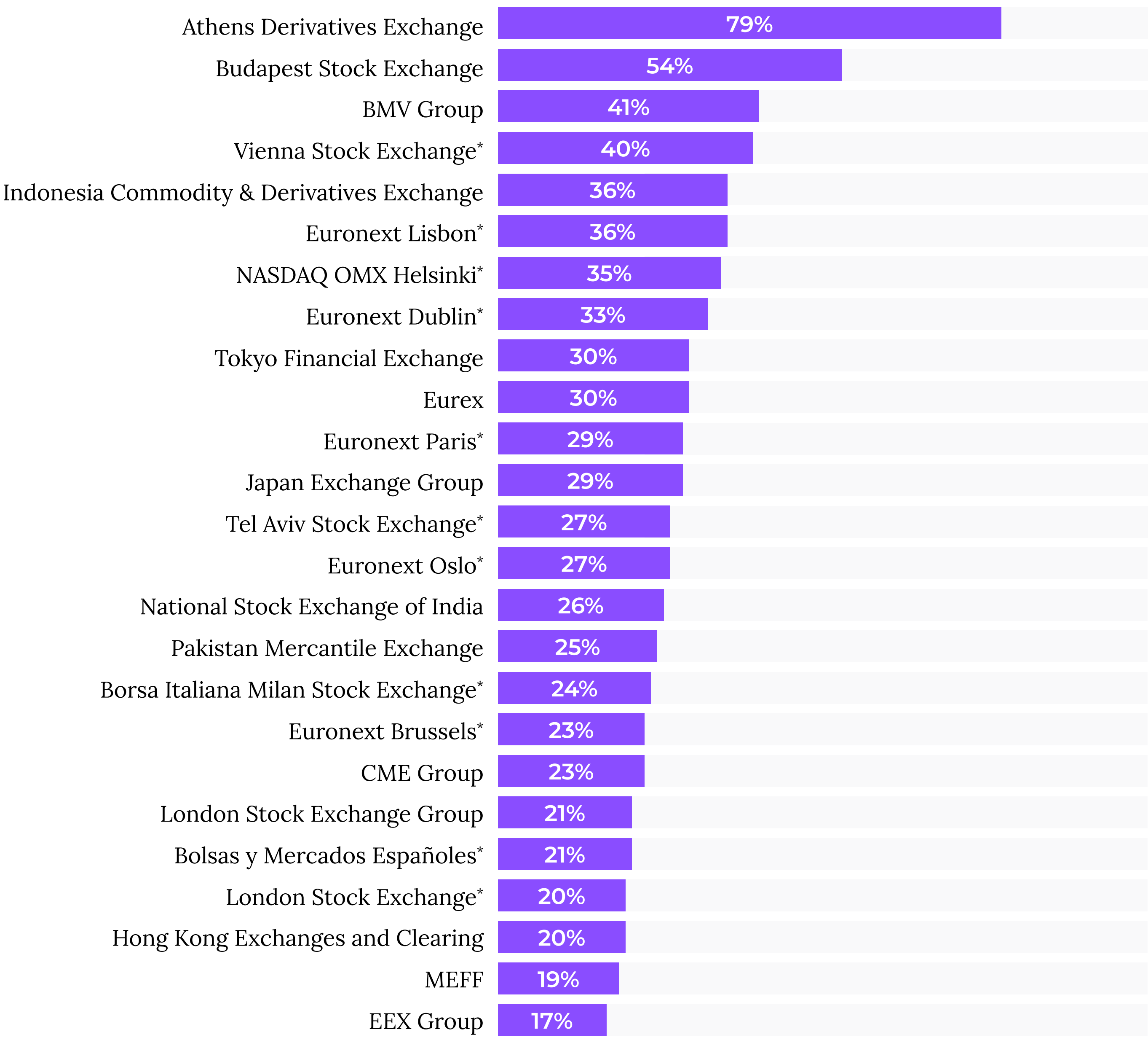


Respondents to the survey said that the biggest opportunity for arbitrage was between derivatives and spot followed by between native exchanges.

Markets and contracts

The AVELACOM Exchange Growth Index

The Avelacom Exchange Growth Index is a benchmark of quarter-on-quarter volume growth across cash equities and derivatives markets. Exchanges must have been trading for more than one year to feature in the index. Futures and options data is provided by the FIA, cash equities from the exchange websites.



**Cash equities*

Source: FIA, Exchange Websites

New contract watch

The table below, based on data provided by Euromoney TRADEDATA, profiles the performance of the top 20 new contracts launched last quarter based on average daily volume.

Exchange	Contract Name	Type	Volume	Open Interest	Average Daily Volume	Launch Date
Multi Commodity Exchange of India	Natural Gas	Option	**1,314,408**	**21,859**	**21,547**	17-Jan
NSE IFSC	NIFTY 50 Index	Future	**290,291**	**470**	**12,621**	01-Mar
Chicago Mercantile Exchange	Micro Ether	Option	**10,000**	**10,000**	**434**	28-Mar
Chicago Mercantile Exchange	Micro Ether Week 3 (Fri)	Option	**10,000**	**10,000**	**434**	28-Mar
SGX	USD/INR (USD) Month-end	Future	**20,030**	**71**	**312**	24-Jan
Moscow Exchange	Moscow Real Estate DomClick Index	Future	**19,827**	**4,522**	**309**	31-Jan
Chicago Board of Trade	20 year US Treasury Bonds	Future	**12,802**	**1,869**	**200**	07-Mar
Moscow Exchange	Russian Government Bond Index	Future	**2,658**	**1,182**	**115**	28-Feb
NSE IFSC	INR/USD	Future	**1,631**	**-**	**70**	01-Mar
Cboe Options Exchange	Nanos S&P 500	Option	**2,599**	**-**	**61**	14-Mar
Moscow Exchange	Oil & Gas MOEX Index	Future	**3,752**	**466**	**58**	08-Feb
National Stock Exchange of India	Nifty Midcap Select	Option	**3,514**	**84**	**57**	21-Jan
Moscow Exchange	Financial MOEX Index	Future	**2,375**	**272**	**37**	08-Feb
National Stock Exchange of India	Nifty Midcap Select	Future	**2,235**	**68**	**36**	24-Jan
Moscow Exchange	Metals & Mining MOEX Index	Future	**1,557**	**298**	**24**	08-Feb
Moscow Exchange	Consumer MOEX Index	Future	**1,155**	**528**	**18**	08-Feb
New York Mercantile Exchange	Iron Ore China Portside Fines CNH fot Qingdao (Argus)	Future	**1,000**	**200**	**15**	10-Jan
Cboe Futures Exchange	Cboe AMERIBOR Term-90	Future	**587**	**80**	**9**	24-Jan
Chicago Mercantile Exchange	Micro Ether Week 1 (Mon)	Option	**100**	**100**	**4**	28-Mar
National Commodity & Derivatives Exchange	Refined Castor Oil (First Special Grade)	Future	**155**	**90**	**3**	21-Mar

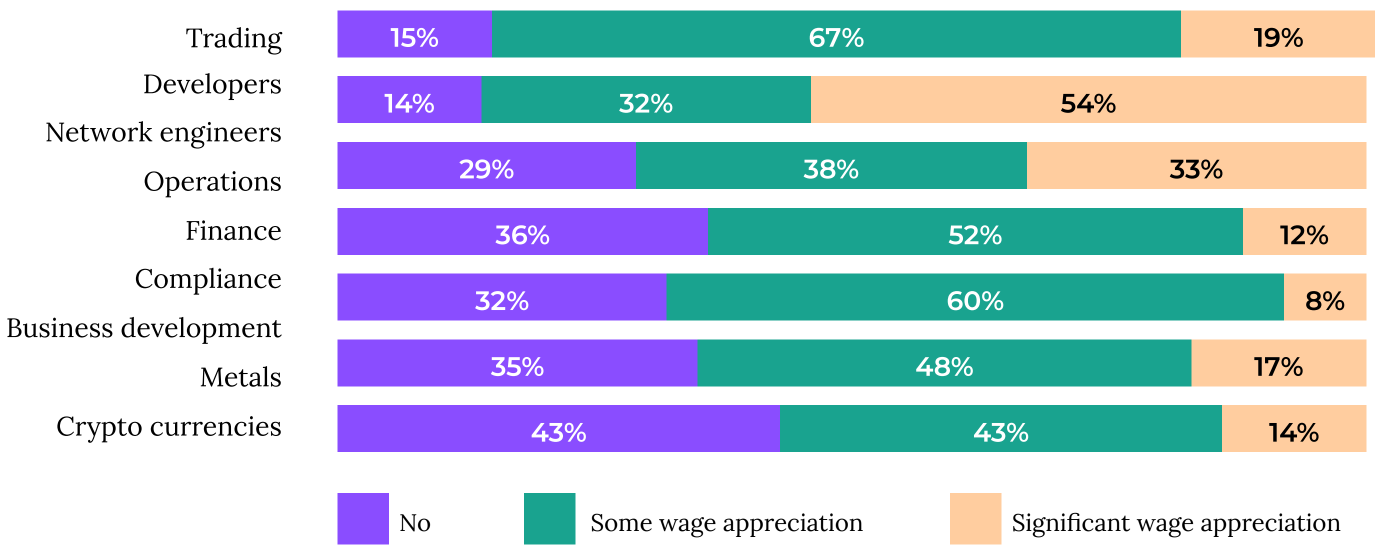
Source: EuromoneyTRADEDATA

Hiring trends

A majority of firms contributing to this report that are currently hiring are experiencing wage appreciation in all roles with developers and network engineers seeing the most acute increases.

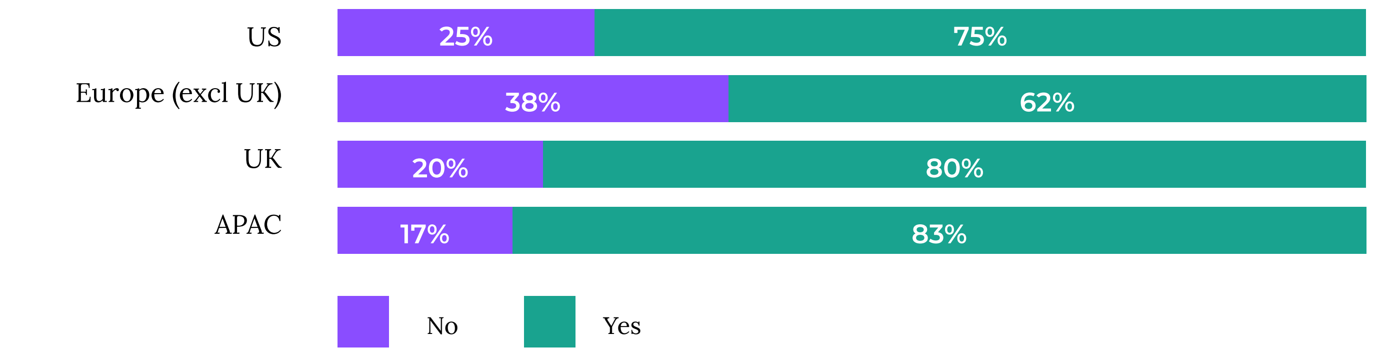
Over half of firms reported significant wage appreciation for developers, a trend supported by news reports last month that wages for new developers in the US were hitting highs of over $400,000.

Are you seeing wage appreciation in any of the following job functions?



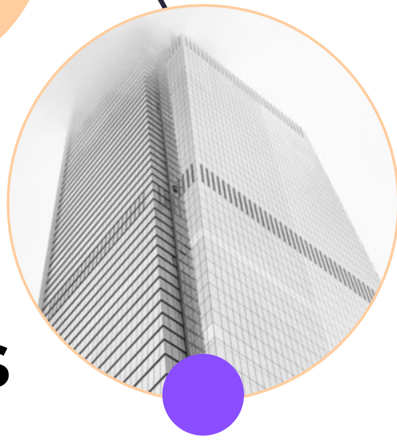
Non-trading or technical roles such as finance, operations and compliance were also subject to wage appreciation although not on the scale of deverlopers or engineers.

Overall, do you see wage competition in your local jurisdiction resulting predominantly from competitive offers from other proprietary trading firms?



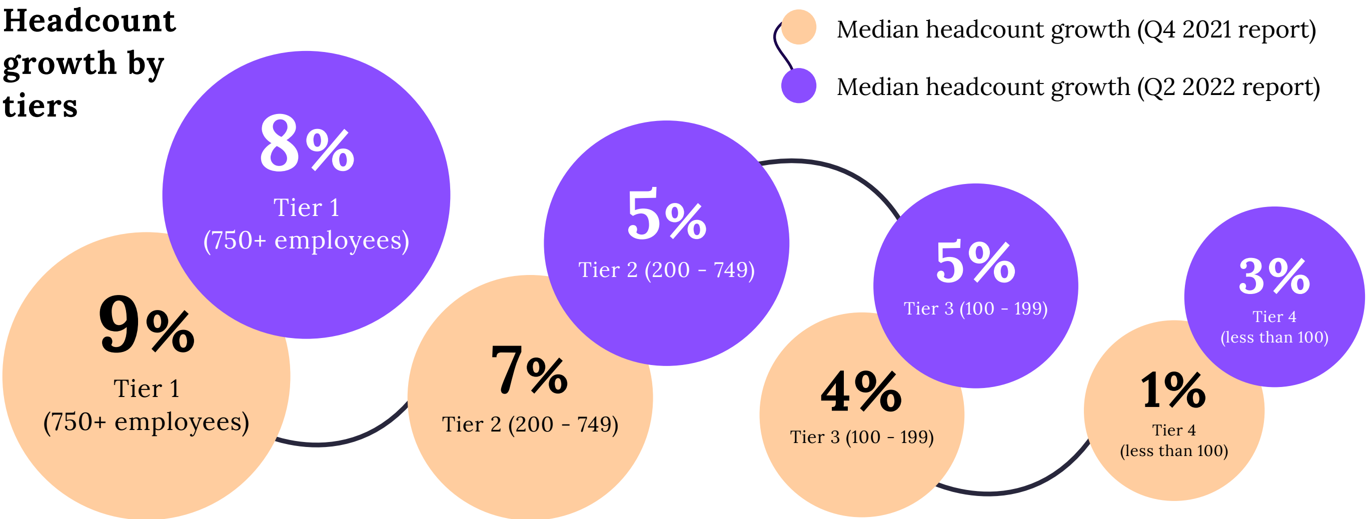
Respondents in the UK and APAC were most likely to attribute wage increases in their jurisdiction to competition from other proprietary trading firms with 83% of those based in APAC attributing increases to this factor compared with 62% in Europe.

Fastest growing proprietary trading firms



The acute salary increases is beginning to slow the median pace of growth for proprietary trading firms' headcount for all but the smallest firms who have picked up the pace of growth.

Headcount growth by tiers



The table aross shows the fastest growing companies worldwide by % headcount growth over the past six months according to the number of new staff Linkedin.

B2C2	33%
Da Vinci Derivatives	23%
Alpha-Grep	22%
Maverik Derivatives	22%
Hudson River Trading	20%
IMC	14%
GTS	14%
Optiver	12%
Jump Trading	12%
Jane Street	11%
Maven Securities	11%
Quadeye	11%
Citadel	9%
Akuna	9%
Grasshopper	9%

Source: Linkedin

AVELACOM Emerging Exchange Profile: Deribit

In little over five years, Deribit has established itself as the leading options market for crypto derivatives attracting institutional flow from across the globe. Avelacom caught up with **Luuk Strijers, chief commercial officer at Deribit**, about the changing face of prop activity on the market and the recent launch of Solana derivatives.

How is the proprietary trading flow you see on Deribit changing?
One of the main differences is how the market has evolved in terms of its sophistication and institutional engagement. Two or three years ago there were significant differences in price between venues, which made arbitrage simple if you were relatively sophisticated in terms of latency or infrastructure.

These differences have now gone and it has become a world in which milliseconds matter as on traditional markets. So for firms trading between different markets globally, infrastructure has become central. The choice of lines, routes and server locations is much more relevant today than it was a few years ago. This is attractive to firms that specialize in low latency trading but currently trade traditional equities, FX etc creating a virtuous circle of activity.

How have the native crypto trading firms responded?
As a group, they have stepped up their game. In the beginning, the native crypto prop firm was two guys in a garage. That has changed now and many of those firms have become much more sophisticated. We have also seen a lot newly launched firms led by previous employees of the largest traditional proprietary trading firms that were slow to embrace crypto.

What is holding back proprietary firms from joining the crypto derivatives market?
Regulation is obviously a key barrier. While regulators develop an environment in which everyone can trade, some firms are sitting back and waiting. But the longer it takes for that clarity to develop, more and more firms are deciding they are going to take steps into the market regardless.

Another issue is the 24/7 nature of crypto trading. Even many of the largest proprietary trading firms are not set up to trade round the clock, especially over the weekend. Firms engaged in crypto market making have to adjust to a world in which there is no settlement time and the market is truly 24/7. It is a big lift for the larger firms to adapt to that.

Finally, I think there is still a barrier with crypto itself. Firms are used to dealing in dollars but the entire crypto setup operates in digital assets and firms have to integrate that into all their operations, adapting all the while to the market structure and regulatory uncertainty.

You recently became the first crypto derivatives exchange to offer data via a multicast feed, what does that bring to the market?
As mentioned above, legacy is becoming much more relevant today. Our market is fundamentally an institutional market with over 80% of the flow coming from institutions and so we need to develop products and services to meet demand.

We looked at how we could improve latency on a dual level: orders and market data. We have made order processing much faster than it was before at 1.5ms per round trip, the fastest in the crypto industry, where all trades have to be risk checked by the venue before being executed.

But the market data side is equally important in terms of latency. And so we have launched a multicast feed which is a highly optimized means of sending data across a network and is five times faster than the previous internet-based feed.

Today firms that cross-connect to us, whether through direct connection to our colo facilities or through third party connectivity partners, can use the new multicast feed to get the data as fast as possible.

You are also launching solana futures and options, what is behind that?
We launched BTC and ETH products several years ago and haven't expanded the range of coins since then so Solana is a natural evolution as interest and volumes in the spot market grew.

We don't believe that there is demand for derivatives on every coin but there is clearly demand for some coins beyond BTC and ETH. We have made Solana options and futures available this month and the first signs are positive. We have also launched a USDC perpetual contract which allows investors to buy exposure to 17 different coins using USDC on Deribit.

What's next for Deribit?
The launch of Solana is a test case for us to see how it grows and the market adopts it so we will closely monitor that and launch derivatives on other coins if the demand is there. We are also soon to launch combos. These combos will enable investors to trade options spreads in one trade, which is an important development in the market.

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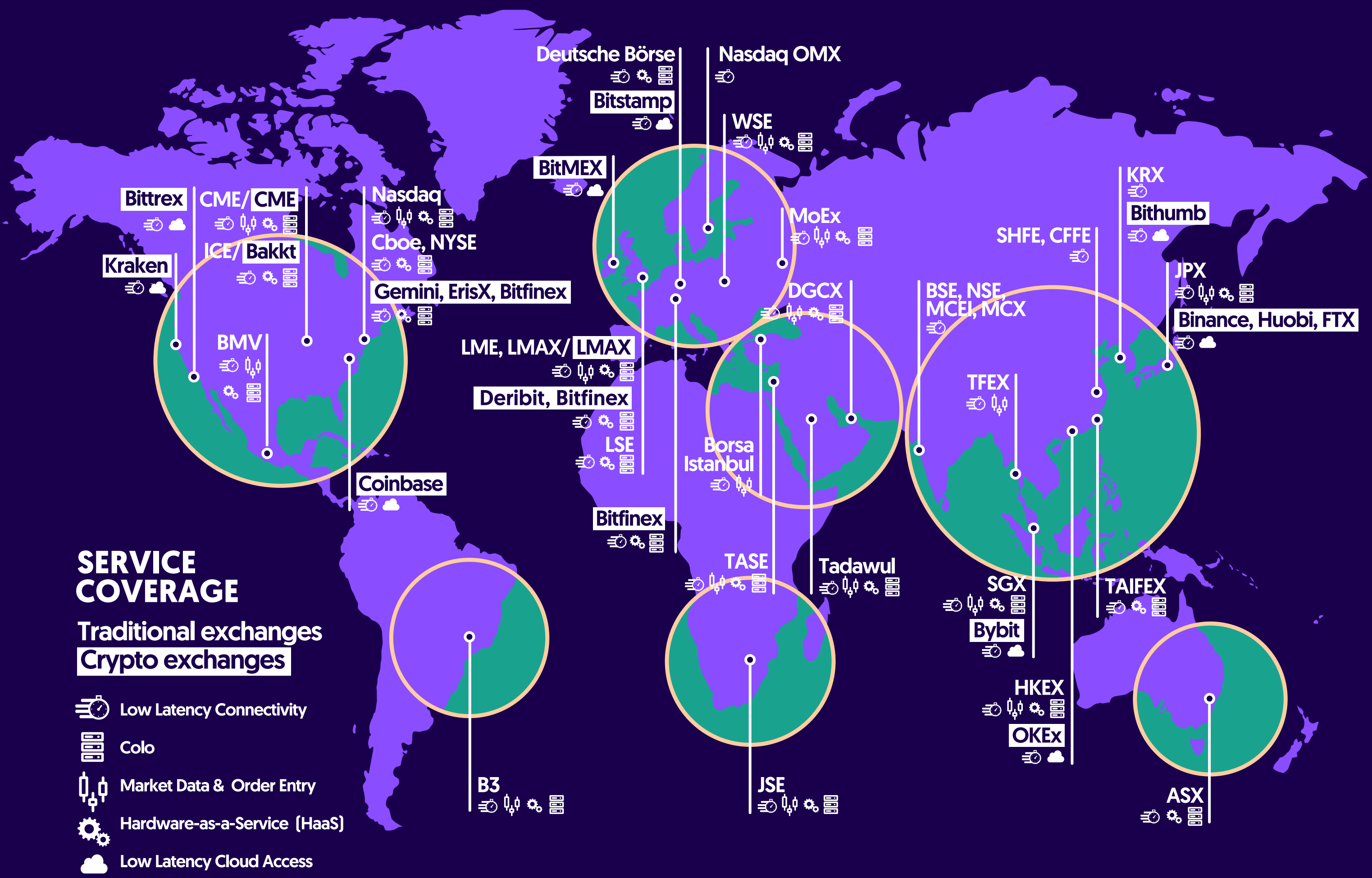
#1 ULTRA LOW LATENCY INFRASTRUCTURE FOR MARKET MAKERS AND ARBITRAGE TRADERS



All types of assets:

- FX
- Crypto
- Equity
- Commodity
- Derivatives

A one-stop shop:

- Connectivity
- Colocation
- Market data & order entry
- HaaS (Hardware-as-a-Service)

Standing out because of:

- Global coverage
- Best-in-market latencies
- Fast setup
- Exceptional customer service

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