acuiti management intelligence

Acuiti Proprietary Trading Management Insight Report

Q4 2024

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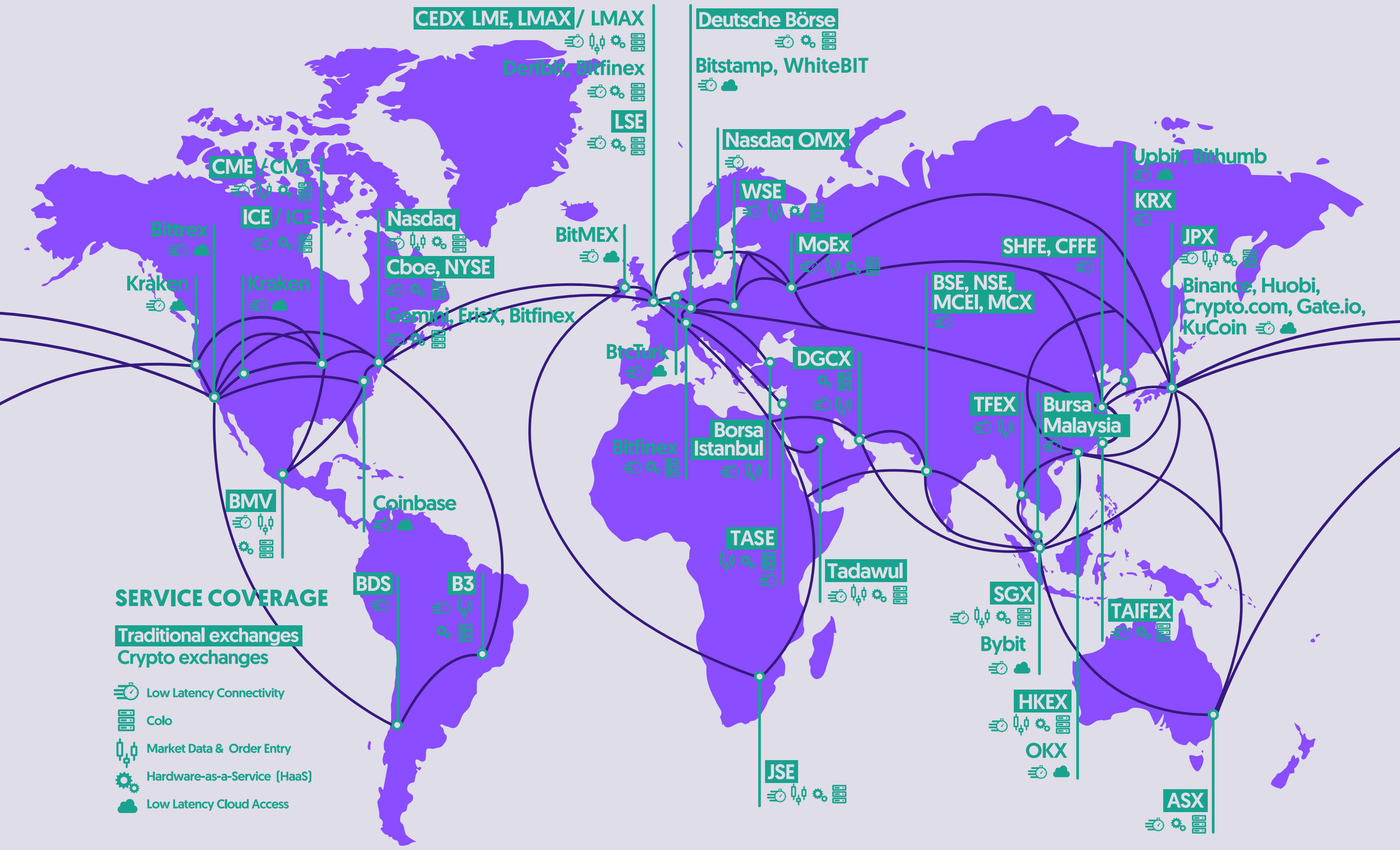


#1 ULTRA LOW LATENCY INFRASTRUCTURE

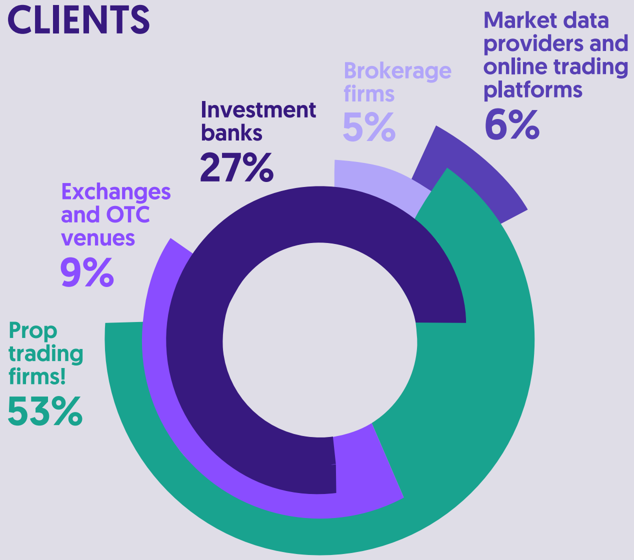
FOR MARKET MAKERS AND ARBITRAGE TRADERS

TradFi

CeFi

DeFi

OUR CLIENTS



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Introduction

The recent Financial Times series, The New Titans of Wall Street, highlighted how dominant in global equity, listed derivatives and FX markets the largest proprietary trading firms have become.

This quarter's report suggests that dominance is likely to grow further in 2025 as the ultra-low latency firms in the network increase investment budgets at a faster rate than other firms.

What this means for smaller and less latency sensitive proprietary trading firms remains to be seen, but it is clear that a two-tier market exists today and is likely to continue.

These firms are finding an edge in their own ways, though—expanding the asset classes they trade and investing in algorithmic trading tools and market data to increase sophistication.

However, this quarter's report finds that consolidation is likely to be a factor in the market next year and beyond, as costs and the regulatory burden continue to rise.

Also in this report we take a look at the latest questions around IFR/IFD, how volatility is changing and the European options market.

This report is based on a survey of the Acuiti Proprietary Trading Expert Network, a network of senior proprietary trading executives from across the global market.

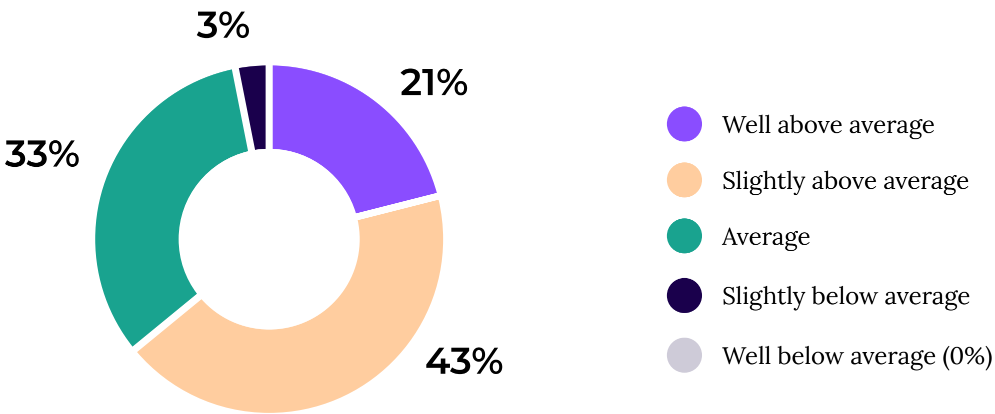
Each quarter, members of the network suggest topics and questions which are then sent around the group in an anonymous survey. If you are a senior proprietary trading executive that is not yet part of the network, please contact Alice at alicekristiansen@acuiti.io.

Looking ahead to 2025

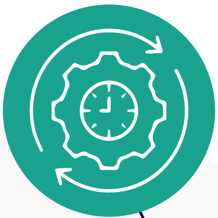
This year has been one of ups and downs for proprietary trading firms. Despite record revenues from the largest firms, most proprietary trading firms have experienced more challenging conditions in which brief periods of volatility haven't made up for quieter markets overall.

Acuiti will fully analyse 2024 performance in the next Insight Report. This quarter, we sought views on expectations for 2025 and found a market looking ahead to next year with cautious optimism as almost two-thirds of firms expect an above average year.

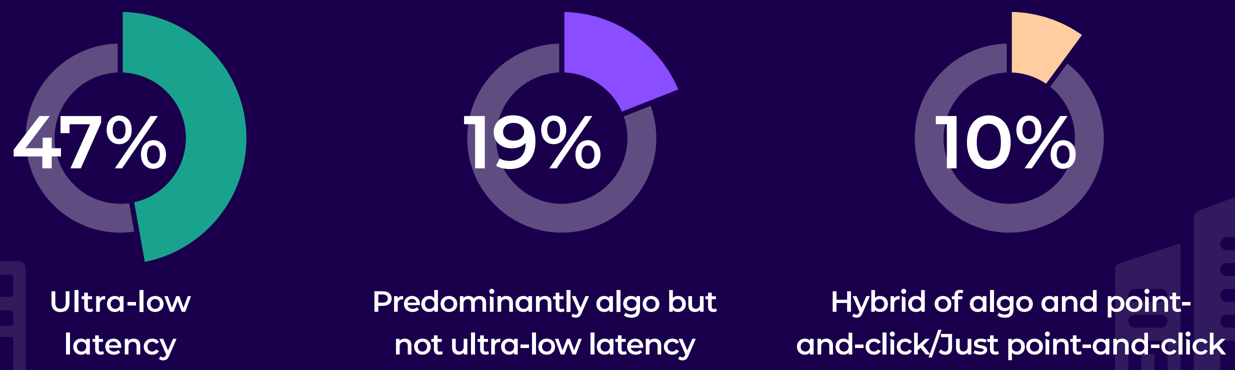
Looking ahead to 2025, how strong a year for your business do you expect it to be?



There were, however, significant differences in outlook depending on the type of proprietary trading firm. Just 15% of ultra-low latency firms expected an average year with the remainder expecting a slightly or well above average performance in 2025. This compared with 52% of firms that deployed either hybrid or point-and-click focused strategies – 7% of which expected a below average year.



% of firms expecting a well-above average year

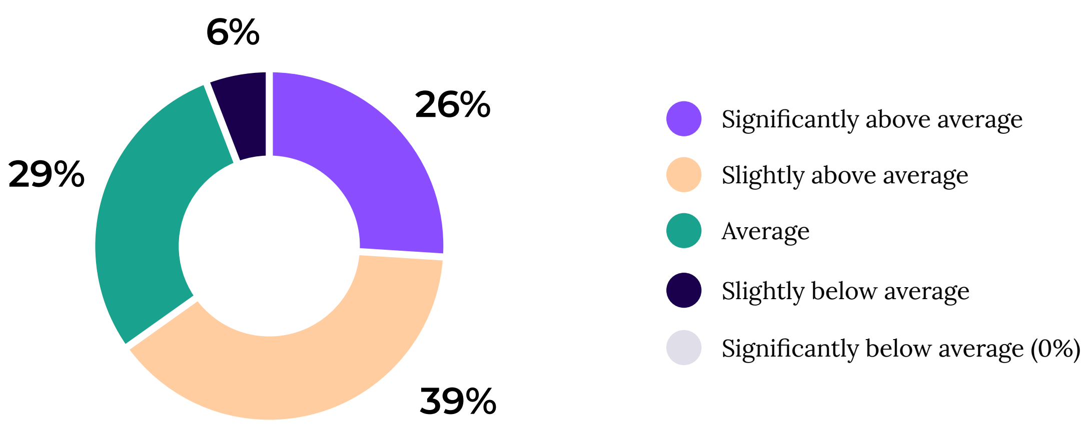


Firms in Europe were the most optimistic, with 75% of respondents predicting an above average year compared with 37% of firms based in the US.

Technology investment budgets

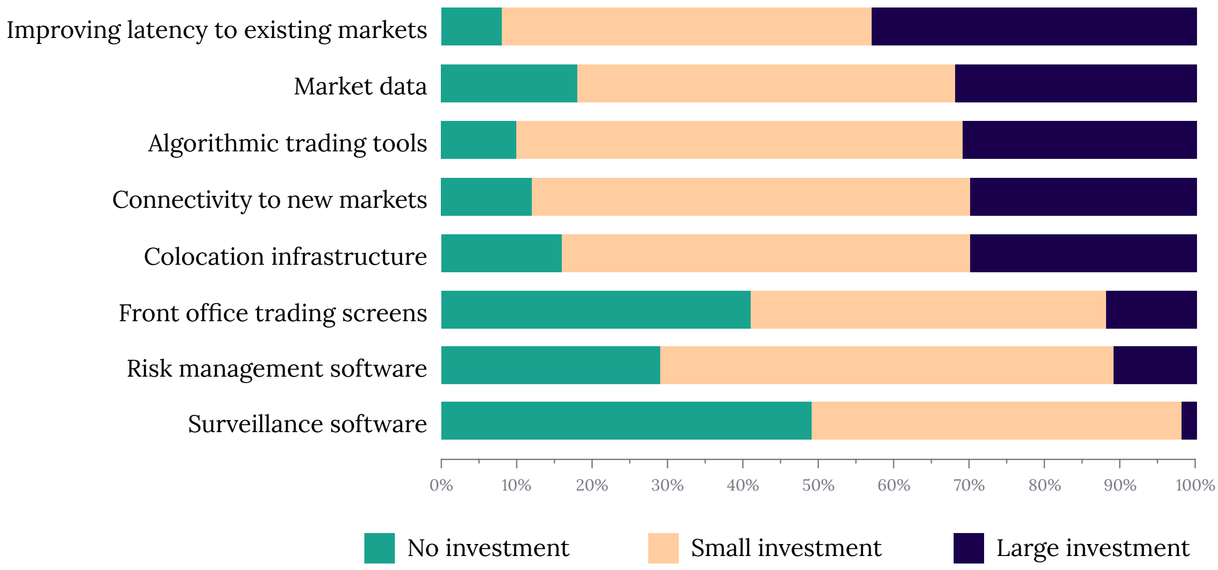
This split between firms depending on their strategy was also reflected in investment budgets for 2025. While 65% of firms were planning above average investment next year, 54% of ultra-low latency firms were planning significantly above average investments compared to just 10% of predominantly algo but not ultra-low latency firms.

How big do you expect your technology investment budget for 2025 to be?



These findings point to a growing divide between the top tier 1 trading firms and the tier 2 and 3 and less latency focused firms. As the top firms invest more in technology, there is a risk that their dominance of the market will continue to grow, further leaving behind smaller firms.

Overall, firms were most likely to be making large investments in improving latency to existing traded markets, market data and algorithmic trading tools (see next page). Improving latency to existing markets was driven by ultra-low latency firms – 85% of which were planning a large investment in this area.

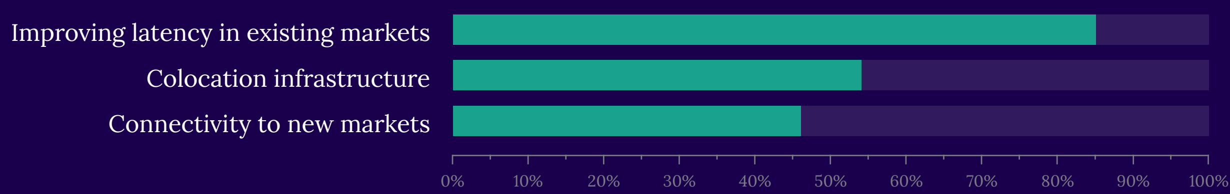


Firms that described themselves as "predominantly algo but not ultra-low latency" were planning investments in connectivity to new markets and algorithmic trading tools.

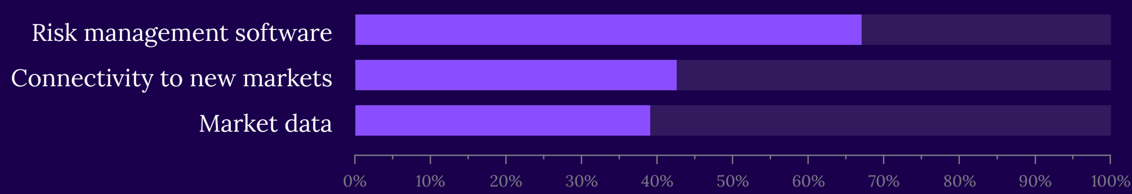
Where are firms investing?

% of firms planning a large investment in each category

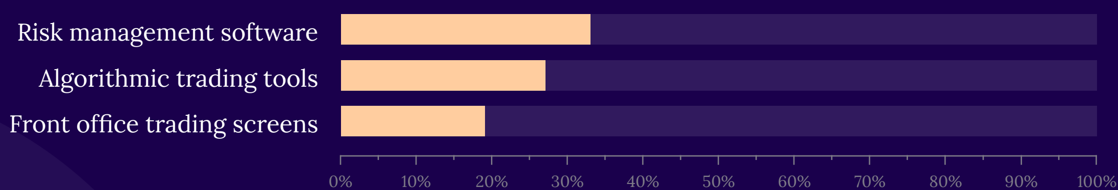
Ultra-low latency



Predominantly algo but not ultra-low latency

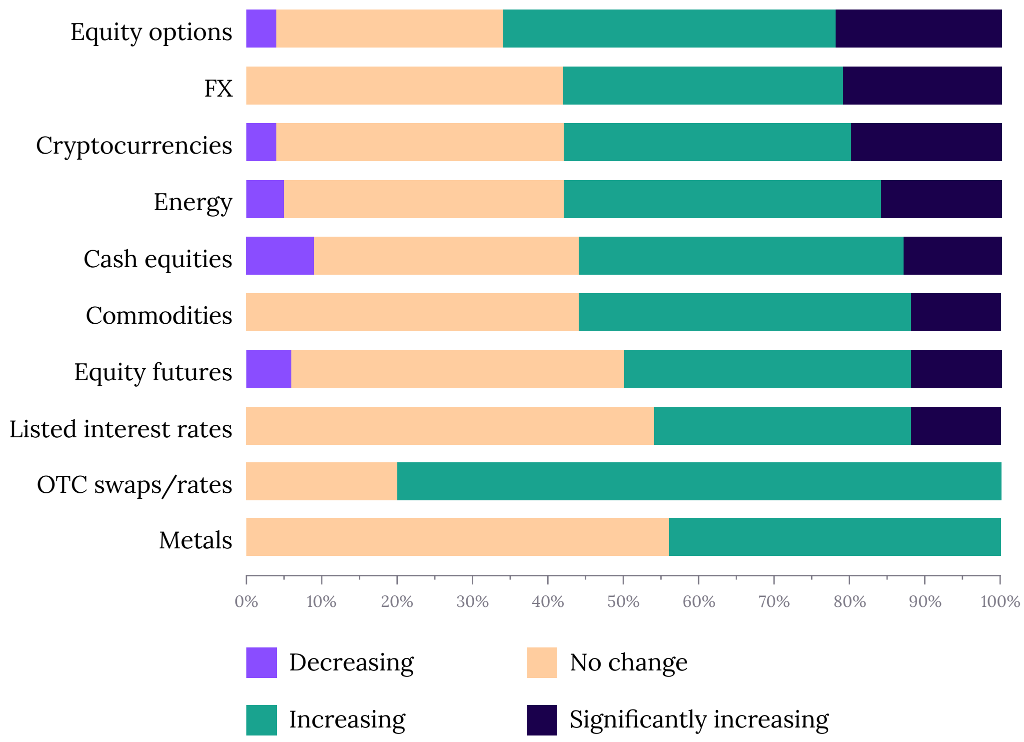


Hybrid of algo and point and click



Asset class coverage

Proprietary trading firms are planning to expand their existing exposures in equity options, FX and cryptocurrencies in 2025. No firms were planning a significant expansion in metals or OTC swaps. However, the number of firms trading OTC swaps was limited, so the data is relatively thin for this asset class.

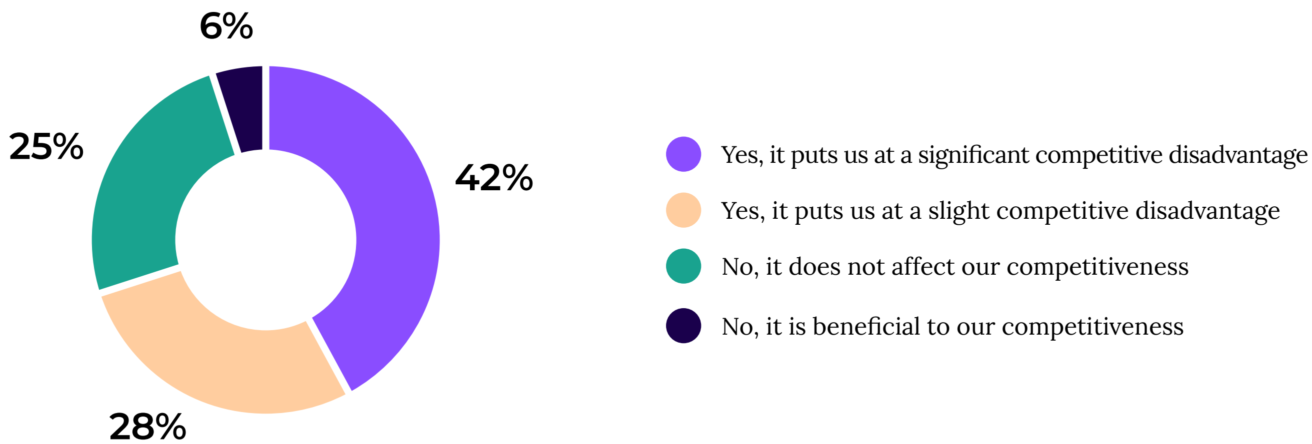


Overall, 58% of respondents were planning on expanding into a new asset class in 2025, with FX, cryptocurrencies and commodities the main areas that firms were looking to launch into.

The IFR and the EBA consultation

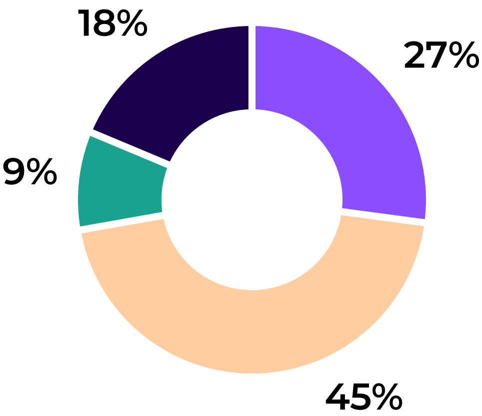
The EU's IFR/IFD rules continue to pose challenges for proprietary trading firms, who argue that the prudential framework is too complex and adds harmful costs to their business model. A major area of concern for many are governance and remuneration rules, which the framework applies to the non-EU operations of firms that are based in the EU. The EU is the only jurisdiction to take this approach to remuneration for non-bank investment firms, a path that many firms believe puts them at a competitive disadvantage to peers in regions such as the US. Three fifths of the network take this stance, with 42% seeing the rules as a significant competitive disadvantage.

As currently phrased, do the extraterritorial application of IFR/IFD governance and remuneration rules to your firms' non-EU operations put you at a competitive disadvantage to non-EU competition?



As currently structured, the rules could hinder firms' ability to compete for talent and transfer skills and experience into the EU. While just over a quarter of the network believe that a complete overhaul and review of IFR/IFD is needed to remedy these weaknesses, 45% believe a targeted revision will be more effective.

What would be the best way to remedy this?

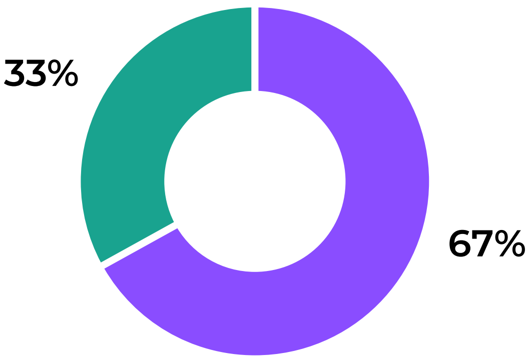


- A complete review and overhaul of IFR/D
- Targeted revision of the IFR/IFD governance and remuneration requirements
- Broader availability and application of capital group tests
- An alternative to capital group tests

Related to IFR/IFD is the effort to quantify proprietary trading firms' operational risk. EU firms have been assigned K-DTF, which is calculated by traded volume, as a metric for this risk. While this is recognised as a suitable baseline for judging operational risk, there are concerns that an operational risk framework will develop that is too rigid.

However, two thirds of the network thought that K-DTF alongside a self-assessment on capital (pillar 2 with current guidance) was the best way to quantify operational risk. This approach is advocated by many because it better allows for nuances, which are common across most proprietary trading firms' risk models.

Do you believe that KDTF plus a self-assessment on capital (Pillar 2 with current guidance) is the best way to quantify operational risk?



- Yes
- No

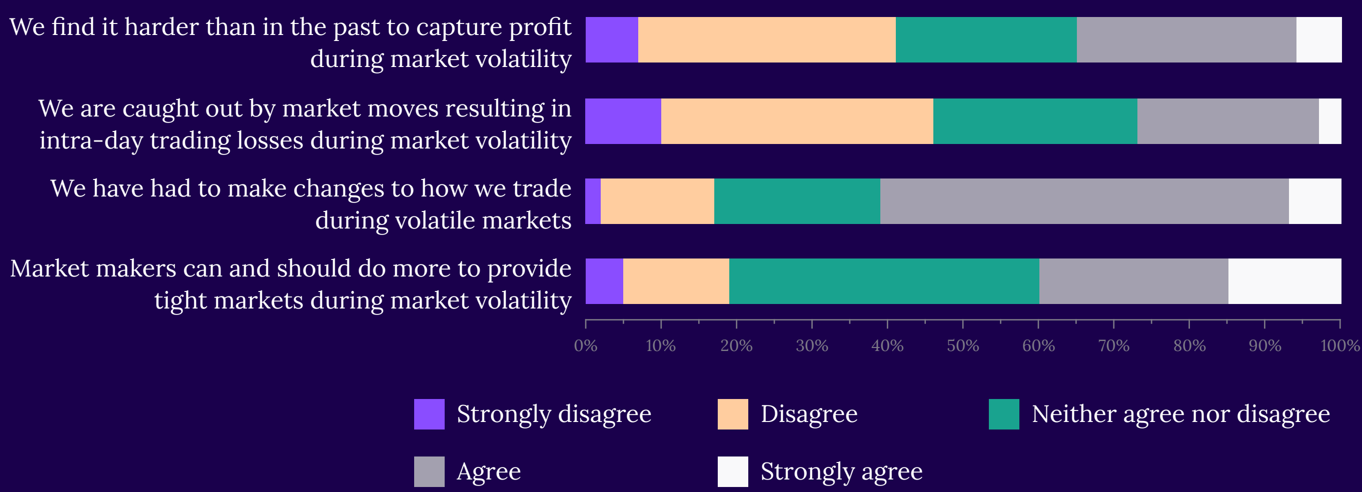
Hot Topics

The wrong kind of volatility?

This quarter, a member of the Proprietary Trading Expert Network sought views on how recent volatility patterns had posed challenges for firms. The view was presented that market moves are more rapid and short-lived than in the past, making it hard for proprietary trading firms to profit from.

While over a third of the network agreed with this sentiment, surprisingly the view was most prominent among ultra-low latency trading firms – half of whom agreed compared with 37% of predominantly algo but not ultra-low latency firms and 29% of point-and-click or hybrid firms.

Thinking about the volatility patterns you have seen in the market over the past three years, do you agree or disagree with the following statements:



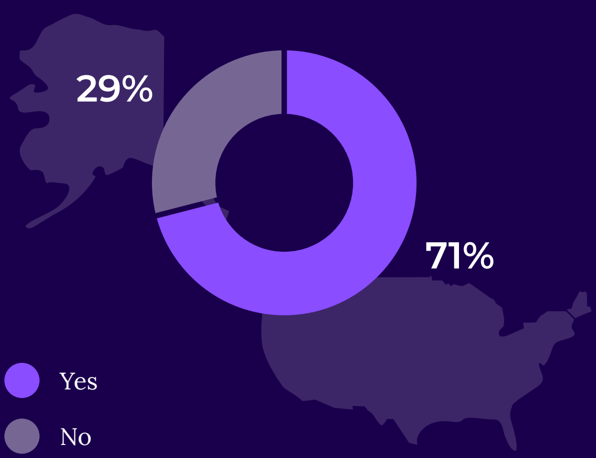
The same pattern was seen with firms reporting being caught out by market moves. Again ultra-low latency firms were most likely to agree to this – with over half doing so compared with 20% of the rest of the firms.

Is consolidation on the cards?

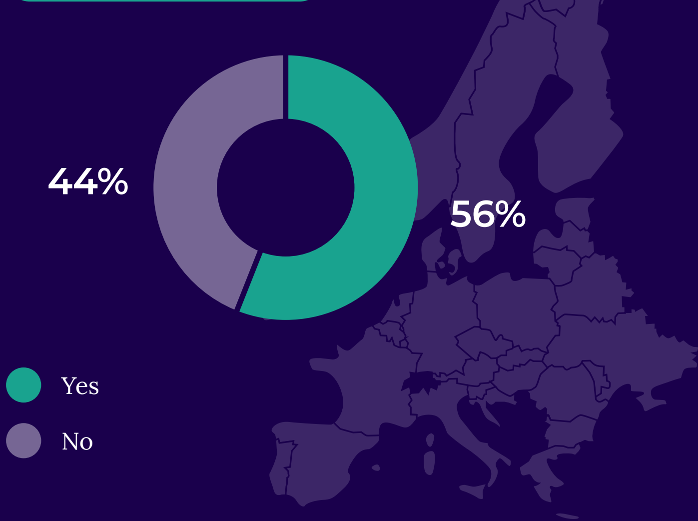
Futures First's acquisition of OSTC earlier this year marked the latest in a series of consolidatory deals between prop firms over the past decade. While the pace has slowed somewhat since the raft of deals in the early and mid 2010s, many executives are predicting that consolidation might be back on the cards as costs and regulation rise. Firms based in the US were most likely to be anticipating consolidation while those in Europe (excl UK) and the UK were broadly similar in their outlook. Firms in Asia, where regulatory pressures are the lowest, were the least likely to anticipate consolidation.

Do you think that 2025 will bring consolidation/M&A activity between proprietary trading firms in your home jurisdiction?

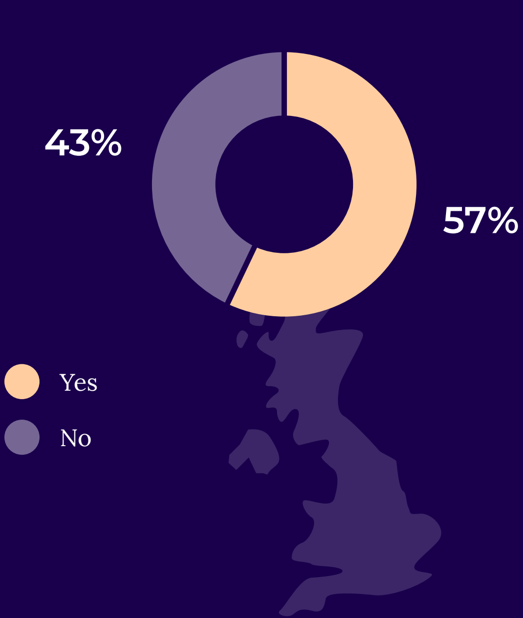
US



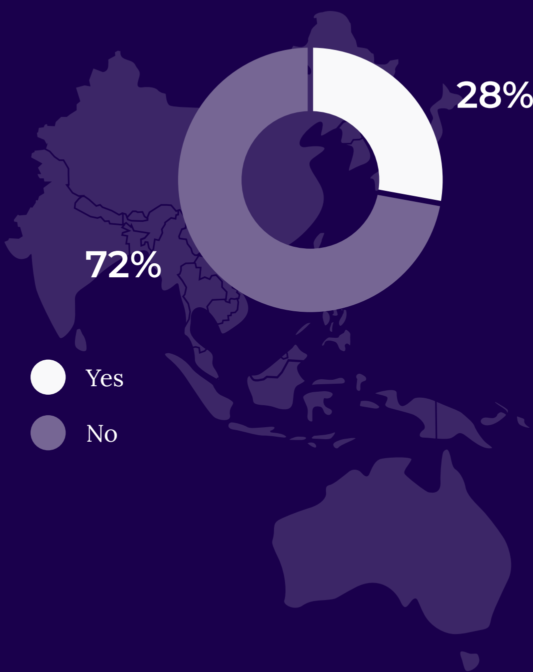
Europe (excl UK)



UK



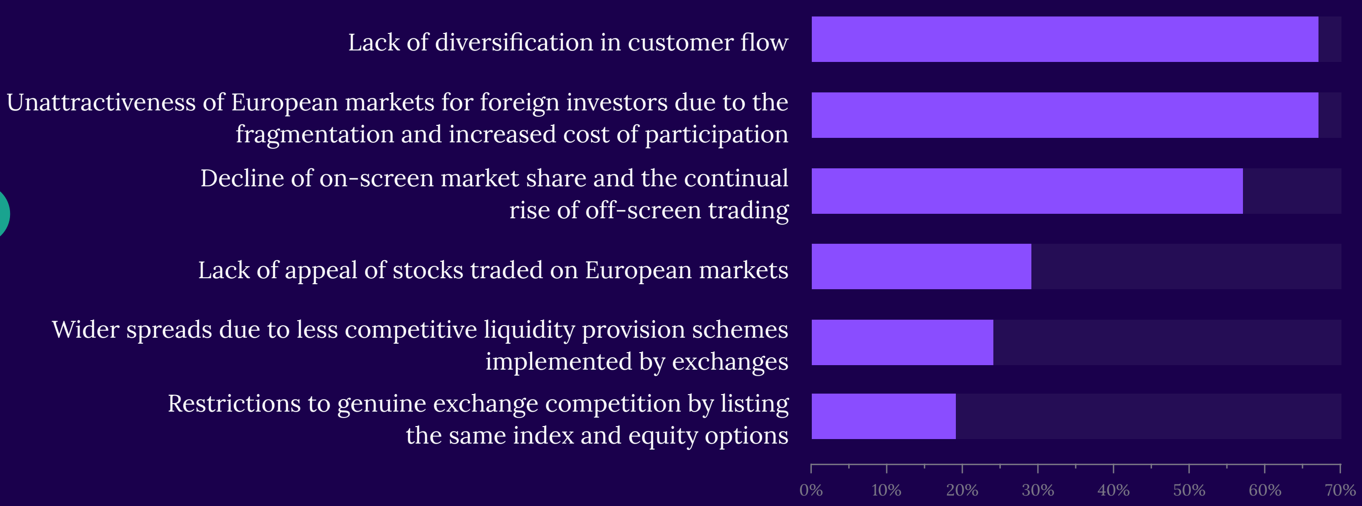
APAC



On-exchange liquidity in European index and equity options

The relative lack of growth in European options markets compared to the US is well known and a well-trodden topic in our Proprietary Trading and other reports. This quarter, a member of the Expert Network asked for views from those trading in the European index and equity options market about what was holding back growth today. In addition, they asked if those firms that provided off-exchange bilateral liquidity in the market were planning to expand their offerings in 2025.

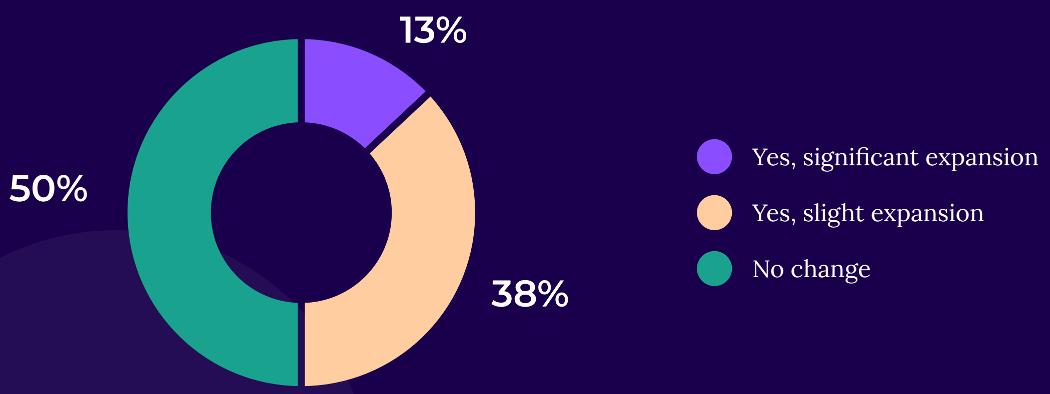
What's most holding back the growth in on-exchange trading volumes for European index and equity options?



Two-thirds of firms in the network that traded in the European options market believed that a lack of diversification in customer flow and the unattractiveness of the European options market structure were the main reasons holding back growth.

The decline of on-screen market share was also selected by more than half of respondents. This factor looks like to grow in 2025, as half of the larger prop firms that provide off-exchange bilateral liquidity in the market are set to expand this offering next year.

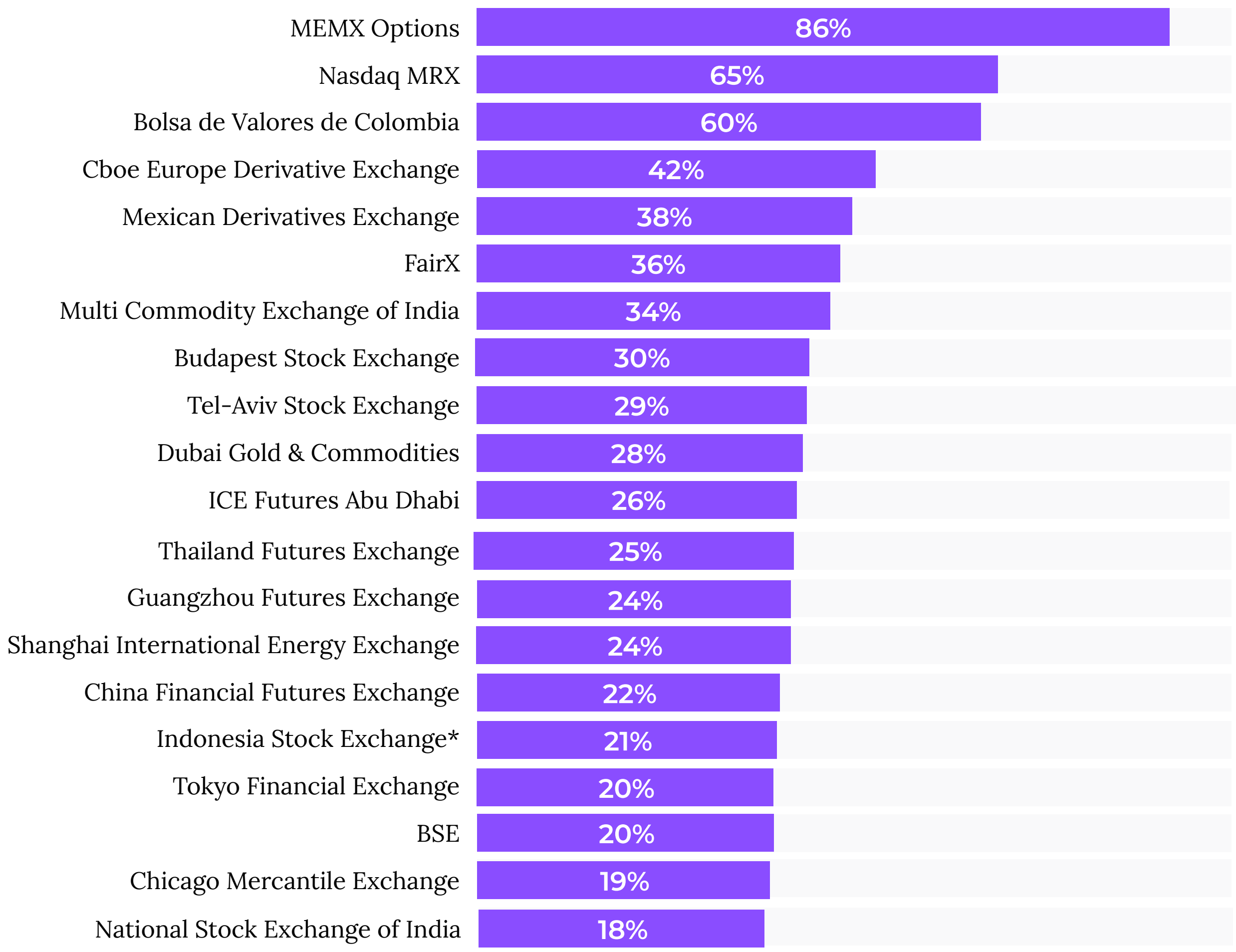
Does your firm plan to increase off-exchange bilateral liquidity provision in European cash equities markets 2025?



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 contracts

The table below, based on data provided by FOW Data, profiles the performance of the top new derivatives contracts launched last quarter, based on average daily volume.

Exchange	Contract	Type	Volume	Open Interest	ADV	Launch
Shenzhen Stock Exchange	CSI 300 ETF	Option		760,000	188,125	01-Jul
Taiwan Futures Exchange	Micro TAIEX	Future	6,332,538	69,118	97,423	29-Jul
Zhengzhou Commodity Exchange	Bottle-Grade Polyester Chips	Future	1,772,580	26,406	41,222	30-Aug
Dalian Commodity Exchange	Corn Starch	Option	232,937	55,586	5,681	23-Aug
Dalian Commodity Exchange	Fresh Hen Egg	Option	198,356	39,933	4,837	23-Aug
Shanghai Futures Exchange	Aluminum Oxide	Option	113,694	18,727	2,773	02-Sep
Dalian Commodity Exchange	Live Hog	Option	59,909	18,517	1,461	23-Aug
Singapore Exchange	Three-Month Tokyo Overnight Average Rate	Future	82,550	1,222	1,250	29-Jul
Shanghai Futures Exchange	Nickel	Option	45,016	7,082	1,097	02-Sep
Coinbase Derivatives	Avalanche	Future	68,157	2,547	1,064	15-Jul
Chicago Mercantile Exchange	Bitcoin Friday Futures	Future	31,498	10,482	732	30-Sep
Coinbase Derivatives	1k Shib	Future	46,561	1,596	727	15-Jul
Shanghai Futures Exchange	Tin	Option	22,444	2,789	547	02-Sep
Shanghai Futures Exchange	Lead	Option	20,794	3,349	507	02-Sep
Tokyo Financial Exchange	Nikkei 225 Micro Daily with Reset Date Rolling Spot	Future	12,682	2,195	204	30-Sep
Coinbase Derivatives	Chainlink	Future	11,969	711	187	15-Jul
Coinbase Derivatives	Polkadot	Future	8,744	493	136	15-Jul
B3	Small Cap Index	Option	8,940	59	135	05-Aug
MATba ROFEX	GD30	Future	2,405	1	114	23-Sep

Source: FOW Data

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