

Special Report Clearing and settlement

# Citadel adds phone trading to European swaps market push

US electronic market maker aims for fixed income as banks retreat



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Citadel Securities has added a surprising weapon to its market-making arsenal in Europe as it attacks a fixed income market left by retreating banks: old fashioned voice trading.

The Chicago group known for its use of cutting edge technology is going old school on the continent to build its share in a new market as its banking competitors struggle with capital rules and old computer systems.

With the move, the US financial services group is stepping up its push to become one of the financial industry's biggest winners from the 2008 crisis.

In Europe its electronic market-making Securities unit has enabled more than a dozen of its growing fixed-income team to trade over the phone to supplement its electronic operations.

Citadel Securities says the pivot is partly due to the fragmented market but also because rules forcing more fixed income electronic trading — as happened in the US — have yet to come into effect.

Paul Hamill, global head of fixed, income, currencies and commodities at Citadel Securities, says: “As similar regulations have not yet been enacted in Europe we are building our business there to operate both under the current regulatory framework and the one we expect to eventually emerge. We’ve added three dedicated voice specialists to our team, all of whom have the ability to trade via voice as well.”

In some ways Citadel is only one of many investment groups, alongside Virtu Financial, Renaissance and XTX Markets, that have used better technology to carve out niches in markets traditionally the preserve of investment banks.

Larry Tabb, co-founder of Tabb Group, a capital markets consultancy, says their relatively small size is an advantage. “Banks . . . have diseconomies of scale. The bigger they get they worse they get at doing one individual thing. Just to get new server provisions can take months or just getting things through purchasing can be a nightmare.”

In recent years Citadel has begun foreign exchange, treasuries and credit and interest rate swaps market-making. Now it is among the top three traders in interest rate and credit swaps on Bloomberg in the US, and holds a similar position in Treasuries trading. Mr Hamill says Citadel intends to move into market making for government bonds and credit default swaps in Europe too.

As a privately owned company, information about its earnings is difficult to deduce but a comparison can be made with Virtu, the US group that last year reported a 15 per cent increase in adjusted net trading income to \$500.7m. But Virtu lacks Citadel’s US equities wholesaling business and does not trade fixed-income in as large amounts.

But Citadel’s push reflects a more profound trend affecting off-exchange markets: a global post-crisis move towards centralised clearing of most derivatives trades; and its status as a “non-bank”.

Forcing derivatives trading through clearing houses reduced the banks’ role as the principal risk manager. Highlighting the extent to which it is breaking new ground, Citadel became the first member of LCH.Clearnet’s SwapClear, the largest clearing house for interest rate swaps that was not a bank.

That status also allows them to avoid some of the onerous Basel capital requirements that have severely squeezed their competitors.

Those changes are beginning to reshape banks’ fixed income trading models radically, moving towards a more neutral position in the market to retain market share.

Russell Dinnage, a consultant at GreySpark, says in a recent report: “A few banks [have begun] to transition away from principal trading models and toward hybrid agency-principal business models.”

The ultimate aim is to replicate in fixed income its dominant position in US equity markets. A share broker for more than a decade, it has made itself the biggest destination for US retail order flow in equities and options, trading more than 1bn US equity shares a day.

To get to that point in fixed income will require more expansion. Last week it appointed a new chief executive in Kevin Turner, the chief operating officer at Microsoft. That indicates a greater use of technology in the future.

“The assumption is that we’re simply going to provide more aggressive prices,” says Mr Hamill. “However, our model resonates with investors because of our willingness to trade all sizes in all market conditions. Banks on the other hand are becoming more selective.”