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THE REVOLUTION OF 2013 ON THE WSE – INNOVATION OR CATCHING UP ON?

Introduction

The Warsaw Stock Exchange is a very cautious and conservative market in respect of introducing new solutions on its parquets – this could be very gentle description, because more appropriate and more honest characteristic is that the WSE is totally obsolete and ignores investors' needs or even acts against them. Technological backwardness, preposterously high commissions and incompetence in the prosecution (together with the Polish Financial Supervision Authority) of market crimes and abuses are the features that associate with the Polish capital market and cause investors' escape.

Taking into account the above, the year 2013 on the Warsaw Stock Exchange with its novelties appears almost as a revolution and by that means is presented by the 'revolutionist'. New trading technology, new orders, new indices and new instruments – sounds great and should make the WSE not only a shining star among CEE parquets, but also evens up the level of development with the top EU and US markets.

But are these changes really so worthy and revolutionary? Were there really needs of changes in this manner and direction? Is it not just the process of catching up on with the others that should be done many years earlier? And how does this transformation affect further development, turnover, capitalization and new investors' interest?

1. UTP – Unable To Perform?!

The Warsaw Stock Exchange has never spoiled investors with state of the art trading technologies. Naturally, hardware and software aspect were not totally obsolete, but did not keep up with the West-European and US markets stand-

ards. The most significant technological upgrade was carried out in November 2000 when the WARSET – trading and quoting system – was introduced. It was not the top of the top solution but met the WSE and its investors' expectations. There was also a small upgrade in 2007 when order capacity of the WARSET was four times greater than before modification, however inefficiency in other fields (for example delay in placing orders) was perceivable.

Another six years were needed to introduce a modern trading system with completely new hardware and software solutions. The UTP (Universal Trading Platform) was launched on the 15th of April 2013 and ultimately superseded the WARSET. Fortunately, until now¹ in general the theory is in accordance with the practice, but obviously it demands stronger analysis.

The most significant milestones are in aspect of technology. The UTP offers theoretical performance of 20,000 orders per second which is more than twenty times higher than the WARSET (or even sixty times higher, because real observed performance of the WARSET did not exceed 328 orders per second, and theoretical performance was 850 orders per second)². For regular session the WARSET performance was sufficient, however economic data publications, rapid movements on foreign markets, opening and closing hours (fixing) – that is all events causing increased volatility and turnover – were too excessive challenges for the thirteen-year system. Today's efficiency 'hiccups' went down to the history. Additionally, the order capacity was doubled to 15 million per day what ensures the adequate reserve for the futures.

Increased performance would be nothing worth if the latency of the order fulfillment was not improved. This was one of the weakest point of the WARSET, because 60 milliseconds in the trading means eternity. Now it is 0.15 millisecond, so finally the world standards were achieved. Unfortunately lower latency is available exclusively on the WSE servers and it means that without similar revolution affecting broker's hardware investors do not feel the difference.

The access to the low latency orders is available especially for institutions (rather not for individuals due to high costs) since September 2013, when the WSE launched High Performance Access (HPA)³. This service offers server collocation in the direct neighborhood of the Universal Trading Platform and guarantees 0.05 millisecond communication latency between collocated machine and the UTP server.

¹ As of 31.12.2013.

² *Architektura UTP*. GPW 2013.

³ *GPW oferuje usługę kolokacji High Performance Access (HPA)*. Instytut Rynku Kapitałowego, 3.09.2013.

Main aim of launching HPA is the high-frequency trading (HFT). The HFT was unavailable in Poland due to sluggish WARSET, low turnover and ridiculous level of commissions. The first impediment has now passed away, but increasing trading volume and diminishing costs of placing orders require something more than just hardware modifications. Nonetheless, the WSE has made quite a nice change for the better.

There are a few more technical advantages in comparison to the previous system. The most important are: scalability, that expands performance by 10,000 orders per second after additional unit installation, as well as disaster recovery, that makes separate units irrespective of breakdown of other system elements. In case of hardware or software damage the WARSET was not able to proceed the session, but it could only finish the current one. Now, with the UTP, continuation is possible.

Technical features of the UTP are really splendid and it is a great chance for the Warsaw Stock Exchange to strengthen position in the CEE region. However it rather should not be called revolution, because there are much more things to do than the WSE, unfortunately, has not planned or are independent on the WSE decisions.

Sophisticated hardware and software are only at the WSE side, but brokers have improved nothing in this area. Orders are still tardy and platforms are far away from advancement of foreign brokers or forex applications. Practically they do not offer algo-trading. Only few brokers are prepared for black-box traders⁴, but their solutions are primitive and unreliable. Moreover commissions are at an unreasonable level, especially for individuals – on average they are ten times higher than the US prices on stocks and seventy (!) times higher than the US prices on derivatives⁵. This fact together with low turnover and consequently wider spreads raise the costs of trading to a hardly acceptable level.

The easiest solution for diminishing commissions is the competition. On capital markets it can be achieved by introducing so called ECNs (Electronic Communication Networks) that act as brokers as well as market makers and also decentralize securities turnover. But ECNs are still on Polish parquet unavailable. Maybe they will appear in a new WSE development strategy 'Gielda.2020' (small probability), but details of this project will be known in late January 2014⁶.

Together with launching the UTP, the WSE has initialized new order types, pretty useful for traders and market makers. These are PEGs orders, that follow buy and sell limits in the book and take their values to maximize probability of

⁴ e.g. DM BOŚ SA, DM BZ WBK SA, XTB SA.

⁵ P. Dąbrowski: *The level of Warsaw Stock Exchange Commissions as a Short-term Trading Impediment*. „Journal of Finance” 2013.

⁶ *GPW zaprezentuje w styczniu nową strategię rozwoju do 2020 roku*. ISB News, 19.12.2013.

fulfilling the order, as well as bulk or mass orders, that allow market makers to quote a few instruments simultaneously. There is no revolution in this area, however the UTP offers itself algorithmic trading therefore investors should wait for the next step of brokers (nine months after the UTP initialization brokers have not yet prepared adequate solutions – shall investors still wait?).

Among less significant changes the UTP handles the old, well known orders in modified way. These are:

- market order (so-called PKC) which can be fulfilled partly, even after fixing is still active and has the same priority as market price order (so-called PCR),
- market price order on opening (so-called PCRO) is no longer available; functionality was transferred to modified PCR that now can be placed at the phase before opening,
- the term of validity now can be set for: fixing only, for closing only or for determined period only,
- stop orders are not taking part in fixing⁷.

Perhaps, it is too early to assess the Universal Trading Platform on the Warsaw Stock Exchange. However in the IT branch a few months are usually enough to see if novelties are revolutionary. In case of the WSE, presented modifications are rather catching up on and it is very likely that they were introduced too late. Investors that really needed sophisticated hardware and software for professional trading have already changed the market. Most world markets, for example German, French, UK and US parquets as well as currency market, implemented similar solution many years ago. So, are there any remarkable incentives of the WSE that can really recompense features of this second-rate place of trading? Poor daily volume and highly-inflated costs of orders fulfillment are main impediments for short-term traders. And long-term traders do not really need the UTP. For them the WARSET offered more than enough functionality.

2. Index will tell the truth

Fast growing capitalization of the Warsaw Stock Exchange and increasing number of companies listed on the Polish parquet induce the WSE to introduce new indices, that widely describe the situation. This solution seems to be perfect for the Polish market conditions, because currently used indices have some mal-adjusted features that can mislead the investors.

⁷ UTP – nowy system transakcyjny GPW. gpw.pl (02.2013).

The WSE decided to replace WIG20 with WIG30, mWIG40 with WIG50 and sWIG80 with WIG100. Introducing wider indices of mid- (WIG50) and small companies (WIG100) is positive response to a greater number of firms traded in Warsaw. They will be launched in March 2014 and the way of calculation will remain the same as so far.

Main changes cover WIG20 – the index of blue-chips and the most important and respected indicator of the Polish stock exchange that is the basis not only for derivatives, but also for other sub-indices like WIG20TR, WIG20lev, WIG20short. Since the 23rd of September 2013, the WSE started publishing WIG30⁸. It is going to replace WIG20. For more than two years WIG20 and WIG30 will be published simultaneously and the 31st of December 2015 will be the last day of WIG20⁹.

WIG20 has some features that are no longer proper for valuation of market condition. It consists of 20 greatest and most liquid companies, but no more than five of one sector, which is today not enough to represent properly the market profile, and one instrument can achieve maximum 15% share in the index, what affects too strongly on the level of WIG20. The new WIG30 is free from these defects – one sector can be represented by no more than seven companies and a share in index is diminished to maximum 10%.

The WIG30 implementation was performed exactly in the right moment. Growing capitalization, growing number of foreign companies on the Polish market, privatization and IPOs of the greatest state-owned enterprises forced this modification. Moreover the migration from WIG20 to WIG30 is carried very smoothly and cautiously and gives enough time for investors to close positions related to WIG20 and to transfer them to the new blue-chip index. The revolution is just in time.

3. Multiplier trick

Unfortunately another 2013 novelty connected with financial instruments listed in Warsaw is like shooting the WSE in the foot. Namely the most common and popular futures contract in Poland – futures on WIG20 (FW20) – is going to disappear and to be replaced by similar one, but with modification.

⁸ *Komunikat Zarządu Giełdy Papierów Wartościowych w Warszawie SA z dnia 8 sierpnia 2013 roku.*
gpw.pl

⁹ *WIG30 harmonogram.* gpw.pl

The new well-constructed idea to implement index WIG30 (and also WIG50 and WIG100) naturally results in changes of derivatives connected with blue-chip index. Because WIG20 will have been handled only by the end of 2015, there is necessity to transfer all the futures and options from WIG20 to WIG30. The migration of derivatives could be as smooth as of indices, but in the meantime the WSE decided to double the multiplier of FW20, what caused many complications.

In the first run, FW20 with 10 PLN multiplier will have been listed only by the expiration of M14 contract (June 2014). On the 23rd of September 2013 the WSE introduced first futures series with doubled – 20 PLN – multiplier. These were: Z13 (December 2013), H14 (March 2014), M14 (June 2014) and U14 (September 2014) and they are going to be main contracts¹⁰. In the second run, from December 2014 to September 2015, the migration from FW20 with 20 PLN multiplier to FW30 with 20 PLN multiplier will be handled. It means that all new futures on blue-chip index will be traded with 20 PLN per point. In September 2015 the migration will be ended and only FW30 will be available on the market¹¹. It is worth mentioning that multiplier on other derivatives will stay the same.

Decision of doubling the multiplier looks like assassination on futures market. First and foremost threat is just killing the turnover. Polish blue-chip futures contract is the most liquid non-OTC derivative, but in comparison to the top markets and their instruments – for example DAX, CAC, FTSE, DJ, NIKKEI – the turnover is extremely poor. Now after doubling the multiplier the daily volume is going to be even lower. This is not just prediction. This is the fact. Comparing trading activity on contracts with 10 PLN multiplier to 20 PLN multiplier the difference is enormous: in average the old ‘version’ of blue-chips futures is traded 10 times oftener than the new one and it already takes into account the doubled multiplier. Of course after 10 PLN multiplier liquidation there will be no choice for traders, however it is more likely to diminish the engagement on this market than easily adjust to new condition.

Another not acceptable aspect of increasing the multiplier by seasoned traders is impediment of position sizing possibilities, which is the part of one of the money management elements that cares about investor’s safety. Now the limits and number of position increment in the strategies are disrupted and it may result in retreating from the market of traders with smaller portfolios.

¹⁰ *Harmonogram migracji: duży mnożnik. gpw.pl*

¹¹ *WIG30 harmonogram. gpw.pl*

The Warsaw Stock Exchange claims that new multiplier should increase (!) the daily volume, because the commission stayed at the same level and now it is possible to earn right after price change by only one point. Moreover the WSE emphasizes, that higher multiplier means higher and faster profits¹². Such explanation is ridiculous and sounds like a bad joke! Already today one can see that the most common reason why people are losing money is over-leveraged positions. So offering them even more speedy contract is like giving a baby a knife to play. Presenting doubled multiplier as a trick that decreases the commission, changes respectable ('respectable'?) Polish parquet into a bucket shop.

Conclusion

New era of the Warsaw Stock Exchange had a chance to start in 2013. Successful launch of the Universal Trading Platform and wise concept of indices modification foretold prosperous future with satisfied investors. Perceiving these novelties as the revolution is certainly too strong, it is better to call it evolution. Unfortunately, all the efforts were wasted by a true upheaval among futures contracts. At times of instrument tailoring, the WSE makes something totally opposite. Maybe being a provincial parquet for green traders and a few local financial institutions is the aim of the Warsaw Stock Exchange?

Bibliography

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REWOLUCJA 2013 NA GPW – INNOWACJE CZY NADRABIANIE ZALEGŁOŚCI?

Streszczenie

Wydaje się, że uczestnicy warszawskiej GPW zapamiętają 2013 r. jako okres istotnych zmian i nowości. Opóźnione, ale skuteczne i niemal bezawaryjne wdrożenie nowego systemu obsługującego parkiet (UTP), jak również reforma w segmencie instrumentów pochodnych poprzez w praktyce zastąpienie dotychczasowego najpopularniejszego kontraktu FW20 nowym FW30 o podwojonym mnożniku oraz wprowadzenie szerszego indeksu blue-chipów (WIG30) zrewolucjonizowały ofertę GPW.

Artykuł jest próbą oceny nowych rozwiązań polskiego rynku kapitałowego i wyróżnia potencjalne zagrożenia w zaproponowanych zmianach. Postawiono w nim pytanie o ich sens i przydatność w kontekście dotychczasowego funkcjonowania warszawskiego parkietu, jak i w porównaniu z giełdami bardziej rozwiniętymi.