

# Institutional Investor



Direct Edge CEO William O'Brien wants to create a new exchange

## Trading Up

Upstart electronic communications network Direct Edge wants to take a place among major exchanges.

●● BY DAVID GRAUBARD

# D

**IRECT EDGE HOLDINGS, AN ELECTRONIC** communications network that has captured 10 percent of the U.S. equity trading market over the past four years, has thrived by offering traders in search of alternative platforms more than just speed and cost efficiency. “That’s the price of admission. We know that’s not enough,” says chief executive officer William O’Brien. “We’re perpetually innovating.”

Based in Jersey City, New Jersey, Direct Edge is part of a second wave of emerging trading firms that cater to institutions. Early entrants, such as Island ECN, started to take on the established exchanges in the 1990s by coming to market with newer technology and lower prices. Direct Edge has upped the ante with a varied pricing plan and powerful partners.

A multiplatform pricing model drives the firm, according to O’Brien, who previously was senior vice president of marketing and new listings at Nasdaq Stock Market. Direct Edge’s EDGA service offers clients free trading and, for a fee, the opportunity to tap such advanced services as access to dark pools, which make anonymous, off-exchange trades. Its EDGX service gives various levels of rebates to passive “black box” traders and other high-volume users. Direct Edge is seeking exchange licenses for both platforms so that it can generate revenue by listing companies. The company also offers an enhanced liquidity provider service that caters to dark pools. The ELP, which works with 25 of the 40 dark pools that exist in the U.S., is ten to 15 times more profitable than Direct Edge’s other services, O’Brien says.

The firm came into existence in 2005, when Knight Capital Group bought a tiny ECN called Attain and changed its name. Since 2007, when it had a market share of 1 percent, Direct Edge has been owned by a consortium of investors that includes Knight, Goldman Sachs Group, Citadel Derivatives Group and JPMorgan Chase & Co.’s e-finance unit, LabMorgan. Direct Edge now matches 10 percent of all equity trades in the U.S., according to Citadel estimates. That would make it the fourth-largest trading platform in the country, behind NYSE Euronext, with 32 percent, Nasdaq OMX, with 25 percent, and BATS Exchange, with 11 percent. The company currently has a staff of 72 and is on track to generate \$500 million to \$600 million in revenue in 2009, according to O’Brien.

Now that it has increased heft, Direct Edge is sharpening its attack on its rivals. In December 2008 the company completed a deal to take control of the New York-based ISE Stock Exchange, the equity exchange set up by the electronic options trading group International Securities Exchange. ISE, which is owned by Eurex, the derivatives exchange controlled by Deutsche Börse and SIX Swiss Exchange, acquired a 31.5 percent stake in Direct Edge as part of the agreement. As an ECN, Direct Edge is obligated to run its quotes through a licensed exchange, which is costly. The ISE deal enables Direct Edge to meet that requirement, pending approval of its own license applications. Assuming those licenses are granted, ISE will be rolled into the new Direct Edge exchanges.

The ultimate goal is to become one of a handful of major global trading centers, according to O’Brien. He says an initial public offering may be in the future as well.

O’Brien, 39, has spent his entire life around the exchange business. His father worked on the floor of the New York Stock Exchange. After earning a bachelor’s degree in political science at the University of Notre Dame and a law degree at the University of Pennsylvania, O’Brien joined global law firm Orrick, Herrington & Sutcliffe in 1995 and moved to Goldman Sachs’ legal department in 1998. He shifted to Brut, an ECN, as general counsel in 2000 and rose to chief operating officer in 2002. He went to Nasdaq after it bought Brut in 2004.

Direct Edge has benefited from low barriers to entry. The Securities and Exchange Commission allowed the creation of ECNs in 1998, and the price of trading technology is falling too. “The rules are structured to give advantages to nonexchange entrants,” says Lawrence Leibowitz, head of U.S. markets and global technology at NYSE Euronext. That environment leaves Direct Edge potentially vulnerable to the next upstart, though. That’s why O’Brien is keeping the focus on innovation, so his company can maintain its edge. ●●