

The rising tide of FX

As FX trading evolves through electronic trading, the potential for a central counterparty (CCP) has been realised in the form of FXMarketSpace.

Jake Smith explains the company's vision.



Jake Smith, head of marketing, FXMarketSpace.

The FX market has experienced significant growth in the last 10 years, to a level many suggest is approaching USD 3 trillion a day. This is the result of an evolving market, where efficiencies have been generated by successfully developing technological solutions for both the interdealer and dealer-to-client markets. As increased trading efficiencies have been developed, new market participants have been attracted to the FX market.

Electronic trading has had a significant impact on the FX market, offering organisations the ability to closely monitor prices, trade when they choose and reduce the number of dealing errors. By streamlining the dealing process, banks have been able to increase efficiency and extend FX trading to more of their customers, not just those trading significant volumes.

E-commerce has been so successful in terms of market adoption that whilst it was seen as a novel way to trade in 2000, in 2007 an organisation's e-commerce strategy is key to its future profitability and market share.

Maximising credit

Technology has allowed institutions to process trades more efficiently; reducing the cost per trade and thus allowing smaller ticket business to be executed. By reducing the cost per ticket, customers including proprietary desks, hedge funds and Commodity Trading Advisors, have been able to implement algorithmic trading and rules-based systematic trading, allowing algorithms to generate a high level of lower value trades 24-hours a day. As a result, any market

movements have been maximised by these algorithms, which in turn have created a deeper, more active 24-hour FX trading market. The FX market has also found creative ways to deal with the requirement for bilateral credit between trading counterparties. To date, the market has adopted credit solutions in the form of prime brokerage which has enabled trading firms to maximise their credit lines and access liquidity from an increased number of counterparties.

Prime brokerage has been hugely successful, but is still recognised as only a partial solution to the cash market requirement for bilateral credit. It does not fully satisfy the demands of institutional customers wanting to see and trade on all market prices and has, at times, caused concerns for some trading desks where their own



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credit lines have been used up by their prime brokered customers. The potential of a CCP trading platform has been discussed for a number of years, in terms of the efficiencies an exchange can bring to cash FX. On 26 March 2007, a new way to trade in the cash FX market was launched in the form of FXMarketSpace.

FXMarketSpace's CCP model is the next step in the FX market's evolution and offers:

- Transparency – both buy-side and sell-side institutions have equal access to all prices
- Anonymity - all customers trade with a central counterparty and therefore all trading is anonymous
- Credit efficiency – including risk offsets between currencies, potential cross margining between FX cash and FX futures and multi-lateral netting between customer and house positions, reducing the overall cost of trading
- Guaranteed settlement – provided by Chicago Mercantile Exchange Clearing House.

In addition to benefits derived from the central counterparty model, FXMarketSpace also provides access to a diverse community, by supporting connectivity for screen-based trading on Reuters' desktops, automated trading using CME's iLink API and select independent software vendors (ISVs). The equity markets provide an insight into the future growth of FX, having experienced significant growth, with increased electronic trading and algorithms allowing for more trading activity. It is

likely that the FX market will follow this trend and will need technology to support both minimum latency and maximum order throughput. With this in mind, FXMarketSpace supports a robust, scalable trade matching engine in the form of CME Globex.

Potential outcomes

Whilst it is expected that some consolidation in eFX trading platforms will occur, it is likely that a range of venues targeted at specific client segments will still exist in the next five years:

- Single dealer trading platforms offered by banks will continue to attract business, as they add ever increasing numbers of solely-banked customers. These platforms have the advantage that they are usually offered to customers without an explicit charge. The more advanced single dealer platforms supporting cross-product services will differentiate themselves from the competition and appeal to a more active trading community.

- Multibank platforms addressing the specific needs of client segments will also be successful. For example, multibank platforms that focus on corporates with multiple credit relationships allow the client to request quotes from a number of banks in an environment where their name is displayed. As a result, increased efficiency is offered to customers and their FX business is seen to be rewarding the overall relationship with the banks.

- ECNs offering a differentiated service will continue to survive. However, if any ECNs are seen as a commodity then they will only be able to compete on price, which will result in consolidation.

- Platforms supporting the CCP model will be successful, not only in appealing to users of other platforms, but also in attracting new customers to the FX market. It is well known that some customers familiar with exchange trading have avoided the cash FX market because they saw it as opaque. By delivering exchange-like benefits of transparency and anonymity, it is likely that new customers will begin to trade cash FX.

The most important factor for all eFX trading platforms is the continued investment in technology and the delivery of benefits to address specific customer requirements. The delivery of increased efficiencies has already driven the market forward over the past 10 years, but the arrival of a platform supported by central counterparty clearing in the cash FX market should result in the market experiencing even more growth over the next three to five years. If this does happen, then ultimately all participants will benefit from increased market volumes and liquidity. Contrary to some thoughts in the eFX market, the result will be that FXMarketSpace does not threaten existing eFX venues, rather it helps them to add more volume. Or, as some say, 'All boats float on a rising tide'. //