

# More intelligence and control -

taking FX Aggregation services to the next level



Nicholas Pratt

A return to the traditional values of the FX market is seeing a greater demand for transparency. Nicholas Pratt examines how these demands are influencing the development of next generation aggregation services.

The FX market has always had a wide variety of liquidity sources, hence the popularity of aggregation services. However over the last few years, these services have now moved on from the initial objective of gathering up multiple liquidity sources into one easily viewable and executable location. As the platform providers look to develop next generation products that take the aggregation model to the next level, there are now far more things to consider.

The first of these is customising, tailoring and optimising the services to match the evolving demands

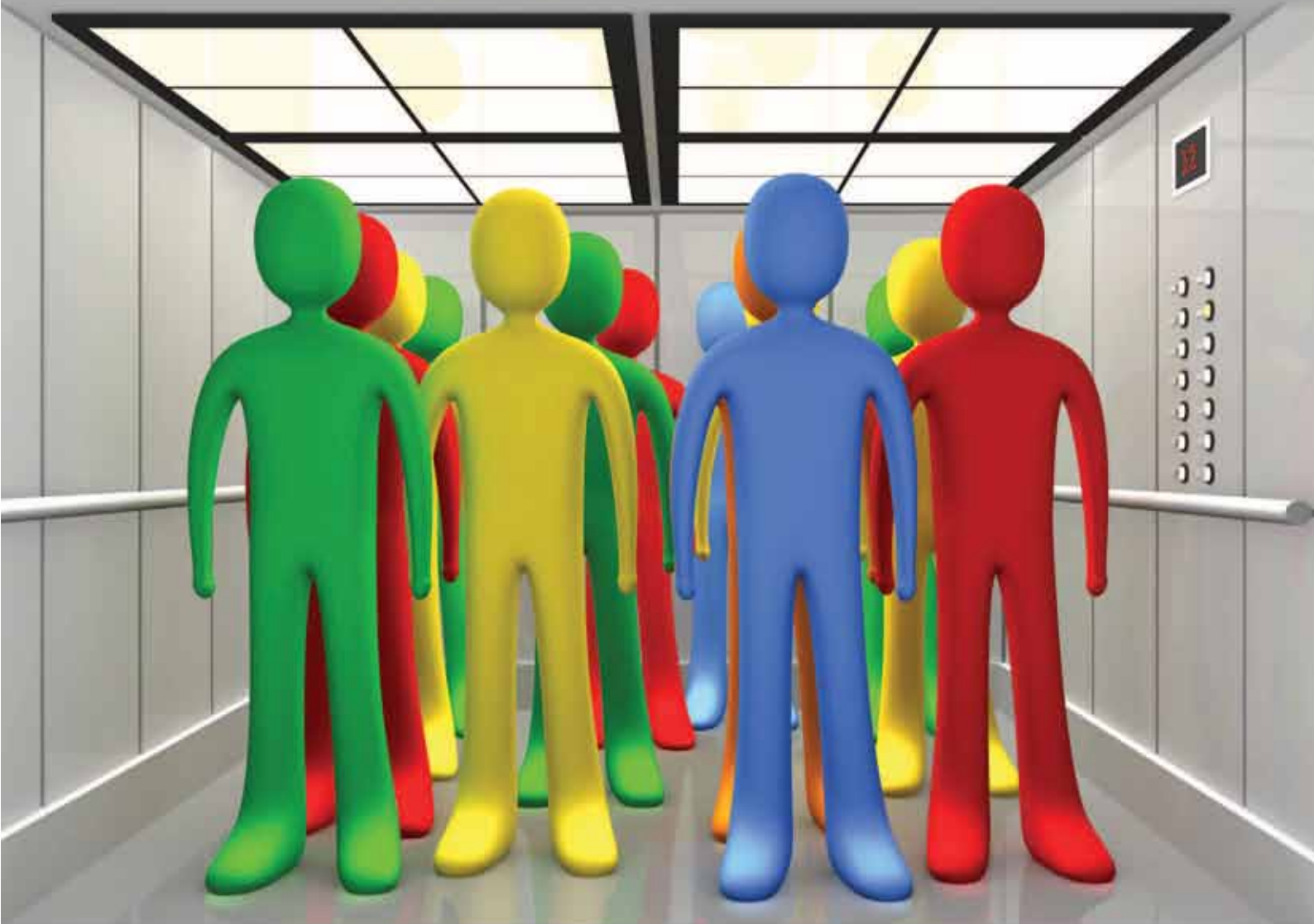
of the different FX trading participants – whether they are market makers, buy-side desks or high frequency trading firms. What has become clear is that the FX market now houses a wider variety of trading strategies than ever before. Many of these strategies have developed thanks to the advancement of technology and algorithms, allowing for greater sophistication, faster executions and increased trading volumes.

FX trading strategies have also been influenced by the developments in other asset classes, especially the equities market where the dominant trend of the last few years has been the emergence of so-called dark trading, where participants trade anonymously in off-exchange locations such as crossing networks and the systematically internalised order books of large sell-side brokers. Sure enough dark trading has become a feature of the FX market, despite the fact that it is an over-the-counter market without the central counterparties in the equities market. In fact, for a while it appeared that the imported trading model of anonymity, dark liquidity and agency brokers would become more prevalent than the traditional, relationship-based trading model that had always prevailed. Now though it appears that the thirst for tradition has returned.

## Meeting demand for transparency

TraderTools, a leading FX trading platform vendor that includes liquidity aggregation as part of its overall offering, has responded to this demand for transparency by launching its LightFX service, a fully-disclosed, relationship-based FX pricing and aggregation service, which has been developed in partnership with Citi's Prime Finance.

“Over time we have built a database with our liquidity providers based on who is better in certain currency



pairs, with certain counterparties and at certain times of the day,” says Yaacov Heidingsfeld, TraderTools chief executive. “Increasingly we are finding it is all about transparency. Liquidity providers want to know who they are providing prices to. They want to know the predictability and reliability of their flow and how aggressive that flow is. We have always had this data but with the improvements in technology we are now able to do more analysis in a much quicker timeframe. Through our partnership with Sybase and its Aleri division we are able to employ CEP technology and then feed this into our SOR technology.”

The service is really aimed at the mid-tier and below, where banks are redistributing prices and for those banks that are outside of the top 15 banks that make

up the FX interbank market, says Heidingsfeld. “These banks are more regionally focused and will be strong on particular currency pairs and not so strong on others, which is why it is important that there is more transparency around the liquidity. There are also more sophisticated liquidity takers in the corporate space that are trading FX for alpha or hedging purposes that require more transparency around liquidity and execution. And by giving the liquidity-providing banks comprehensive data on how their liquidity is being redistributed and executed against, the top-tier banks are able to provide better prices.”

#### Differentiation from ECN services

The reason for the LightFX offering is to differentiate from the ECN-based services which provide



Yaacov Heidingsfeld

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the bulk of the liquidity in the FX market, says Heidingsfeld. He believes the market’s demand for more transparency and a return to relationship-based pricing will appeal to both liquidity takers (who will receive better, relationship-based pricing) and liquidity providers (who will be able to offer a more transparent service to their clients). “The biggest chunk of liquidity in the market is still provided via the ECNs which are based on an anonymous trading model. We asked if that anonymity was something our clients wanted. And while there are those that do, such as high-frequency traders and hedge funds, there is a large part of the market that wants more transparency. So we are filling a void.”

The lack of transparency is a big issue in the FX market. For example, in February an Arkansas pension fund sued a custody bank because it believed that it

was being overcharged for its currency transactions. The lawsuit suggests that buy-side firms operating in the FX market are now paying greater attention to the pursuit of best execution and this is something that liquidity aggregation services will have to cater to, says Heidingsfeld. “The information we are providing is post-trade data and transaction cost analysis and best execution – things that have been prevalent in other asset classes, namely equities, but have largely been absent from the FX world. We are not just providing data for single executions but for multiple executions over time so that firms can use that data to formulate their strategy.”

It is important to make the distinction between what Heidingsfeld calls “curve-fitting” (where traders will devise their strategy first and then fit the data into this pre-meditated plan) and developing the strategy around the data. And by making post-trade data more available and accessible firms, they can more easily adopt the latter approach.

When money was more available across the board, many financial institutions were willing to take what was being offered by prime brokers. But now that things are a bit tighter and liquidity is less available, we’ve been witnessing a return to relationship pricing. Banks are being more selective about who they supply to, and customers are going back to the banks that used to serve them. In addition, although liquidity is less free-flowing and markets are far flatter, a number of things have improved, especially the availability of hosting services. Banks have devoted more resources to the hosting services they offer and the attitude of their customers has changed. Whereas previously hosting services were seen as a low-rent option, they are now being seen as the model of choice – and not just because of the money that is saved on IT implementation and maintenance costs.

### Dark pools

There is no one size fits all approach in the FX market but it is clear that some approaches have been more fashionable than others, says Heidingsfeld. For example, the last three years has seen the rise of so-called dark pools. “Dark pools were the flavour of the month. Everybody wanted them. The trading firms thought that the big FX banks were not giving them good prices because they knew who they were and this led to a desire for anonymity and the spread of the dark pools. But now those trading firms have found that it was not as great on the dark side as it promised

to be and we are seeing them coming back into the light. I still think there is a place for dark pools and I think they are here to stay. But we are definitely seeing a greater appetite for transparent liquidity. We are able to tell our clients that we are aggregating single banks at a price they can execute on. We are not aggregating the aggregators, where the liquidity on display may be part of mirage. I don't think anyone would deny that banks give different prices to different people, but in the whole debate over the need to be anonymous to avoid unfavourable pricing, the baby was thrown out with the bathwater. Now we are seeing that there are still some firms that favour anonymity because it is fundamental to their trading and business strategies. Essentially, they are trading firms rather than firms that also trade. But there are many others that have no demand at all for anonymity."

Now, an educated market participant will be able to choose the solution that best suits them because all types of solutions are available. And by adding an expansive data service to the aggregation solution, Heidingsfeld believes that aggregation services can truly remain a trader's best friend. "Information is the key to any industry and, in this context, the information is beneficial to both parties involved in the trade and is not harmful to either."