



The future of FX: Exchange traded and OTC liquidity?

Best Execution talks to David Holcombe, Product Lead for FX Futures and Clearing, 360T

Is the FX market really heading towards being an exchange traded and centrally cleared market?

This isn't an all or nothing point in either direction. One size does not fit all in the FX market. The Deutsche Boerse Group FX strategy is actually a good view of the end state of the FX landscape – where informed clients will establish whether to clear any given trade, then use the right tools to achieve that.

When will that be? Cleared and exchange traded FX is still a small fragment of the overall FX market, so surely that “end state” view is still many years away?

My role is to ensure 360T exploits tight integration between 360T, the Eurex Exchange, Eurex Clearing and other group entities to create a truly front-to-back FX offering for our clients that covers Exchange and OTC FX liquidity. We haven't made a public song and dance about this, but this integration really is very well advanced, and you will see FX futures traded via 360T in the first quarter of 2018.

Beyond tools to let our clients choose the right FX product for the trade they need to do, using the right execution model, and the right credit and clearing model to exploit all the benefits available, the challenge the industry faces right now is to understand what clearing means, and what it can do for them.

OK, so if clearing is the start point for all of this, how do I know whether to clear something?

It's actually a complex consideration. We've had a specialist consultancy in to prepare analysis to quantify the benefits of central clearing for FX, as in the absence of clearing mandates, the decision process to clear needs to consider multiple attributes for any given scenario. With so many moving parts as variables in the model, we are now going through these results with clients individually, offering to put their sample portfolios through our modelling tool to see where they will gain.

Ultimately though, one has to understand what the real drivers for each trade are, and also to

consider the full impact that the trade will have on the portfolio in each form it could take, in order to then make an informed decision of how and where to get the best trade done with the best outcome.

So, once you need to clear, how do you choose between OTC executed flow or exchange products?

While the use of exchange listed products amplifies the benefits of clearing, the answer is still pretty much down to product access and liquidity.

It's understandable that OTC execution is a place many start when considering clearing, because exchange-traded FX has never really been centre stage in the FX market. The majority of our clients being real FX participants state that a market built on the foundations of "how much and who's asking", with a myriad of ways in which LPs and clients can meet to bilaterally negotiate and trade OTC FX, have meant the US-focused exchange offerings, with limited value dates and product flexibility, have always been too far away from being a good fit for their needs.

Also, it is fair to say that trading on an exchange platform doesn't suit everyone, and clients with strong relationships that have historically served them very well, particularly in bilateral disclosed models, are understandably inclined to favour those routes to interact with the market. This is the execution model you will see in our 360T Block and EFP network: access to FX futures, while trading using familiar OTC models and tools.

When OTC products are the right route though, the availability of a clearing service for the product you need is the first obvious consideration. While interdealer NDF clearing is pretty much routine now, no CCP has yet been able to satisfy the regulators that they are effectively managing the settlement risk they concentrate between members for deliverable OTC FX products, in order to address the bulk of the market's ADV – deliverable Spot, Forward and FX Swaps. Deliverable OTC FX clearing will become a reality in 2018 though, as we are one of two major CCPs currently finalising a deliverable FX clearing service, with the Deutsche Boerse Group's Eurex Clearing service being the only one focused

on letting you clear FX Spot, Forward, FX Swap, alongside cross currency swaps.

Once you have determined the position is going to be cleared, then your focus should be whether listed or OTC products give you the best route to get that position into the clearing house, considering all liquidity available: in the exchange orderbook and off-book – exactly the model 360T has with support for OTC alongside exchange listed FX products.

Well that's clear – the customer gets the choice of using an OTC or exchange FX product, and accessing those exchange products on or off the exchange orderbook, but surely the problem with listed FX remains – the products are not a particularly good fit for OTC users?

The uptake of FX futures will be helped by next generation products that evolve FX futures from the US contracts with a small number of infrequent value dates, to something closer resembling the flexibility of OTC products.

We do have classic shaped FX futures contracts, albeit with OTC characteristics like having the currency pair quoted the right way around for OTC users, but a perfect example of next generation FX is the Eurex Rolling Spot Future. This is the simplest way to get FX spot exposure into the CCP, using an exchange listed product designed with a focus on removing incumbent costs in OTC rolls, with multiple liquidity providers considering the exchange orderbook and also how they can use the 360T block and EFP functionality to increase their distribution.

With all of these points aligning, the future of FX is here. Giving the customer true choice of product, execution type, and credit/clearing model so they can exploit the benefits that clearing can bring is certainly a challenge, but all of the foundations are already there for this client choice to become a reality in 2018 within 360T and the Deutsche Boerse Group. ■



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