That ever-shrinking distance between OTC and Listed FX

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The FX market is the largest and only truly global capital market. With the most diverse set of participant types, each with disparate trading ambitions and time horizons, it's a market that has always operated as a set of pools of activity, which are bridged by the firms providing liquidity to specific client sets then using other pools to offset and manage their risk. While the abundance of pools still rings true, the FX market is quite a distance through a front-to-back evolution that has changed it from where bilateral and disclosed liquidity was the norm, to a landscape where there are multiple routes you should consider in order to get the trade you need, done.

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As a client, you are no longer constrained to dealing with a panel of brokers to get a price based on your relationship and what your counterpart knows you are trying to achieve, and where your broker bilaterally provides the credit as well as liquidity for the trade. Indeed, our transformation in 360T over the past three years is a good reflection of this. We know FX will remain very much a relationship market, so our OTC FX offering still has our market leading bilateral and disclosed liquidity propositions, but our clients are now also enjoying 360TGTX, our undisclosed ECN with curated liquidity, plus a true all-to-all central limit orderbook, with credit intermediaries breaking the constraint of being bound to only facing trading counterparts where you have credit too.

Our philosophy is to provide clients the tools they need to choose and use the right execution and credit model for the trade they need to get done. And while we will see new execution models, it is fair to state that the majority of change throughout the FX market over recent years has actually been in or because of changes in the credit layer – with the provision of credit and liquidity starting to separate.

It is evident this trend for separation will continue, with providers either unwilling, or from regulatory constraint or purely their balance sheets, unable to warehouse the amount of risk they have previously held. It is also evident that this void, with continued market shockwaves tightening the belt of bundled OTC credit/liquidity, has created fertile ground for new credit paradigms for OTC FX participants to start to emerge.

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At the same time this change is going on in OTC FX, there is a similar revolution happening with Listed FX, albeit in the opposite direction.

LISTED FX

The start point of Listed FX Futures and Options is that these products are listed in an exchange order book, so they start from a position of trading in an all-to-all anonymous environment, where all members access the same price, regardless of who they are or what their driver for the trade is. Here credit and liquidity separation has always been part of the exchange proposition, with CCP central clearing and exchange membership for trading access being distinct roles and activities.

But until now those benefits alone have not been enough to break the volume ceiling on FX Futures products. So even with no credit or relationship constraints - an exchange order book with single, visible top of book and firm no last look liquidity (which is of course great for price discovery), suffers the flip side of firm liquidity in that the book only contains what is truly available and executable, so if you are looking for depth in an order you cannot break up, then an exchange order book might not always be the perfect route to get every trade you need, done.

While some brokers have provided off-exchange pricing for FX Futures trades in size, it is only now with 360T offering the first multi-dealer off-exchange FX Futures liquidity pool, that users can enjoy using familiar OTC execution models for their FX Futures activity, literally running this alongside their OTC activity.

As CCP Central Clearing still provides the credit layer on Futures executed this way, once you get access to the products you have a credit model enabling liquidity providers and liquidity consumers to form trading relationships that are entirely liquidity focused, rather than having to consider and constrain and manage all of the credit and operational issues inherent with OTC relationships.

Couple this with innovative new FX Futures products – such as the Eurex Rolling Spot Futures product that is a synthetic equivalent of the OTC spot market, albeit cleared in a futures wrapper, rather than rigidly sticking to third Wednesday Futures IMM deliveries, and it is evident that Futures liquidity is now additional pools of activity you should be considering, and indeed exploiting to meet your FX trading requirements.

OTHER BENEFITS

There are of course many other benefits of CCP central clearing, but beyond asset protection against counterparty default, the first may be to consider how you could exploit the multilateral netting that CCPs give when you face a single counterpart for all of your activity in these products. You can net and optimise your position/activity, so don't have to fund or margin multiple lines, or maintain legal and operational agreements and processes with each trading counterpart you have. This will of course become increasingly important as the next and final waves of UMR (Uncleared Margin Rules) kick in over the next 18 months, and more counterparties face mandated margin requirements.

For those arguing that multilateral netting is already available by using FXPB. Yes of course it is, but as the Eurex & Oliver Wyman model illustrating the regulatory costs of transacting bilateral OTC or cleared exchange traded derivatives consistently shows, the use of Futures can lead to a mutual cost benefit for both bank liquidity providers and their liquidity taking clients. While the base case for this is circa 600 USD per million saved in the transaction, the model shows the overall calculation is complex, so we tend to work through specific scenarios with clients to generate their bespoke illustration.

Of course, this doesn't change the fact that a bilateral OTC FX transaction, or a Prime Broker facilitated trade may still sometimes be the best route to take. But when you have the ability to decide whether to use Listed or OTC FX, with an all-to-all anonymous or bilateral and disclosed model, you know you are armed to navigate the multiple pools of activity you need to consider in order to get the best outcome for each trade you need to do.

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