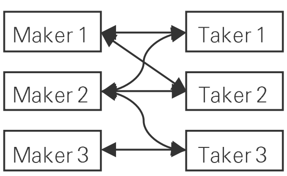
eFX ‘Explainers’ Secondary Venues

As part of our ‘Explainers’ series, we shed light on how the electronic FX market operates. This issue continues on the theme of external venues, focusing on the FX Secondary Venues.

What are Secondary Venues?

- Secondary Venues are marketplaces where participants may trade with one another but are not one of the two Primary Venues[1]
- Each one is unique in its offerings, quirks, and features. The larger of them are Cboe FX, Fastmatch (Euronext), GTX (360T), Currenex, and LMAX
- Anonymity – Liquidity consumers (‘takers’) are only known to the liquidity providers (‘makers’) via anonymous codes (‘tags’)
- Curation – Makers do not have to price, or show the same prices to all takers, while takers may choose which makers are in their liquidity pool
- On Secondary Venues, takers and makers trade through either a streaming relationship or the Centralized Limit Order Books (CLOBs)
- Secondary Venues have various matching engines, where participants interact. Not all participants have a presence in all engines. The venues typically operate in at least New York, London, and Tokyo. Singapore is also becoming an increasingly popular location
- All venues allow the trading of deliverable FX while some also offer the trading of Precious Metals and NDFs

Streaming Trading on Secondary Venues



- Maker 1 does not price Taker 3
- Maker 2 prices every Taker
- Maker 3 prices only Taker 3

- Taker 1 does not see Maker 3
- Taker 2 does not see Maker 3
- Taker 3 does not see Maker 1

How does trading happen here?

- The vast majority of trading on Secondary Venues occurs via Streaming Trading where makers stream tradable prices to their takers, identified just as tags
- Makers have multiple streams with a given venue and will quote prices to multiple tags on a given stream
- Makers may move the tags from one stream to the other as they see fit. The streams are typically differentiated by the quality of the flow they see from their tags
- Sometimes takers may have makers removed from their liquidity pools. E.g. due to a maker’s market impact, response time, or their fill-rates. **HSBC regularly reviews its makers to optimise execution**
- Venues operate CLOBs to offer a source of firm liquidity
- Restricted Orders – Participants may leave limit orders which only some tags are able to see or trade with
- Dark Orders – Participants may leave orders which cannot be seen but will match against other orders
- Floating Orders – New and popular, participants leave orders which are pegged to the market mid +/- an offset

		Secondary Venue				
		Cboe FX	LMAX	Fastmatch	GTX	Currenex
	2023Q1 ADV ($bn)	43.8	21.5	21.3	11.1	Not Disclosed
Offering	Deliverable FX	X	X	X	X	X
	NDFs	X		X	X	X
	Metals	X	X	X	X	X
	Sweepable	X	X	X	X	X
	FA	X	X	X	X	X
	Last-Look	X		X	X	X
	Firm	X	X	X	X	X

[1] If you want to know more about Primary Venues, take a look at the previous issue of this eFX Explainers series (Issue 1: Primary Venues).

Last-Look vs Firm

- If liquidity is Firm, the maker cannot reject a taker's attempt to trade on this pricing. Otherwise, makers have the ability to apply 'last look'
- Firm Streaming Trading is dramatically less popular than Last-Look Streaming Trading
- Reject Rates – What stops a maker from systematically waiting to decide whether the market has moved in their favor before accepting a trade? Reject Rates. If a taker finds that a maker frequently rejects their trades, then they will remove this maker from their liquidity pool. Some venues actively monitor these rejection rates and will remove makers based on this measure

Full Amount vs Sweepable

- Historically, most trades were done on sweepable liquidity, where takers may simultaneously trade on multiple makers' prices
- Now, Full Amount (FA) trading has risen in popularity. Trades that are parts of sweeps have proven difficult to risk-manage, can disclose a taker's intent to multiple makers, and can cost the taker more through wider prices
- With FA Trading, a taker may trade on only one maker's price at a given time. FA trading is tightly monitored and trading frequency is restricted
- What constitutes FA is not so black and white. It has generally become understood that a taker may trade on a FA stream in less than their full interest so long as they allow appropriate time for "liquidity to replenish". If the taker does not allow sufficient time, then they may be disabled or widened

Credit – Compatibility with Anonymity?

- On Secondary Venues, makers and takers do not always need to have legal / credit relationships directly with each other as these relationships can reside with their respective Prime Brokers
- This unique structure allows the instantaneous addition of new trading relationships. Want new trading takers? Just turn the tags on
- Semi-Disclosed Trading – This structure also allows for a taker and maker that are acquainted with one another to expeditiously begin trading by having the venue set up an exclusive stream between the two

Latency – How fast is trading done?

- Round Trip Time (RTT), the time between a taker launching a trade request and hearing back on the outcome of that request, is the standard measurement of latency
- While processing a request, a maker will verify credit availability with the taker and consider last look
- RTTs have been rapidly improving, 30ms is now considered achievable. Most venues set a maximum allowed RTT to reduce misuse

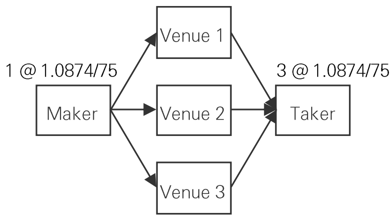
The Good – Why are they so popular?

- Curation for Makers – Makers may select takers that fit their risk management, have bespoke pricing for takers, and may turn off takers that prove too difficult
- Curation for Takers – A taker may turn off a maker if they are too slow to respond to trade requests, reject too many trades, or have too much market impact. They may also choose makers that fit their trading style. **HSBC have bespoke liquidity pools for voice traders by site and for the eFX Market Making / Algo Desk**
- Functionality – A slew of useful features including floating orders, dark orders, and fast onboarding
- Granularity – Whereas Primary Venues have minimum sizes of 1mn and minimum price increments of at least half a pip, Secondary Venues have no minimum sizes and price increments of only 1/10th of a pip; **e.g. for EURUSD, the spread HSBC pays at inception on Secondary Venues is only 1/6th compared to EBS**
- Market Impact – Trading and pricing on Primary Venues has greater market impact as all participants see what happens. On Secondary Venues, only the specific makers and takers see what happens; **e.g. we observe that in the 30s following a EURUSD trade, EBS moves 8x more than Cboe FX**

The Bad – What are the downsides?

- Liquidity Mirage – If a maker prices on multiple venues, they will refresh their prices on all venues when they receive a trade on one of them. What is present everywhere in one moment may be gone the next

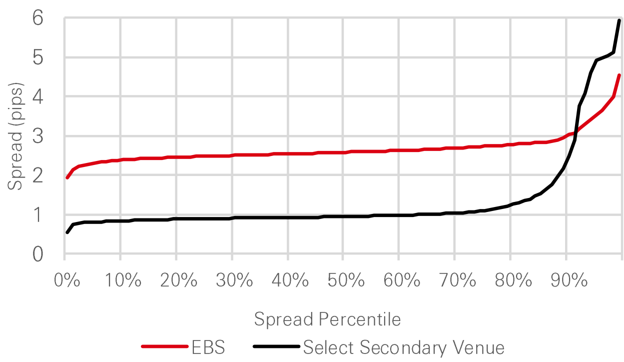
The Liquidity Mirage



To a taker that sees the same maker on multiple venues, the market seems much more deep than it really is. Here, if they tried sell 1 @ 1.0874 on each venue, they would get only 1 done.

- Reject Rates – Takers may get rejected asymmetrically and need to continuously monitor this
- Scouting – Pricing and liquidity granularity allow makers to risk little money to help derive alpha. Takers need to continuously monitor the market impact of their makers
- Stability –The liquidity available on Secondary Venues, especially for EM pairs, is more competitive but much less stable than what is available on Primary Venues

Spread for 20mn EURUSD on EBS vs Select Secondary Venue on May 3, 2023 (FOMC)



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