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THE FINANCE HIVE LIVE

London Global FX Steering Meeting

Kensington Roof Gardens
December 2017

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Summary of the day..

We were thrilled to welcome so many familiar faces to our second Finance Hive Live: London Global FX Steering meeting held at the magical Kensington Roof Gardens. Opening the day was our Chairman, David Clark (Chairman, European Venues and Intermediaries Association) who spoke candidly about the Libor scandal and the financial crisis which ultimately led to the establishment of the FX Global Code of Conduct in May 2017. David went on to chair the keynote debate on international cooperation between Central Banks and the FX Global Code of Conduct which featured Christophe Beuve, European Central Bank, Meredith Beechey Osterholm, Riksbank and Vladimir Shapovalov, Central Bank of Russia.

Throughout the day our Finance Hive members each participated in four of the following round table discussions:

1. Using Algos Under Regulatory Reforms
2. Accessing Moscow as a Financial Centre
3. Exploiting Non-Bank Liquidity
4. FX Trading under MiFID II
5. What Will ‘Best Execution’ Mean in Tomorrow’s World?
6. Different Options for Execution to Make the Best Platform Choice
7. The Role of Exchanges in FX
8. Post-Trade Transparency
9. The Changing FX Environment and How Liquidity Will Evolve

The meeting concluded with an interview by Anthony Belchambers, Financial Services Negotiating Forum Advisory Board talking to Kay Swinburne, MEP for Wales about the impact of Brexit negotiations on the FX trading community in particular looking at issues such as equivalence and clearing (visit www.thehive-network.com to see clips of this interview). In this report you’ll find the key takeaways from our round table discussions and please don’t hesitate to get in touch if you’d like further information. We look forward to seeing you at one of our Finance Hive meetings in the near future.

Best wishes
Noj, Sally and Julie.

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Thank you to our partners:

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USING ALGOS UNDER REGULATORY REFORMS

State Street

In summary

Overall approximately 50% of the Finance Hive members who trade FX use algos. There was a clear split between hedge funds who build their own algos, and real money who use bank-provided products. Interestingly, only hedge funds were using algos to generate alpha whereas both hedge funds and real money use them for sourcing liquidity.

The attitude towards algos is strongly divided; of those that use algos there was a majority who use them exclusively but a significant minority who use them for some trades but not all. In the latter group, mainly asset managers, the reasons cited for not using algos for certain trades were (a) unavailability, (b) poor quality data, (c) large size, (d) non-deliverable forwards There was a general theme that electronic execution and algos in particular are likely to increase as a result of MiFID II and the Global Code of Conduct as the automatic data feeds make compliance reporting simpler.

Questions discussed

- Should you trust humans or machines?
- How do you trade with algos and still maintain anonymity?
- What is the view of the regulator on algos?

Key takeaways

- Lack of data stifles innovation in FX algos.
- Importance of control & transparency when using algos; vital the banks explain to the buy side how algos actually work.
- Algos suffer the same issues of last look as other FX market activity.
- Build vs. buy: Majority build their own algos to protect trade information.
- Good algos can only be as good as per the liquidity setup; if there is one bad player in your pool this ruins the whole algorithmic pattern so clients are looking at their liquidity and the impact of adding players.
- Algos are partly driven by governance; they give the institutional community the ability to give evidence which is what the regulators want to see.

“

The best event I have attended in 25 years in the business! A unique opportunity to get up to speed with key FX issues in a relaxed fashion.

”

2 ACCESSING MOSCOW AS A FINANCIAL CENTRE

Moscow Exchange and Raiffeisen Bank

In summary

There were many surprises during the day's discussion; surprise that the Russian market is well regulated by the Central Bank of Russia and also that there is a strong economy when focusing on the country's monetary policy and targets – 4% inflation and 7% interest rate.

At each of the round tables Hive members were taken through key points demonstrating the attractiveness of the Russian market:

- Strong links from the Central Bank of Russia to other central banks and capital markets elsewhere in the world.
- Deep liquidity in Russia that trades on exchange through a CCP with a well-regulated solid platform.
- The Russian market has a good source of bank and non-bank liquidity; 50% of liquidity comes from overseas investment.

Key takeaways

- Enormous on-shore FX liquidity.
- Sanctions have a negligible effect.
- Russian economy is strong, less oil dependent, well regulated, MiFID II compliant and transparent.
- Keen to understand economy & attracting real yields for investors under sanctions.
- Russia's enormous development on capital markets.
- Direct access to RUB Moex liquidity via Thomson Reuters FXAll.
- Open active FX/rate market with minimal intervention.
- The potential of CNY-RUB trades; alternative capital markets away from USD.
- Can Raiffeisen help create securities which replicate a dynamic hedging strategy?

> "*This has been a very useful networking & educational event. In an excellent venue. Thank you Hive for organising it. I hope to be invited again.*"

3

EXPLOITING NON-BANK LIQUIDITY

Citadel Securities

In summary

Over half of the Hive members today had not used non-bank liquidity, didn't know exactly what it was but still were interested in learning more. Therefore those who had used non-bank liquidity were in the minority.

There are different models and not all non-banks are doing the same thing, there are many differentiating factors based on what you're looking for and what you need. Non-bank liquidity is spreading in more spot markets, but will this improve liquidity?

There was unanimous agreement that more discussion needs to take place around the challenges and solutions to non-banks launching forwards from a credit and financing stand point.

Key takeaways

- Relationship is key even in a fully automated trading environment.
- Non-bank liquidity will become increasingly important.
- Forwards challenging due to balance sheet issue; this is a main concern for buy side managers.
- Last look direct limits warehousing percentage.
- Looking to partner with banks to provide credit.
- Non-bank liquidity is going to add different values compared to banks; it is more transparent, better client service and less bureaucracy.
- Is there really a difference between bank and non-bank liquidity?
- Non-banks might internalise a lot more from banks outside the top 10 Euromoney banks.
- Top non-banks are now top 10 FX liquidity providers.
- Are you ready to provide your spreads curves at a seven point of time to your clients?
- Non-banks vs. banks: It's all liquidity.
- Need to consider liquidity during tail events and how to manage.
- Skew is not shown homogenously to all clients – added value in EM.

> *Exactly the right amount of variety, whilst focusing on the core issues.*

4

FX TRADING UNDER MIFID II

Currenex and FX Connect

In summary

From the conversations during the day, many believe MiFID II is destructive to the FX business. However of course we have to commit and it will change the fabric of the FX community.

The minority of people believe they are ready for MiFID II in January 2018, however what will be interesting to see is how will the regulator monitor compliance and feedback on our performance?

Questions discussed

- Can TCA & cost benefit analysis immunise banks and asset managers from litigation?
- Are the regulators ready to enforce MiFID II?
- MiFID II is anyone really ready? Everyone is so afraid of doing things wrong – will it affect the original business model?
- How about a dual regulatory regime EU/Non EU?

Key takeaways

- The difficulty of implementing rules; there is a disconnection between legislators and markets.
- We don't know all the answers on MiFID II but don't be afraid to interpret and evolve past January 3rd.
- Regulation pendulum is at an extreme which gives a liquidity concern; MiFID II will not be good for liquidity.
- FX does not fit continuously into MiFID II. As a consequence preparing for it has been a challenge.
- Closer to implementation does not imply closer to comprehensive buying.

> *Excellent platform for exchanging innovative ideas.*

5 WHAT WILL BEST EXECUTION MEAN IN TOMORROW'S WORLD?

Thomson Reuters

In summary

Without proper TCA you cannot determine execution quality and the differences to executing, depend on the venues you choose;

- whether primary or secondary venues?
- whether they are disclosed ECNs or RFQ?

Remember best execution is not just about best price; other factors include obviously venue, but also available pools, size and time of trade, currency pairs. Therefore you need a good TCA tool.

One big issue discussed was the distribution between primary and secondary platforms; primary market platforms and firm pricing as opposed to indicative pricing is worth considering in some market conditions. Furthermore does more banks mean more liquidity? Adding a liquidity provider on to an existing venue doesn't necessarily provide you with better execution, perhaps look at different venues e.g. ECBs.

The growth of algos is part of the evolution of the FX market; a return to the single bank model using their liquidity and credit. What next? User defined algos. However not everyone is on the same evolutionary path.

Key takeaways

- Not just best price that determines execution quality; consider the pool available, size of trade and type of flow.
- Contrast for best execution; Bank RFQ vs. algos/streaming platforms..
- Adding additional counterparties into an existing venue is not as effective as adding a new venue type to improve your liquidity/ position for better execution.
- Algos: from multibank back to single bank (use their liquidity pool).
- Evolution? Venue pools & algos (user designed) aggregate liquidity pools.
- Very few buy side traders are actually using primary market venues. Perception is that this is only for banks (interdealer) not so!
- Only primary market platforms provide firm prices i.e. Exchanges, Reuters, EBS.
- Secondary markets: Good indicative prices subject to last look. Best execution – firm price is better.
- Size of trade will determine:
  - Which venues to use
  - When to trade
  - Which counterparties to engage
  - How many counterparties to engage
- RFQ to banks: Bank's price will consider:
  - Who you are
  - Risk profile (Increase OR Decrease)
  - CCY pair/size
  - Warehouse vs. auto hedge
  - Market conditions
  - Size pricing ladder
- Algos: key benefit to buy side is access to primary markets. Why not participate direct on the primary market venues?

6

OPTIONS FOR EXECUTION TO MAKE BEST PLATFORM CHOICE

NEX Markets

In summary

With the FX Global Code of Conduct now in place there is a desire to deliver a platform that is over-prescriptive, for example the requirement to trade orders in sequence as they arrive is in conflict with the desire from asset managers to net trades together. However an over-prescriptive platform and pressure from your compliance team may force you to adhere to the sequencing rule, something which could go against your client's interests.

Another issue was access to liquidity through credit; middle/ small sized asset managers want PB access to markets and there is, currently, nowhere they can do that as major PBs simply don't want to deal with middle/ small sized clients.

Finally, there was much discussion over blockchain and the future of the markets. One interesting suggestion was that there could be a modern securities trading platform beyond FX, which could act as a Trojan horse into European markets. You may not need to have a local presence if your platform does?

Key takeaways

- Requirements in a platform are vastly different under FXPB or bilateral execution set-ups.
- Transparency market impact and quality of algo execution.
- Sequencing of trades platform is part of market ecosystem.
- Platforms – an answer for Brexit & 'passporting'?
- Minimum requirements which are the most important; data centric, assessing the market impact of your trades and monitoring.
- One differentiation factor of ECN is the price taken participants.
- More work on TCA needed at LP level.
- Is blockchain changing the world?
- Adhering to new codes may incentivise different trading behaviour which might negatively impact performance.

> *Very insightful challenging debates on critical market themes.*

7

THE ROLE OF EXCHANGES IN FX

CME

In summary

There was a broad agreement that exchanges do have a role to play in FX that they will become more prominent in the future and will co-exist with OTC.

During the day's discussion there was a focus on the increasing cost on the supply side however this received a mixed response as some Hive members saw spreads going wide and PB fees going up, whereas others saw no impact at all.

In conclusion, the role of exchanges going forward is to offer firm liquidity in a regulated market place to get around some of the MiFID II requirements. There will be increased focus on new products such as monthly futures as a proxy for forwards and integration of the OTC and Exchange market place for the first time.

Key takeaways

- Need rolling spot futures for new contracts to match CFDs/ETFs.
- The FX Code of Conduct is bringing awareness that is favourable to exchanges.
- New products facilitate access.
- Margin efficiencies.
- Crypto currencies; futures on a Bitcoin index is being launched.
- Costs trading futures vs. OTC.
- Most participants collateralise.
- Diverse liquidity.
- Futures and OTC will exist as hybrid, exchanges may become bigger than it currently is.

> *"The FX Hive was an outstanding opportunity to network with similar entities and finding joint solutions to market structure, liquidity, and compliance issues."*

8 POST TRADE TRANSPARENCY

CLS

In summary

'Transparency is a universal good and we need more of it in post-trade.' Absolutely not according to today's discussion! The majority of costs that could be a cause for concern are hidden in parts of trading other than price and therefore there are mixed views as to whether more transparency in needed. Those trading large positions say if there was more transparency they would know they were in the market and so it would be more even.

However others trust their PB and don't need more transparency. There was one statement that received unanimous agreement which was MiFID II is NOT the answer. The fields mandated by MiFID II in terms of transparency do take the focus off other things e.g. charges on borrow costs if trading short. There is concern that transparency comes at a massive cost; you get more accuracy on your price but your overall cost for your trade gets more expensive and therefore is it a deal you want to do? In conclusion, transparency should be driven by the client; use the principles required of those in the market to drive what information you need.

With regards to blockchain; many Hive members have different understanding of blockchain is and what it can do in FX. There are many supporters but currently people are adopting a 'wait and see' approach; it's certainly not the FX transparency solution for 2018.

Key takeaways

- MiFID is dictating what transparency is required and it is missing many important aspects, potentially increasing cost unnecessarily.
- Regulators also need to help keep down the cost of regulations for smaller companies.
- Transparency is what the PB agrees to tell me!
- Not everyone uses the information we think the market is demanding.
- What is the cost-benefit of transparency for clients?
- Price matters much more than cost.
- Blockchain does not solve all problems but provides accuracy.
- Blockchain evolution should enable greater post-trade transparency / efficiency in settlement & matching. Cross-asset efficiencies too (common ISDA).
- Huge potential for blockchain technology across all aspects of trading, post-trade in FX & beyond.
- The buy side (especially smaller firms) don't yet have a vision on how to use DLT.

> *"Excellent event. Great roundtables with a variety of participants, fantastic place to table ideas and raise concerns."*

9 CHANGING FX ENVIRONMENT & HOW LIQUIDITY WILL EVOLVE

CBoe

In summary

Like many sectors, electronification has played a key role in the changing FX market. In the spot market for small transactional amounts the market is very efficient. However in large amounts there is an opportunity set; you either take it on yourself or you manage your liquidity externally through a platform to get the best out of it. The more transparent the markets are, this leads to more TCA, either internally or outsourced. Despite many tools being developed the forwards/ swaps markets are not yet electronic.

The discussions also included the changing of execution protocols and how the buy side trader role has changed, for example the Buy Side are taking on increased responsibility for the handling of their orders and the pressure to demonstrate best execution has never been greater.

In summary, there is no doubt that liquidity is becoming more fragmented with electronification of the FX market and this, coupled with tightening regulation and the need to achieve, evaluate and demonstrate best execution, it is perfectly logical that further changes and additional execution strategies will take place.

Questions discussed

- How to protect your interests/positions from market makers/liquidity controllers?
- Which LPs actually provide genuine liquidity?
- Liquidity management is a full-time job. How do you really know what LPs are doing with your order?
- How persistent will voice trading be going forward?
- It is worthwhile monitoring reject rates, liquidity?

Key takeaways

- Buy side execution is about risk management.
- Code of Conduct – impact on liquidity: Likely to see non-adoption in order to maintain last-look capabilities (hence tight spreads).
- Liquidity & pricing has actually improved if you are active in spending the time to look at it.
- NDFs will be an interesting topic to watch as they become more electronic and cleared.
- Venues are moving towards minimum standards & penalising market participants who don't live up to the standard.

> "*Amazing event filled with knowledgeable peers ensuring The Hive delivers an unmissable FX event.*"

- e-Tools provide better liquidity in quieter times. Less so when the market is volatile.
- Electronification has transferred the need for / necessity for liquidity management expertise to the price taker.
- The collateral impact to NDF will change where liquidity sits.
- Electronic means more transparency but signal leakage is critical to manage.
- Bank LPs have much higher challenges than non-bank LP.
- More analysis needed on LP providers.

Future Hive Live Meetings...

For more information or to reserve your place at any of the upcoming Finance Hive meetings please contact Julie Nicolas - MD, The Finance Hive:

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Finance Hive Live: USA Global Steering Meeting

Boston - May 3, 2018

In 2018, the Finance Hive's USA Global FX meeting for the Buy Side will be held in Boston with 150 leading Finance professionals meeting to discuss the evolution of the FX market structure and financial technology.

Finance Hive Live: FX Leaders

London - June 5, 2018

This invitation-only exclusive meeting brings together a select group of senior buy side FX professionals to discuss the latest issues affecting the industry today.

Future Hive Live Meetings...

Finance Hive Live: Fixed Income

London - October 17, 2018

Accessing Liquidity amid Regulatory, Market Structure and Geo-Political Change

Regulatory pressure in the new MiFID regime; global geo-political uncertainty in the wake of Trump, Brexit et al; the continuing liquidity drought; the rise of new Buy Side platforms and technology; the deluge of data. The Fixed Income meeting in London is part of a series of Buy Side-to-Buy Side forums created to foster dialogue and collaboration among the Buy Side in response to rapidly evolving market conditions.

Finance Hive Live: London Global FX Steering Meeting

London - December 6, 2018

The London Global FX Steering meeting is the only meeting created by and designed for fully engaged senior buy side professionals with the aim of bringing the buy side together to debate the big issues impacting FX right now such as geo-politics, macro strategy, liquidity and regulation.

For more information or to reserve your place at any of the upcoming Finance Hive meetings please contact
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