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Getting to grips with FX



A new multilateral trading facility (MTF) for FX derivatives will help to reshape the currency markets to a more efficient, more transparent model, says Evgeni Mitkov, CEO, SURFACEExchange.

FX has traditionally been seen as a secondary consideration for many traditional asset managers. But legal disputes between buy-side firms and custodians have helped draw attention to how best execution can be achieved in the asset class. SURFACE has been building up its pre-trade analysis capabilities, a central order book, and a range of exchange-traded products. The upshot, according to Mitkov, is that buy-side firms need no longer rely on custodian banks for their FX execution.

Investor choice

"FX is a market in which phone trading has left buy-side firms and end-investors the prisoner of the top five big banks," says Mitkov. "Banks have been able to set a 'my way or the highway' pricing policy, to the disadvantage of asset managers. But we are offering a platform that users can connect to via the Internet, that gives investors real choices and control over their execution."

Active in Europe and the US, SURFACEExchange launched in August 2011 with G10 currency pairs and crosses listed in the form of OTC forwards and options. It now encompasses both vanilla and customised volatility products across G10 options and forwards. Its stated aim is to provide a level playing field to market participants, with open price transparency and an anonymous trading system for OTC FX derivatives. SURFACEExchange currently has 30 market participants; Citigroup is acting as the platform's central counterparty (CCP). Price on the exchange are determined by the participant firms dealing with each as there are not specific market making firms on the platform.

Other electronic platforms already exist in FX. These include interdealer broker platforms, aggregated liquidity pools, multi-bank trading platforms, and electronic communications networks. But Mitkov insists that SURFACEExchange opens up a new front for investors.

"SURFACEExchange operates an exchange-type model for the OTC contracts that have been traded on the phone previously," he says. "On our platform, you can access a central limit order book for that product on a completely anonymous basis. Our platform provides depth of book information, automated execution and anonymity with the minimum of hassle – it's like going from a donkey to a Ferrari."

Automated solutions

SURFACEExchange offers users several automated order types, such as icebergs, as well as the ability to sweep the book in search of liquidity. It is also grandfathered into the Dodd-Frank regime, avoiding the danger of any incompatibility with new regulations for the central clearing of OTC derivatives.

In addition, the MTF also devoted considerable resources making the expiry process electronic. The reduction of expiration risk helps to make the buy-side comfortable on the platform, according to Mitkov. While some observers have warned that front-running could still be a problem in FX, due in part to the predictable, scheduled nature of some trade participants' execution strategies, he sees the anonymity provided by the MTF as a useful tool to help buy-side firms trade safely and efficiently in FX.

“Some firms had previously abstained from developing systematic trading strategies in FX, because you could be worked out very quickly,” he says. “But the MTF is anonymous, so it’s possible to deploy valuable advanced automated strategies without people reading you.”

Buy-side market participants are fuelling a rise in FX volumes and liquidity through their increasing use of currency instruments to hedge equity exposures. In the US, many asset managers are either hiring separate managers for their currency exposure or have started hiring traders themselves. The fact that volatility is generally lower in FX than in equities makes FX an ideal hedging tool, says Mitkov.

“Global FX is a huge market,” he says. “Banks have dominated this space for years, concentrating flows for their own advantage. But investors lacked innovative electronic solutions. SURFACEExchange is building a more efficient, more transparent market that can benefit all market participants to achieve best execution in FX.”

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