Foreign Exchange Contact Group

Frankfurt, Monday 7 July 2014, 14:00-18:00 CET

S U M M A R Y   O F   T H E   D I S C U S S I O N

1. Latest development regarding Thomson Reuters

Paul Clarke (Thomson Reuters) reviewed the **latest developments regarding Thomson Reuters**. With the acquisition of FXall, Thomson Reuters has now several platforms to serve different types of customers, including the buy side. Regulation will require more foreign exchange (FX) over the counter (OTC) volumes to trade on regulated venues. Fair access rules for platforms are a requirement of Swap Execution Facilities and include a need for greater transparency and disclosure to clients.
Thomson Reuters has recently released an updated *Matching Rule Book* designed to safeguard behaviors that support genuine market activity with new specific trading rules designed to encourage a high frequency of execution, discourage abuse or manipulation and reduce trading styles that do not enhance liquidity for the whole market. Before launching this, Reuters conducted a thorough review of the practices in its trading platform over 12 months, analyzing a broad set of data and in consultation with market participants. It introduced new, specific and measurable trading rules and reports to clients about their own fill ratio. Sanctions can be imposed in case of non-compliance with the rules. Thomson Reuters has also announced its aim to run a pilot for order randomization, in order to put some limits to the "race for speed". For some currency pairs, the granularity (i.e. tick size) has been changed (e.g. the Mexican peso or the Russian ruble) to curb "tagging" (i.e. when a new top of the book order is immediately accompanied by another order inside the bid-offer spread).

2. Algo execution

James Dalton (Citi) discussed **algorithm execution in FX**, an activity that was initially developed in equities and has recently gathered momentum also in FX, where large dealers and buy-side entities are increasingly using it. Several type of algo are available: agency model (direct market access), bank execution model (internalization) and an hybrid model which is a mix of the two previous models. Direct market access strategies are designed to target liquidity within a limit price as quickly as possible or work order stealthily orders over a longer period of time. Internalization models enable banks to offer algo to client that limit client footprint in the external market by retaining a large part of the flow internally. Algo execution offers several benefits to FX end users: cost reduction, auditability of transactions, ability to perform a detailed transaction cost analysis, anonymity in execution and also responds to the shift in regulatory environment fostering more transparency in the execution. The creation of algo requires significant investment in development and infrastructure, but some providers are now offering basic forms of algo execution at competitive prices.
Members reported that the usage of algo execution in FX remains on an uptrend, also on an agency basis, but some customers remain reluctant to use it due to some lack in technology resources, on possible concerns over automation or simply lack of expertise.

3. FX Transaction Cost Analysis and benchmarking

Peter Eggleston (Morgan Stanley) discussed about **Transaction Cost Analysis** (TCA). TCA use is increasing in FX, as investors respond to an increased demand for transparency, to regulatory requirements or to a pressure on returns (and the explanation of their sources). TCA is available from

third party providers, platform providers or from dealers directly. The main focus is on post-trade analysis, with the objective of adding value to the execution. TCA requires the need to analyze large data set. Benchmarking in FX and for TCA is also critical: they can be point in time benchmarks (e.g. WMR, arrival price), interval based (e.g. TWAP) or experience based (e.g. peer group).

Members discuss the need and the benefits of having independent TCA and the fact that the specificity of the FX market is an additional challenge for conducting TCA (e.g. there is a consolidated price tape in equity markets, where TCA was developed, differently from the FX market). Some members noticed also that independent offers are valuable, but may present some limit in term of access to data.

4. Suggestions for an update to the ACI´smodel code: summary of answers

Guy-Charles Marhic (ECB) provided a summary of the answers received from the members for **a possible update on the ACI Model code**. On the need to strengthen the use of the codes, members made several propositions: to have mandatory adherence, to strengthen education (e.g. certified traders and sales), to have a clear and strong backing from central banks and regulators or making their endorsement by banks as an additional selection criteria of counterparties for the buy-side. It was also proposed to add a chapter on execution including FX benchmark execution on communication (e.g. market colour and pre-trade communication). Members emphasized that the code should be clear and provide simple explanation and possibly real life examples.

5. Market review and discussion

Ulrich Leuchtmann (Commerzbank) provided **a review of the FX market development**. Exchange rate volatility has reached the lowest level since 2006, and the low volatility is prevailing across financial markets. In his view it is driven by the extraordinary policy measures of central banks (forward guidance and quantitative easing), which lessen the impact of shocks and foster hunt for yields. Members note that regulation may have also depressed volatility. It was said that market complacency, including in FX, has recently increased steadily. The end of quantitative easing by the Federal Reserve may, however, be a trigger for an exit from the current low volatility environment. Some members reported that corporates have reduced FX hedging in view of the low volatility environment, although the interest rates differential is also relevant for long-term hedges.

As regards the euro, several members noticed the resilience of the euro exchange rate, although they deem that further appreciation is unlikely. Some reckon that market participants are still waiting for the exit from quantitative easing by the Fed and that only then the US dollar would strengthen and the euro depreciate. Some added that the recent developments may also be explained by market positioning, as well as by the fact that many market participants are still uncertain about the effects of the recent ECB monetary policy decisions. On the other hand, some members noted that strong equity inflows continue to provide some support to the euro and that this should continue, as valuation of European equities are lagging those in the US.