ECB

Foreign Exchange Contact Group

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LSEG FX

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Non Bank Market Makers: FX Market

Brief:

- *What is the* ***evolving role of NBFIs (and in particular PTFs) in FX liquidity provision****, with a particular focus on* ***market behaviour in periods of stress and the implications for overall market functioning?***

Classification:

- Non Bank Market Makers (NBMM) emerged in FX Markets in 2004 and have been prominent ever since
- While there is some diversity across the range of participants they share the following common characteristics:
  - **Limited Risk Inventory-** hold negligible risk positions overnight
  - **Technology Sophistication-** reliance on high speed execution through significant investment in technology and infrastructure
  - **Prime Brokerage Dependency-** reliance on bank prime brokers to provide credit intermediation and market access as well as operational efficiencies
  - **Capital Light-** not subject to bank regulatory capital requirements
  - **Activity**: FX Trading on Primary Markets, Secondary ECNs and FX Futures & Options
    - Some firms have branched out to provide more traditional dealer to client liquidity businesses
    - Some firms now base their edge on forward price prediction models

Alternative views from Academic Literature:

"In normal times, we find that NBFIs contribute to market liquidity by passively trading against the pricing errors created by dealers' aggressive trade flows. On price discovery, NBFIs contribute the dominant share, mostly through their high-frequency quote updates which incorporate public information."
(HFTs and Dealer Banks; Huang et al., 2023)

"Liquidity provision by non-banks tends to be more opportunistic and more prone to evaporate at times of stress, with entities that generally provide liquidity suddenly turning into liquidity consumers."
(NBFIs and Financial Stability ; Aramonte et al., 2021)

Medium-term Trends

LSEG Matching

Fig. 1

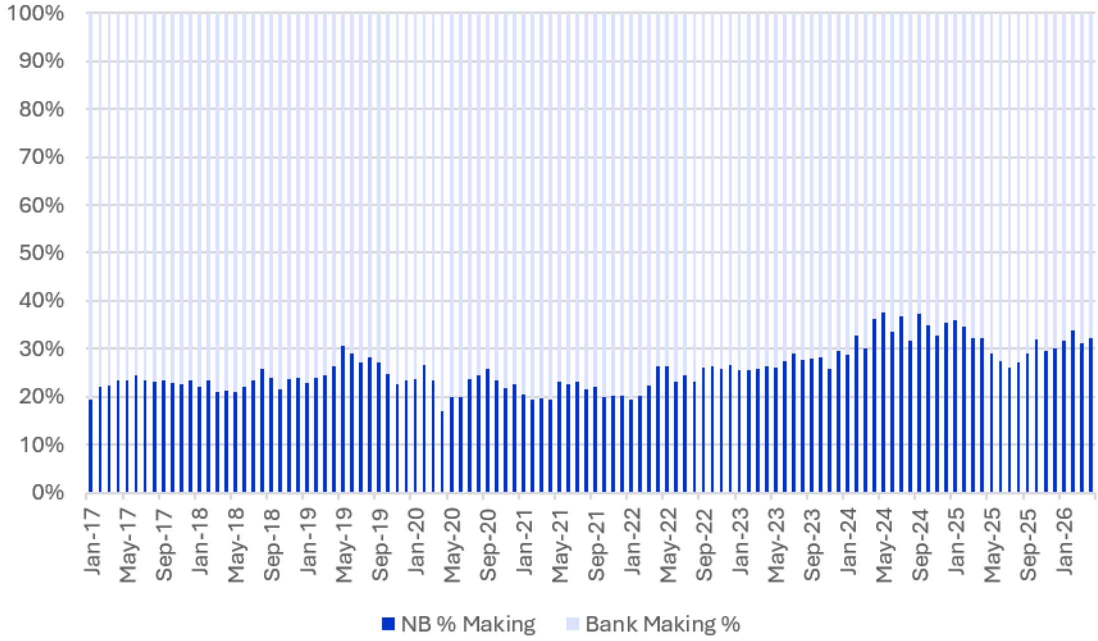
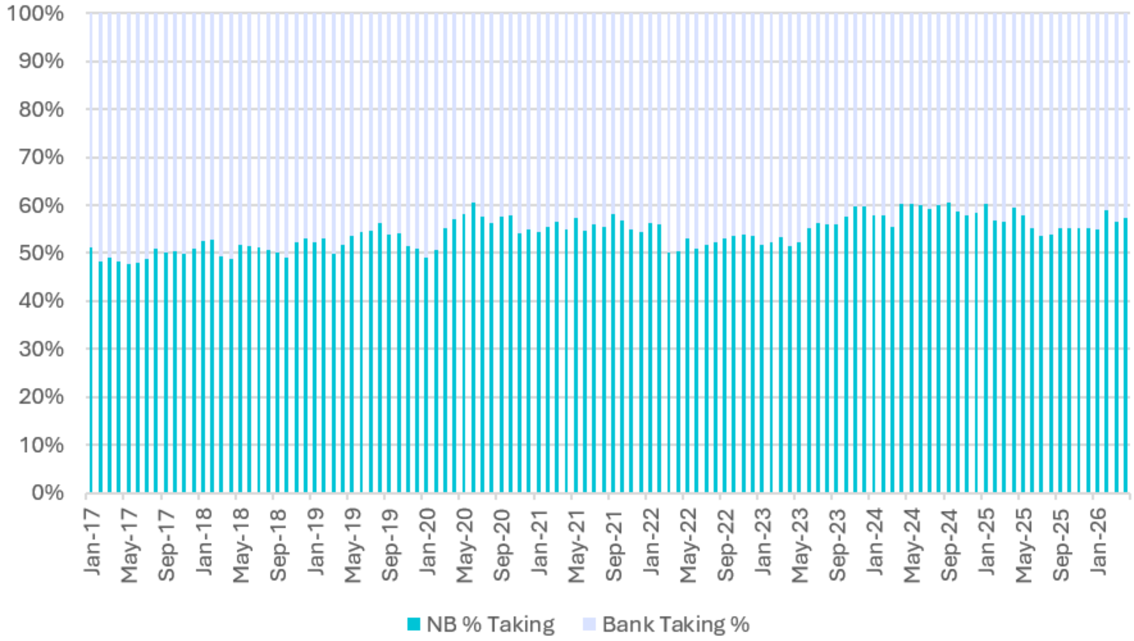


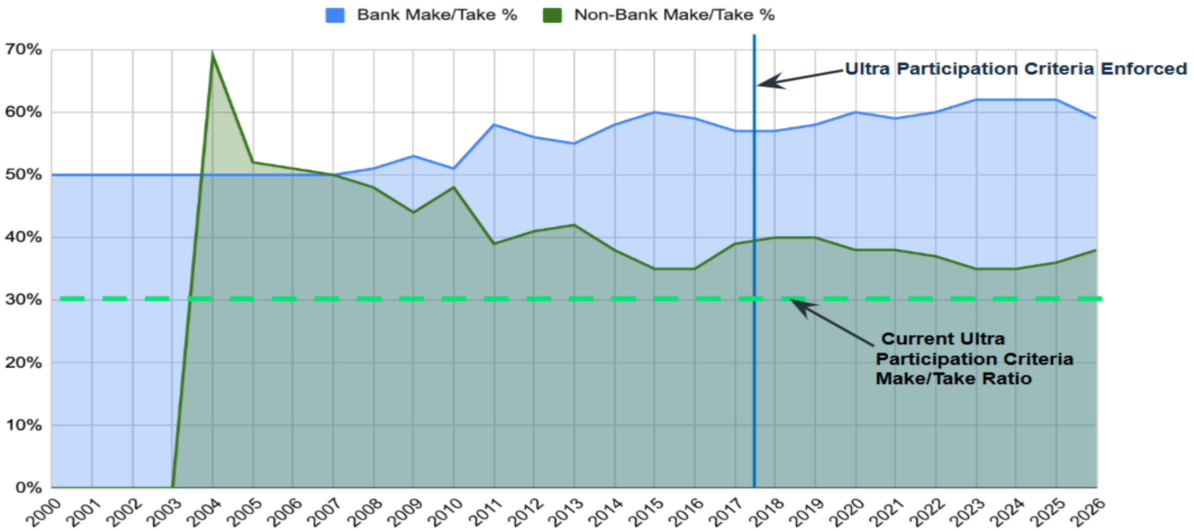
Fig. 2



EBS Markets

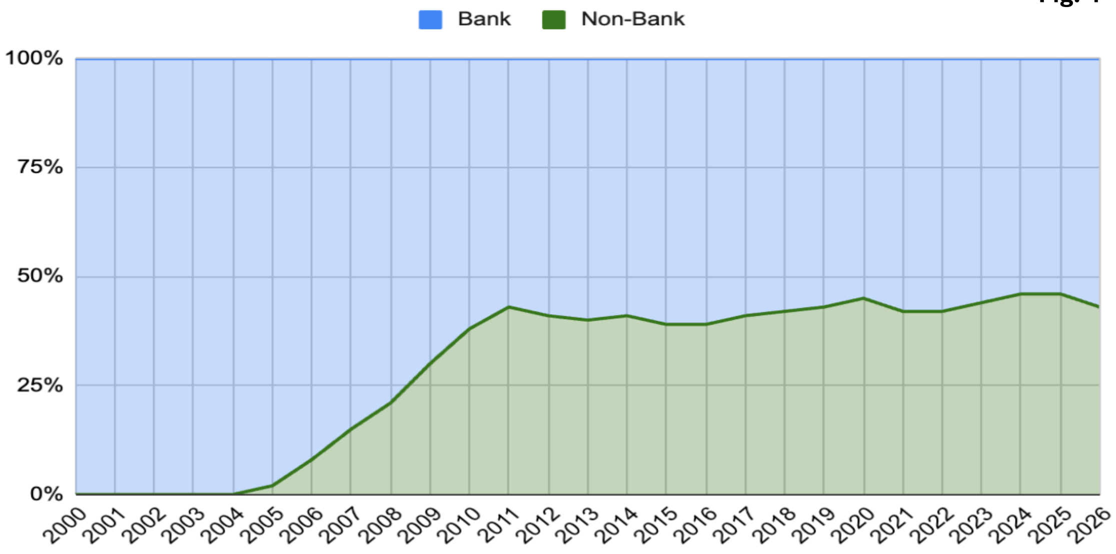
Fig. 3

Bank vs. Non-Bank Make/Take Ratio



Bank vs. Non-Bank Dealt Volume Ratio

Fig. 4



LSEG Matching

Fig. 5

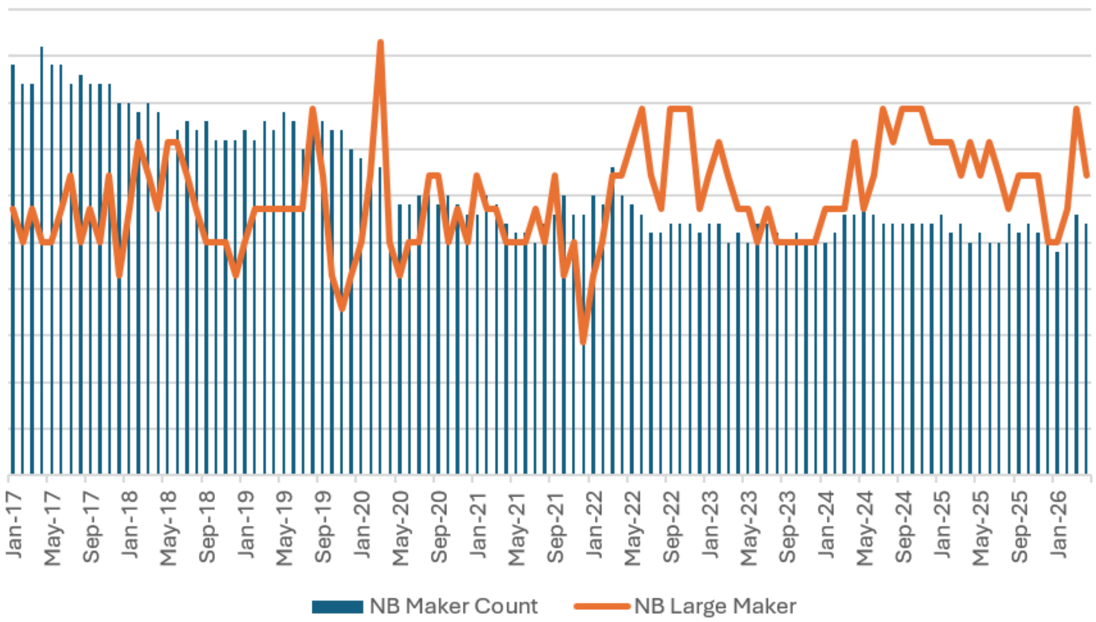
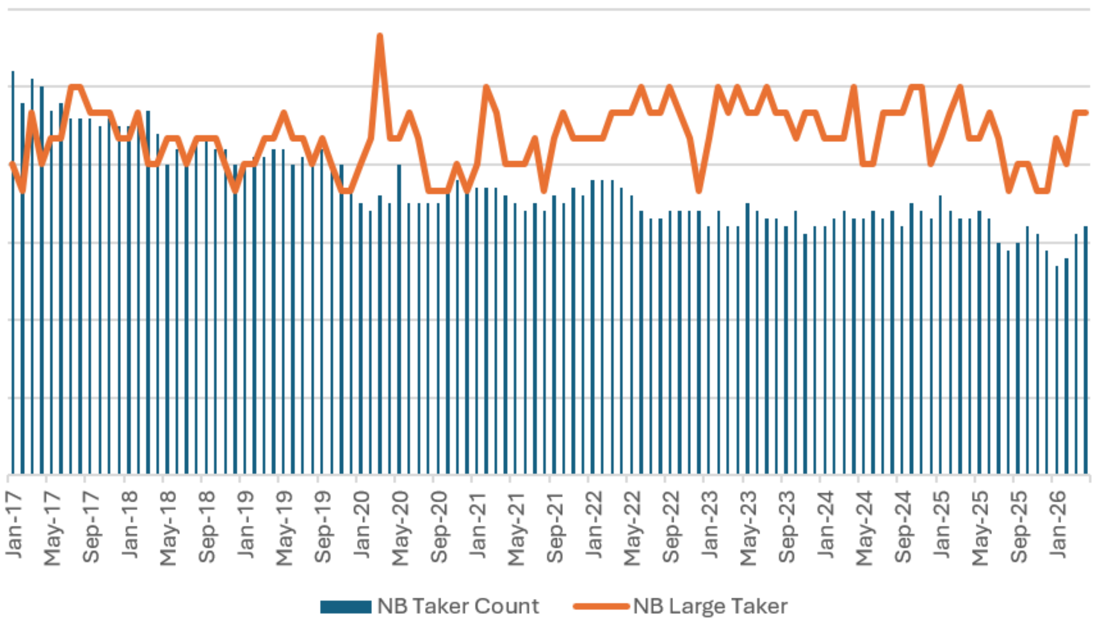


Fig. 6



CME / EBS Markets

Fig. 7

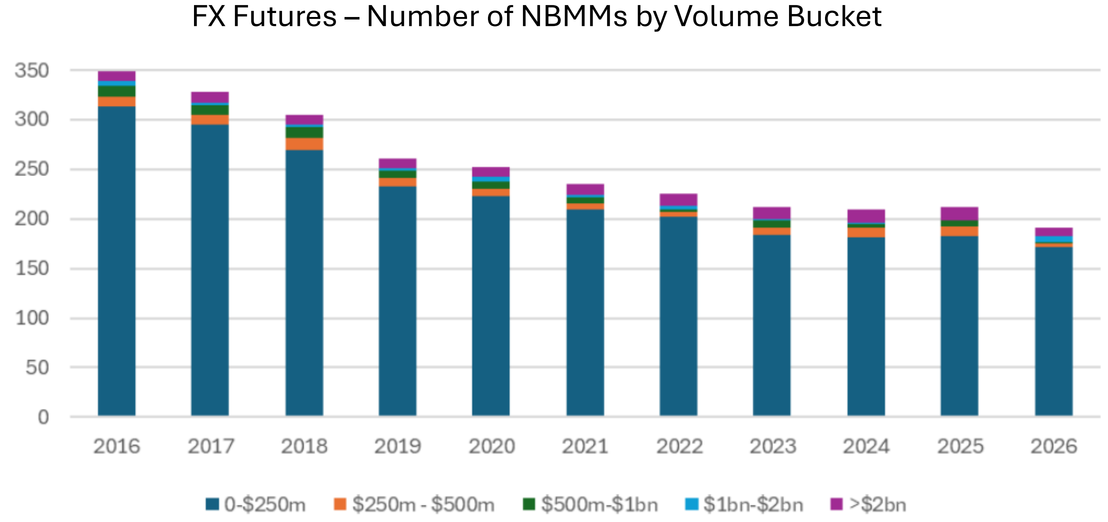
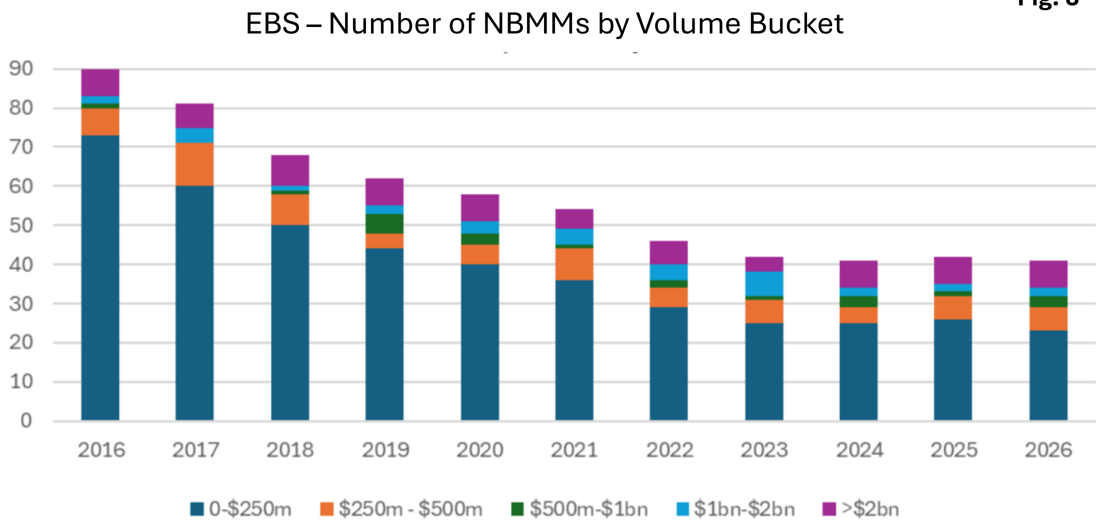
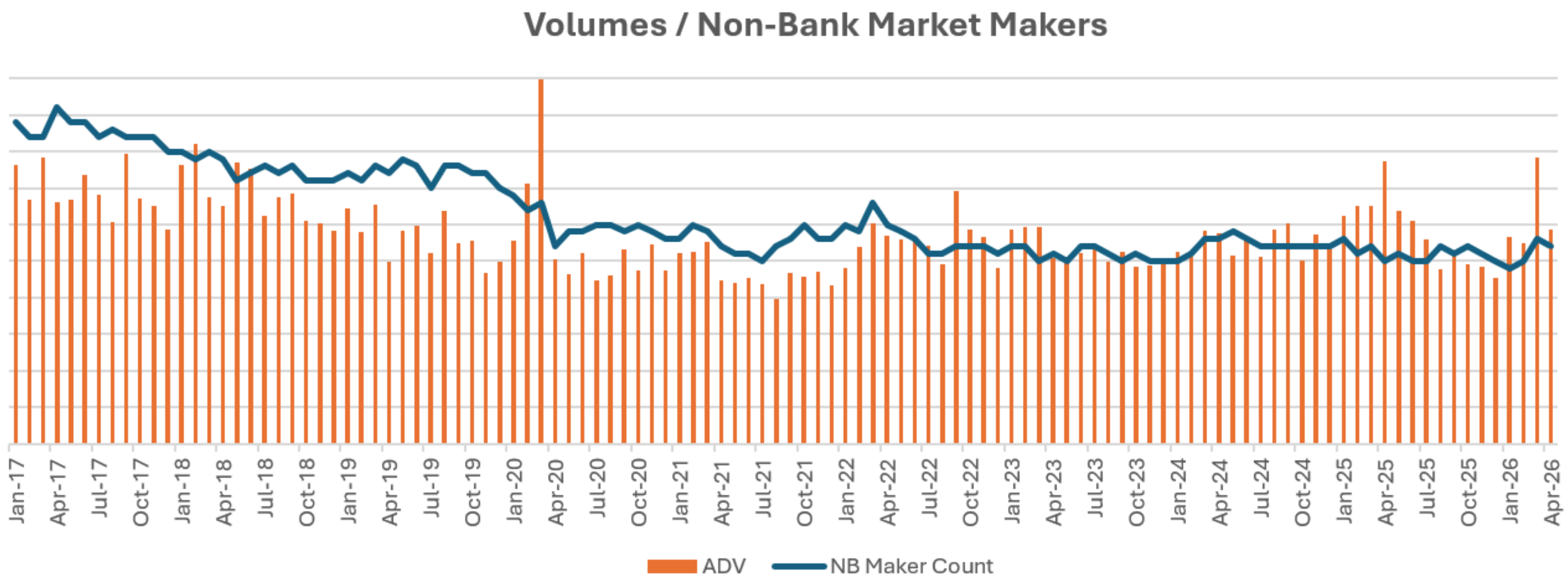


Fig. 8



LSEG Matching

Fig. 9



Make:Take Ratio

Bank

EBS Market	60:40	
LSEG Matching	55:45	(Mar 3rd 70:30)
FX Futures	25:75	

Non-Bank

EBS Market	37:63	
LSEG Matching	33:67	(Mar 3rd 30:70)
FX Futures	50:50	

Median Order Life

Bank

EBS market	290 seconds
LSEG Matching	181 seconds

Non-Bank

EBS Market	2.95 seconds
LSEG Matching	1.64 seconds

Case Study

LSEG FX CME Group

EBS Non-Bank Passive Order Action

Dynamic Price Tracking

Non-bank market participants kept passive liquidity tight to the active market price, strictly tracking the aggressive downward trajectory.

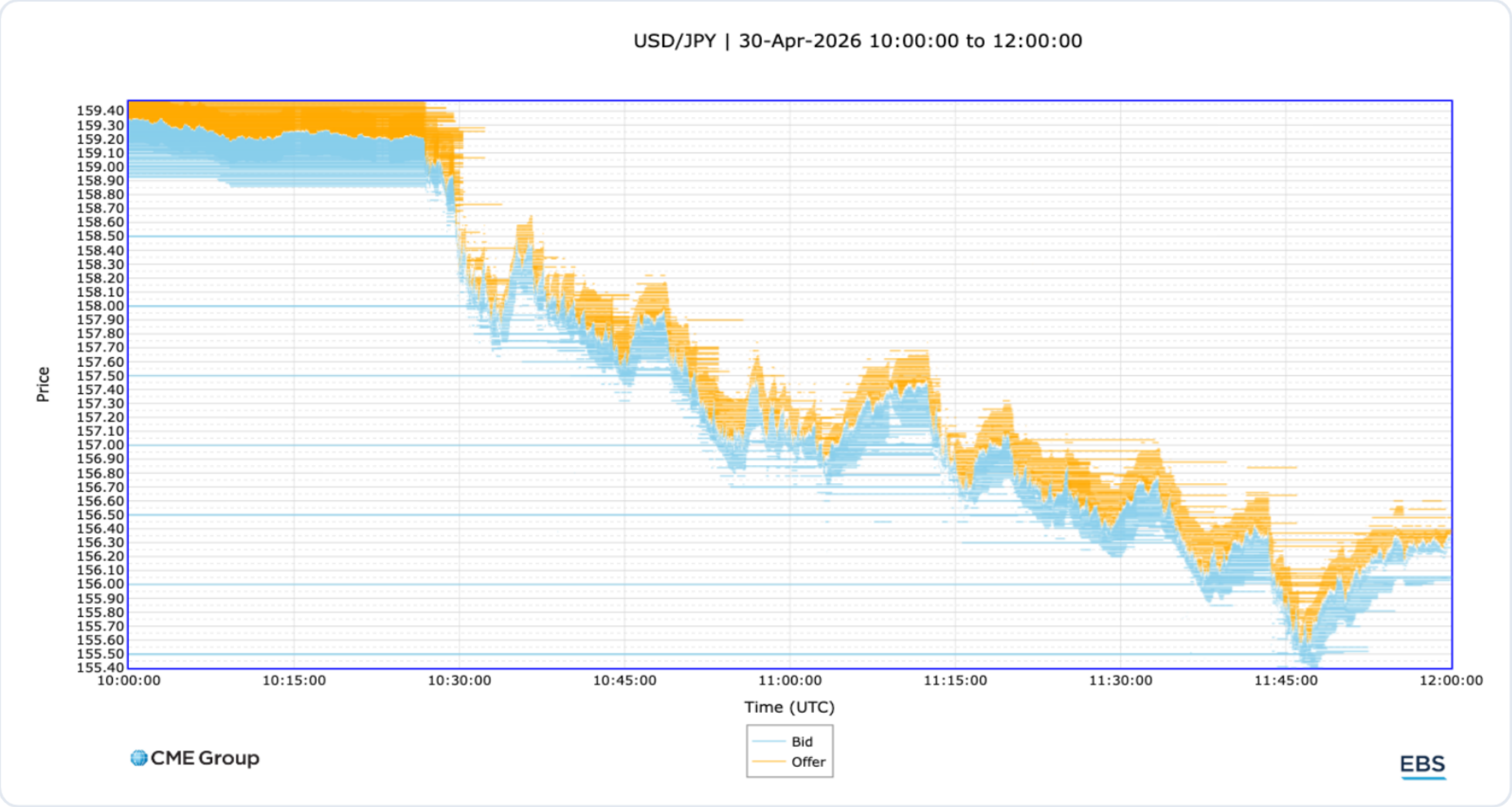
Low Order Persistence

Absence of long-lasting resting orders. Liquidity resulted tight TOB quoting as prices moved.

Proximity-Focused Depth

Liquidity concentrated near immediate market action for high-turnover, responsive risk management during the sharp market move.

Fig. 10



During the two-hour period:

- **385 pips** traded through between **155.50** (touch low of the day) and **159.35**.
- **98.4%** of all available price pointes were traded.

EBS Bank Passive Order Action

Highly Persistent Resting Liquidity

Banks provided "sticky" long lived passive orders. The chart is dominated by long, continuous horizontal lines, indicating orders remained active for extended periods.

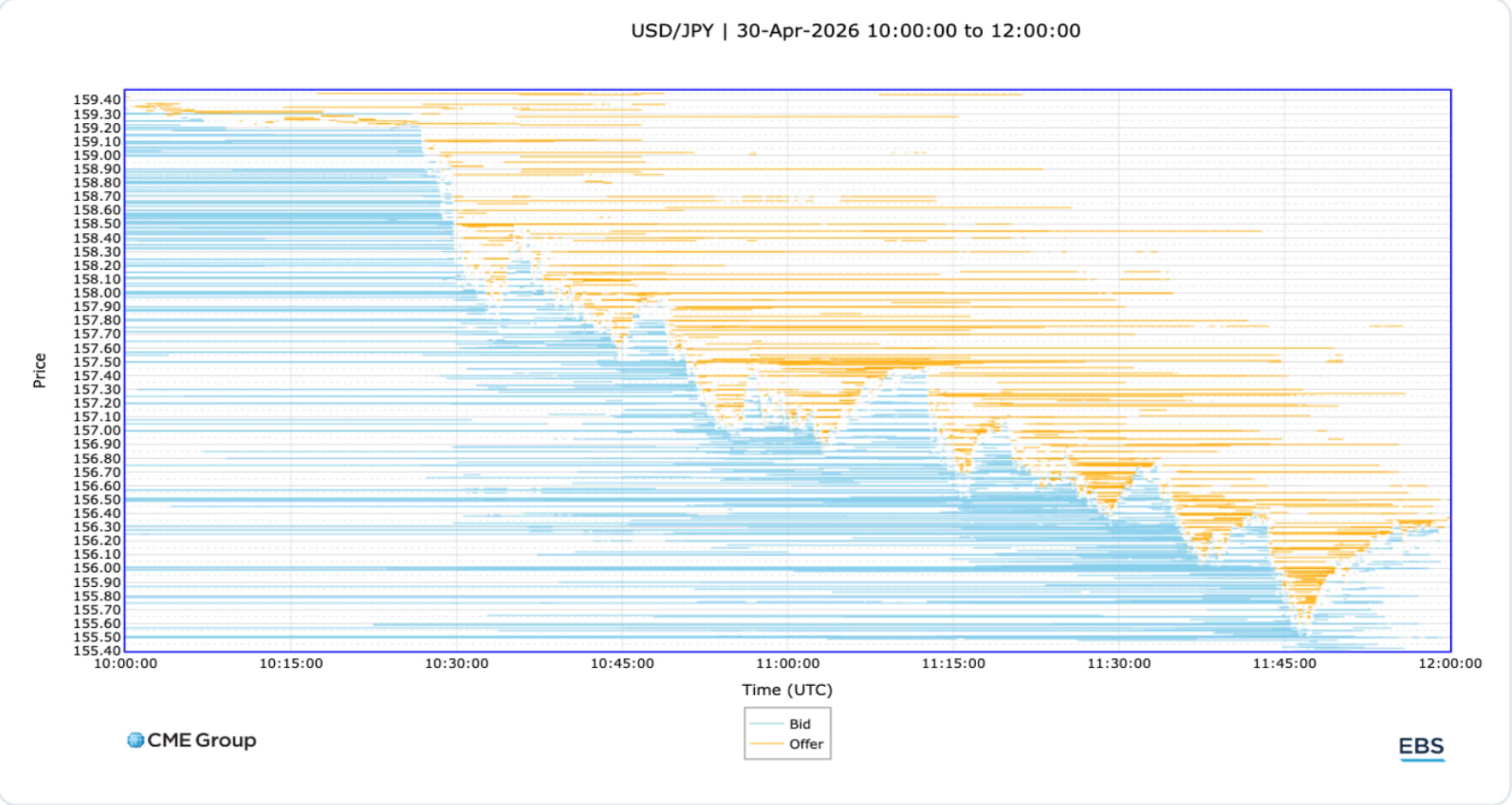
Extensive Depth Support

Massive structural depth across the entire grid. Resting bids were placed down to 155.40 well before the drop, with a dense matrix of offers left behind.

Order book resilience

Unlike non-banks, banks provide passive orders deep into the order book, resulting in a wide footprint spanning nearly the entire 385-pip range.

Fig. 11



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Discussion

1. Is the concentration trend of non-bank participants a concern for the FX Market?

2. This quote from a 2023 BIS paper was shared in a March 2024 ECB FXWG presentation "primary venues remain an integral part of the FX Market where the prices published and critically printed, that are of greater importance than their share of volume" – is there any change to the view over three years later?

3. Does the case study show that during highly volatile times non-bank participants ensure the market operates continuously; important for consistent trade execution and risk transfer?

4. Have non-bank participants made the FX market more efficient?

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