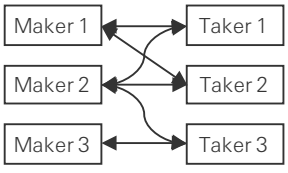
eFX 'Explainers' Secondary Venues

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 HotSpot (CBOE), 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				
	Hot Spot	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

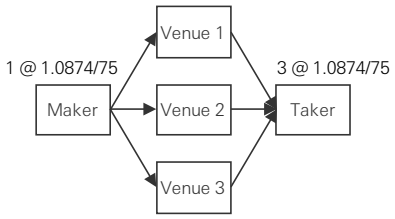
The Good – Why are they so popular?

- 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 HotSpot**

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

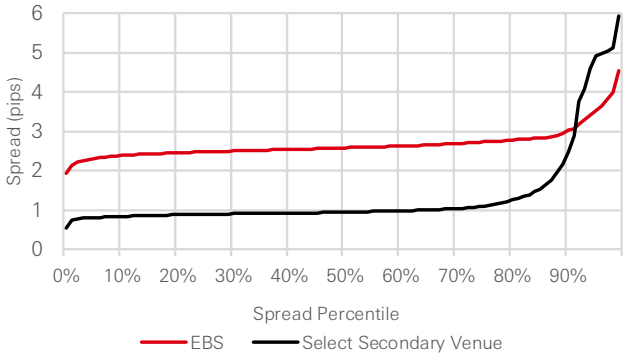
The Liquidity Mirage



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)



Disclaimer and Important Information:

This document has been issued by HSBC Bank plc, which has based this document on information obtained from sources it believes to be reliable but which it has not independently verified. Neither HSBC Bank plc nor any member of its group companies ("HSBC") make any guarantee, representation or warranty nor accept any responsibility or liability as to the accuracy or completeness of this document and is not responsible for errors of transmission of factual or analytical data, nor is HSBC liable for damages arising out of any person's reliance on this information. The information and opinions contained within the report are based upon publicly available information at the time of publication, represent the present judgment of HSBC and are subject to change without notice.

This document is not and should not be construed as an offer to sell or solicitation of an offer to purchase or subscribe for any investment or other investment products mentioned in it and/or to participate in any trading strategy. It does not constitute a prospectus or other offering document. Information in this document is general and should not be construed as personal advice, given it has been prepared without taking account of the objectives, financial situation or needs of any particular investor. Accordingly, investors should, before acting on it, consider the appropriateness of the information, having regard to their objectives, financial situation and needs. If necessary, seek professional investment and tax advice.

The decision and responsibility on whether or not to purchase, subscribe or sell (as applicable) must be taken by the investor. In no event will any member of the HSBC group be liable to the recipient for any direct or indirect or any other damages of any kind arising from or in connection with reliance on any information and materials herein.

Past performance is not necessarily a guide to future performance. The value of any investment or income may go down as well as up and you may not get back the full amount invested. Where an investment is denominated in a currency other than the local currency of the recipient of the research report, changes in the exchange rates may have an adverse effect on the value, price or income of that investment. In case of investments for which there is no recognised market it may be difficult for investors to sell their investments or to obtain reliable information about its value or the extent of the risk to which it is exposed. Some of the statements contained in this document may be considered forward looking statements which provide current expectations or forecasts of future events. Such forward looking statements are not guarantees of future performance or events and involve risks and uncertainties. Actual results may differ materially from those described in such forward-looking statements as a result of various factors.

This document is for information purposes only and may not be redistributed or passed on, directly or indirectly, to any other person, in whole or in part, for any purpose. The distribution of this document in other jurisdictions may be restricted by law, and persons into whose possession this document comes should inform themselves about, and observe, any such restrictions. By accepting this report, you agree to be bound by the foregoing instructions. If this report is received by a customer of an affiliate of HSBC, its provision to the recipient is subject to the terms of business in place between the recipient and such affiliate. The document is intended to be distributed in its entirety. Unless governing law permits otherwise, you must contact a HSBC Group member in your home jurisdiction if you wish to use HSBC Group services in effecting a transaction in any investment mentioned in this document.

Certain investment products mentioned in this document may not be eligible for sale in some states or countries, and they may not be suitable for all types of investors. Investors should consult with their HSBC representative regarding the suitability of the investment products mentioned in this document.

HSBC and/or its officers, directors and employees may have positions in any securities in companies mentioned in this document. HSBC may act as market maker or may have assumed an underwriting commitment in the securities of companies discussed in this document (or in related investments), may sell or buy securities and may also perform or seek to perform investment banking or underwriting services for or relating to those companies and may also be represented on the supervisory board or any other committee of those companies.

From time to time research analysts conduct site visits of covered issuers. HSBC policies prohibit research analysts from accepting payment or reimbursement for travel expenses from the issuer for such visits.

HSBC Bank plc is registered in England No 14259, is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority and is a member of the London Stock Exchange. (070905)