

Anonymous ECNs



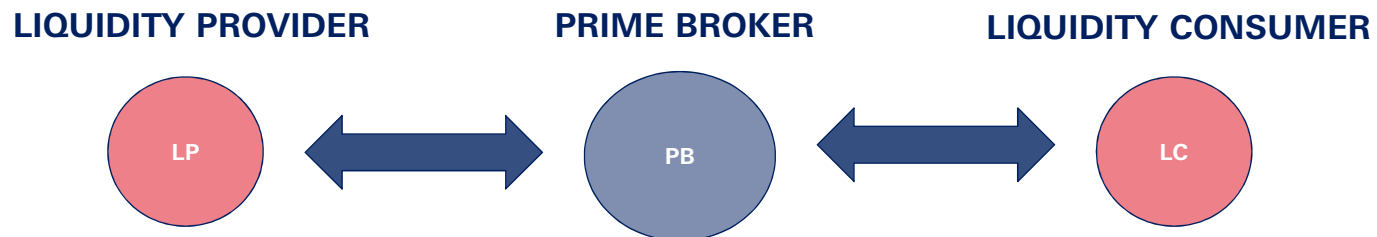
What is an anonymous ECN?

Anonymous Electronic Communication Network

- An ECN facilitates trades in the FX market by bringing together multiple Liquidity Providers and Liquidity Consumers

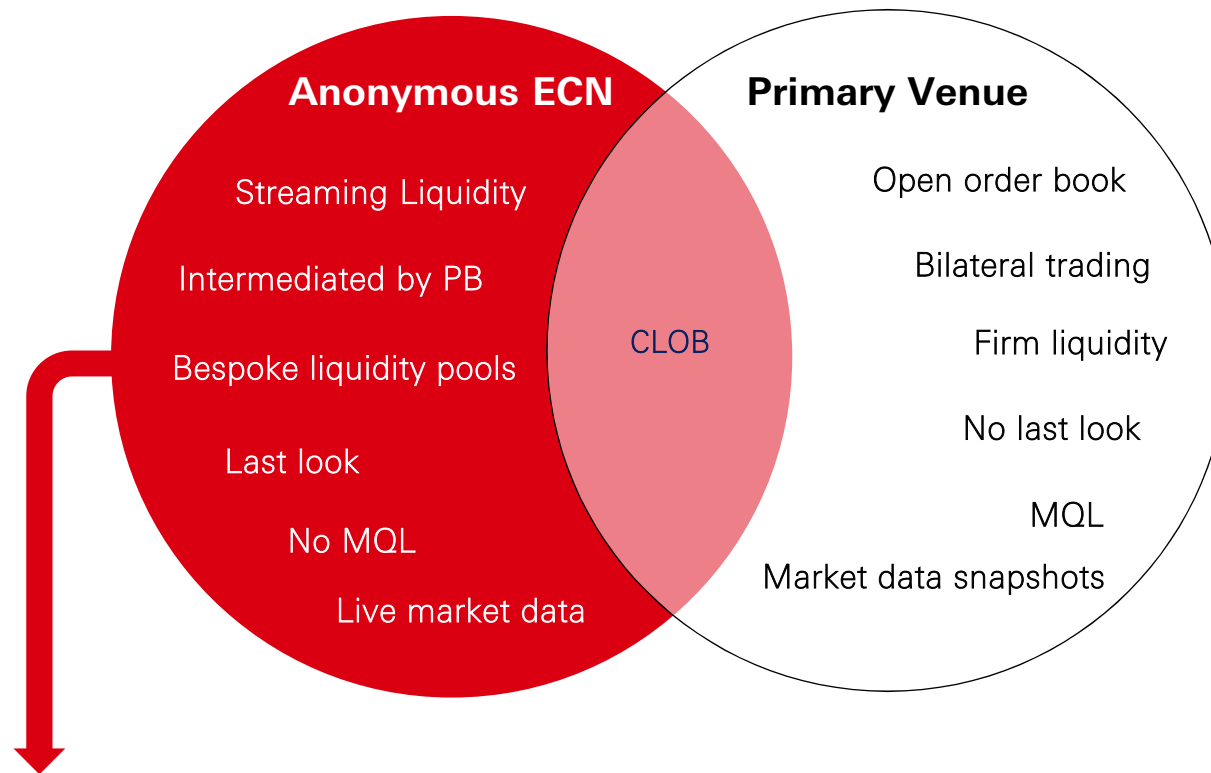


- An ECN does not trade directly with its participants. Trades facilitated by an ECN are between participants.
- In the case of an anonymous ECN, trades are intermediated by a Prime Broker.



What characterises an anonymous ECN?

Characteristics



Use of tags to control anonymity

Liquidity Providers

- Receive tags to customize to whom prices are streamed
- Able to specify at a tag and currency pair level to whom they can provide liquidity

Liquidity Consumers

- Are able to specify taking requirements to build a bespoke pool of liquidity
 - Hold Time
 - Market Impact
 - Fill Ratio

Anonymous ECNs

Benefits

◆ Connectivity

- Anonymous ECNs connect market participants that may not otherwise have established trading relationships with FX liquidity providers



◆ Technology

- Anonymous ECNs provide the technology for LCs to access liquidity from multiple LPs, as opposed to the LC managing multiple bilateral connections



◆ Flexibility

- Anonymous ECNs provide the ability for LCs to define bespoke pools of liquidity, and for LPs to define to whom they will provide liquidity



◆ Consistency

- LCs in particular can benefit from the consistency achieved by accessing the market via one single connectivity network



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Challenges

◆ Price discovery

- Lack of transparency in trading over anonymous ECNs leads to challenges in price discovery
- By design it is difficult to discover the true source of a price



◆ Dispute resolution

- Lack of relationship between the LP and LC means it is challenging for either party to make contact in the event of a dispute
- Anonymity helps to mask those who may abuse liquidity



◆ Information Leakage

- Liquidity management driven strategies facilitate the derivation of LP specific information



◆ Latency

- Latency varies by LP and LC for any given ECN
- Latency is often hardware dependent
- The source of latency issues can be hard to identify and often it takes a collaborative effort to find a resolution



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Challenges: Last Look

- ◆ Employing **last look** to validate a trade request before accepting or rejecting is common practice amongst LPs
- ◆ The **FX Global Code** states that “Market Participants employing last look should be transparent regarding its use and provide appropriate disclosures to Clients”
- ◆ While many LPs have provided such disclosures to their clients, when trading over an anonymous ECN it is not possible to identify the LP or to know whether such disclosures apply
- ◆ **Cover and deal** is a practice where an LP seeks to cover the market risk during the “last look window”, before deciding whether or not to accept a trade request

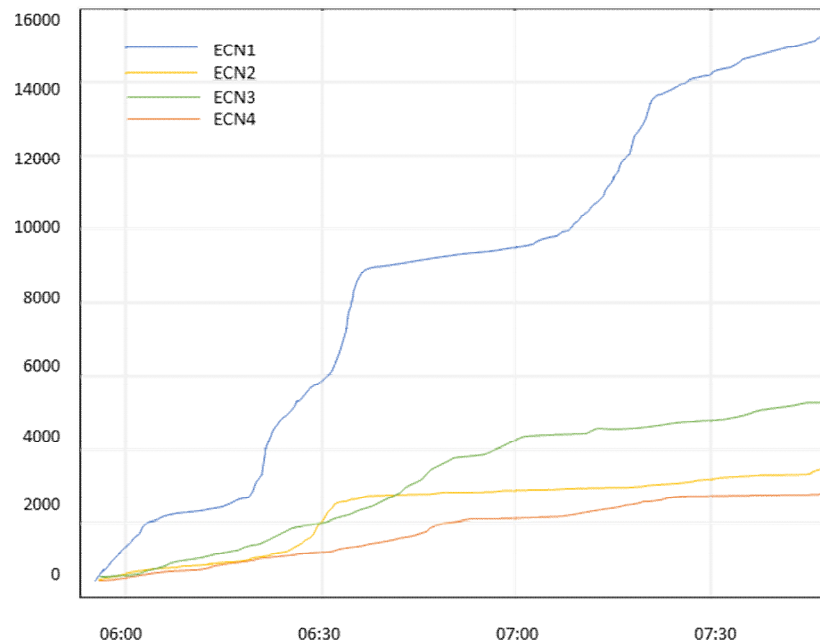
- ◆ When trading over anonymous ECNs it is typically harder to understand:
 - Whether last look is applied
 - Who is applying last look (the LP or the ECN)
 - Whether there is a hold time allowed (the application of hold times varies across both ECNs and LPs)
 - The type of last look that is applied (e.g. asymmetrical or symmetrical)
 - Whether or not the LP is dealing on a cover and deal basis

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Challenges: Liquidity Recycling

- ◆ **Liquidity recycling** takes place when the liquidity from one LP relies on liquidity from another LP
- ◆ The challenges of liquidity recycling are compounded where the identity of the LP is masked
- ◆ Liquidity recycling often occurs as a result of **Cover and Deal** practices being employed by an LP
- ◆ An example:

Count of price ticks across ECNs



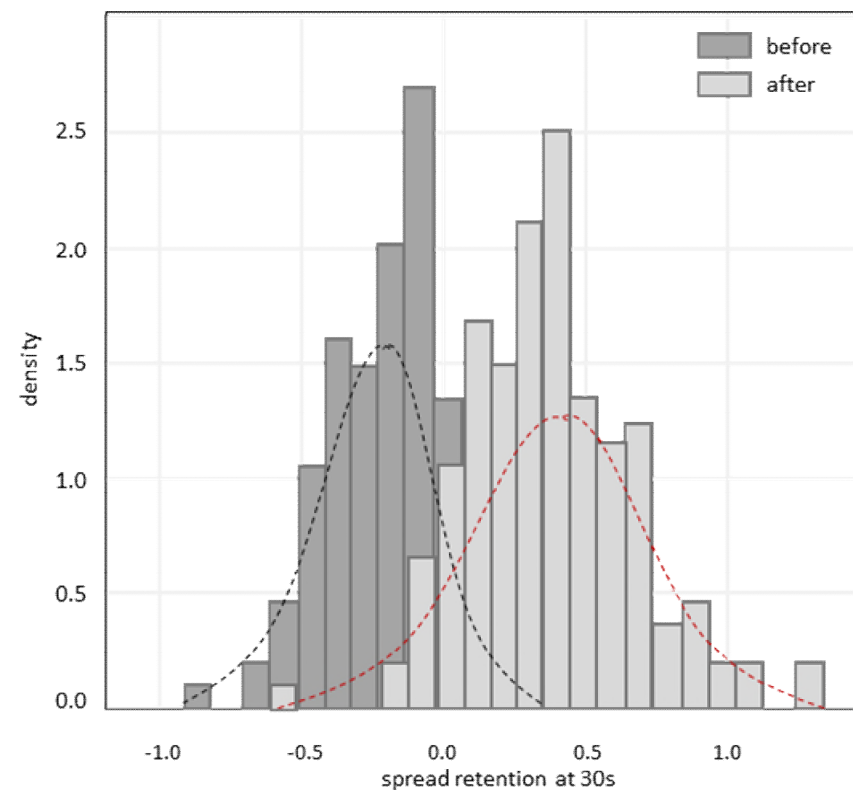
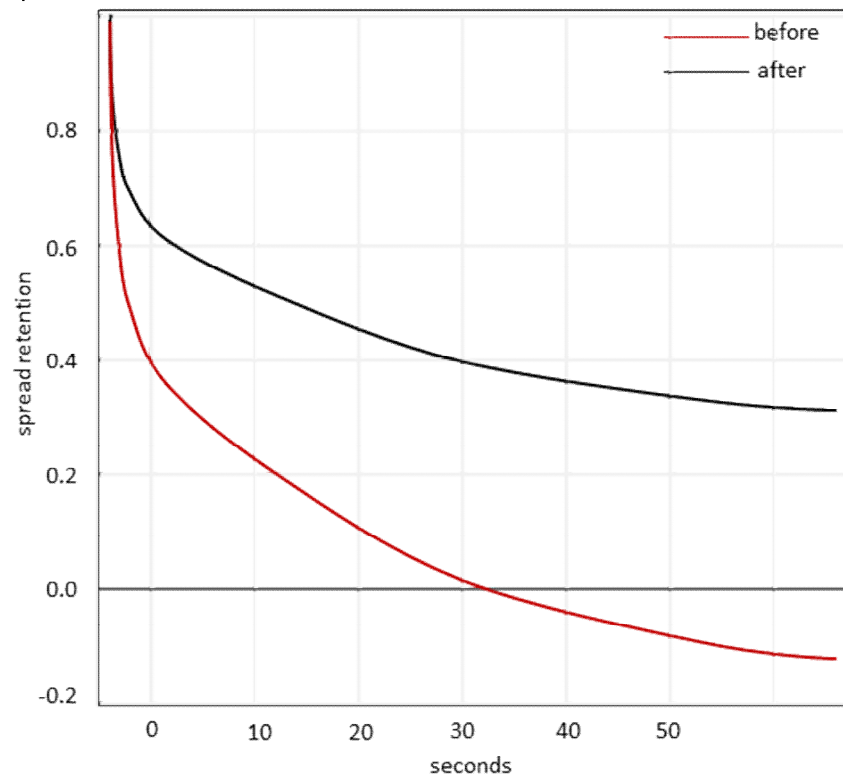
- ◆ An LP is observed to be reading all incoming prices through both direct and anonymous market data feeds
- ◆ The LP updates their price on an ECN (ECN1) with every single tick update they receive
- ◆ The result is thousands of price updates in a short time window, driven by a single LP

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Challenges: Liquidity Management

- ◆ Anonymous ECNs typically offer the ability to create bespoke liquidity pools
- ◆ Reliance on ECN for liquidity management typically does not prove as beneficial as coordinated liquidity management from all participants (the LP, the LC and the ECN)
- ◆ An example:

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