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e-FX Awards issue

e-FX Initiative of the Year
Best e-Derivatives Platform
CME

FX·Week Winner e-FX Awards 2018


Paul Houston

Listed and over-the-counter FX markets have co-existed happily for years, but the two liquidity pools remained separate. On top of that, historically, FX futures have formed a very small part of the more than $5 trillion-a-day mostly bilateral space.

Regulation has completely changed the picture and Basel III, uncleared margin rules and the second Markets in Financial Instruments Directive are threatening to unbalance the equation of costs, and potential benefits, between listed and OTC.

"The listed space has continued to grow over the last 12 months. Aside from this organic growth, we have added a number of new products to this market. The make-up of our client base has also changed, with a 25% growth in banks, and a similar increase in buy-side and asset manager participants," says Paul Houston, global head of FX at CME Group.

CME Group has been voted the winner of the e-FX Initiative of the Year and Best e-Derivatives Platform categories at the 2018 FX Week e-FX Awards. The wins follow 18 months of launches and product releases, culminating in CME FX Link going live in March.

The new launch is a listed spread that is quoted on Globex, between OTC spot and the first three-monthly FX futures expiries. CME FX Link took 18 months, and so far it has been validated with nearly 100 clients, who can now switch exposures between OTC and listed markets.

"The new CME FX Link is a complementary addition to our listed product suite. The idea evolved from customers asking us to make FX futures more accessible, and to develop a bridge between OTC FX and listed FX marketplaces for efficient exposure management," Houston adds.

Fast-forward futures

First, CME set about expanding its futures products. In February 2017, it launched monthly futures to create more hedging points for clients in the front months of the FX forward curve for the first time.

"Six months later, we switched on implied functionality for these contracts, linking all implied combinations between outrights and calendar spreads within one year. It is already present in other CME markets, but was introduced to FX for the first time," says Houston. "This means liquidity is optimised between the traditional quarterly FX futures outright market and the spread market."

Foreign exchange futures notional on CME is now nearing 40% of the aggregate cash FX traded on major FX ECNs, as more banks, non-bank market-makers and, quite significantly, asset managers look to trade futures.

New regulatory frameworks for OTC derivatives have raised the costs and operational burdens of trading. According to a research paper from financial consultancy Greenwich Associates, switching from trading in OTC markets to futures can cut costs by up to 75%, while entities subject to Basel II could see bigger savings.

Since the launch of CME FX Link, interest from banks has been driven by their desire to trade FX Link as a synthetic FX swap. Even though FX swaps and forwards are exempt from mandatory clearing requirements and initial margining, derivatives users have been affected in currency markets by Basel III capital requirements and the mandatory exchange of variation margin (VM) on deliverable swaps and forwards in the European Union.

"This activity is very complimentary to our FX monthly expiry initiative and building spread trading in our FX marketplace. Several bank forwards desks are now looking to use the FX Link product and trade FX swaps on an electronic central limit order book (Clob) for the first time," Houston says.

Buy-side interest

Buy-side interest in the product is also picking up, as several banks connected to FX Link are willing to extend credit to participants who do not have credit. Due to this arrangement, an asset manager can use their spot relationships with their bank or algo provider, and then subsequently move their spot exposures into futures.

"The fact that CME FX Link is traded on a Clob means asset managers can achieve best execution and at the same time have highly compatible workflows," Houston says. "We have seen the product building nicely, and both volumes and liquidity are growing. Price increments stand [at] around 0.1 pips most of the day and the top of the book is building towards the hundreds of millions."

Volumes in FX options are also building, despite a slower migration towards e-trading in these products than in spot. Average daily volumes in listed FX futures are at $100 billion this year, and around $10 billion of listed FX options volumes are traded a day on average.

"We have launched additional option maturities, adding Wednesday options at the end of last year. Weekly expiries have seen a 30% growth in trading," Houston notes. FX *Eva Szalay*

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