P&L Talk Series with Alan Schwarz

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Profit & Loss talks to Alan Schwarz, CEO of FXSpotStream, about competition amongst multibank FX platforms and why he thinks that FX trading is undergoing a structural shift towards a disclosed bilateral model.

Profit & Loss: Today, on the four-year anniversary of FXSpotStream (FSS), you announced that Bank ofTokyo-Mitsubishi UFJ has gone live on your platform**. You now have 12 liquidity providers streaming prices into the aggregation service, do you have a target number for LPs you are trying to reach?**

Alan Schwarz: We've now doubled the number of liquidity providers (LPs) on our service since we launched, but the plan isn't to keep adding LPs indiscriminately. You have to be thoughtful about why you're adding an LP, because having more liquidity providers doesn't necessarily lead to more liquidity. In fact, when it comes to LPs, sometimes more can actually mean less.

P&L: What do you mean by that?

AS: If a platform has 10 liquidity providers and five clients and then adds two more liquidity providers, it doesn't necessarily lead to more trading. It could instead just lead to those five clients spreading liquidity across more trading partners.

Bringing on more LPs can bring more clients onto the platform, but you have to ensure that they're bringing the right types of clients.

For example, look at the last two banks that we've brought on. We added Standard Chartered because they bring a strong franchise in Asia, Africa and the Middle East, in addition to Europe and the Americas, and thus they bring a very different client mix onto our service. Likewise, Bank of Tokyo-Mitsubishi (BTMU) is the largest bank in Japan by market value and again it helps diversify the client base that we have on FSS locally and globally.

P&L: You currently only have bank LPs, would you ever consider having non-banks stream prices into FSS?

AS: That's a question that comes up from time to time and for now the answer is that we only have bank LPs. We've done a very good job of connecting all these different clients on our service, so naturally we have demand from banks and non-banks to come on the service. But at the moment, we have plenty of liquidity and the focus is to service the clients and LPs we have and continue to grow the business.

P&L: The FX platform space is a crowded market right now, do you expect it to remain that way?

AS: In the next couple of years we're certainly going to see further consolidation in the number of FX trading venues. Two years from now, some of the venues in the market will have different owners, and possibly some of them will merge. This is because not only does consolidation reduce the amount of fragmentation in the market, but it also reduces the cost of running that business. I think there's still plenty of room for the incumbents to find savings for their clients and those who do, like we have over the last four years, will be around for many years to come.

I think that if they could afford it, we would have seen the bigger FX players already in the market buying other platforms, not for their underlying technology, *per se*, but to consolidate market volumes. That's what the exchanges are bringing to the table right now, a bit of financial resources and also because it allows them to diversify their offering, which is also subject to increasing cost pressures.

P&L: You argued at P&L's Chicago conference earlier this year that more FX volumes will shift towards disclosed bilateral trading venues such as yours, do you still think that this is the case?

AS: Absolutely. There are two big changes that are taking place right now. The first is a market structure change – more FX business is taking place away from anonymous platforms and moving onto fully disclosed platforms. The second is how platforms charge their clients is changing – we are the only fully disclosed venue that does not charge LPs a per transaction fee and charges takers nothing to use the service.

P&L: So what do you think will drive volumes towards fully disclosed platforms?

AS: It's part of a broader push for more transparency in the market. As an example, we're seeing the demand for more transparency in the wake of the SNB decision at the start of the year.

I think that on "SNB day" a lot of people were surprised – and not in a good way – about who was on the other end of their trades.

As a result, post-SNB there has been a real interest from market participants in knowing who they're dealing with. Trading is fundamentally about relationships, and if you want to enter into a long-term relationship it makes a difference if you know who is on the other side.

P&L: In your view then, does anonymous trading still have a place in FX?

AS: Yes, anonymous trading will always exist because it serves a useful function in the market, such as when firms need to do large sized trades. But overall, the market is moving towards less opaque trading.

P&L: What about internalisation? With the banks still internalising so much of their flow, doesn't this suggest that the overall FX market is going to remain very opaque?

AS: I don't think that internalisation and opaqueness are the same thing. Internalising can be about finding efficiencies and ways to reduce costs, not for the sake of being opaque.

P&L: But if a client order gets internalised at a bank, how do they know that it's the best price? Do you think that efforts towards clear, best execution on the client side, combined with a distrust of some banks following the recent controversies in FX, could lead to less flow being internalised and more going out to multibank channels?

AS: Firstly, people talk about the "trust issue" in FX, but we have to be careful not to generalise issues that the FX market is dealing with as being emblematic of the entire market. Our clients only trade with banks and they do so on a fully disclosed basis. Our business continues to support more volume year-on-year because a strong relationship exists between our banks and their clients. If trust is an issue, then trading on a bilateral disclosed basis is the best way to solve that, because then your counterparty can't hide.

But with regards to knowing if they're getting the best price, you have to remember that no one in the FX market trades with just one bank. So whether they get internalised or not, these firms have 'x' amount of sources that they can count on for pricing, so they'll know if they're getting good prices or not.

P&L: You say that a counterparty "can't hide" with bilateral disclosed trading. Can you please elaborate on this a bit more?

AS: Both the takers and the makers in the market have become so sophisticated now that they can tell if their counterparty does something that they don't like with their order. In the bilateral, fully disclosed model, firms can't hide because their counterparty knows them and can ask, "What did you do with my price, with my order?"

P&L: Earlier you talked about another change taking place in terms of how platforms charge clients. What's driving this change?

AS: Previously, the FX market has been underestimating how significant it is to reduce the cost of execution and create efficiencies. In years past, people were less concerned about the fees that they were paying to venues, because the revenues that they were generating offset this cost. But this is now changing and a subsequent change in pricing is occurring, driven by the clients and banks.

P&L: OK, but as we've already noted, there's a lot of options for these clients when it comes to multibank platforms right now. What's the motivation for them to connect to FSS over some of the other players in the market?

AS: The motivation for these clients to connect to us is that it doesn't cost them anything. There is no other venue in the market today that charges the clients nothing and the banks a fixed fee to participate in the venue. Plus, clients only have to write and connect to one API and they can trade with up to 12 banks of their choice.

P&L: But do you think that cost is the only factor that drives client behaviour?

AS: There are other factors, although certainly cost is an important one. They look at things like price, if the party making prices to them has a better model so that it is reflected in their pricing, then that's attractive to these firms. Time to market is another consideration; if they can connect to one venue and get access to liquidity from a wide range of sources, then it can be more efficient for them.

And while having stable technology is always extremely important, one thing that always amazes me is how little attention some people pay to customer support. We have invested in customer support in New York, Europe and Tokyo, and we've won business as a result of it.

I think that this is one area where some venues have lost their way a little bit, because although some people say that with all the technology involved in trading now, that relationships don't matter as much. This simply isn't true. The relationships will always be key, they'll never go away.