



Game changer?

London-based LMAX Exchange, the first FSA regulated MTF for FX and metals, aims to bring market participants together in an anonymous, order-driven, and fully transparent manner. Best Execution asked David Mercer* what impact his business model has on delivering best execution in FX trading and to what degree this strategy anticipates future regulatory changes.

MiFID I attempted to define “best execution” for the equities market, but MiFID II failed to develop it further. In this context, what are the key differences between these two asset classes, and how would you define best execution in FX?

FX is the last major asset class to move to exchange trading. The regulatory proposals, such as MiFID II and Dodd Frank, are driving this change by requiring pre- and post-trade transparency and centralised clearing for standard FX derivatives.

LMAX Exchange is the first FSA regulated MTF for FX and metals. It was established based on the vision that the exchange execution model is the most efficient and cost effective way to trade liquid products, such as spot FX. The exchange execution model is at the core of an MTF concept; just as on an exchange, orders are matched in price/time priority but trading is still bi-lateral with FX trades cleared through the prime broker network.

By offering an exchange style execution for spot FX, we address

key industry challenges such as the lack of transparency of the true cost of OTC traded FX, and the lack of precise, consistent & reliable execution in FX trading.

How does your business model aim to achieve best execution, and can this be improved upon?

In the context of a single platform we achieve best execution for spot FX by delivering precise, consistent execution, pre- and post-trade transparency and a level playing field for all market participants. Unlike brokers, we don't run risk to make money but just match orders, and we are different from ECNs in that the execution is order-driven against streamed, executable limit orders supplied by the general members, who don't have the “last look” and ability to re-quote.

In addition, as an FSA regulated MTF, LMAX Exchange complies with the following MiFID obligations:

- Pre-trade and post-trade transparency – deals are published to all members;
- Prices and charges are public and applied consistently across all members;
- Operating principles and membership rules are described in the publicly available rulebook.

Given the competitiveness of the FX market and increasing fragmentation of liquidity, we focus on continuously improving the trading experience for both clients and liquidity providers. We invest in technology to further improve execution performance and increase liquidity by adding new general members.

You have been quoted as saying that your greatest strength is technology, and that you employ “disruptive” technology. What exactly do you mean by disruptive technology and what is the competitive edge it confers?

Our technology enables reliable,

ultra-low latency execution. To date, we have the fastest FX trading technology with an average trade latency of under 3 milliseconds and internal exchange latency of 500 microseconds. In-house developed 'Disruptor' technology, partially Open Source, refers to our ultra-low latency matching engine that has been developed to maximise performance and has been recognised by the industry's most prestigious awards – 'Best Trading System' at the Financial Sector Technology (FST) Awards and Oracle's 'Duke's Choice' Innovative Programming Framework award.

The buy-side have traditionally not been early adopters of new technology or new platforms. How do you intend to win them over to your offering?

We only started focusing on the institutional FX segment a year ago and now over 50% of volumes are traded by buy-side institutions – represented by proprietary trading firms, money managers and broker dealers hedging risk. These volumes are rising every month. Yes, it takes longer to get institutional buy-side clients on-board, but once they start trading they stay because of the transparency, precision, consistency in execution and low latency that the platform delivers. The proof is our growth momentum in the industry – for the last 12 months our overall volumes and revenues have

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been growing consistently at over 20% per month.

Is your business model capable of stimulating demand from the buy-side, and if so how?

Absolutely. New buy-side relationships can be acquired directly, or through independent corporate brokers/agents, who advise buy-side clients on best execution.

Your current structure would allow you to apply to be an SEF (Swap Execution Facility in the USA) or OTF (Organised Trading Facility in Europe). Is this where you expect the regulations to take you, and if so over what time frame?

Among FX products we currently offers only spot FX, which are out of scope for Dodd-Frank and MiFID II. However, if we were to offer non-spot FX, such as FX swaps and non-deliverable forward (NDF), we can apply to become a SEF in the US. If we

pursue the strategy of product diversification, this is something that we may consider.

What opportunities do you see in becoming and SEF/OTF?

The opportunity is big. In my understanding more than half of the total US\$4.4 trillion in FX daily trading volumes is subject to Dodd-Frank and MiFID II.

Over the next five years, what other regulatory changes do you foresee?

We see a gradual move to exchange style execution, central clearing and greater transparency.

Where do you see LMAX Exchange in five years time?

Our goal is to become the leading FX venue with a global presence and multiple exchanges. ■

**David Mercer, is CEO of LMAX Exchange. LMAX Exchange is the first FSA regulated MTF for spot FX.*

Best Execution

Best Execution is a quarterly publication reviewing the issues that impact the achievement of best execution in the global securities markets *throughout* the trading lifecycle (from pre-trade to trade execution to post-trade). Increasingly driven by regulation we report on the seismic shifts that are occurring in capital markets, with a key focus on the cutting-edge technology solutions and services that are needed to meet these changes.

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