What steps are crypto exchanges taking to meet the needs of institutional traders and investors?

e-Forex spoke with Jenna Wright, Managing Director at LMAX Digital, one of the industry’s leading trading venues, to discuss some of the issues that are likely to influence and shape how crypto exchanges continue to evolve to meet the needs of institutional clients.

Jenna Wright, LMAX Digital

Our institutional client base recognises that the global cryptocurrency market is at a nascent stage of its development. These firms need a legitimate and regulated venue on which to acquire, trade and hold cryptocurrencies securely with high quality, deep institutional liquidity. That’s ultimately why we launched LMAX Digital, informed by our knowledge and depth of experience in the FX market.

How are crypto exchanges going to make their venues even more attractive to institutional players?

Meeting the needs of institutional clients requires taking the things we have learned from our history in FX and established capital markets and applying them to cryptocurrencies.

There are also aspects of developing crypto market structure that have great potential to benefit traditional finance; take 24/7 trading for example.

The key is having a pragmatic approach that brings together the best elements of both. In practice, for us, this means delivering the same quality and robust technology institutional clients have become accustomed to and applying it to a new asset class.

Importantly, it also means acting as an established and regulated market, following best practice in the areas of KYC, AML, security, compliance and risk management. LMAX Digital was launched to allow institutional participants to enter the crypto market through a regulated and safe environment. This remains our focus as more institutions move into the market and hold more capital in the cryptocurrency market.

What impact will increased regulatory oversight of the crypto markets have on institutional exchanges?

Global regulators have turned more attention to crypto than ever before – rightly cracking down on violations, and enacting standards to protect consumers, reduce market fragmentation and participation by bad actors. We fully support regulation coming to the industry as it protects consumers, creates stability and harvests innovation – conditions that institutions look for.

Regulation takes time but the progress and focus on it is encouraging. We would like to see policymakers working with the industry to ensure frameworks are robust, effective, and under the supervision of respected regulatory bodies. Once a regulatory framework is set, institutions will have clarity and can participate without fear of stepping out of line – clearly beneficial for exchanges.

How do you see the client mix of digital asset exchanges changing as professional investors increase their crypto activity? Will any category of firms be likely to dominate?

Currently, the crypto market is predominately retail, with the prop trading firms and institutions who make markets in retail crypto, dominating institutional trading venues and utilising those venues to exit risk. However, as the tokenisation of real-world assets continues to gather pace, that will allow more efficiency of capital in the years ahead, so we expect digital assets to become de rigueur and more institutions to get involved – for example asset managers and banks.

The lack of a credit mechanism or credit intermediation within the institutional markets for banks to offer their clients crypto trading credit remains a challenge that also needs to be addressed in order to unlock the full ability of institutions to participate.

What datasets (historic and/or real time) do you feel digital asset exchanges need to provide to accommodate institutional clients?

Access to accurate and real time data is paramount when trading in any asset class and cryptocurrencies are no different. Real time, precise, reliable market data is the foundation of efficient asset pricing and valuation that ensures a robust and orderly marketplace. At LMAX Group we will always take lead, which is why we became the first market data exchange contributor to the Pyth Network, the decentralised financial market data distribution network in 2021. We also provide our crypto market pricing data via crypto indices such as CF Benchmarks and CoinDesk indices to enhance market structure and facilitate accurate price discovery.

Bitcoin can be a valuable risk sentiment indicator for investment management professionals. Crypto markets trade 24/7, allowing investors to adjust risk amid unexpected macro events even when other markets are closed. Bitcoin’s liquidity offers a unique opportunity to use BTC as a hedging instrument. BTC can be used directly to re-adjust risk and indirectly as a proxy to gauge how markets will react to significant events.

Do you expect to see more institutional crypto exchanges being launched and what issues may influence whether the market reaches a saturation point?

At LMAX Group, we welcome competition from other market participants and view it very much as a tide that can lift all boats. At a time of upheaval in the development of the cryptocurrency market, encouraging and increasing competition between regulated, positive actors can only be a good thing. For the asset class to continue to mature, institutions need supportive regulation to provide certainty to all sides of the trade, provide growth and innovation within the market and ultimately foster healthy competition.

What other factors are likely to shape how institutional crypto exchanges evolve over the next few years?

What we’ve seen in the past year is a clear flight to quality within the market. This will benefit the industry as a whole, providing an opportunity to focus less on personalities and more on cutting-edge technology and the long-term benefits this asset class can bring to capital markets and the future of finance.

Ultimately, what we expect to see in the next few years is exchanges continuing to develop their products and invest in increasingly lower latency, robust technology enabling their customers to react to market events faster. Increasing use of such technology will continue to compress spreads leading to less arbitrage amongst exchanges.

Blockchain can be a valuable risk sentiment indicator for investment management professionals.