

Best swap execution facility: GFI

The advent of swap execution facilities (Sefs) at the end of last year caused unprecedented upheaval in currency markets, as brokers and both sell- and buy-side participants scrambled to interpret and adapt to changes in derivatives-trading rules.

US persons have been able to trade FX options and non-deliverable forwards (NDFs) on Sefs since October 2, 2013, but they are not yet mandated to do so by the Commodity Futures Trading Commission (CFTC). As a result, on-Sef FX liquidity is low and many Sefs are struggling to turn a profit.

Market participants have reported a bifurcation in liquidity since the regime started. Many buy-side firms have pulled back from trading options and NDFs on electronic trading platforms, opting to use voice brokers instead.

“Initially, people had been reticent to trade on a new venue, but I think that’s changing. The market is definitely moving towards Sef trading. Having said that, there has definitely been a bifurcation of liquidity and it’s difficult to know when that will end or whether it’s something we’ll just have to live with,” says Ron Levi, chief operating officer of broker GFI.

GFI has won the ‘Best swap execution facility’ category, because of its strong emphasis on combining electronic and human interaction in a hybrid model the company has long been known for.

“Broker and machine work very well together,” says Levi. “We have always regarded ourselves as an exchange, so we see the Sef regulation as the codification of a framework that has evolved over the past 20 years. We have always had an established liquidity pool and a clear, comprehensive set of rules for trading. I believe the new landscape is good for the market.”

But while the electrification of the mar-



Ron Levi, chief operating officer, GFI

ket has led to a dramatic shrinkage in the number of human traders and brokers in it, Levi believes the latter will always be needed in wholesale financial markets, despite the rise of machines.

“Humans bring a subtlety to the process that technology just can’t. You will never see inter-dealer broker markets without humans, in my opinion. In the more commoditised segments, such as major spot currency pairs, technology can adequately do the work, but, in some more complex contracts, human intervention is necessary for price and size discovery,” Levi says.

He likens the process to online shopping, noting the majority of people are happy to buy books and groceries online, but few would purchase a house without seeing it first. “In some markets you need people and in others you just need technology. I believe we found the right mix.”

Even with the right mix, market conditions remain challenging as volatility hovers around historic lows, the regulatory push continues and liquidity remains thin.

“There is a perfect storm in the market right now. I believe things will turn

around and activity will pick up, but in the meantime everybody is struggling,” Levi admits.

His main concern is that basis risk could creep dangerously high if regulators don’t keep a close eye on the liquidity effects of regulatory initiatives, which could result in major losses for retail investors if pension funds struggle to exit positions.

“Regulators need to have an eye on overall liquidity and the impact of their decisions on it. If they fail to consider liquidity, it will eventually drop to even lower levels, which will increase basis risk significantly. This, in turn, will hurt retail investors, so this is an issue that is about the wider market, not just wholesale markets. You can’t measure basis risk until something happens and then it’s too late. When pension funds try to get out of their positions, but can’t because the exit route has been blocked off, it will be everyday people who get hurt,” Levi says.

Another aspect of the flurry of new rules is the mammoth task of managing technology change. Altering trading protocols, and tweaking systems and infrastructures takes time and resources, which is placing a huge burden on market participants. At the same time, focus has turned towards European regulation where many issues remain unresolved.

“I have personally never seen a market like this. There is increased regulation, flat interest rates in major economies and a prolonged economic stagnation. Emerging market volumes have held up relatively well, but leverage has generally declined. In the G-10 countries, change can only come when rates start moving. We will continue focusing on EM, and adding new products and services to our offering, while we wait for conditions to change. I’m always mildly optimistic. You have to be – it’s just the nature of the business,” Levi adds.  [Eva Szalay](#)

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