Introduction

MiFID II laid down the law - best execution is an absolute mandate, not a best efforts process. In defining the elements of the best execution journey, Cürex has previously described the five steps that must be followed to comply with this regulatory requirement (see ViewPoint Vol 17/5 Pursuing Best Execution in the FX Market: The Journey is the Destination). In this ViewPoint, we want to dig a little deeper into the connection between best execution and improved FX trading outcomes. After all, that’s the point, isn’t it? So it would make sense that there should be some analytical basis that supports this goal of improved trading outcomes. Transaction cost analysis – post-trade analytics – should clearly be a critical tool, among others, that drives this proof of best execution and more importantly guides FX traders to improved, future performance.

A Baseline Requirement for Proper TCA

TCA products have evolved and improved over the last few years. The anticipation and onset of MiFID II has driven the adoption of TCA and witnessed the entry of new providers with better tools. But at the very foundation of all TCA is the matter of data quality and benchmark integrity. Unfortunately, this foundational issue is mostly underplayed to the buy side, especially by those who are selling compliance support only and not the opportunity to improve trading outcomes. Cürex has always maintained that data quality and benchmark integrity are both fundamental to proper TCA, and without access to these elements, TCA is merely a set of calculations lacking real content.

We maintain that the underlying data used in TCA should be entirely consistent and represent only executable prices. TCA based on aggregated, redundant market data, which is either indicative or subject to last look, is of diminished value. Similarly, benchmarks reliant on such inconsistent data or those that are point-in-time Fix-based cannot be judged as meaningful in the context of fully accurate measurement.

Measuring What Matters – The Importance of Time

In the world of FX options, we know that buying options costs money and selling them creates premium. The premium paid is the price for the right to buy/sell one currency against another at a predetermined price at some point in the future. The option price is based on a formula that incorporates implied volatility (expected market move). In the case of an option seller, the premium received is the price for accepting the risk of the market movement.

Ironically, many buy side portfolio managers are willing, or at times forced to accept market risk without a premium when time exists between the creation of an FX exposure and the actual FX execution. The typical argument is that the spot trader that accepts this market risk has a 50/50 chance of cost/benefit, resulting in a zero sum outcome over time. We do not believe that this assumed calculus should be part of any serious investment strategy. In fact, with more market knowledge and access to analysis, we believe strongly that such an approach is plainly at odds with MiFID II’s best execution mandate.
From Order Creation to Execution

Cürex believes that every portfolio manager should care about FX rate change between the time of the decision to buy/sell an underlying security and the time of the related FX trade. This is especially true when transaction sizes are large or occurring in less liquid currency pairs. Measuring P&L between these times is critical for internal process and workflow improvements. Once measured, particularly in the instances of larger sized trades or more illiquid pairs, the PMs may realize that the 50/50 rule is a myth and the cost of time decay can be substantial, affecting their overall investment performance.

Getting More Granular Matters

FX price movement can occur during two periods: the time between order creation and order placement; and the time between order placement and execution.

Measuring the impact of price movement between order creation and order placement should inform buy side institutions if their internal workflows are efficient and if they have devoted enough resources to the trading function. This analysis is especially pertinent for buy side firms that consider their trading desk to be a cost center. If an FX trader has a mandate to evaluate the optimal order placement time, this measurement is critical to determining that effort.

Measuring the impact of price movement between order placement and execution informs the buy side about the cost of their execution method. The request for quote (RFQ) is still a popular order type for the buy side. The underlying theory behind the use of RFQs is that competition among price makers drives more favorable pricing via tighter spreads. But this execution choice requires all parties to be disclosed – a potential negative. Furthermore, constraints caused by credit counterparties, the number of parties being asked to quote, order amount, market volatility and other factors can cause the RFQ window to stretch from 5 to 30 seconds, or even longer, potentially impacting the execution due to market movement or information leakage. In the electronic FX marketplace five seconds can be an eternity.

While the time between order placement and execution may be the shortest part of the buy side’s workflow, observing and analyzing the market movement during this period provides the buy side with critical information that could: affect the choice of execution styles – risk transfer vs. algorithm; shorten the window from order placement to execution; or lead to a different selection of price makers for future executions.

Analyzing Execution Choices Using Pre-Trade Tools

Everyone knows that the spread between BID and OFFER is the efficient price for an immediate risk transfer. But there is more to consider:

- Are the prices shown fully executable or subject to last look risk and its associated, potential negative cost?
- Is the spread shown appropriate for the actual market environment (volatility)?
- Is the rate shown really the market or is it faded based on information leakage or intelligent guessing?

Presently, many buy side traders trust their own judgment when answering those questions since there are few real-time, independent data-based pre-trade tools available to them.

The buy side is increasingly embracing algorithmic execution as a trading choice, using passive and aggressive strategies that include intelligence that can react quickly to changing market conditions.

When deciding between risk transfer and algorithmic execution including the factors of cost and efficiency, the buy side needs analysis that is reliable and robust. To be informing, this analysis must be based on a data source that is consistent and stable.
enough to simulate an algorithm scenario and the anticipated market impact of the trading approach. The buy side’s embrace of intelligent pre-trade analysis will certainly benefit their trading outcomes.

---

**TCA and Pre-Trade Tools Should Improve Trading Outcomes**

Regulatory actions have driven the beginning of a sea change in the FX trading marketplace. In the last two years, the provision of intelligent analytics to a broader set of FX market participants has swelled. Not that long ago, only the banks and the most sophisticated hedge funds had access to real time FX market intelligence. Today, the buy side also has access to tools that can improve their trading performance. But having access alone is only half of the equation. And not every tool is equally potent. The purpose of TCA and the critical measurement of the cost of time, among other important factors, is to help FX traders improve their processes and make better trading decisions.

---

**Cürex’s Tool Kit**

At Cürex we give our customers even more. To begin with, our data is consistent – live, streaming and fully executable. Our customers have fully transparent access to our live market and full depth of book for 200 currency pairs. We also provide them with powerful pre-trade analytics to help them evaluate choices around execution timing and execution style. And after a trade is completed, we give them immediate analysis of their trade to prove they executed at the best price in a large, multi-contributor liquidity pool. We even give them a tool to walk the book forward and backward to analyze any potential market impact of their trading timing or execution style.

Cürex’s mission is to improve the trading outcomes of all of its buy side customers. Our approach is differentiated from any other FX ECN in the marketplace. Our rapidly growing customer list is proof of our commitment to the buy side and the value of our analytical tool set. If you have not evaluated the Cürex solutions, you should. It will improve your trading outcomes.