All That Glitters Is Not Gold – Mid-Pools Require a Closer Look

Introduction

Certain algo providers are pushing mid-pools with smart order routing as an alternative execution strategy for their real money customers. The sales push is alluring at first blush. The aggregated liquidity supporting the mid-pool seems to offer a tighter spread compared to individual ECNs and the idea of saving spread has got to make these pools better than anything else on the market. Right? I was schooled early on in life that if something seems too good to be true, then it probably isn’t. Cürex is fortunate to have many buy side customers. We capture data from our customers who employ mid-pools and are in the position to help them understand the issues they should consider if they choose this execution alternative. Let’s just say my early life schooling is as relevant today as it was way back when.

Let Us Repeat This for the Eighth Time

When I started on Wall Street I was fortunate to work for one of the legendary figures in the investment banking industry. He had a saying - actually he had many - that I continue to use even today. It goes, “you have to tell someone the same thing eight times before they begin to get it.” Over last few years, we have written a lot about what best execution is and what it is not. So for perhaps the eighth time: best execution is not simply best price. BEST EXECUTION IS NOT THE SAME AS BEST PRICE. Buy side FX traders have got to begin to understand that. Maybe we should dust off MiFID II regulations to go through it again. Many factors contribute to the concept of best execution – and it is a concept. We’ve called it a journey. It starts with research, adoption, utilization, evaluation, and judgement and then the cycle begins again. And why isn’t best price the same as best execution? Because of market impact, front running, last look liquidity, fill rates and a host of other considerations. And when your counterparty benchmarks your trades, you must be living on another planet if you celebrate your own success. Remember, this is the FX market.

Mid-Pools – What They Are and Are Not

To begin with, the buy side should be absolutely clear about what a mid-pool is not. It is not a platform for peer-to-peer matching. It’s important to clear up any confusion on that score since we have spoken to some clients who believe that that is a characteristic of mid-pools.

As advertised, mid-pools with smart order routing provide access to all the liquidity available to the algo provider to deliver the customer the tightest spread and best price execution for individual orders. So what about that liquidity? Does it include the algo provider’s proprietary, internal liquidity? Does it include high frequency market makers? Does the mid-pool mix last look and no last look liquidity? Is the client’s identity tagged? If the answer to any of the last four questions is “yes,” I would suggest the buy side FX trader consider the implications of any “yes” answers in the context of best execution standards. But let’s follow the FX trader who begins to execute an algo into a mid-pool. With certainty, the algo is executing at the best price. So far so good. But what about market impact? What is the relationship between the rate for the first child order and the last? Are different liquidity providers using the identity or trading intention of the algo user to take advantage of them. Of course, the TCA provider to the user will document that a best price was achieved...but at what price? ►
What Cürex Has Learned

Cürex’s liquidity is integrated onto a dozen bank algo platforms. **We have a strong relationship with our buy side customers since we are the only execution and analytics platform that is completely conflict-free and dedicated solely to the buy side customer set.** Our customers have the ability to select Cürex-only liquidity when they execute on numerous algo platforms. And we have proven time and again, and our proof has been substantiated by third-party TCA providers, that our customers experience the lowest market impact for their algo executions when they execute in our liquidity pool.

So what is Cürex’s experience as a liquidity source facing a mid-pool? Candidly, not optimal. How come? For one, our fully executable prices are a pinch wider at the top of book compared to last look liquidity and the rates provided by high frequency market makers. In spite of that, our customers experience superior trading results when they execute in our liquidity pool exclusively because of our very low market impact posture. When a mid-pool customer begins to execute, the algo being used hits the top of book rates. High frequency market makers will read that activity and adjust pricing. Or a matched trade may be rejected if it is last looked. Once the brief last look window concludes, that market maker can use the information in that trade attempt to advantage itself against the client’s trading intention. **Since the buy side trader is typically executing a large order using an algo, the trader’s performance is at risk if its trading intention is recognized by any singular counterparty.** By the time the algo reaches our liquidity, market impact has already occurred and a small percentage of the total volume is executed against Cürex’s no last look liquidity pool.

Cürex operates a unique and powerful analytics platform. We are collecting market data every day and all our clients’ trades, whether they trade in mid-pools or choose to execute in Cürex’s fully anonymous and no last look liquidity pool. **We share market impact analytics with our customers that substantiates the benefit of executing their algo trades in our transparent, conflict-free liquidity pool.** We would be happy to share that analysis with any buy side institution, of course protecting the identity of our clients, to demonstrate that best execution must be measured in the context of total algo execution performance – not on an individual trade basis. *Please let us show you our conflict-free data.*

The Punchline

**The buy side FX trader is responsible for following best execution protocols. BEST EXECUTION IS NOT THE SAME AS BEST PRICE.** The buy side is made up of some very smart folks. The FX game has not changed in long, long time. **We should be careful not to be distracted by the shiny new product. All that glitters is not gold. Best execution is hard. It requires work – by the buy side. Improving trading results and complying with best execution standards is not going to come as a result of aggregating liquidity – we should know that by now. Improved trading results will come from using intelligent analytics, enhanced data tools and ultimately from predictive intelligence.** We have said that the best execution journey starts with research. The buy side should ask a lot of questions. **If the mid-pools seem interesting and worth trying, know what they are and what they are not. You have a right and an obligation to know. Cürex is always here to help you. Our data and analytics provide a big head start. We’re completely conflict free – that’s a big head start too.**

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