

# MilanFX

## - Electronic Block Trading comes to FX

*Anand Iyer, Vice President and co-head of Foreign Exchange at Flextrade, discusses the impetus behind MilanFX and why their broker neutrality uniquely positions the company, as a non-aligned venue provider, to service the block FX segment.*

### Block Trading – A brief history

The burgeoning of electronic FX in recent years has pushed the envelope to create faster and fairer trading avenues. The FX spot market is liquid, volatile and dominated by a small set of instruments making it a perfect candidate for trading innovation. While more than 40% of the FX market is traded electronically, a large portion of it is still conducted over the phone -- especially for block size amounts.

It is in this environment that our FlexFX customers made us aware of the need for an FX platform that allows for trading block size amounts. Thus was born MilanFX, Flextrade's latest trading innovation that targets the block FX community.

As always we used the equity markets as our crystal ball. Over the years we had seen several trading paradigms emerge in equities, including market making, central limit order books and block trading. Electronic block trading platforms came into being to address the need to execute large volumes without information leakage and market impact. In FX, too, we saw the growth of market makers and central limit order books; however, electronic block

trading appeared to be the missing element. This provided the impetus for MilanFX.

We chose the "Dark Pool" paradigm to implement our block trading platform. Typically this trading mechanism is one that lowers market and information impact at the expense of price transparency. While the term "Dark Pools" is being bandied with impunity these days, the idea has existed for centuries. A Dark Pool is analogous to a Dutch auction, which relies on a trader's "reserve" price -- an undisclosed price at which the trader is willing to trade. It is this lack of price disclosure that makes the pool of liquidity "dark". In contrast, ECN Central Limit Order books function as English auctions where buyers and sellers can clearly gauge interest by looking at open bids and offers through a depth montage. Dutch auctions are everywhere -- US treasuries are sold through a Dutch auction, as were Google's stock when it conducted its Initial Public Offering.

MilanFX, however, really functions as a "grey" pool of liquidity because some indicators of liquidity are made available to end users. We do this by flashing currency pairs to orange to indicate that there is



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block liquidity available without indicating size, side or price. Additionally we also indicate contra liquidity to aggressive orders by flashing the currency pair green.

### Philosophy

The name "Milan", arising from the Celtic phrase "in the middle of the plain", was chosen for the platform because it captures the philosophy and spirit inherent in its design -- creating a level playing field and trading at the mid-market. This is accomplished by:

- Ensuring minimum block sizes (which vary by currency pair and are generally around the vicinity of a 100 million USD notional)
- Inviting participants from both the buy- and sell-side
- Score-carding participants and throttling malicious behavior

Establishing minimum block sizes serves two purposes:

- It segments the market into a block trading community and a non-block trading community.
- It serves as the primary bulwark against sniping.

In the spirit of creating a level playing field, MilanFX does not discriminate between the buy- and the sell-side, and there is no notion of a liquidity provider (market maker) and liquidity taker (market taker). Players have to post their orders in the platform to receive fills. From a credit perspective, most buy-side institutions will trade in the name of their Prime Broker, whereas the sell-side and other self-clearing institutions will trade in their own name. In either case credit lines are checked on a per-trade basis before providing fills.

We believe that in order to participate in a Dutch auction, the customer should have a "reserve" price for the currency pair. Since the notion of high-frequency cancel/replacing goes against the spirit of this platform, the system monitors usage for gaming and maintains a score card for each participant. Should participants attempt to perform high-frequency cancel-replaces to game liquidity, the system throttles these orders by introducing a delay based upon the scorecard.

### Trading Mechanics

Simply put, traders can post limit or pegged orders and receive executions against the orders. However, indications of liquidity are provided to traders in a unique way. Key to this are the following three concepts:

- Reference Price
- Block Reference Range
- Liquidity indicators

**Reference Price:** MilanFX displays a single non-tradable price called the Reference Price for each currency pair. This price represents the fair market value of the currency and is generally the mid-point of the inter-bank spread. We generate this price algorithmically from indicative price feeds sourced from prime-brokers, which were chosen because they are non-trading entities that merely serve as credit intermediaries for the buy-side. In addition, our algorithmic generation of the Reference Price has another safety check in that we use the median mid-price rather than the average mid-price of the prime broker feeds, as averages tend to get skewed easily.

**Block Reference Range:** Users can broadcast their interest by placing orders in the Block Reference Range. The Block Reference Range is a price range centered at the Reference Price and is calculated algorithmically to reflect market liquidity conditions. It is important to note that both the Reference Price and the Block Reference Range are derived from external pricing and interest placed on the platform. This makes it impossible for people to game these prices by placing large orders on the platform.

**Liquidity Indicators:** A user attempting to place an order within the Block Reference Range will cause the currency pair to flash orange to all users, indicating that there is block liquidity available. Other users will not know on what side that liquidity is available, nor will they know the price and the size. They will, however, know that the size is greater than the minimum block size, and that the price is within the Block Reference Range.

Additionally, a user placing an aggressive order (an order placed at the Reference Price or better) will get a green flash if they are within one pip of contra liquidity. In this instance, only the aggressor will get this indication and the passive contra liquidity will not. It is this feature that makes MilanFX a level playing field where liquidity information is provided to aggressors to level-off against the price improvement that passive contra-liquidity receives.

Using the above indicators, users can place orders within MilanFX without fear of information and market impact. Each of these indicators has been carefully designed to reduce gaming and preserve the reserve price of the trader. Users can trade at the midpoint by placing pegged orders or place regular limit orders. Also, buy-side users need not be restricted to a single prime broker and may select the prime broker in whose name they wish to trade.

### Deployment & Technology

MilanFX is available to users through the following deployment channels:

- Internet front-end
- FlexFX
- FIX protocol

We leveraged the thin-client innovation and operational expertise of our subsidiary, TraderForce, to develop and deploy the MilanFX front-end. The browser-based front-end has an innovative, yet simple look and feel that will appeal to spot traders. MilanFX will also be available to existing users of FlexFX via the FlexTrader front-end. And for businesses that prefer to use their own proprietary platforms, MilanFX can be accessed through the FIX protocol.

From a settlement perspective, the MilanFX crossing engine sends Notice of Execution (NOE) messages to the Traiana Harmony platform, which passes this information to Prime Brokers/Self Clearing institutions. We partnered with Traiana Harmony because of their extensive settlement network and mature technology.

### The MilanFX Nutshell

MilanFX attempts to segment the market rather than further divide up the pie. It caters to an untapped segment of block FX trading which has no electronic trading outlet. Moreover, it attempts to augment existing trading paradigms such as ECNs and single bank portals rather than supplant them.