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# Comment: Making FX safer from market disruption

**By Gil Mandelzis**

Scanning the headlines in the foreign exchange (FX) industry press, you will notice a distinct lack of hyperbole in the coverage of high-frequency trading when compared with other asset classes.

In its place are stories covering the rapid rise in volumes from algorithmic, or algo, trading by traditional firms and high-frequency trading shops. The reason is not an industry in denial. It is rooted in the different path that the FX industry has taken to build a market that protects itself, and importantly its traders, from algo trading scenarios seen in the equity markets.

At its core, the FX market is built in a way that reduces the risk of these types of market dislocations because of its roots as a global over-the-counter traded asset with greater daily turnover than any other asset class.

There are numerous, diverse venues on which to trade FX. This diversity brings with it a depth and resiliency which simply is not present for a given exchange-traded security, which typically has a small fraction of the active volume of a major currency pair, and trades on fragmented venues, which are correlated far more rigidly from a pricing standpoint.

Furthermore, the FX industry has a history of "grass roots initiatives" to address the needs of market participants and regulators. The settlement bank CLS was created by the industry to address so-called Herstatt risk, and a decade later the CLSAS (Aggregation Service) was a further example of the industry identifying a need in the market and acting on it to stay ahead of innovations in trading methods and technology.

Last month, Traiana, Citi, Deutsche Bank, JPMorgan and Morgan Stanley, along with all the main FX trading platforms, announced an industry initiative to reduce further risk in algorithmic and high-frequency trading of foreign exchange. It is the latest in a long string of investments the industry has made to protect traditional and electronic FX traders, while embracing the growth in algorithmic trading that has brought significantly greater liquidity to FX markets.

The result has been substantially greater trading opportunities and tighter spreads, all achieved without the market dislocations and drama that have roiled other asset classes.

This latest industry effort, launched with the support of such FX trading platforms as BloombergTradebook, Currenex, EBS, FXCM, Hotspot FX and Thomson Reuters deploys a comprehensive system to monitor algorithmic trading activity in real-time across every leading FX venue, giving prime brokers and their clients the ability to halt or limit trading activity via a "kill switch" if one of the "machines" begins to malfunction or a client breaches risk limits.

With a "pattern-recognition" algorithm technology, it even looks for evidence that things are beginning to go wrong, before those limits get breached or losses start racking up.

While risk controls at the trading platform level provided a layer of protection against these dangers on a single platform, no solution in the market allowed a prime broker or client to look across all trading venues in real time, or allowed a prime broker or client to turn off trading activity quickly across all venues if something was going wrong.

The primary benefit of this solution will be to ensure that counterparty technology failures or risks do not give rise to undesired market risk for FX trading firms – but the additional benefit will be another layer of insulation in FX markets.

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