# Liquidity explained.

## How to find the right provider for you

# What is Liquidity?

**Liquidity can have several different meanings, so it's important to clarify what we mean when discussing the function of liquidity providers.**

In trading, liquidity is about providing or getting a price to buy or sell an asset. Liquidity providers, or LPs, offer executable prices to different types of institutional clients with the aim of delivering maximum trading efficiency and tradability.

It's generally understood that the more liquid a market, the easier it is to seamlessly execute a greater number and/or size of trades. What is less well understood is how liquidity providers, by acting as key intermediaries, play a crucial role in market functioning. When markets are illiquid, prices are more volatile and less informative. That's why the emergence of specialist liquidity providers has proven important in improving market quality and functioning.

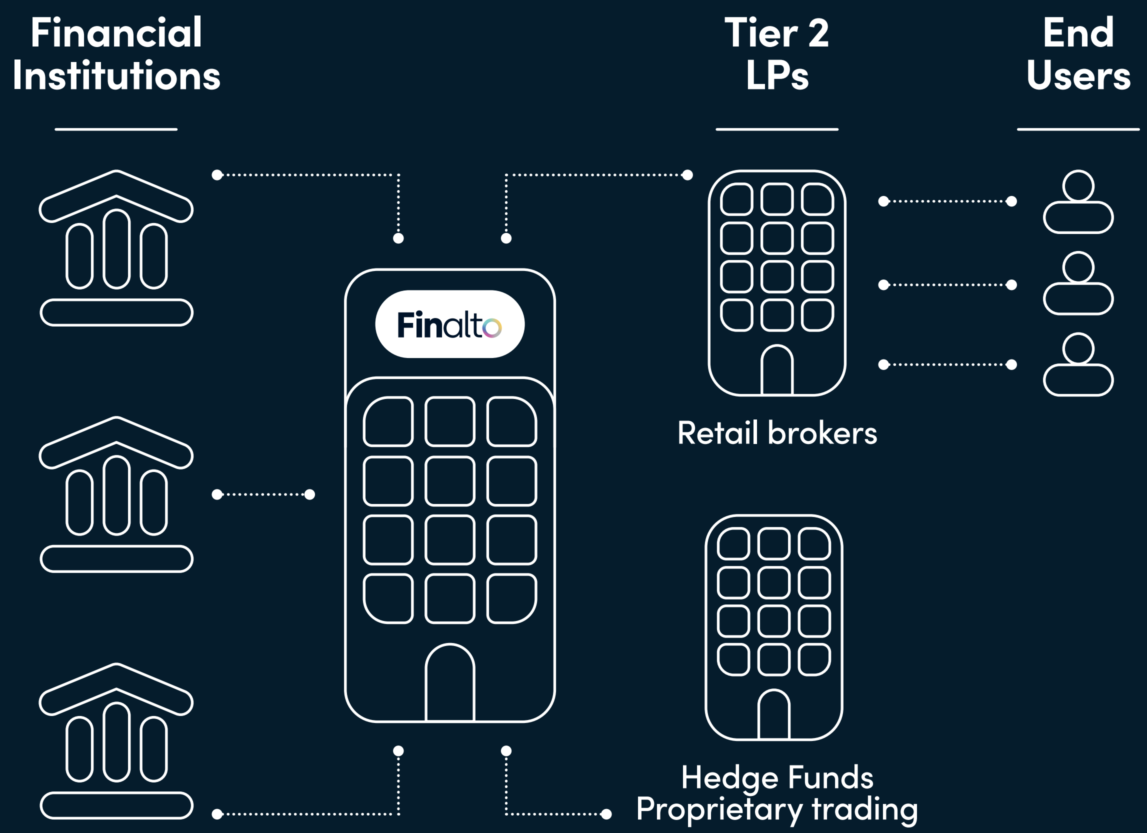
Not all liquidity providers are the same, however.

**In this paper we will talk about the nature of liquidity, what a truly best-in-class liquidity provider delivers and what multi-asset brokers should look for from a provider.**

# Who supplies Liquidity?

In the past, formal exchange specialists or market makers provided most liquidity, for example through pricing. More recently, though, this role has been taken on by specialist liquidity providers, using emerging technologies to deliver bespoke and sustainable liquidity to a broader range of end clients.

**There are 3 broad classes of 'liquidity provider'; however, it is important to remember that this space is evolving, and providers are developing their own bespoke liquidity provision as technology advances.**



**Tier 1 liquidity** providers connect brokerage companies with the ECN network – the electronic system of bid and ask orders execution. ECN unites the largest tier 1 bank market makers.

**Tier 2 providers** typically act as an intermediary between the Tier 1 liquidity providers and end clients. This often includes smaller financial institutions, hedge funds and retail brokers.

**Prime of Prime (PoP):** These providers aggregate pricing from as wide a range of sources as possible (Tier 1 banks, OTC brokers, dark pools, etc) into their own liquidity pool. They are then able to deliver bespoke pricing to their end clients.

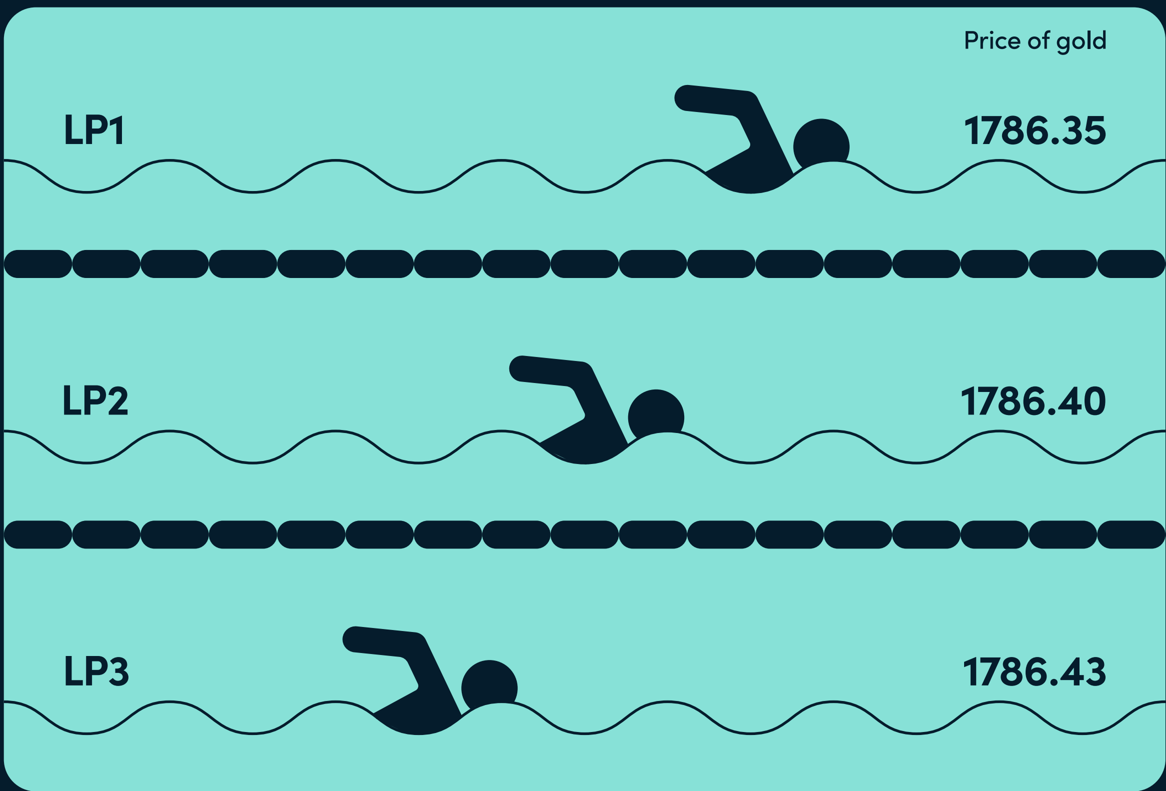
**It should be noted that Tier 2 and Prime of Prime (PoP) liquidity providers overlap, to an extent. This reflects the dynamic and evolving nature of the marketplace; technology and changing demands placed on them by brokers and other non-bank financial institutions means liquidity providers are constantly adapting to the needs of their clients and the market: adaptability is a key trait of any good provider.**

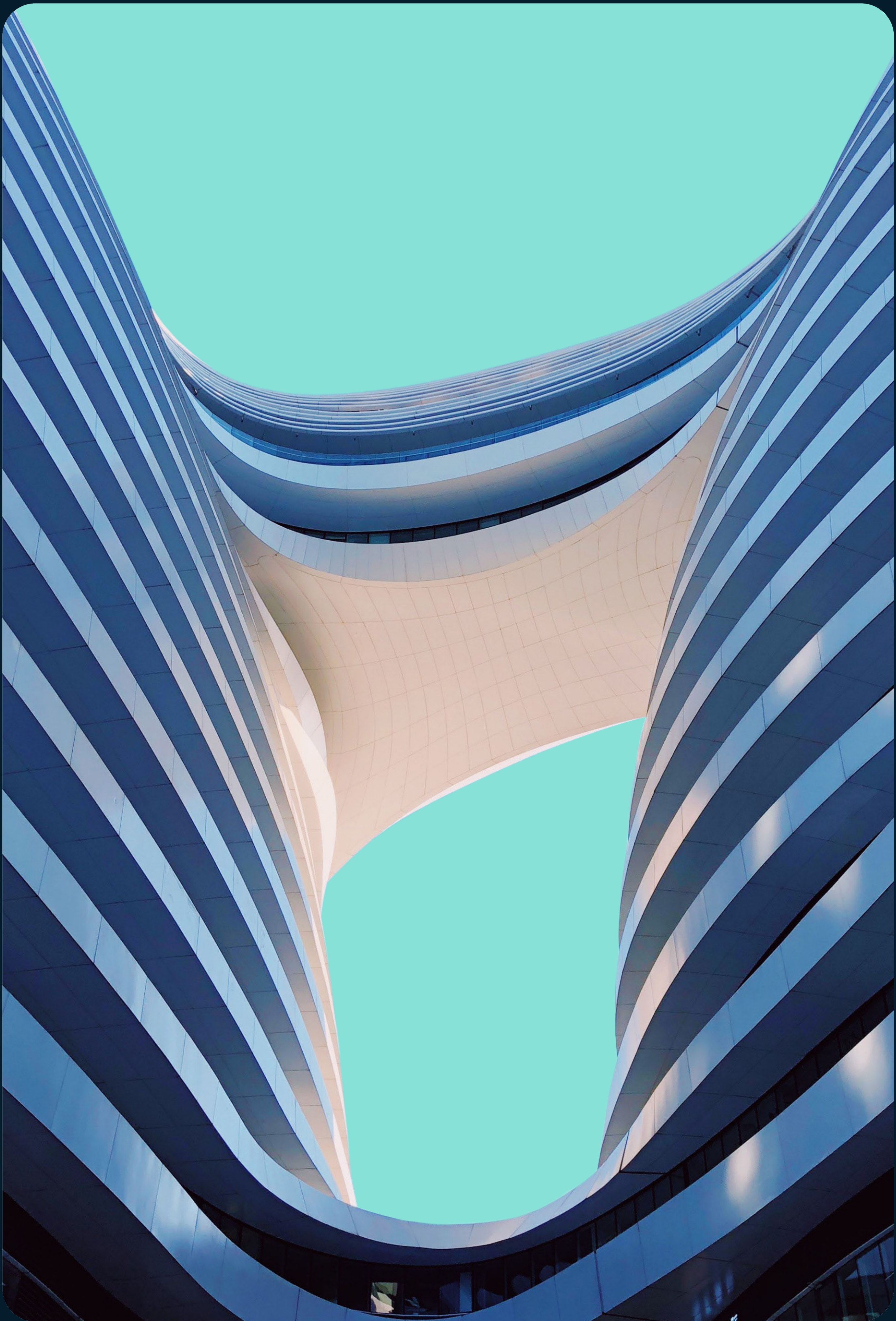
# Liquidity Pools

A PoP can curate pricing from market makers – who take risk – in order to lessen the market impact and improve liquidity. Adding pricing to liquidity pools from market makers who internalise risk over a short-term timeframe can significantly reduce market impact and therefore increase pricing stability and longevity.

Finalto curates pricing from a range of Tier 1 banks and other non-bank liquidity providers to create a liquidity pool from which clients can derive pricing. The advantage of this is a more bespoke and sustainable liquidity. At Finalto we have developed systems to empower clients with greater access to additional pools of liquidity.

This approach involves a focus on connectivity to multiple electronic trading venues; the aggregation of multiple sources of liquidity from different venues; streamlining trade workflow, such as the number of steps required to execute a trade; and creating analytical tools to proactively manage and improve end-client experience.





## FBS Liquidity update

Things to bear in mind when choosing an LP

# Price

You can be sure that Finalto will always focus on providing bespoke and sustainable pricing.

As you might imagine, liquidity provision is all about providing a price. However, liquidity provision is by no means a one-size-fits-all model. As the landscape has evolved and technology has improved to enable a wider range of products, clients are increasingly looking for tailored liquidity that serves their needs, while also retaining access to a large, established and respected liquidity provider.

**The importance of pricing skew – how we narrow spreads for our clients.**

Skewed price feeds are important as they allow us to provide a Bid/Offer that's as close to mid (or through it) as possible. Providers can do this by pooling multiple sources of liquidity (pricing) and aggregating this out to meet the needs of individual clients.

# Bid and Offer price by LP:

| | Bid | Offer | Spread |
|---|---|---|---|
| LP1 | 1.0005 | 1.0009 | 0.0004 |
| LP2 | 1.0001 | 1.0005 | 0.0004 |
| **LP3** | **1.0004** | **1.0006** | **0.0002** |

While LP3 shows us what seems to be the most competitive spread, we can make an aggregated book to create more competitive pricing on both the bid and ask.

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| LP Bid | Bid | Offer | LP Offer |
|---|---|---|---|
| **LP1** | **1.0005** | **1.0005** | **LP2** |
| LP2 | 1.0004 | 1.0006 | LP3 |
| LP3 | 1.0001 | 1.0009 | LP1 |

Although LP3 has the tightest individual spread, it isn't part of the Top of Book price we would send to a client, as the other two spreads show a 'skew' at mid-price (1.0005) on one side.

# Bespoke Liquidity

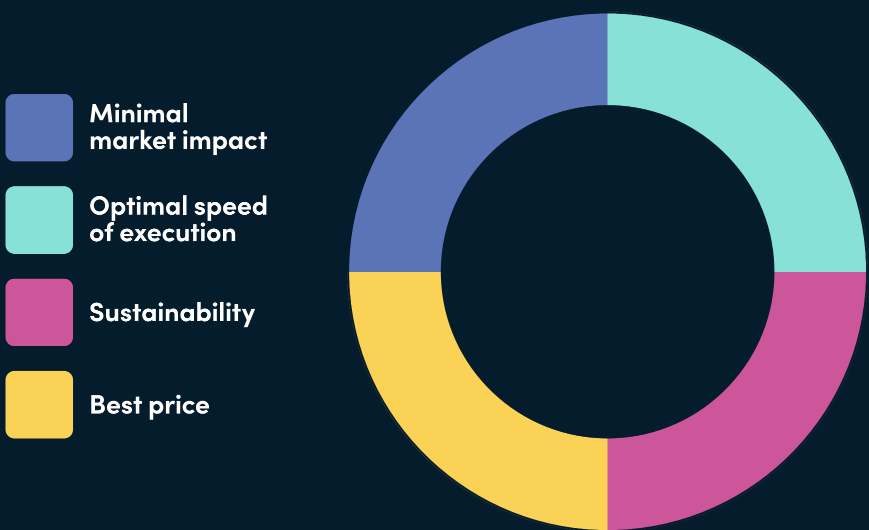
'The tailoring of our solution is modelled on a range of factors and depends on trade size as well as type of client,' says Andy Biggs, Group Head of Risk and Trading at Finalto. For example, offering liquidity at various prices is different when we're dealing with a trade size of £1k, as opposed to a regular flow of £100m trades.

'This is where our creation and careful management of deep and dynamic liquidity pools, and the technological development to support them, has been instrumental in us being able to service the needs of a wide range of clients,' Biggs adds.

Additionally, different types of clients will look for different attributes. A retail broker may, for example, be more focused on a lower average spread which enables them to add the mark-up they can pass on to their end clients, while still being able to offer the product with lower costs. A fund, on the other hand, will almost always want to focus on its long-term performance by ensuring it has constant access to the best overall price.

Good communication with clients is therefore an essential part of the process, as placing flow in the wrong pool might lead to an LP pulling or widening pricing. By ensuring that the pricing model is best suited to an individual client, we also make it sustainable. That's why we place a high level of importance on setting clients on the right path and why we create different pools to reflect our clients' individual needs. Building a suitable price feed for a client enables longevity of their liquidity and a client trading larger tickets will benefit from a different structure to a client trading micros.

Another factor to consider is the lowering of market impact. The structure of a client's book can be created as 'sweepable', or tiered, to suit their execution and where possible reduce the impact on pricing.



# Speed

Arguably, execution speed is every bit as important as pricing itself. Why? Because the speed at which a price is delivered and executed can make a big difference to performance and also plays a central role in delivering pricings ustainability. The fact that high-frequency market makers can put out more than one quote per millisecond means that an LP's ability to customise what they then pass on to the client is critical. And as some clients will want that kind of frequency while others have no need, we believe it's important to tailor not only the pricing but also the 'pressure' on that flow, depending on the client's needs.

These days, in-house technology plays an important role in delivering speed of execution. So in our opinion multi-asset brokers should look to LPs who have implemented their own technology. This will enable them to take a more precise approach to ensuring maximum speed of execution, without compromising on price.

Of course, some brokers may prioritise speed over price to reduce latency, while others may prefer to get the best price at the expense of a millisecond or two in speed. At the end of the day, it all boils down to individual circumstances.

# Analytics

In-house tech is important for another reason - data is a powerful tool for tailoring and improving liquidity for specific clients, and liquidity providers should take a proactive approach to maximising the utility of the data it sits upon. At Finalto we use data in discussions with clients themselves, and with the institutions our data derives pricing from, to constantly make improvements and fix problems before they can become a bigger issue.

In order to maximise the benefit of data analytics, multi-asset brokers should look to LPs who have their own technology. Again, we consider scale to be an important coefficient in the analytic equation, for the simple reason that the speed of data delivery is vital. In fact, the speed of the data flow itself is instrumental in lowering the number of rejected trades, while faster data flow creates a more accurate price flow for a broker's B Book. To put it simply, volume of data x how this data is used = better outcomes for brokers.

Antony Parsons, Head of Liquidity at Finalto, explains: 'Clients need an LP who's got a good analytics package so they know they are managing the flow correctly. And it works both ways – our LPs will only deliver pricing to Finalto if we are analysing and optimising all the time.'

Finally, a good LP will not only be able to analyse the flow they sit across, but will also be able to view the data of the broker's end clients. 'Some brokers may not have the tools to analyse their own clients' flow - we have the ability to deep-dive by their end user, which can help improve their outcomes and pricing,' Parsons says.

# Operations

Multi-asset brokers should also consider simplifying their back-end processes and cash management through a single multi-asset account with their liquidity provider. However, this service isn't available from most prime brokers and other non-bank liquidity providers, but Finalto have developed a fully cross-margined single currency account that facilitates trading in different assets.

These include index CFDs, FX, precious metals, energy, base metals, equity CFDs, cryptos, and NDFs. Because separate accounts aren't required for each individual asset, this can reduce capital management and risk monitoring, as well as improve data reconciliation, thereby reducing overall costs for the broker.

# Support

Support and coverage are important throughout the relationship and should be considered when looking to appoint a liquidity provider.

'Our breakdown of Sales, Liquidity & CS [client services] means there is always a team that can help with an issue or query,' says Parsons. 'CS have a fast response time and will provide as much information to a client as they need, together with solutions to their problems.'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