FXPA Guidance: Definitions & Best Practices for FX Internalisation in Algo Execution

Published by the Foreign Exchange Professionals Association (FXPA) – July 2025

Executive Summary

As electronic trading continues to evolve across the global FX market, the practice of internalisation has emerged as a key mechanism by which liquidity providers manage risk and offer efficient execution. However, the term "internalisation" is often used inconsistently, leading to potential confusion and lack of transparency between counterparties.

This paper outlines the FXPA's recommended definitions and practices for internalisation, with a focus on transparency, venue disclosure, and market integrity. Our aim is to foster greater understanding and alignment around how internalised liquidity is managed and disclosed in algorithmic execution.

I. Overview: The Importance of Defining FX Internalisation

Internalisation is a common practice among liquidity providers (LPs) in FX markets where client orders are filled using the LP's own risk book or offset against other client flows without routing the trade to a public market or other liquidity providers. While efficient, internalisation practices must be transparent and clearly defined to avoid issues of information leakage, market distortion, or execution bias.

II. Venue Transparency and Disclosure

To promote clarity in understanding how internalisation operates in algorithmic execution, we define this as:

> **Algorithmic Trading:** The use of computer programs to automatically place and manage orders based on pre-defined strategies, such as minimizing market impact, capturing short-term trends, or optimizing execution costs. These algorithms can respond to real-time market data and execute trades faster than manual methods.

When trading via algorithmic execution, **Liquidity Providers must disclose the venue or mechanism used to internalise trades.** Specifically:

- **Trade venue identification** should be clearly labelled in post-trade reporting.
- If internalisation is used, clients must be informed as to whether this represents offsetting client algo flow or commercial LP activity, as described in the following discrete definitions of "internalisation type"
- Full timestamping and audit trails are recommended to ensure execution integrity.

III. FXPA Definitions of Internalisation in Algo Execution

Internalisation Type A – Client-to-Client Neutrality

In this model:

- Client A's algo order and Client B's algo order transact bilaterally via an LP.
- The LP acts as a non-influencing intermediary.

Key principles:

  - The LP does not use information from Client A or B's trade to influence pricing or other market flows.
  - Trades are executed under firm liquidity conditions, with disclosed full amounts, where possible, or through the life of the order (e.g. schedule algos)
  - **No use of "Last Look"** is applied.
    - Last Look describes the practice in which a market maker provides a price quote to a client or marketplace, but after a client attempts to execute a trade, the market maker may review and/or reject the rate provided (i.e., take a "last look")*
  - Pricing and execution are not skewed in anticipation of or response to market events.

This model represents a **clean internalisation** flow and prioritizes market neutrality, anonymity, and transparency.

Internalisation Type B – LP Commercial Flow Offset

In this model:

Client trades are offset against **the LP's commercial or risk management flows**, which may include:

1. The LP needing to trade opposite to a client due to a natural position existing within its market making desk or pre-existing commercial flow.
2. Delta hedging or other derivative-related flows (e.g., options).
3. Correlated product execution to manage portfolio or market exposure.

4. The LP's Principal stream is best price at time of execution
5. LP skewing prices to match with other client interest

Key principles:

- LP may skew prices in response to internal positions and algo interest but **must ensure such information is not leaked or used to influence client pricing beyond the bilateral transaction.**
- Bilateral competition (e.g., in RFQ settings) should not result in price deterioration or cross-venue information dissemination.

What Internalisation is Not

Common fills that should not be labelled as internalisation:

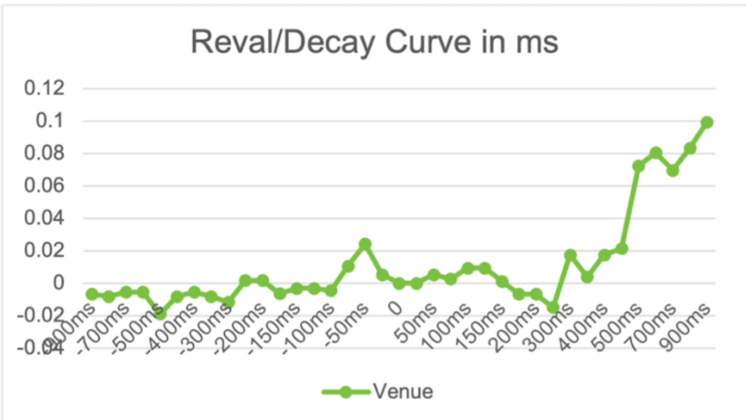
- Matching client algo flow with another LP's disclosed streaming price (whether skewed or unskewed)
- Mid-book fills, which refer to trade executions that occur at the midpoint between the bid and ask prices in an order book.

IV. Execution Quality & Data Integrity

For voice trades, RFQ, RFS and algorithmic executions, the following best practices are recommended:

- **Child order fills should be timestamped**, with records maintained for audit and post-trade analysis.
- **Execution quality should be assessed** using **price decay** or **slippage analysis** over the period of execution.
  - For example, leakage or impact may be measured by comparing the arrival price vs. the volume-weighted average execution price over the trade window.

For example:



- Both user and L.P. can utilise data to improve execution outcome over time supporting the relationship model. All users should develop nuanced methodology to assess performance.

V. Recommendations for Industry Adoption

1. **Standardise Definitions:** FX market participants should adopt the FXPA's definitions of Internalisation A and B to promote clarity.
2. **Enhance Trade Disclosure:** All liquidity providers must disclose internalisation practices to clients at or before execution.
3. **Implement Post-Trade Analysis:** LPs and clients should collaborate on post-trade reviews, including slippage, latency, and information leakage assessments.
4. **Preserve Client Confidentiality:** Skewed pricing or bilateral executions should not result in the dissemination of sensitive client order information.
5. **Support Auditability:** Full timestamping and record-keeping of execution data should be implemented to enable independent verification and compliance review.

Conclusion

Internalisation remains a powerful tool in FX markets when applied transparently and fairly. By clearly distinguishing between types of internalised liquidity and enforcing robust execution practices, the industry can promote confidence, reduce information asymmetry, and align with the highest standards of market integrity.

The FXPA encourages all market participants – liquidity providers, venues, and asset managers – to adopt these definitions and practices to foster a more efficient and transparent FX ecosystem.

* FXPA Focus on Last Look

The Foreign Exchange Professionals Association ("FXPA") is a Washington-based organization that represents the collective interests of professional foreign exchange market participants. The group engages with key regulators and policymakers through education, research, and advocacy, with the goal of advancing a sound, liquid, transparent and competitive global currency market. See more at www.fxpa.org