Defining Stop-Loss Orders

Defining Stop-Loss Orders

The following definitions have been added to the *Guidelines for Foreign Exchange Trading Activities* in the trading section:

Stop-loss orders typically fall into four classes, although some dealers may offer products that vary in their structure and complexity. Some classes are more commonly used than others and dealers do not typically offer all classes of stop-loss orders.

To varying degrees, each type of stop-loss order balances protection against the risk of "slippage" (the difference between the order level and the actual trade price) and the expense of an early exit from the trade position. While slippage is a function of liquidity at different price levels, it may be magnified or mitigated depending on the type of stop-loss order used.

All of these definitions apply to normal market amounts under normal market conditions. As always, counterparties should ensure that they have an independent understanding of the parameters of normal market conditions for each currency market and can effectively recognize risks during abnormal market conditions.

BID/OFFER STOP

The order is executed when the market bid (offer) price reaches the level indicated by the bid (offer) stop order. This stop-loss order becomes an "at best" order (executed at the best price available), which may result in significant slippage in volatile market conditions.

Example:
Buy 10 mio Eur at .90xx s/l BID

When the euro bid price is at .90xx, the customer's order will be filled at the next offer price. In this example, the order may be filled at a much higher price than the original order level, depending on the market liquidity at the time of the trade.

ALLTAKEN/GIVEN-NEXT STOP

The order is executed when the market is no longer offered (in the case of a buy stop) or bid (in the case of a sell stop) at the level indicated by the order. While this stop-loss order becomes an "at best" order, the slippage may be less than a bid/offer stop under normal liquidity conditions.

Example:
Buy 10 mio Eur at .90xx s/l Alltaken Next

When the euro trades through all remaining .90xx offers, the customer's order will be filled at the next available offer. It is not necessary for the market to be bid at .90xx.

ONE-TOUCH STOP

The order is executed if the order level trades in the market. It is only necessary for the level to trade once for the stop loss to be executed. This type of stop-loss order may provide additional protection against slippage. However, it typically does not protect against the risk that the order may be executed even if the market price does not trade through the order level.

Example:
Buy 10 mio Eur at .90xx s/l One-Touch

If the euro trades at .90xx, the customer's order will be filled at the next offer, including any remaining .90xx offers. In this example, the order fill may be closer to the order level than a bid/offer stop or an alltaken/given stop order.

AT-PRICE STOP

The order is typically a one-touch stop in which the dealer will guarantee, under normal market conditions, that the order fill will not exceed the level of the order. The customer typically faces the risk that the order may be executed even if the market price does not trade through the order level. It should be noted, however, that at-price stops are not typically offered by all dealers, given their implied guarantee.

Example:
Buy 10 mio Euro at .90xx s/l At-Price

If the euro trades at .90xx, the dealer will buy 10 million euro. The dealer will sell 10 million euros to the client at .90xx regardless of where the dealer covers the position in the market. In this case, the risk of slippage is borne by the executing dealer, given that the trade price may exceed the order level.