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- ▶ Establishing procedures to achieve best execution and transparency
- ▶ Responding to a changing regulatory environment
- ▶ Seeking liquidity in the current market
- ▶ Bank technology – in-house or outsource?
- ▶ Case study: Trafigura

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Moving forward in a time of change

Foreign exchange adapts to a new market environment

Developments in the FX industry over the past year have been significant. The goal of this year's Euromoney/FXall Best Practice in Foreign Exchange Markets handbook is to bring together contributions from different market participants, across both the buy and sell side, to shed light on key market topics that are important for all participants with respect to best practices.

Our first article, Establishing Procedures to Achieve Best Execution and Transparency, examines processes that are currently accessible to institutional investors to ensure all compliance regulations are met, with trades executed at a fair price. The second article couldn't be more critical in a time when OTC market regulations are being established: Responding to a Changing Regulatory Environment looks at how investors should be preparing for the new regulatory environment and examines possible regional differences. Seeking Liquidity in the Current Market examines the varied ways to make markets today and the different tools and execution methods needed to access these new sources of liquidity. With the rising availability of outsourced technology solutions specifically for banks, banks are now able to focus their attention on risk management or elsewhere. The article Bank Technology – In-house or Outsource looks at different types of solutions covering the many technology requirements in the bank's offering to clients. The handbook concludes with a case study of how a corporate client, Trafigura, exemplifies best practice through the use of FXall as a complete workflow solution, protecting their organisation against regulatory changes and fraud.

As the industry grows and develops, FXall continues to prioritise not only being aware of all aspects surrounding best practice in the FX market, but bringing together thought leadership in them. As we look forward to the advancements of the next year, we aim, together with our partners, to actively encourage the outcome of many industry developments.



Phil Weisberg, CFA
Chief Executive Officer, FXall

Establishing procedures to achieve best execution and transparency

Many FX market participants still need to focus on their execution strategies to ensure they can demonstrate best practice to both regulators and stakeholders

The issue of best execution in FX has recently achieved heightened visibility for pension funds and asset managers that are not trading on a third-party basis. The issue is hardly new – best execution has been a consistent theme in FX for the past decade. Nevertheless, its re-emergence highlights how many FX market participants still need to assess their execution strategies.



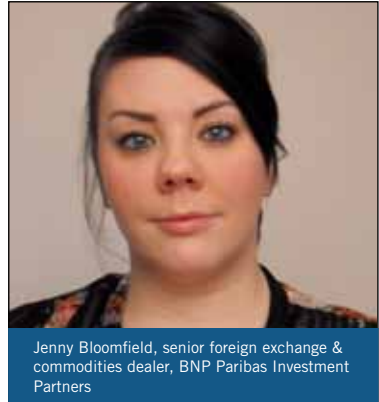
“There is now light being shed on some corners of the FX industry which has revealed that in some cases there is little consistency among industry participants in their ability to understand what they are paying to execute and how efficient their strategy is,” notes Philip Weisberg, chief executive officer at FXall. “Given that the FX market is huge and generally extremely efficient, companies that are missing a framework to communicate the efficacy of their decisions and their strategy will be at a clear disadvantage.”

Until now

Historically, asset managers and other market participants have focused less attention on FX best execution and costs because they were often a by-product of other transactions and therefore considered purely an operational exercise. For example, completing an underlying equity or fixed income trade often made executing with a custodian or equity prime broker the default choice because of operational simplicity. Remuneration for these services was sometimes implicitly priced into the rate received on the transaction - rather than reflected explicitly to simplify operational processes.

Strategic decisions that evaluate the costs and operational risks of insourcing these activities, by actively managing execution risk and trading with third parties, versus outsourcing both the operations and execution to the prime broker or custodian, are complex. Such decisions need to take into account the volumes and breadth

of currencies traded, current operational capabilities of the market participant, costs and the appropriate way to reflect these costs between asset management expense ratios and underlying fund performance. As data to make these decisions could be difficult to collect, it was more difficult to focus on FX execution costs relative to other operational expenses.



“As we trade FX as an asset class, there has always been a focus on best execution,” says Jenny Bloomfield, senior foreign exchange and commodities dealer at BNP Paribas Investment Partners. “However, it is fair to say that among portfolio managers, using currency

to hedge their underlying positions in other asset classes (equities, for example), there is generally more focus on equity prices to ensure compliance than in best FX execution. We mostly, depending on the size of the transactions, sweep their orders into our electronic tools, where they can be priced in competition, and we ensure we still achieve the best price for the client.” BNP Paribas Investment Partners favours multi-bank platforms as they give a better spread, thus eliminating risk in terms of bank exposure. “That was important during the financial crisis, when some banks fell below our rating requirement,” says Bloomfield. “Around 90% of our orders go through FXall.”

Regulatory changes bring new focus of attention

“The world has changed following the financial crisis and with impending legislation,” Weisberg says. “Now people with fiscal stewardship for other people’s money will be under increased pressure to disclose the strategies they choose and the performance of those strategies.” With the increased emphasis on transparency, it is expected that best execution will need to be established with measurable checks and procedures in place for all FX trades.

Just as it is important to understand the conditions that give rise to the requirement to enter a currency transaction, it will be equally essential to understand how that transaction is executed and what roles various people play in the execution. “Current regulatory changes are not primarily about FX but they will raise awareness of the importance of considering a counterparty’s motives and understanding the relationship between the buy side and sell side.”

Areas of focus

It is clear that demonstrating best practice, whether regulated or not, has become

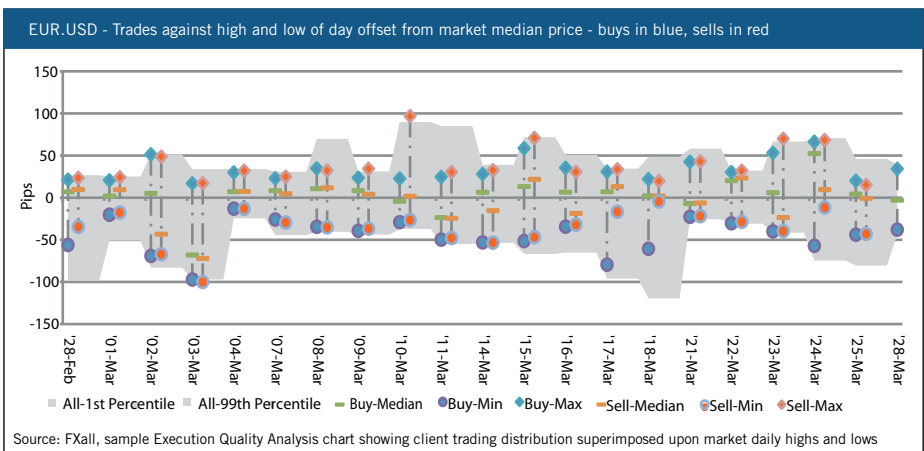
increasingly important and will become even more so.

A key ingredient in proving best execution is data. In FX, that means a time stamp is needed to assemble the information required to show how decisions are made. Historically, execution analysis in FX has been tricky because of the over-the-counter (OTC) nature of the market. However, the advent of electronic trading offers straightforward solutions to prove best execution by providing a full audit trail, controlled workflow processes, independent benchmarks and time stamps. Electronic trading's evolution has also helped to overcome some of the principal operational hurdles in seeking best execution. "Electronic trading venues now mitigate the risk of non-settlement of an underlying trade on an equity, for example, by automating custodian notification," says Jim Kwiatkowski, head of sales Americas and Asia at FXall.



Jim Kwiatkowski, head of sales Americas & Asia, FXall

Some electronic platforms also now offer valuable additional services which build on transaction cost analysis (TCA) concepts imported from equity markets yet take into account the unique nature of foreign exchange. FXall offers Execution Quality Analysis (EQA) advanced reporting, which analyses clients' trading data over time according to multiple metrics to help clients assess the effectiveness of their current execution strategy in the OTC world in which they operate. These types of improvements are becoming increasingly popular in FX, driven not only by compliance but also by the need to improve trading practices and performance. It is



a method of monitoring and analyzing price information and the relative performance of different FX venues, brokers and execution strategies.

Moreover, in recent years there has been a huge growth in emerging markets investment. Currencies in these markets are less liquid than major market pairs and therefore asset managers potentially have more to gain from seeking best execution when completing an equity order, for example.

Increasingly, asset managers and other FX market participants see the automation and netting tools provided by online trading platforms as the most straightforward and effective way to enhance the efficiency of their currency trading function, thereby demonstrating best practice.

Electronic trading venues not only lower transaction costs and offer multiple execution strategies, but they provide the opportunity to achieve the most advantageous pricing. They also meet all compliance regulations, such as FAS 133 hedge accounting and Sarbanes-Oxley. Crucially, they also deliver broader efficiency benefits as a result of efficient trade processing and simple error resolution that reduce operational risk by transforming a series of manual steps into a seamless, automated process.



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Responding to a changing regulatory environment

Considerable uncertainty remains about the extent to which the FX markets will be affected by current regulatory reforms in both the US and Europe

In response to the financial crisis, the US and Europe are in the process of implementing the most significant regulatory reforms in living memory. Although the implications for FX are less than for some other asset classes, they could be profound.

In the US, the Dodd-Frank Act, enacted on 21 July 2010, will increase regulation of over-the-counter (OTC) derivatives and establish new regulated entities called Swap Execution Facilities (SEFs). The Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC) are now working through the rules that will govern derivatives – a process that was originally expected to be completed by mid-July 2011 and to be implemented 60 days after that, although extensions are likely which could push the timetable back to 2012.

In Europe, the reform process is under way but lags the US by some months. Change will be enacted through the European Market Infrastructure Directive (EMIR) and a review of the Markets in Financial Instruments Directive (MiFID) dubbed MiFID II. A final version of EMIR is expected to be agreed in mid-2011, with implementation in early 2012. Details of MiFID II (which focuses on pre- and post-trade transparency and where trades are executed) are expected in the coming months.

Regulatory reform of the OTC derivatives market in Europe is expected to be broadly similar to that of the US in an effort to prevent regulatory arbitrage. In both regions, there remain considerable uncertainties about which FX products will be covered by new regulations. Although spot is exempt it is likely non-deliverable forwards (NDFs) and options will be covered by the new rules. At the time of writing, it seems likely that forwards and swaps under a designated maturity will be exempt and longer-dated maturities could move towards a centrally cleared regime.

And what about Asia? Jonathan Woodward, head of Asia at FXall says “While Asia does not operate a unified regulatory environment akin to Europe and the US, the global banks and global investment managers operating in the region will need to conform to the highest level of regulation or risk having to turn away

customers from certain jurisdictions. Purely local operators could benefit from regulatory arbitrage; however, they would risk being disadvantaged due to restricted access to liquidity. FX is such a global market that we expect to see a level playing field for all participants.”

Trying to fix a market that doesn't need fixing?

The move to include FX derivatives in OTC derivatives reform has been controversial. “The goal of Dodd-Frank and reforms in Europe is to address systemic risk and consequently there is an element of one-size-fits-all in their prescriptions,” says James Kemp, managing director of the global FX division of the Association for Financial Markets in Europe (AFME) and the Securities Industry and Financial Markets Association (SIFMA). “There is the possibility of unintended consequences given the diversity of the FX market,” agrees Wayne Pestone, chief regulatory officer at FXall.

One of the most important elements of current reforms is central clearing, which is designed to address credit risk. However, Kemp says that research has shown that 94% of the risk of FX trades up to six months relates to settlement, which in FX is already effectively managed through CLS. Consequently, credit risk is a limited problem. Moreover, there is already good use of credit support agreements (CSAs) in FX. Excluding corporate transactions, research shows 85% of the credit risk in FX trades is collateralized with CSAs.



James Kemp, managing director, global FX division, Association for Financial Markets in Europe (AFME) & Securities Industry and Financial Markets Association (SIFMA)

“Overall just 1% of FX risk is uncovered residual credit risk,” says Kemp. “The plan is to introduce clearing to address that 1% risk, resulting in a major upheaval in a market that worked well during the financial crisis.” Kemp says that many market participants are concerned that clearing will increase costs unnecessarily (proving a drag on performance), increase concentration risk (by introducing a central counterparty) and reduce liquidity. “Moreover, it could undermine an already competitive single- and multi-dealer platform environment,” he adds.

Electronic trading to the fore?

One specifically intended consequence of



Jonathan Woodward, head of Asia, FXall

regulatory reform is a likely increase in electronic trading volumes of FX. As regulators push for electronic trading to gain unbiased information that they can use, FX users need to be aware of likely requirements to capture data, which will make a move to electronic trading more likely.

Electronic trading clearly has other benefits for end users. Some platforms offer multiple execution mechanisms including request for quote, collaborative trading and an anonymous order book, in addition to providing an audit trail of information that makes it straightforward to prove best execution and facilitate improved reporting.



Wayne Pestone, chief regulatory officer, FXall

The regulators' end goal for FX is likely to be a market more similar to equities, where electronic trading is ubiquitous. Similar to the equity markets, there will be continued emphasis on open access to products and trading platforms. Regulators believe that by forcing open access requirements they will create competition which will include electronic trading as an important part of that change.

What should end users be doing?

In the short term, users should not only keep track of fast-moving changes to the scope and detail of regulatory reform: they should be actively involving themselves in the process, according to James Kemp.

“Corporates and investors need to reach out to regulators to understand what’s happening and to work with the CFTC, the EU Commission, the European Securities and Markets Authority and other regulators to help to define the new rules and provide data for that process as well as help to explain the potential unintended consequences of regulation,” says Kemp. AFME and SIFMA are acting as a forum for debate of Dodd-Frank, EMIR and MiFID. “We’re collating industry views and helping people find the most effective ways to engage with regulators,” adds Kemp.

In the medium term, all end users of FX derivatives will need to determine whether they are a major swap participant (a user that maintains a substantial position in swaps, excluding positions held for hedging or mitigating commercial risk). If they are, it will have significant implications for the requirements and responsibilities they have in relation to clearing, execution and reporting.

For all market participants, clearing – as a new concept in FX – is one of the

central issues to be addressed, and therefore how users will access central clearing is probably the most pressing decision. Some end users may decide to settle directly, having considered the costs and benefits of such a decision, although it is currently uncertain what types of institutions will be allowed to join clearing houses as members.


There are three questions participants are likely to ask themselves:

1. Are we exempt from clearing?
2. If non-deliverable forwards and options need to be cleared, should our trading style be adapted?
3. Is it worth considering joining a clearing house ourselves?

For most end users, however, access will most likely be through prime brokers, which will therefore play a key role in the transformation of the FX market. End users should begin to evaluate what in many cases will be unfamiliar entities, in addition to considering entirely new procedures. Users may have to post collateral to brokers to access central clearing, which will be a new experience for some. Therefore the role of prime brokers will probably become more important, with them taking on a broader role in helping their clients navigate.

Kemp at AFME says a new market infrastructure will develop and users need to consider the practicalities of establishing and building links and data messaging to the new world of clearing houses, Swap Execution Facilities (SEFs) and swap data repositories (SDRs).

Andrew Coyne, head of FX prime and G10 e-commerce at Citi, says that it is incumbent on prime brokers to ensure that their clients have a positive transitioning experience to a clearing regime. “How documentation is managed and the way data is presented – for example, how cleared and non-cleared FX appear in a portfolio – will be crucial,” he says. “Prime brokers also need to help with offsetting and margin financing and end users should ascertain the extent to which prime brokers are prepared to do so.”



FX: what you can't see can hurt you

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How do you measure performance?

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Seeking liquidity in the current market

The growth of a more diverse FX market has been broadly positive for end users – provided they understand how to make best use of the opportunities available

In the past few years, how and where liquidity is accessed by FX market participants has changed substantially. New venues have emerged while some established ones have lost market share. At the same time – and not coincidentally – new entities have begun to make markets in FX. As a result of these many changes, the nature of liquidity in the FX market has changed fundamentally and end users such as corporates and institutional investors need to respond accordingly.



Sang Lee, managing partner, Aite Group

“As the 2010 Bank for International Settlements (BIS) report makes clear, there’s been a continuing increase in volumes in the FX markets, especially compared to other asset classes, which suffered during the financial crisis,” says Sang Lee, managing partner at independent research and advisory firm Aite Group. According to the BIS’s 2010 Triennial Survey, published in September, global FX turnover was 20% higher in April 2010 than in April 2007, with average daily turnover of \$4 trillion compared to \$3.3 trillion.



Jonathan Wykes, director and head of advanced execution services, foreign exchange sales, Credit Suisse

However, the same survey highlights the changing nature of the FX market. Activity of reporting dealers with other financial institutions surpassed interdealer transactions for the first time. Other financial institutions, a category that includes non-reporting banks, hedge funds, pension funds, mutual funds, insurance companies and central banks, grew by 42% from \$1.3 trillion in April 2007 to \$1.9 trillion in April 2010, according to the BIS.

The change in the balance between the interdealer market and bank-to-client transactions is attributable to a number of factors, according to Jonathan Wykes, director and head of advanced execution services for foreign exchange sales at

Credit Suisse. “It has been prompted by an increase in customer-to-customer execution through ECNs, internalization at banks, liquidity sharing by banks and the advent of alternative market-makers, especially in the US,” he says.

Symbiotic changes

Many of these changes in the market are symbiotic. For example, the shift in emphasis of the FX market away from the interdealer market is being reflected in the use of particular venues. “There has been a massive shift from primary venues in recent years,” says Wykes. “We’re an agency business so all our execution is in the wider market. We used to do the majority of our business in the primary venues but over the past few years we have seen a dramatic shift to alternative venues and we can see this falling further for some currency pairs. We’re now connected to many different and diverse pools of liquidity.”

Mark Warms, general manager for EMEA at FXall, says that the way in which banks act in the market has changed entirely. “When electronic trading first appeared banks made prices to a client based on a price in EBS or Reuters,” he says. “They dealt with clients and then covered the risks at a profit elsewhere. That strategy is increasingly difficult, with tighter prices, increased competition and faster moving markets.” As a consequence, banks are changing strategy and more often are internalizing transactions from their distribution franchises and passing those improvements to relationship clients on disclosed channels. Alternative market-makers, which use price-making activity to interpret flows and profit from them using algorithmic trading strategies, are picking up the slack in making markets to anonymous venues.

The ability to internalize coupled with the diversity of anonymous venues means market participants are no longer so reliant on single sources for reference pricing. Banks are rediscovering the true art of market-making, albeit with a new, electronic twist. However, they will always have business that they cannot match up and need to offset. This will continue to be a source of flow to traditional venues and alternatives that are optimized for the new world of internalization.

What end users should consider when sourcing liquidity

The overall effect of the changes in the FX market in recent years is the creation of a larger but more fragmented market, according to Aite Group’s Lee. “That is a challenging dynamic for end users. Corporates and asset managers need to be



Mark Warms, general manager, EMEA, FXall

“The future is not complete automation but a hybrid model where basic tasks are automated, freeing up traders’ time for more complex trades”

sharper to understand and access the different competing pools of liquidity and make best use of them.” A further consideration is a change in the pace of the FX market. “A decade ago, everything was RFQ,” notes Lee. “Now there is much greater variety through streaming pricing and other methods of price discovery. As a result, there is greater pressure to act quickly in what is a complex and fragmented market.”

Indeed, one of the most important consequences of the changes in

the market from an end user’s perspective is that price discovery has become more important than ever. “You can’t just call up a dealer and ask for a price,” says Wykes at Credit Suisse. “There’s \$1.6 trillion traded daily in the spot market and you need to find ways to access as much of that liquidity as possible without having an impact.”

Given the increased complexity of the FX market – including the increased use of products such as NDFs and swaps – and the pressure to deliver results, increasingly automated tools are helpful to end users to better navigate venues and trading strategies in order to access liquidity. “It’s a steep learning curve for all market participants,” says Lee. “The future is not complete automation but a hybrid model where basic tasks are automated, freeing up traders’ time for more complex trades.”

Wykes says that there have been some adjustments among end users, especially at large asset management firms, to account for how the market now functions. “We’re increasingly seeing centralized dealing of FX by big real money accounts, often with former heads of equity trading in charge,” he says. “There’s a lot of overlap in terms of technology and methodology – such as slicing trades to get the best deals – so that makes sense.” Nevertheless, Wykes says that some end users have yet to make the necessary change. “There are still many people who just trade with their custodian and see FX as a hedging tool rather than an implicit cost that should be minimized – or an asset class in its own right. Given increases in market volatility, costs have increased and users need to seriously consider their choices.” The difficulty of trading in size means that users need to consider how they trade, says Wykes. “Users need to devise a new way of dealing that reflects order size, liquidity, order books, volatility and other parameters. They need to work out what they are trying to achieve – simply to exit risk quickly and efficiently or to generate alpha – and act accordingly.”

During the volatility of the financial crisis clients rediscovered the value in their relationships with liquidity providers by witnessing their willingness to put their capital at risk through disclosed collaborative execution mechanisms. Although liquidity has recovered since the financial crisis, when it was difficult and costly to execute many trades, the importance of being able to access multiple execution mechanisms to cope with the range of trade sizes and market conditions was proven. On one end of the spectrum, relationships matter even more for larger trade sizes and volatile markets, and at the other end, “smaller trade sizes used to be turned away because dealers had a finite throughput but now volume is the critical factor and nothing gets turned away from automated pricing capabilities,” says Warms.



New environment creates challenges

While the growth of a more diverse FX market has been broadly positive for end users – provided they understand how to make best use of the opportunities available – electronic trading has also had some broader liquidity implications for end users, according to Duncan MacInnes, owner and CEO at FX trading firm Xenfin.

Current developments in the FX world – most especially regulatory reform – need to be considered carefully to ensure that they benefit users. While there is much talk among regulators and the media of the benefits of an everything-to-everything exchange model, there is little consideration of the benefits of the OTC market where the attributes of a supplier can be defined.

For example, for some end users it is convenient and advantageous to negotiate a long-term FX deal with a handful of banks to build a relationship. Such an arrangement allows investment to be made by both sides to optimize the value of that relationship and increase efficiency.

Moreover, such a long-term relationship can ensure guaranteed spreads or liquidity regardless of market conditions. The alternative – considering every trade as a separate transaction – does not give an end user such certainty or, potentially, such value over the long term. “The FX market is a special case,” says Aite Group’s Lee. “Although it is an OTC market it has many of the features of an exchange market. Liquidity is just one important element and is determined by many other factors such as timing and the size of a trade. For that reason, a pure exchange-type model is not automatically the solution to all FX requirements. Building relationships with prime brokers is still essential for end users.”

Bank technology – in-house or outsource?

Buy or build? Banks are increasingly finding that some of the technology they would have developed themselves can be brought in from outside suppliers. The difficulty lies in knowing where to draw the line

Banks' core business is the facilitation of credit and their core activity is the development and maintenance of customer relationships, providing lending to sustain those relationships and managing the risks associated with them. Given the fierce competition that exists in many sectors of banking, many have come to think over time that proprietary technology gives them a competitive advantage and the top-tier institutions have adopted a largely in-house approach to systems development. However, the procurement of vendor solutions saves the top tier re-inventing the wheel for non-proprietary applications, and gives an opportunity to the middle/lower tier to catch up and punch above their weight. Observers increasingly believe that, to maximize shareholder value, banks need to decide not whether or not to buy or build certain technologies, but which ones to outsource.



Justyn Trenner, CEO & principal, ClientKnowledge

“Banks recognize that their core skills are in risk and market-related services but it’s not clear that they have fully evaluated what elements of those services – such as market access, market risk or credit risk – they get paid for and what are the most efficient processes for delivery,” says Justyn Trenner, CEO and principal at research and advisory firm ClientKnowledge. “Electronic trading and increased liquidity in FX means that this absence of evaluation no longer needs to be the case: it is possible to work out to what extent a bank is being compensated for taking credit and market risk and therefore make a decision about doing so.”

Trenner says that using technological tools to disaggregate what elements banks are paid for – and which they are not – is valuable to banks. However, they need to determine at what point it makes sense to apply such technological tools. “There may be a lower threshold should a solution be developed out of house (which also has the benefit of eliminating project risk),” he says. “In the past three or four years, more of the tools that a bank might seek to use have become available on an outsourced basis.”

In recent years, many banks have begun to run their core systems on server farms managed by technology companies. “To make the move to outsourcing is therefore a marginal call: it’s just a question of due diligence and risk control. However, there are other issues to be addressed. Firstly, for any application to run efficiently, a material degree of customization – of trader and customer interfaces and connections to legacy systems – may be required, which could alter the threshold at which it makes sense to outsource. Secondly, there is a differing cost structure: a deployed solution might have higher upfront costs such as licensing fees and build costs but may be cheaply scalable. That may not be the case with an outsourced solution. Finally, there is also, of course, an emotional aspect as to whether a bank is happy to use a system with someone else’s name on it.”

Why a decision is pressing

Some banks may take the view that they are happy to continue building systems as they always have. However, for many other banks circumstances have changed sufficiently to warrant a reconsideration of the reasons for buying rather than building technology such as order management systems (OMS), internal matching engines or client front-end or so-called single-dealer solutions.

For example, many banks, while having excellent customer relationships, simply do not have the business, workflow or technical expertise to build an FX trading system to interact with their clients.

Perhaps most importantly, economic and regulatory circumstances have made a decision more pressing for banks. “The credit crunch resulted in a decrease in the availability of discretionary resources,” says John Ashworth, global head of enterprise solutions at FXall. “Typically, up to 75% of development resources are focused on maintaining current offerings. When economic black clouds appeared the first thing to happen was a clampdown on new technological innovation.”



John Ashworth, global head of enterprise solutions, FXall

At the same time, regulators are putting increasing pressure on banks. New regulations such as the Dodd-Frank Act, which was enacted in the US on 21 July 2010, and the European Market Infrastructure Directive (EMIR) and a review of the Markets in Financial Instruments Directive (MiFID) – both currently under way – in Europe will have a profound effect on the business models of many banks active in non-cash FX instruments, such as forwards and non-cash options.

To complicate matters further, the final details of the Dodd-Frank Act, EMIR or MiFID have yet to be determined. While it seems likely that single-dealer systems will be ruled ineligible for certain FX products and certain that swap execution facilities (SEFs) will become the sole venue for others, it is not yet clear exactly which products will be included. Consequently, banks have to anticipate the likely shape of final regulations while building systems that enable them to remain competitive.

Banks' considerations on what can and can't be outsourced

Banks need to consider why they are developing a new piece of technology: is it strategic or non-strategic? For example, banks no longer develop their own sales contact systems because there is broad recognition that it creates no competitive advantage. What many banks are now realizing is that there is similarly no competitive advantage in building an OMS – the value is in the customer base and the order details.

Similarly, with algorithmic models the strategic element is not the graphical user interface (GUI) or the coding, but the rules devised by quants that govern the system's operation. However, while there may be no competitive advantage to be gained by developing an OMS – or indeed a GUI – there may be a strategic disadvantage if the interfaces it uses are inadequate or are missing opportunities for automatic output, for example.

“While some of the more commoditized components of a bank's offering can be outsourced, other components are tied to intellectual property and how a bank differentiates itself,” explains Eddie Wen, global head of rates and FX e-commerce at JPMorgan. “For connectivity solutions, for example, there may already be some standardization (such as FIX and STP feeds) which many clients already expect. If everyone is already using broadly the same offering then the only determinant of whether something is brought in or developed in-house is cost. Whereas, for components that are algorithmic pricing, risk or trading related, there are few vendor solutions that are suitable and such functions are



Eddie Wen, global head of rates and FX e-commerce, JPMorgan

seen as a value-add so the preference is to keep them in house.”

Wen says that there has been a gradual shift in terms of what components can be outsourced and what developed in-house. “For example, banks used to develop proprietary STP solutions in order to create stickiness with their customers,” he notes. “But as customers began to rely on standardized STP feeds it became prohibitively costly to integrate such proprietary systems.”

The cost of developing technology must also include time to market and the ability to innovate. “One question that may become increasingly important is how banks feel about using outsourced technology as a means of innovation,” says Wen. “The issue historically has been that innovation requires lots of iterations and constant attention to get right and it is therefore inherently difficult to achieve with an outside vendor. Keeping control of technology development allows the creation of new solutions quicker and retention of intellectual property; thus allowing banks to maintain an innovative edge. However, while retaining intellectual property will always be important to banks, it is possible that in the future some innovation will come from vendors.”

Trends for outsourced solutions include front-ends for forwards, spots and swaps, options trading and matching systems, given that banks are starting to see that these solutions are in the most part non-strategic.

Choosing a technology partner

The provision of technology in financial services is no longer limited to simply supplying a black box. It is essential that a vendor can be relied on to provide 24/7 support, often including site visits. Can banks support such communities of users themselves and do they want to? Are there any strategic benefits to doing so? Many market observers believe the answer is no.

Instead, banks are increasingly working with technology vendors that they trust to provide good products and services that their users require. It is critical that banks select vendors that have sustainable business models – they need to ensure their partners will continue to be in business. Equally, they need to ensure that they have access to new product developments ahead of the broader market.

A partnership approach is increasingly being favoured by banks. However, what is noticeable is how banks are choosing to work with vendors. The reluctance of the past to outsource anything is giving way to a preference for one-stop shopping. Rather than working with a number of start-up companies – with all the potential vulnerability that implies – banks are instead working with established companies, including FX venues, which then act as a prime contractor and do systems integration.

For example, one major bank is using FXall's matching engine to internalize its own flow and that of its customers before netting it out in the external market. Similarly, the securities service division of one of the world's largest banks is using non-proprietary technology to connect to its asset management clients, while other global banks are using OMS platforms designed by FX venues. The financial crisis and its aftermath have put pressure on banks and they have responded by rationalizing their approach to technology: precious discretionary resources are increasingly being allocated only to projects perceived as strategic.

In short, banks should ask the questions, how good is the solution? How reliable is the company and is it well capitalized for the future? And how efficient is the support and training it offers?

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Case study: Trafigura

With 67 offices across the world, commodity trader Trafigura needed a single solution to streamline its FX operations

Trafigura is the world's third largest independent oil trader and the second largest independent trader in the non-ferrous concentrates market. Established in 1993 as a private company, it has access to approximately \$24 billion in credit facilities, with investments in industrial assets around the world of more than \$1.5 billion. Trafigura handles every element involved in the sourcing and trading of crude oil, petroleum products, renewable energies, metals, metal ores, coal and concentrates for industrial consumers. A total of 67 operational offices globally provide local knowledge to enable the company to anticipate and respond to variations in global supply and demand. As a global business, its foreign exchange operations have demanding requirements.

What were Trafigura's operational challenges?

Prior to using FXall, Trafigura used multiple single bank platforms which created many challenges.

- **Technology:** Ongoing technical support was required to install and maintain multiple systems and connections to minimize possible technology conflicts.
- **Trading:** Traders had to view several monitors simultaneously, which made daily tasks demanding. Particularly in fast-moving markets, it was extremely difficult for traders to be confident of dealing on the best price available.
- **Operations:** With multiple single bank platforms, executed deals had to be keyed in manually or Trafigura required a straight-through processing (STP) interface to be built between its in-house system and multiple counterparties.

What were Trafigura's requirements?

Trafigura needed a single solution to streamline its trading to ensure the company received the best price, while still enabling it to maintain good relationships with the banks of its choice.

“**Trafigura were very clear about their requirements and which changes needed to be made in order to put together a complete system with full workflow capabilities to match their business requirements**”

A multi-bank platform would allow Trafigura to achieve this goal for its workflow requirements by reducing the manual steps in booking trades through a single front-end interface for all the traders. The goal was to implement STP and have a robust audit trail and reporting suite to help the company analyse its flows and support its compliance requirements.

Why did Trafigura choose FXall?

“FXall were able to offer us access to multiple execution methods within one platform. FXall could provide us with the key functionality we needed: continuous streaming prices through FXall’s Bank Stream product and Request for Quote through their QuickTrade product,” says Richard Ecob, head of FX at Trafigura.

- QuickTrade is used by the traders to compare prices in order to obtain best execution, or to direct trades to the banks of their choice for relationship reasons.
- Bank Stream shows streaming spot prices from all bank relationships
- Audit trail capabilities and the reporting suite allow for the complete analysis of all trades.

Benefits of a strategic execution partner

“FXall’s team worked closely with us to ensure that all our goals were met by customising a solution to meet our needs,” says Ecob. The on-boarding and integration process was a true partnership with both parties providing input: “FXall provided the environment and custom formats quickly and were extremely responsive to our needs,” says Gregor Mueller, treasury manager at Trafigura. Keith Hill, head of EMEA sales at FXall notes that “Trafigura were very clear about their requirements and which changes needed to be made in order to put together

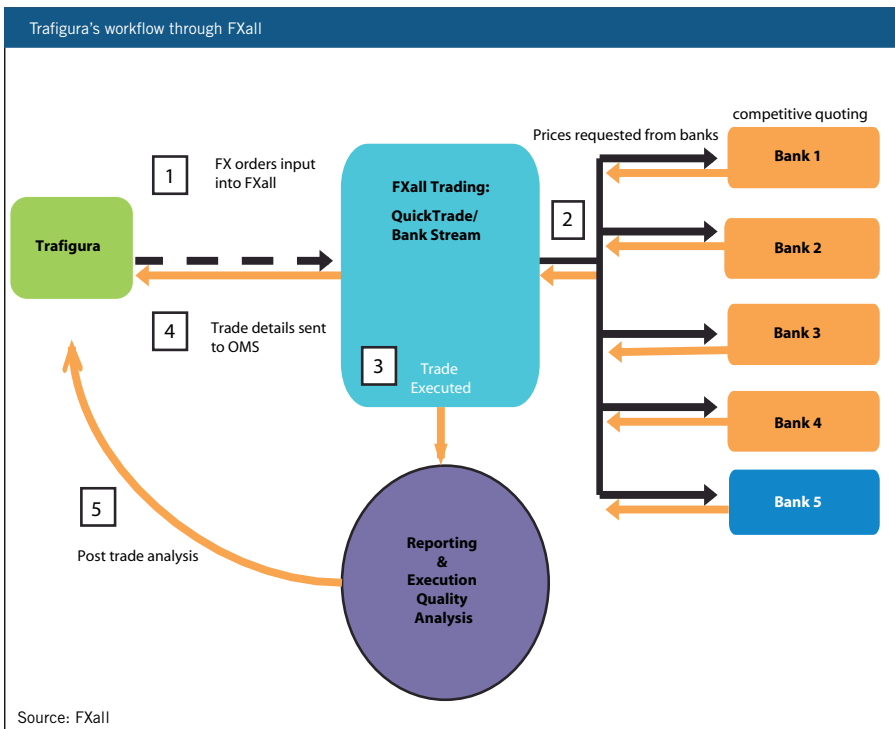
a complete system with full workflow capabilities to match their business requirements. Their proactive approach to testing and immediate feedback on any changes allowed FXall’s integration team to provide the seamless straight-through processing they were looking for.”

“**FXall has made our day-to-day trading life much more efficient – FXall Trading is truly a simple and effective workflow tool for users, and we benefit greatly**”

A simple, efficient workflow solution

“FXall has made our day-to-day trading life much more efficient – FXall Trading is truly a simple and effective workflow tool for users, and we benefit greatly

from the speed and ease of the straight-through processing. We regularly trade twelve currency pairs; the cost savings have been substantial and quantifiable. In addition, we find the reporting and new Execution Quality Analysis tool extremely valuable in that we are now able to demonstrate how our trading strategy helps meet our business goals. FXall has gone above and beyond our original trading expectations, and as our requirements change and our business develops, FXall continued to offer us timely and effective support,” says Gregor.



FXall contacts

FXall gives its clients an edge in foreign exchange trading as the leading independent electronic platform. We deliver the expertise, resources and commitments of a neutral platform with the broadest suite of FX trading solutions that combine execution tools with end-to-end workflow management and straight through processing. Our flexible tool set delivers the right execution strategies and liquidity in all market conditions for over 1,000 institutions globally across active traders, asset managers, corporate treasurers, banks, broker-dealers and prime brokers. Among multiple other award wins, FXall has been voted the #1 multibank platform in the annual Euromoney FX polls for a decade. These awards highlight the satisfaction of our customers and also FXall's ability to keep pace with the evolving foreign exchange market and incorporate industry best practices into our solutions.

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execute faster

Hello
My trading objective is

*match 3rd party
benchmark*

Hello
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lower transaction costs

Hello
My trading objective is

*keep large trades
confidential*

Hello
My trading objective is

*minimize
market impact*

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