Feel the platform pull

JULIET TEWUNGWA REPORTS ON A RECENT ACT EVENT THAT CONSIDERED THE SEEMINGLY INEXORABLE RISE OF FX TRADING PLATFORMS.

Will electronic-based trading become the norm over the next decade? On hand at a recent meeting of the ACT's London regional group to explain the rise in the use of technology for trading were Steve Canning, head of corporate sales UK and Ireland at 360T Trading Networks, and Keith Hill, head of sales EMEA at FXall, two of the fastest-growing FX platforms. Martin O'Donovan, deputy policy and technical director at the ACT, was also present to explain how new regulations may affect treasurers making FX transactions.

There is a myriad of reasons why trading platforms are taking over from phone-based trading. Between 2007 and 2009, volumes traded on platforms grew rapidly (37% growth in 2008/2009 and another 8% the following year). However, the picture more recently has been mixed, with volumes for the UK and Asia continuing to rise but falling in Europe and the US.

Demand for platform trading has grown because it allows treasurers to perform a range of operations, including accessing money markets and money market funds as well as the FX markets. They also allow treasurers to obtain best pricing easily and quickly. In the past, treasurers might have called up to eight banks in an effort to obtain best pricing, but more recently the pressure on treasury resources might result in just a couple of banks being contacted. More and more treasurers now regard trading platforms as a "best of both worlds" solution and the consensus seems to be that platforms give better pricing and increase resource efficiency.

IMPACT OF DERIVATIVES REGULATION Forthcoming regulation may also have a decisive impact for several reasons. First, with phone-based trading lacking an audit trail, unlike execution on an electronic platform, e-trading FX may simply be made mandatory.

Derivatives regulation could also make a big difference. O'Donovan pointed out that the G20 and the EU wish to regulate the derivatives market, which would affect the large number of trades in FX derivatives undertaken by treasurers for hedging purposes. New legislation is expected at the end of 2012 in the form of the European Market Infrastructure Regulation (EMIR) and the Dodd-Frank Act in the US with the aim of reducing the systemic risk of derivatives.

There has been considerable debate about the role of central clearing in derivatives regulation and the possible impact this could have on corporates in particular. If they have to put up collateral to remove credit risk, they will then be exposed to unlimited calls on their liquidity. Fortunately, following heavy lobbying, non-financial companies transacting within certain limits may be exempted.

Banks will have an equivalent requirement, laid out in Basel III, to hold increased levels of capital against risk positions. This credit valuation adjustment will result in a huge step up in capital requirement, which will in turn push up transaction costs. The aim is to bring order to the marketplace but the worry is that this could lead to fewer deals, with banks seeking more security on FX transactions.

The idea of a tax on transactions has also been mooted. If a transaction generates further transactions then each transaction will be charged, accumulating cost to be passed on to the corporate.

As a result of the changes in regulation, it is likely that more and more transactions will take place on trading platforms. The European Commission would like, ultimately, the electronic trading of all standardised contracts for over-the-counter (OTC) derivatives, which are defined by the Markets in Financial Instruments Directive as regulated markets or multilateral trading facilities.

While technology in the form of trading platforms offers many benefits, it is important not to lose sight of the personal element. Despite human error, people who understand the foreign exchange markets remain key. The people risk can be mitigated by introducing additional controls such as a requirement for two people to confirm deals and to impose limits on the size of transactions.

Maintaining a good relationship with your bank also helps if a problem occurs. If an error is made, being able to pick up the phone and speak to your bank to sort out the problem remains an invaluable option.

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