As more and more firms reap the benefits of carrying out their foreign exchange deals online, it pays to know what your options are.

Essential tools of the trade

THERE IS LIGHT at the end of the tunnel: for the treasurer, e-commerce is rapidly moving towards providing a holistic set of products and services. Furthermore, there is a strong move towards facilitating the integration of these products and services alongside those provided by non-e-channels and continual development of new tools. It is estimated that within the next three years, 70% of all foreign exchange (FX) deals will be transacted online.

This prospect raises challenges and opportunities, not only for those companies yet to move online, but also for those that have not completely embedded an electronic channel into their FX dealing. All elements of the FX transaction can be migrated online. This article highlights where e-commerce is going and the criteria that determines what best suits a buy-side corporate.

Today, with increased intensity, corporate clients are examining more closely the type of business they transact online and which method of execution is best-suited to handle their FX needs. There is the reality that e-commerce can deliver more than just a range of execution tools. The principal focus of the providers of these tools and solutions is to anticipate and understand client needs, and to respond to these needs through the provision of online and offline products and services, as well as tailor-made client solutions. Efficiency remains the buzzword and straight-through processing (STP) is a key component of current and future solutions. For both the buy and sell side, it is essential that these solutions continue to emphasise and deliver efficiencies in FX dealing.

The birth of an FX exposure

Historically, once the FX exposure had been identified and confirmed, the focus of the corporate treasury was to ensure the best execution of the deal. Today, treasurers are expected to add value to the organisation and, as a result, analysis of exposure management has an ever-increasing role. E-commerce can greatly assist this process by providing the unique analytical tools necessary, in a safe and secure online environment. Tools such as VaR, back-testing and flow analysis models, as well as other sophisticated risk analytics, can provide the framework needed to assist with managing exposures. The most advanced players in the marketplace have progressed to link FX analytics with other asset classes, allowing treasuries to perform, in depth, multi-asset class portfolio analysis.

Providers need to ensure that they prioritise 'ease of use', a key and often overlooked element of any online application. The look and feel of analytical tools must be as user-friendly as possible, creating a 'one-stop' shop that will further entice treasuries not just to go online,

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but to stay online for all stages of the trade cycle, from research to post-deal analysis. Also the integration of smart technology, such as remembering 'my favourites', customisable screen layout and other such tools, will further increase ease of use, allowing treasuries to have a higher comfort level with using online systems.

Execution: are the choices endless?

In the current economic climate, FX is a mature market with razor-thin margins. The influence of price has diminished, and FX providers are aware that business is increasingly won through offering value-added services and that e-commerce has a large role to play in this strategy.

As technology progresses, so, too, do the choices available to corporate treasuries: from banks offering unique proprietary solutions such as benchmarking (a fixing snapshot of FX rates for spot and forward deals, allowing transactions to be executed at independently sourced and audited rates) and multi-bank portals to the development of application program interfaces (APIs).

The buy-side needs to look closely at how to match the various methods of execution to their specific exposure management requirements. A one-size-fits-all approach is clearly not the best way forward in this area. It is time-consuming, in some respects, not to have one solution for everything. However, for a patient and diligent treasurer, by ensuring the appropriate match between method of execution and intended goals, this exercise can pay handsome rewards.

The multi-bank space continues to expand and develop. In the long term, online distribution of prices through portals will not only focus on price discovery, but on the overall level of services that meets companies' needs. A treasurer must ensure a good return in exchange for the introduction of a third party into an existing FX relationship.

The multi-bank space at present includes Currenex, FXall and FX Connect, of the more globally known multi-bank portals, alongside more regional players such as 360T (Germany) and Centradia (Spain and France). Prospective corporate clients not only need to ensure the service provided meets their needs, but should also consider the long-term future of their chosen partner. A key to each of the portals' long-term success will depend on providing the full benefits of electronic connectivity, both for the end user as well as the liquidity provider.

For those treasurers investigating slippage reduction from internal accounting or budget rates, there is the continuing development and expansion of benchmarking as a set of execution tools. These tools allow treasurers to focus on ensuring best execution against an internal benchmark, as well as reducing the bid-offer spread from dealing. Taking this idea one step further, Instinet FX Crosssm, for example, has been designed to allow clients to cross orders and reduce the cost of transacting, particularly in emerging markets and other illiquid currencies. Crossing orders allow corporate clients to benefit from the efficiencies of aggregating liquidity at specific points in time and therefore avoid high transaction costs created by paying market bid-ask prices.

European treasuries are now grappling with the implications of IAS 139, similarly to their US counterparts with FAS 133. E-commerce can have a valuable role to play in ensuring clients retain the degree of detail required for accounting systems and internal and external regulatory requirements. A central treasury solution allows multinational treasury operations to benefit from their regional offices to increase corporate governance and to decrease their transactions costs. Subsidiaries can input FX trade requests online to their liquidity provider, after which the central treasury can add their own deals and approve their subsidiaries' deals. Deals are then netted and transacted at the benchmark rate +/- pre-agreed fixed spread, and all post-deal information can be viewed online by the treasury and the subsidiaries. The company benefits from aggregating its deals, reducing costs and improving controls. Since this is all carried out online, a central treasury solution can provide several benefits simultaneously with no set-up onsite at the company's headquarters or the subsidiaries. Using these benchmark rates as a company's accounting rate can also decrease volatility in its earnings statements.

Options online remain an area where companies can see potential value-added benefits. An increasing number of FX providers, in addition to providing basic option information, are now in a position to provide real-time pricing and execution online.

With all these possibilities, the challenge for the treasurer remains the need to focus on solution flexibility, with an eye on future developments.

Post-deal

This area has always been the most e-friendly for all parties concerned. Confirmation and settlement of the FX deal should only be concluded via electronic means, allowing the treasurer to manage this process on an exception basis. This will further reduce operation risks and costly errors.

Portfolio analysis is also an area of increasing interest to companies. This set of tools allows evaluation of the historical impact of currencies on international exposures. Users can construct portfolios of international assets, liabilities or cashflows by specifying country weights and hedging strategies. The ability to view a portfolio of exposures, at a glance, as well as having them marked-to-market in real time, are becoming vital elements.

Looking ahead

With this brief outlook, there remain several issues to consider when looking into the future of e-commerce's role in the management of FX and the freeing of resources on both sides of the FX transaction. Functionality and flexibility remain paramount for corporate treasuries. From research and analytical tools to confirmation and settlement online, all must add value to any company's processes. Tomorrow's tools must provide integration possibilities, without overwhelming the user.

Pricing and transparency continue to develop in new and innovative ways. The development of tools such as benchmarking and cross ordering will continue to ensure a competitive market for businesses. Any opportunity to reduce the market risk and slippage will be welcome developments.

Enhancing performance

Order management is also an area of growing interest. Treasuries have yet to fully appreciate the gains from an integrated workflow. An initial internal decision facing treasurers is how best to connect a treasury management system (TMS) directly to their liquidity providers, including online order management tools. This process would greatly enhance the efficiency of performing an FX transaction. An API can go a long way to achieving some of these goals and should be considered as more banks develop such technology. Only a minority of clients are truly starting to embrace the complete range of options; this area will be ripe for further expansion over the coming year or two.

The approach from FX liquidity providers also needs to be refined – with so many alternatives, banks will be rewarded for providing advisory services, around the critical elements of going online, given a set of requirements from a client. The bank may be channel neutral but the corporate needs to make a long-term commitment, establishing how best to truly reap the benefits of online dealing.

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