WILL E-FX WIN YOU OVER?

IS ELECTRONIC FOREIGN EXCHANGE JUST BEGINNING TO GET INTERESTING FOR TREASURERS? OUR UPDATE LOOKS AT WHY, WHERE AND HOW YOU MIGHT TRADE FOREIGN EXCHANGE ONLINE SOON. **ANNE QUERÉE** REPORTS.

If you are tired of hearing about foreign exchange (FX) portals and if e-FX is way down your list of priorities, you are not alone. A study by research and consulting firm ClientKnowledge revealed 70% of corporates in Europe will not trade over an FX portal in the next year, while Greenwich Associates found 26% of respondents in its global 2001 Electronic FX survey were not considering trading FX online, compared with 19% in the same survey in 2000.

Yet the multibank providers are just gearing up – FXall and Atriax only opened for business during the summer months and Centradia and 360 Treasury Systems' TEX have yet to go live. Centradia is targeting mid-market companies with a range of transactions, not just FX. 360T offers hosted software through which corporations can directly access banks for online dealing. Together, these new players will significantly increase last year's online options of Currenex, the now defunct CFOWeb, and a range of single bank portals. State Street's Global Link only targets institutional investors at present.

For many years corporates have argued the need for easy access to simultaneous multibank pricing of deals, while the banks declared "over our dead bodies". It is worth remembering that it was non-bank providers such as Currenex and CFOWeb (and before them, Cognotec which now markets its e-FX systems directly to banks) that dragged the banks to the party and, eventually, into their own online huddles as a defence against the emerging new economy businesses.

But a few things have changed recently. FX volumes have fallen considerably – from $1,400bn dollars a day in 1998, to $1,000bn a day in 2001, according to ClientKnowledge – largely in the interbank market. Smaller FX providers have found it harder to compete and spreads have been squeezed across the board, pushing banks towards more automation of process and increasing buy-side power, particularly for the larger corporates. But some things have not changed – credit relationships still influence where treasurers place their FX business.

Today, the leading providers are competing against each other, against single bank sites and the humble telephone for your transactions. For now, most treasurers are sitting on the sidelines, some waiting to see which of the current providers will drop out as the service offerings broaden and mature. E-FX is at what Greenwich Associates coyly calls 'an inflection point.' At last, it is beginning to get interesting. Here, we will look at some of the issues that might influence your decision to trade or not trade online.

WHAT PROBLEMS DOES E-FX SOLVE? "Successful models are those that generate real value by addressing real areas of pain," says Justyn Trenner, CEO of ClientKnowledge. Therefore, e-FX is likely to be valuable to your company if it significantly reduces tedious work, means you can operate with fewer people, makes processing of trade data easier or reduces operational risk. Advocates would claim e-FX can provide all these benefits, as well as delivering better pricing. But the real value may well depend on the volumes of FX your treasury handles on a daily basis.

Greenwich Associate's research of 322 global users trading or researching online found that, surprisingly, improved price discovery was low on the list of benefits they identified, with speed of execution and convenience the highest cited. This could be down to a number of reasons. Larger corporations are doing more online trading at present. And, as Woody Canaday, a consultant of Greenwich Associates points out: "At the top end, the spreads are already so thin." David Woolcock, Managing Director, Corporate Business Development at Centradia, agrees: "Larger corporations are in any case already using their buying power [offline] to squeeze margins."

For these larger corporates, therefore, the potential gains are likely to be more to do with process efficiencies than price. For smaller firms, though, doing fewer, smaller deals, e-FX may also provide a route to better pricing of what dealers traditionally refer to as 'nuisance' deals. However, according to Trenner: "Even at the smaller end of the market, the main opportunity of e-FX is to gain from vastly improved process and – it's a circular argument – these gains are only to be achieved if the [front to back office] workflow is automated."

WHAT'S THE BEST ROUTE TO ADOPTING E-FX? There are three possible modes of adoption of e-FX: through one or more single bank portals, via a multibank portal such as Atriax, Currenex or FXall, or using your own in-house systems – either through to a portal or direct to your fx banks, via a drop down menu in a treasury system, a corporate portal or integrated software. It is difficult to get people to access new web destinations on a regular basis, explains Trenner. He sees integration of e-FX into in-house systems as the most suitable route for adoption. This may be truer for larger corporations, which have FX relationships with multiple banks and typically expect their banks to connect to their systems rather than the other way round, than for smaller ones which may even have a single relationship.

It is these mid-market clients, who typically deal amounts of $/e 1-10m, that Centradia is targeting. Due to launch before spring 2002, Centradia aims to provide the corporate clients of its five European domestic bank members (Banco Santander Central Hispano, Commerzbank, The Royal Bank of Scotland, Sanpaolo IMI and SG) with best pricing and convenience in their local language, without disturbing the underlying relationship. In a prime brokerage-type model, a request for quote will prompt prices from all the participating banks, while the relationship bank will honour the best price the platform comes up with. Centradia will be a multi-product platform, providing primary fixed income, swaps, money market loans and deposits as well as FX.

Another nascent multi-product platform is 360T's TEX Multidealer Trading System, which will interest companies that want direct access to their banks rather than through a portal destination. A number of German DAX corporations will start to transact online using this hosted software solution about now. Christoph Perger, head of marketing at 360T, says: "When we started to talk to large European corporations last year we perceived a strong demand for a multi-product solution." Perger sees the efficient processing of micro-hedges and small transactions – deriving from rules and regulations such as FAS, IAS and Basel II – as an important advantage of electronic OTC trading.

SunGard offers another direct model, proposing to connect users to banks point-to-point via the already existing SunGard Transaction Network.

THE CRITICAL MASS FACTOR. With consolidation in the burgeoning e-FX marketplace inevitable, a battle of the giants is underway for a critical mass of users. In a principal-to-principal market, corporates will mostly be concerned with where their own banks have a presence. But, overall, the portal with the FX leaders – Atriax is backed by Citibank, Deutsche Bank, JPMorgan and Reuters – looks set to be among the survivors. But it is not as simple as just counting up the number of banks on each portal's list – there has, inevitably, been a fair amount of posturing and positioning about this. A better question is, who is actually connected to the platform?

STRAIGHT-THROUGH PROCESSING. Beyond critical mass, the key area of competition between the providers is in the provision of straight-through processing (STP) capabilities for both the buy-side and the sell-side. A great deal of effort is going into the development of application programming interfaces between the e-FX platforms and treasury systems such as Trema, SimCorp, SunGard, Wall Street Systems and others, allowing trades to be initiated from a treasury management system (TMS) and taking details of trades back into the TMS once completed. FXall's recent STP initiatives are detailed on page 15.

But developing API's is costly and time consuming. As described on page 33, an initiative called Twist, championed by Shell and

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☐ DRIVING IMPROVED PRODUCTIVITY FOR GE

Improved productivity is top of the list of benefits the General Electric Company expects to gain from moving its FX trading online via Atriax. "We are growing in double digits each year, and in treasury we want to do more without adding more people," says David Rusate, Deputy Treasurer, Foreign Exchange at General Electric Company, Connecticut, US.

Price discovery is less of an issue for him. The treasury executes some 10,000 FX trades, worth $80bn, a year. "Given our volumes and our AAA credit rating we were already at the cutting edge of price discovery," he says.

GE began trading via Atriax in August. Eight of its 15 FX banks are Atriax members and GE has made it clear to the others that this is now its preferred platform. For now, though, GE must accommodate its old process alongside its new one. In October, GE was set to implement an application programming interface between its FX exposure management system (FXpress) and Atriax, allowing the traders to access Atriax direct from a pull-down menu in FXpress. For Rusate, the API is a big step, as it will also allow trade data to flow directly into the treasury system as a result of hitting the trade button. Looking ahead, Rusate plans to eliminate another step in the current process – the confirmation – next year.

"The electronic trade will become an affirmation, so we won't need to confirm trades separately. We'll also be able to send settlement instructions as part of the trade process" he says. He is also looking forward to having extra FX instruments planned for the next releases of Atriax. Beyond that he sees the potential for Atriax to become a single platform for all products, including commercial paper, investments and cash management.

There are no transaction costs for buy-side users of Atriax. The only incremental cost for GE is the private network line. But that, says Rusate, is "inconsequential, given the productivity gains."

NOT A PRIORITY FOR PILKINGTON

Adrian Marsh, Head of Group Accounting & Treasury at Pilkington, has been active in introducing web-based banking and reporting systems into the group treasury department at the glass-making company (annual revenues: £2.8bn). But, while online FX trading is one of his aims, it is not near the top of the list. "Trading FX online would provide only peripheral benefits for us," he says. "For example, there might be some value for the treasury in allowing operating firms to do small deals themselves online, but monitored by the treasury, and web-based systems make this easier to implement." But almost a third of the deals requested can be aggregated within the treasury to improve pricing, and this benefit would be lost if operating companies dealt directly.

Most of the firm's 150 transactions each month are finance-related. They are spread among the firm's relationship banks. Marsh also believes there would be some peripheral benefit if all these banks could be reached via one portal. For more exotic deals, though, the business goes to those banks willing to actively advise.

NEAR PERFECT PLATFORM

"I'm not interested in having three or more different platforms to cover all the classes of risk I need to trade," says Axel Tillmann, Head of Treasury at German airline Deutsche Lufthansa. Tillmann has been involved with the development of 360T's TEX, a hosted online trading platform that covers money markets and interest rate derivative products as well as FX, including options. TEX lets one dealer source simultaneous prices from up to 10 of the firm's 30 relationship banks at any one time.

Tillmann says TEX is a "near perfect platform designed with the needs of corporate treasurers in mind." The software tracks internal limits and links to Lufthansa's in-house treasury system, GTN from SunGard. The in-house trading model I-TEX also offers internal dealing functionality to optimise the workflow with relevant subsidiaries of Lufthansa.

Tillmann believes TEX, which went live in October, will provide Lufthansa with improved pricing and more efficient processing and hopes to bring at least 50% of the treasury's regular transactions, and most of its banks, online in the next six months.

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Currenex, is looking to develop non-proprietary XML-based standards that would allow easy integration of trading platforms with corporates' preferred treasury workstations. Trema's Transaction Hub is an XML-based, hosted service that links Trema's Finance Kit treasury management software directly with bank servers, allowing dealing data to be transferred in real-time.

INTRAGROUP DEALING. Since treasuries are often responsible for FX dealing on behalf of group subsidiaries, treasurers and e-FX providers are starting to think about how intragroup dealing might be integrated with an automated process. Electrolux is just one company searching for a single platform for internal as well as external transactions.

Brian Maccaba, Chairman of Cognotec, believes there are two different philosophies to consider. He says: "The first approach is for the subsidiaries to send deals into the central treasury where they are stock-piled and dealt at a single point each day." This can be inefficient for both the subsidiary and the central treasury in terms of process, he adds. The second way is for treasurers to negotiate spreads with their banks based on the total value of their business and for this pricing to then be applied to individual transactions dealt directly through the portal.

COSTS. Although most of the e-FX providers charge no transaction fee to the buy-side – at least for the present – some do.

SLOW UPTAKE. Far from honing the appetite, the last year's heavy pre-marketing by the portals has induced indifference among many corporate treasurers, who have a good nose for hype and vapour-ware. But, given the need to gain critical mass on both the bank and corporate sides, it is easy to see why the providers fell so easily into this trap. 360T's Perger says: "Many corporates have lost their initial enthusiasm due to the delays and difficulties of delivering the technology. They had been told this would be a plug and play environment but have seen differently, and now they are careful about which solution to select."

Greenwich's analysis reveals an ambiguity in the market: e-FX is attracting more users as well as more dissenters. "The face of e-FX is changing," says the report. "Although the popularity of e-FX did not sky-rocket in the last year, it has reached an inflection point. E-FX is gaining foothold as a universal tool to trade currency."

Cognotec's Maccaba also thinks that e-FX will succeed. "Banks are genuinely responding to corporate needs. But we will only see a pick up in the market when these good services are actually delivered."

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