

Far reaching changes in the FX market

Graham Broyd of The Royal Bank of Scotland talks to Naresh Aggarwal about the changes in FX markets and FX services in recent years.

Naresh: Graham, thank for you taking the time to talk to me about the changes you have witnessed in the last few years in trading rooms.

I remember at university being taken to see a 'typical' dealing room. I can recall lots of noise and frequent swearing; the only women being secretaries; most people were smoking; and all the desks were littered with paper.

Walking into the bank today, it looks very different.



Graham Broyd

Graham: That's quite right – the dealing room has gone through enormous change over the last few years. It has turned from an environment more akin to a traditional gambling den (with all the rough and tumble associated with it) to one governed more by the rules of long-term relationships and the need to add value to clients' activities.

Part of this change has been due to the rise in the profile and importance of the dealing activities within the bank. The contribution of the dealing room's profits to the overall revenues of the bank has guaranteed its exposure to senior management and external analysts. As a result, the dealing room could no longer ignore the issues and management practices facing the wider financial sector. It has had to change.

increased the length of time the dealers are on the phone – at least that's what they tell me!

Naresh: How has staffing changed over the last few years?

Graham: There was much comment in the press a few years ago that the introduction of the euro would lead to wide scale redundancies in the City. Here at RBS we have found that numbers have been pretty stable, although the mix of people's responsibilities has altered. It is

true that the euro has reduced the range of currencies dealt with, but the corporate market itself has grown.

We have found that our customer base – especially among the FTSE 250 and SME sectors – has grown, and with it the volume of FX undertaken with them. The last few years have seen dramatic shifts in the pound, the dollar, the euro and the yen, and this has increased the profile of the impact of currency risk within these companies. We find companies are dealing with what we call 'second paragraph hedging', (I am referring to the way in which companies' financial headlines often start with data on profits, earnings per share, etc, followed by a second paragraph that explains the impact that exchange rate

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The room has become less noisy. This is partly a reaction to the change to a less aggressive and volatile environment, not just at RBS, but throughout the City. The number of banks directly involved in the interbank FX markets has declined dramatically, caused by the tremendous consolidation in the banking industry at large and also the high cost of maintaining a leading edge trading room. This, plus the reduction in the activity of the large hedge funds and central banks in the currency markets, has significantly reduced the volume of short-term risk taking, and the associated noise and excitement.

The role of our corporate dealers has also changed. Previously, dealers spent much of their time involved in transaction processing. These days, while deal execution is still critical (and I'll come on to how that is developing), our dealers are spending much more time working with customers to develop the right hedging strategies. At the very least this has

fluctuations had on this data,) rather than merely paying foreign invoices at the end of the quarter.

Naresh: How have the needs of the corporates changed?

Graham: Coupled with the growth in the activity of the SMEs has been the increase in the variety of instruments used. Traditionally, we have seen less sophisticated corporates content to either use forward contracts to hedge their exposure or to wait and see until rates move in their favour.

However, dramatic moves in key exchange rates (including the fall of sterling to below \$1.45, or its rise to above 3.25 against the legacy Deutschemark) have directly or indirectly led many companies to miss their budgets or financial targets. The effect of this is that option strategies (especially those with zero or minimal cost) have become more popular. This has

fuelled the need for traders to assist corporates in devising suitable strategies rather than being used solely for deal execution.

The largest companies we deal with typically have large treasury functions. Much of the work we do with SMEs is done in-house by these larger companies. The key to success as companies develop more complex trading and risk management strategies will be to ensure that their risk management strategies remain relevant to the underlying business needs.

As I've mentioned, the role of our dealers has changed. Previously, our dealers spent most of their time on deal execution. These days, they have moved from pure transactional dealings around single products towards developing long-term solutions and strategies. As the market for plain vanilla products has become more commodity-based, we are looking to move up the added value ladder.

Naresh: Where does that leave simple vanilla products?

been a great concentration of client business among a much smaller group of banks, and other banks have found it counterproductive to make markets to those banks. The reduction in counterparties has reduced the ability of banks to lay off their exposure. The result of this is that the risks associated with currency dealing at many banks have increased, although to some extent the introduction of e-commerce is helping to keep margins tight, due to the improved efficiency in bringing all market participants together instantly.

Naresh: Finally, on a softer note, how do you feel the dealing room has changed over the last few years?

Graham: As you look at the dealing room of today it has gone through significant change. Some of the obvious changes are, for example, the environment. Although it is still very stressful, I feel that this is now managed much better by

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Graham: The bank is not abandoning this market. However, the needs of our customers are changing, and as a bank we have to adapt our offerings. We are finding that for standard deals (where price and execution are crucial) some form of electronic execution is increasingly the preferred channel for many of our customers. We find this is driven by efficiency, the desire to remove cumbersome paperwork, achieve straight-through processing (STP) of transactions and the convenience of not depending on the person on the other end of the phone. Although the internet has already brought dramatic change and possibilities to the FX market, corporates are still very concerned about security, controls and the loss of personal contact with their banker. We have found most customers want a mix of e-commerce for efficiency and personal contact for advice, support and solutions. It's what we call the 'high-tech, high-touch approach'.

Naresh: The newspapers were full of stories a few months ago about how the consolidation of FX dealing had led to a less competitive market. Do you agree?

Graham: It is probably true that spreads for certain deals and currencies have widened. However, this is more a function of the reduction of the number of banks in the interbank market. Hedge funds and other investors have significantly scaled back their dealing activities reducing the pool of liquidity. There has

the dealers. We have far fewer chain smokers than we used to and, like many other rooms in the City, it is now a non-smoking environment.

The role of women in the dealing room has also changed dramatically. Whereas women were few and far between – and those who did work in the dealing room provided more of a support role – today they play key roles in all activities in the dealing room.

As the needs of our customers become more complex, the role of our dealers has grown and their skills have had to reflect this. In addition to recruiting more women, we have also taken on an ever-increasing number of university graduates.

As well as graduates with degrees in traditional subjects such as maths and economics, we are attracting those with other skills including degrees relevant for the new economy.

The forex market is experiencing fundamental and far reaching changes. I am happy to say that RBS is successfully adapting its way of doing business in order to meet the ever-changing and increasingly complex needs of its customers. As for what the future holds – ask me in five years time!

Naresh: Thank you Graham. ■

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