The internet: automating and improving global FX

Lori P Mirek of Currenex explains how the internet has revolutionised global FX processes with on-line transactions and straight-through processing.

The foreign exchange market is expanding and evolving significantly. Worldwide financial deregulation, international trade liberalisation, the institutionalisation and internationalisation of savings and investment and internet business-to-business (B2B) growth are driving the increased demand for foreign exchange. As a market, FX is the largest and most liquid in the world, with more than $1.5trn each day in turnover and the most active rates changing up to 18,000 times per day.

The FX market once was an environment that primarily serviced importers and exporters through multiple worldwide banks in loosely connected national financial centres via telephone-based processes. Now, it has become a single integrated international marketplace with consolidated trading outlets in each time zone. Today, the FX market is capable of handling vast amounts of overseas investments and other capital flows in addition to servicing importers and exporters.

While the 'supply-side' interdealer (bank-to-bank) market has become highly efficient due to the rise of electronic brokerage systems in the early 1990s, the 'demand-side' bank-to-corporate and fund market has remained highly inefficient, relying on non-competitive, proprietary bank one-to-one electronic systems or older telephone-based processes. These processes have perpetuated an environment of operational inefficiency. Hours of time were spent via telephone and fax in executing and settling deals, and it was virtually impossible to track and audit any transaction, much less a history of multiple transactions. Failures and repairs were part and parcel of FX trading.

Overcoming trade failures and repairs

FX trades may fail for a number of reasons beyond the control of the trader: funds may not be available for delivery or the buyer may not have credit for immediate payment. However, trades should not fail to settle because instructions were not communicated properly or in a timely manner. FX settlement failures and their aftermath create a significant burden on productivity, opportunity costs, penalties and, occasionally, cause outright suspension from key marketplaces and earnings per share hits. Enormous human and infrastructure resources are necessary to address trades that do not settle because of absent or mismatched settlement instructions, and net money due amounts that do not agree with counterparty details.

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To overcome these challenges, many corporate traders and fund managers are looking at on-line FX trading. But those who have moved to on-line systems are still looking for friction-free FX trading processes – those that allow traders to improve productivity, reduce costs and integrate their information systems, while developing new risk opportunities and taking advantage of opportunities to merge with and acquire other corporations.

FX dealers are demanding greater transparency into their transactions and the ability to transact quickly and competitively. They want systems that not only can perform the FX trade execution but can also manage all the details of settlement with straight-through processing (STP), thereby improving productivity and performance in the face of exploding transaction volumes and diminishing settlement cycles.

Soup-to-nuts on-line trading and standard protocols

Corporate treasury operations have an ever-increasing number of foreign exchange technology integration points with outside providers. Juggling these integration points with different counterparties, however, is fast becoming a thing of the past. With the emerging world of web services, FX transactions can be handled with just one click of a computer mouse – minimising errors, streamlining the separate processes of trading and settlement, and creating a complete audit trail.

In addition, the introduction of electronic FX promises to eliminate the paperwork and inefficiencies caused by splitting trades between various entities. Now CFOs, corporate treasurers and fund managers can execute trades through a single point of access, achieving for the first time straight-through processing and back office integration. Back office integration offers the single greatest area for potential savings in FX operations. Standard protocols (STP) such as XML make it easier for a client to originate their FX trades using one provider's trade capture system, execute trades with multi-bank exchanges, and send the trade results directly to another provider's back-end system. The efficiencies gained by straight-through processing serve to reduce costs, benefiting all FX market participants.

Automatic reporting and audit trails

The emergence of internet-based FX trade execution has created the opportunity for all FX participants to realise the tremendous benefits of straight-through processing. Both liquidity providers and buy-side participants can gain immediate accuracy and efficiency offered by STP. On-line trading systems simplify and enable the process of sharing foreign exchange trading data such as trade requests, trade results, confirmations, and settlement instructions between front office trading workstations, multi-bank exchanges and back office treasury systems.

Recording transactions for audit purposes historically was impossible before on-line services. By trading over the telephone, dealers could not document the work they were doing to provide an audit trail or ad hoc reporting. Other than a smattering of sticky-notes and faxes, traders could not prove they had chosen the best rate and made the best deal each time they conducted a transaction. Today, on-line exchanges and STP automatically create an electronic audit trail, detailing all trades and dealers' bids. Organisations can track and measure FX performance easily, and demonstrate to management and auditors that traders have fulfiled their fiduciary duties of obtaining a competitive bid. Reports can be quickly distributed via the internet and hard copy, and downloaded to local workstations and systems.

STP provides effective settlement risk management for both the supplier and trader, reducing trade failures and amendments. It also offers considerable cost and aggregation savings, eliminating the need to pass these costs directly or indirectly on to the customer.

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KPMG conservatively estimates that using STP for matching key transactions in a cross-border marketplace could save billions of US dollars annually[1]. In addition, STP streamlines accounting and reconciliation activities. Andersen Consulting estimates that up to 40% of back office costs in fund management firms is related to reconciliations[2]. Often, the matching of books and records is not only time-consuming but also a source of contention between corporate treasurers or fund managers and FX dealers. With STP, accounting and reconciliation procedures are streamlined, reducing errors and freeing up traders to conduct more business.

On-line trading brings the speed and convenience of the internet to FX transactions. Traders view prices instantly, a very important benefit in a market where rates change as often as 20 times per minute, with average quotes lasting just five seconds. Previous telephone trading processes required traders to trust that they were getting the best prices from their supplier. Now, dealers can check multiple prices before choosing the best deal. In addition, many organisations do not have the facilities to host STP at their sites. Rather than invest heavily in the information systems needed to bring STP in-house, they opt to outsource STP to qualified exchanges, which manage the entire trading process over the internet, from initial bid to final settlement. In outsourcing settlement delivery and reconciliation to exchanges, traders can focus on increasing productivity and performance while improving reporting and auditing.

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Friction-free trading available now

Software vendors, exchange providers, application service providers, custodians and integrators are partnering to simplify and enable the process of sharing foreign exchange trading data, such as trade requests, trade results, confirmations, and settlement instructions between front office trading workstations, multi-bank exchanges and back office treasury systems.

Web-based FX service providers such as Currenex are committed to delivering interoperability and integration between the variety of technologies and processes that corporate treasury professionals and investment fund managers clients are using today for transacting their FX business. ■

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[1] *Reducing Fails, Controlling Risk/ Global Straight Through Processing: Is It an Example of an Archimedes Lever?* C Steven Crosby, Partner, KPMG Peat Marwick, LLP