SUMMARY OF FX JSC SUB GROUP REPORT ON E-COMMERCE IN FX – April 2002

The FX Joint Standing Committee e-commerce sub group reported to the JSC at its April 2002 meeting about development in the use of e-commerce by the FX markets over the previous year. This paper summarises the sub group's report.

Development in electronic trading

The withdrawal of Atriax leaves FXAll as the major multibank portal. The rate of customer sign-up has increased as a clear leader has emerged. A number of other multibank portals remain. They seek to gain market advantage by, for instance, broking credit lines needed for trading (Currenex) or focussing on particular customer types (Centradia and 360T).

Although adoption of e-FX by customers has picked up, average deal size remains smaller than in the voice market. This reflects customers' desires to have larger deals managed in a more hands-on fashion. e-FX is superbly positioned to handle smaller, operationally based FX transactions arising from day to day cash management or trade flows.

Single bank portals typically do not have the same range of functionality as a multibank portals, but are a useful product for banks that have a 'lead bank' position with a middle market corporate. They may also allow, for instance, the integration of low volume FX deals into a payment or cash management system provided by the relationship bank, facilitating straight through processing (STP).

Straight Through Processing

By systematically focussing on the processes involve in trading FX, as a result of their multibank portal participation, many banks have been able to increase the automation of their internal FX businesses – for instance between different business units – generating operating costs savings. Automated FX trading also offers benefits to banks' customers as the costs of trading support are lowered, audit trails improved and operational errors reduced.

Additional functionality, such as name switching and re-booking at average rate, has allowed the automatic of insignificant manual tasks, freeing staff for other duties.

The sub group observed that the straight through processing benefit that e-FX brings significantly reduces the risks and cost associated with FX trading to the benefits of all industry participants.

Liquidity

The autopricing software required to publish prices efficiently to multibank portals is currently costly to procure and support. Although the sub-group expected that these costs would decrease they do mean that only the largest market participants can justify such expense.

Larger banks are already offering white labelled e-trading packages to smaller banks, which is likely to further focus the bulk of FX activity in a small number of global players. Whilst this has implications for liquidity it should improve opportunities for risk-reducing techniques such as in-house deal matching and netting.

Pricing

Pricing transparency is already very high in the FX market and on-line trading continues to improve this, to the benefit of customers. e-FX autopricing execution times are shorter than manually priced deals and the ability of banks to automatically tier prices depending on deal and counterparty parameters is improving.

The group noted the long standing importance of electronic broking systems in the spot FX market and contemplated the implications of automatically linking multibank portal pricing to these electronic brokers. It recognised that there was a potential risk of creating an automatic dealing loop with pricing algorithms possibly driving the market in a single direction.

Market operations

The dynamics of the overall FX market will be harder for individual participants to read as human involvement in deal execution is reduced. By freeing sales staff from managing routine, low value FX transactions, client service where it counts – in big-ticket deals which require action management - should be improved.

e-FX trading firms will have to develop on-line monitoring of deals to spot unusual trading patterns and report exceptions in order to generate market intelligence and meet know your customer obligations.

The centralisation of FX trading activities, as a result of on-line trading puts more reliance of key technologies. The sub-group encouraged market participants to review the business continuity implications of such developments.

Summary

The sub-group concluded that in the year to April 2002 customer take up had gathered momentum following the consolidation of the e-FX market. As a result the cost-benefit dynamic had improved, accelerating developments in the multibank portal offering. An unexpected benefit of on-line trading is the increased STP opportunities it creates. The subgroup believe that this, along with even greater price transparency, would ensure that migration of FX trading from the voice to on-line environment would continue for all but the very largest strategic deals.