



Caught without a net? Why the big banks now need a netting solution for FX

Increasing FX volumes are putting the strain on many back offices, so is the time now right for netting solution for global spot FX? Richard Brass investigates.

Whisper it quietly; the ever increasing trading volumes in spot FX are putting pressure on the back offices of many banks, but you'll never hear them admit it in public. Research from TowerGroup predicts that by 2007, global FX daily average volumes will exceed US\$3 trillion, with more than 44% of this volume executed electronically.

This represents a significant increase from US\$1.77 trillion in 2004. While electronic FX trading is still

dominated by the large dealing banks, the market has also absorbed hundreds of new participants from both emerging and developed markets and non-banks all seeing great opportunity in FX.

This is, broadly speaking, excellent news for liquidity, as the more volume and diversity of participants, the more trading opportunities for all as organisations can get the price in the currency pair at the time they need. But it also creates issues.

Ticket processing issues

Many back offices are finding it hard to maintain the increasing volume of tickets which need processing. Why? Well for a start there's the pace of the growth in the market, which has outstripped even the most bullish estimates. Then there is the added issue that more traders are trading smaller ticket sizes, but in greater numbers – and it's not just the algo traders. In fact the volume of tickets processed is rising faster than the total notional dollar amounts traded, and it is this which is putting bank back offices under pressure and adversely affecting their margins, because of the high costs associated with ticket processing.

One bank back office head says that ticket processing is a major issue in FX, particularly for those organisations which do not have the infrastructure in place to process heavy ticket volumes. "We're dealing with more tickets, often at smaller sizes and those multiples are increasing. We've invested heavily in our back office but it is an issue because all of those tickets have to be handled and processed."

Jack Jeffery, chief executive of ICAP Electronic Broking confirms the growth in deals per day as an increasing trend. "The average number of deals per day for September 2006 was 73,450 compared with 45,373 in the same month for 2000 and 53,070 in 2002, so you can see how activity has increased. We've seen a systematic increase in deals done over time on EBS, which provides a good reflection of overall global spot FX market activity."

"This activity has been driven by a number of factors - more diverse participants from both bank and non-bank segments, increased interest in FX overall and improved trading performance

following the EBS technology upgrade and the growth of EBS banks using their credit to offer prime brokerage in foreign exchange."

Besides the impact of e-FX trading from non-traditional model traders using API technology to interface with the market, volume in tickets dealt have also been driven by the prime brokerage service offered by a number of the larger market-making FX banks.

Prime brokerage in the spot FX market

Prime brokerage in the spot FX market differs slightly from the model commonly applied to equities and other securities markets, It enables asset managers to trade 'directly' in the traditionally interbank-only spot FX market, by "leasing" credit from a larger bank, and trading in that bank's name. The processing however, and number of tickets generated from those trades can generate more and more activity. With prime brokerage in particular, one trade can result in multiples of tickets.

It is no secret that a well managed back office can itself contribute to cost reductions. However, it is no longer a question of simply passing through ticket volumes. They also have to be handled efficiently. "If you free up back office bandwidth, you have available resources to service more new customer business and it becomes a virtuous circle" adds a US bank back office manager.

Ticket netting

So what's available to the market today for ticket netting at present? Well, in-house it has to be built and maintained, which can be expensive. The spot FX market's main platform provider, EBS, is currently working with FX post-trade specialists Traiana, the providers of the Harmony network for FX prime brokers, to pilot a customer ticket netting system - NetLink.



Jack Jeffery

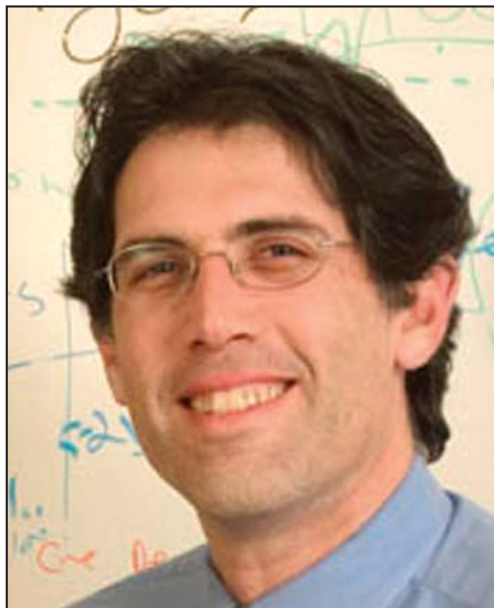
Caught without a net?

Why the big banks now need a netting solution for FX

The system works by allowing the banks to net their customer's FX trades by currency pair at pre-defined points throughout the day. It works by receiving deals from the EBS dealing platform and determining whether or not each deal is netting-eligible based on customer-defined parameters.

The larger number of FX trades are then processed and netted by NetLink. The netted deals are then published to the prime broker bank's back office either as deal tickets or simply as payment records.

Gil Mandelzis, CEO, Traiana confirms: "During the pilot we were able to show a 95% reduction in ticket volume which was achieved without changing any of the existing processes a prime broker has currently in place. Those results speak for themselves and make it a no-brainer from our point of view."



Gil Mandelzis

This would be a major benchmark for the FX market, enabling FX prime banks to net their customer trades efficiently and effectively and thus perpetuate the growth of liquidity. If any major ticket netting solution is to work in this space, the providers need a number of variables to be in place, including the right access to global counterparties across both developed and emerging markets and appropriate distribution channels to reach them.

The lack of an effective ticket netting solution in spot FX has long been a bug bear to the industry. Then there is the small point that it all has to be underpinned by sound technology. The Holy Grail for any bank investing in technology is for a service which is as close to 'plug and play' as possible which meets the needs of their front, middle and back offices. NetLink can strengthen and streamline back office processing.



Eisso VanderMeulen

Could NetLink be the answer for the global spot FX market? Eisso VanderMeulen, Head of FX Prime Brokerage at ABN AMRO, is a strong advocate: "As a leading FX prime broker, faced with significant ticket volumes from high-velocity and algo traders, NetLink gives us the ability to dramatically increase our efficiency and improve through put while keeping a high standard of service. "The way the market is going, We all need to improve efficiency and we're pleased Traiana and EBS have stepped up to the plate."

