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SPECIAL REPORT

# Technology and automation

## Bringing a new dimension to Emerging Market FX trading


Nicholas Pratt

**Nicholas Pratt examines how a new generation of electronic platforms and technology is transforming emerging market FX trading and settlement processes.**

## Technology and automation – Bringing a new dimension to Emerging Market FX trading

The latest triennial survey of global FX volumes published by the Bank of International Settlements (BIS) showed that the use of emerging market (EM) currencies has remained relatively constant over the past 21 years, less than 25% of all currency pairs. In fact the only noticeable trends are that the yen and the euro have seen volumes reduce at the expense of the renminbi with the dollar still involved in nearly 90% of global FX transactions. Nevertheless, as multinationals seek out new markets in search of growth and certain Asian economies continue to grow, EM FX trades are likely to increase in volume and value, which in turn will put pressure on platforms to ensure that trading is just as smooth a process in the less liquid and more volatile currencies as it would be in the G10 currencies.

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Tod Van Name

According to Tod Van Name, Bloomberg's global head of foreign exchange electronic trading, trading in emerging market currencies can be characterised by thin liquidity, high volatility and greater potential for central bank intervention and currency control. "A lower appetite for credit risk by an institution can also reduce the number of counterparties available for trading relationships," says Van Name.

### BROADER UNIVERSE

Fortunately, electronic trading platforms have sought to address these challenges by helping to provide market participants with a broader universe of EM currencies and related services and to increase access to that universe, says Van Name. Bloomberg's FXGO is an electronic, multibank FX trading platform that has provided access to EM liquidity for a number of years, thanks to what Van Name describes as "our significant footprint among regional and local banks around the world" with market makers quoting on FXGO in over 120 countries.

Technology, and automation specifically, is helping to reduce the complexity and manual intervention that can be prevalent in the EM FX trading and settlement processes, says Van Name. "As new electronic trading solutions are developed and released, they are often initially utilised for the more liquid G20 currency pairs and are only later adopted for EM currencies. At the current time, Bloomberg's FXGO sees an active RFQ market in many EM currency pairs with auto pricing of requests by some market makers. In addition, more sophisticated workflows such as algo order execution are beginning to be utilised for EM currency pairs when traded with the global banks who offer these solutions."

"The pattern Bloomberg sees is one of EM currency pairs evolving through the spectrum of electronic trading workflows – from RFQ, to streaming executable pricing to algorithmic orders," says Van Name. "In EMs where settlement process can also be less sophisticated, Bloomberg FXGO has used its confirmation and matching service to bring efficiencies to the local settlement process. In addition, our STP solutions mean we can send trade messages through to the required systems which manage local currency settlement."

The use of API-enabled FX solutions have also helped to improve the lifecycle timing and reduce the operational burden associated with trading EM currencies, says Van Name. "API-enabled FX solutions can improve timing and reduce operational burden by utilising appropriate triggers to instigate trade requests. FXGO's Direct Order Routing (DOR) and Rule-Builder (RBLD) solutions can be used for such workflows, provided consideration is made for certain triggers in potentially volatile and illiquid markets."

Electronic platforms have also been able to reduce the operational risk that it is typically more prevalent in markets where liquidity is sparse and volatility is greater, says Van Name. "Electronic trading platforms enable the seamless flow of trade notifications and confirmations which means trades can be confirmed by both counterparties in a timely way. Completing this process and ensuring there are no trade errors, quickly reduces the potential for larger losses in volatile currencies with thin liquidity."

One consequence of the proliferation of electronic platforms is the growth in NDF trading. "NDF trading has been growing for a variety of reasons including improved market transparency, the reduction in trading costs, and improved management of operational risks that electronic trading have brought. Bloomberg's FXGO provides access to NDF liquidity from banks not only using an RFQ workflow, but also through our FX Trading Grid which is used for streaming executable pricing, as well as providing access to NDF algorithmic order execution. FXGO has seen an average annual growth rate of 43% in NDF volumes over the last five years."

So what can be expected in terms of the digital workflow innovation and automation in EM FX platforms? "The true electronification of trading in EM currencies is still evolving and in the short-term it will focus on an expansion within existing functionality established for G20 currencies," says Van Name.

## MARKET ACCESS

According to Gerard Melia, heads of sales at StoneXPro, the biggest challenge of trading EM currencies, alongside volatility and the political and economic environment, is market access. "Not all brokers offer liquidity in these currencies, and those that do experience higher barriers to entry than for more established currencies. This is because EM currencies are more volatile and risky, and brokers need to be able to manage their risk effectively and have prime brokerage (PB) facilities to support these currencies," says Melia.
Another challenge of trading EM currencies is volatility. "These currencies are often more volatile than developed market currencies, which means that prices can swing significantly in a short period of time. This can make it difficult to trade EM currencies profitably, and it can also lead to higher risk exposure than brokers and traders desire. Not all brokers offer the same level of liquidity and risk management in EM currencies so make such that you choose a broker with a good reputation and the ability to meet your EM currency needs - having access to a trading desk expertise can help clients mitigate some of these risks," says Melia.

EM currencies are also more exposed to political and economic shocks than developed market currencies, says Melia. "This means that changes in the political or economic landscape of an EMC can have a significant impact on the value

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of its currency. This can make it difficult to predict the future direction of EMCs, and it can also lead to sudden and sharp movements in their prices." Thankfully electronic platforms have made it easier than ever for traders to access a broader range of EM currencies, says Melia. "However, it is important to remember that platforms are only a reflection of the underlying broker's operational capabilities. This means that choosing the right broker is more important than choosing the right platform when it comes to gaining access to a broader universe of EM currencies."

Technology also has the potential to significantly reduce operational risk across many facets of an organisation and can also help brokers to better understand and manage their aggregated currency risk, says Melia. "For large brokers that offer multi-asset services, it is essential to have the ability to analyse currency risk, including both established and emerging currencies, across multiple departments, in real time. This allows brokers to identify and mitigate risks more effectively, and to hedge their exposure more efficiently. An electronic platform and robust back-office system are essential tools for managing aggregated currency risk. These tools allow brokers to track and monitor currency exposure across all of their departments, and to make informed decisions about how and where to hedge their risk."

As mentioned earlier, electronic platforms have also contributed to the growth of NDF trading by helping market participants to better exploit these instruments and in that respect Melia says that StoneX Pro has seen a large increase in demand for its NDF products, particularly in the LatAm region. "NDF trading is growing because traders and corporations are seeking access to emerging market currencies to speculate or to support their corporate needs. Again, electronic platforms are the mediums to trade NDFs on EMCs, but the decision making process should focus on finding a broker who can support all of your currency needs, as well as NDFs."

## SELECTING A PROVIDER

Finally, for firms looking to select a suitable EM electronic trading provider, Van Name cites access to liquidity and ability to support required integration to appropriate destinations as "key factors that will influence a buyside's selection of a trading platform provider for EM currencies so that trading can be as automated and seamless as possible." Whilst Melia mentions various additional factors that need considering including reputation, experience, pricing, service levels, technology, risk management, geographic coverage, and compliance with regulatory requirements. "We firmly believe that to be considered by our clients, the top liquidity providers must excel in each of these categories," he concludes.

## ABBEYCROSS AND THE EM FX PAYMENTS MARKET

AbbeyCross is a B2B FX trading and compliance marketplace or platform for emerging market currencies, co-founded by CEO Mike Robertson who previously ran the cross-border payments business at Bank of America.

There are currently 145 currencies in global circulation and most banks offer a transparent, automated and efficient service for G10 currencies with full straight-through-processing. But it is a different and much more challenging picture when it comes to the EM currencies where banks don't have an onshore presence.

Most of the banks have outsourced the payments process in these markets to one vendor, which, says Robertson, is "problematic". "There are continuity issues from using one provider and best execution problems from only receiving a single rate when you have to show regulators you are executing at fair prices. That is the reality of the EM FX payments market," says Robertson.

AbbeyCross has been developed as an alternative infrastructure to solve some of the problems with EM FX payments. "There has always been competition, especially with the emergence of payment-themed fintechs," says Robertson. "However it takes a significant amount of time for these platforms to onboard new clients. And banks have an extremely limited budget for this, especially for EM currencies where the volumes are much lower. Our strategy is to create an infrastructure where integration is no longer an issue."

Mike Robertson

Robertson says that AbbeyCross won't necessarily make it easier – if a bank wants full API integration, it will take time – but the bank only has to do it once and then gains access to a whole host of payment providers. "We believe it is changing the narrative around EM payments," says Robertson.

"There was a structural issue with EM payments. They are complicated and it differs by jurisdiction. Some require physical settlement and there are different documentation requirements and volume thresholds, so it is a messy combination of several structural issues," says Robertson.

But things are changing. "Volumes are increasing and global trade patterns are changing. China has been the dominant manufacturing centre which has driven volumes into China but now we have manufacturing centres in Thailand, Indonesia and elsewhere becoming manufacturing centre," says Robertson.

That said, EM currency payments still remain a very small percentage of overall payment volumes. An EY/McKinsey report shows that the payments market has $140trillion of volume daily - $100trn is in the same currency and $36trn is in G10 currencies while EM currency payments make up the remaining $3-4trn.

So what is it about the technology that has changed? Much of the technology investment to date has been on the funds settlement and trading side of things and less so on the payments side. Where money has been spent on the payments process, it has focused on the front end and user interfaces rather than the back-office infrastructure. "Legacy technology is really at the heart of it," says Robertson. "We are not necessarily providing new technology but creating a payments marketplace that banks can use to access multiple payment providers."

AbbeyCross is currently at the proof-of-concept phase and plans to have live trading clients by this time next year. "We hope to have live trading with at least one tier one bank, starting with EM payments. We believe it is a game-changer, not just in terms of pricing but also innovation," says Robertson.