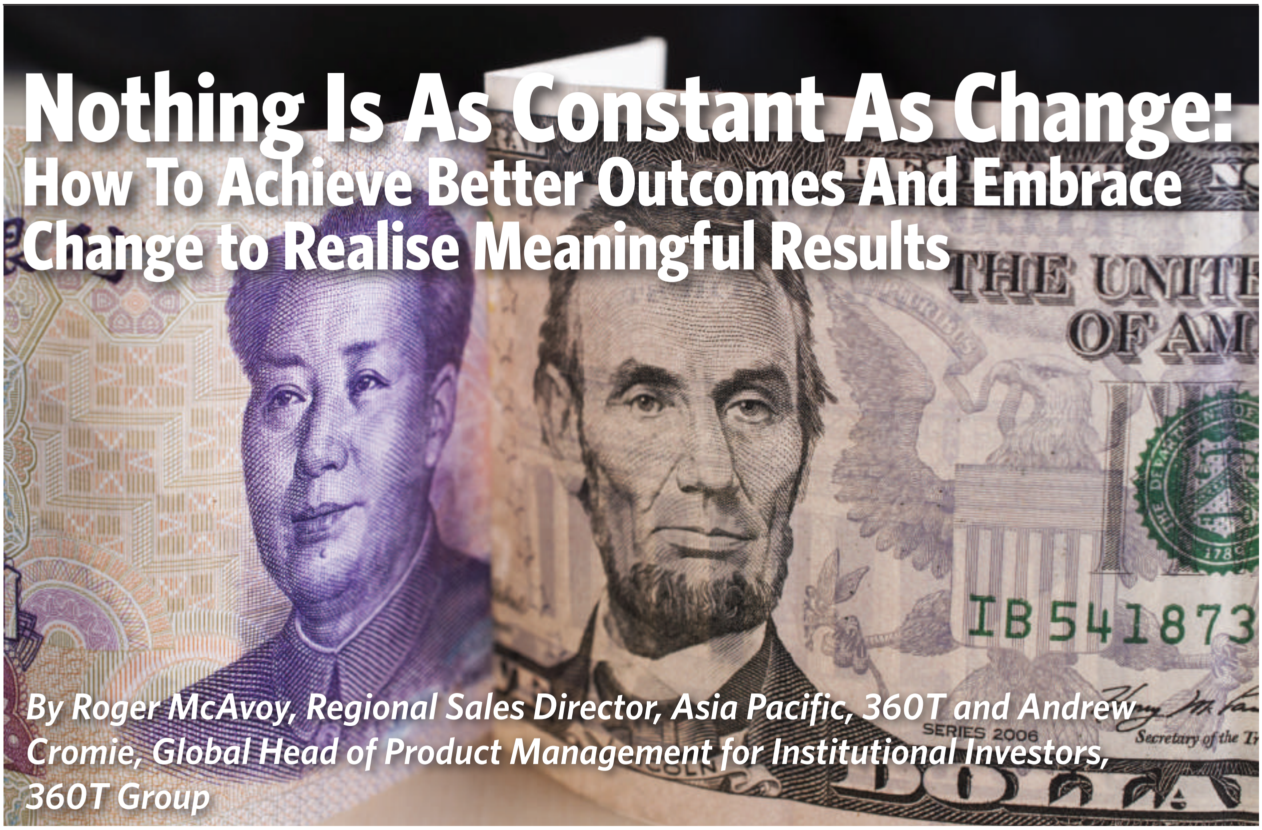

Nothing Is As Constant As Change:
How To Achieve Better Outcomes And Embrace Change to Realise Meaningful Results

By Roger McAvoy, Regional Sales Director, Asia Pacific, 360T and Andrew Cromie, Global Head of Product Management for Institutional Investors, 360T Group

The buy-side recognises that the FX landscape is fundamentally changing. This evolution has a number of direct and indirect macro drivers which, will be about transparency, liquidity and the underlying technology.

At the highest level, regulatory change continues to influence the buy-side dealing desk and the asset manager as a firm. In the past, a buy-side institution might have set up FX execution as a part of the middle office, client services teams or back office operations purely to achieve efficiencies in workflow and error reduction. In other cases, FX might have been done by the equity broker or the custodian of the underlying funds.

Today, more and more heads of dealing have teams and technology that cover multiple asset classes on the execution desk and the amount of FX managed and executed from a central dealing desk continues to increase. With that, there is an even greater focus on how to achieve better transparency and execution quality, improved risk reduction and further trading and operational efficiencies, including automation. Buy-side participants have highlighted that their challenge is how to achieve greater technology adoption, integration, and efficiencies without the budget of a large bank, and how to stay on top of all the choices available to them.

Best execution

For some buy-side participants, the goal of best execution is simple, such as just being able to prove where the market was at the point of execution when the FX is transacted either through competition or at mid-rate in a fixing order. For others, there is a deeper focus on how to optimise the many decisions that are made before execution that greatly influences the outcome of the orders, for example:

- Which orders and which funds should I deal with first?
- Should I net offsetting orders for different accounts, across single or multiple currencies?
- How long do I hold onto orders in the hope they will net?
- What should my netting strategy be, and what should the timing and frequency look like?
- How much "market risk" am I incurring when I hold onto an order?
- Am I better off using an algo, and at what size?
- What is the inflection point where I trade all risk, or am I better off splitting it up to lesson market impact?
- At what point should I move from electronic to voice and how do I still capture that electronically to be able to analyse it?

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Asset managers have a greater demand for a broader set of FX market data and analytics in order to achieve "best execution" policies, understand trader performance measurement, counterpart management, and workflow optimisation. This is driven, in part, as the buy-side dealing desk looks to embrace technology and standards that have been well-developed in the equities markets, and implement the advanced FX technology traditionally only available in the hands of the sell-side. As a result, expectations are high for what should be achievable by the buy-side. Within the OTC FX market structure and practice there is still a gap that is often a result of what banks are capable of versus what liquidity they are willing to provide and how.

TCA standards

In many cases, when it comes to transaction cost analysis (TCA), there are few standards for how transaction costs are analysed. As a result, for example, the United Kingdom's Financial Conduct Authority (FCA) released a consultation proposal (CP16/30) in October 2016 that would require asset managers to provide full disclosure of transaction costs in a standardised format to pension schemes that, directly or indirectly, invest in their funds. This means any asset manager with funds under management for UK pension plans will need to ensure their technology can capture not only the time stamp for the calculation of an arrival price, but also individual time stamps and market prices for each trade execution and individual fills. In the FX market, having the right data warehouse and analytical tools to store and report these values on demand, and an easy to access and understand granular audit trail, will become increasingly more important.

With banks also under increased regulatory pressure, there will be more focus on bank pricing behaviour, e-pricing strategies across distribution platforms, and on their ability to take on and warehouse risk. Having more transparency into counterpart behaviour, pricing quality, and any resultant market impact (for example, not warehousing risk and going to the interbank market) will become increasingly important for the buy-side to further their control of execution quality on the desk. This new understanding will enable buy-side firms to go to the best bank in any given situation rather than rely on "gut feeling". Measurement will drive informed, proactive decisions and support the asset management firm in an increasingly more regulated global environment.

Application of new technologies

For many years, larger banks have been building out tools and analytics which help them hold or exchange risk with other participants efficiently using quantifiable data, resulting in better predictability in their trading outcomes and profitability. The sell-side continues to embrace even greater automation, more sophisticated auto-pricing strategies and the development of bank algorithms to capture client flow and offset risk. While it is certainly possible to build out the infrastructure to measure this, the overhead to store this data, let alone to use it, is highly expensive. The buy-side is able to leverage the FX dealing platform provider to help with these issues, which includes not only data warehousing, but also the opportunity to engage meaningfully around best practice.

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Data analytics and execution technology are now intertwined and having the ability to leverage that data can provide insight beyond the most basic TCA. For example, although post-trade TCA tells a story, in general it is not a reflection of market conditions (whether they be "normal" or not) before, during and after execution. You also need to consider how your benchmark data is sourced and how relevant those prices are relative to your quoted volumes and eligible counterparts.

These are just a few of the questions that we hear from asset managers as they try to build a quantifiable, repeatable process. Knowing where to source this data and how to carry-out this type of analysis are some of the new demands of the interaction. This type of information will help asset managers make better informed decisions around the merits or costs associated with the execution strategy.

The buy-side embraces new ideas and technology that will help them evolve their workflow, address broader market structure and execution quality issues. These are the clear focus of the immediate horizon. Drilling down there are further consideration to bear in mind: working with providers that have a bias for buy-side requirements (or working with providers whose purpose is aligned to the outcomes you desire), getting the right FX data analytics with no hidden fees, and gaining access to alternative solutions that help to deal with liquidity fragmentation.

During the past few years, a broader choice of multi-bank trading technology providers is now available, beyond the traditional FX technology solutions. These providers bring much needed market-neutral FX trading technology, data warehousing and analytics into the dealing workflow and investment process. Gone are the days of having to solely rely on bank-developed or bank-owned technology for FX execution. More measured, independent solutions that address the client's needs can now be quickly and easily implemented. These 'enablers of evolution' can be plugged into many processes, including order management systems (OMS) using FIX connectivity and other integrated workflows.

While not all providers are capable of offering the right solutions and engagement, or have the ability to scale with client and regulatory demand around these issues, those that do are finding more and more invitations to help with solving the dilemma.

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