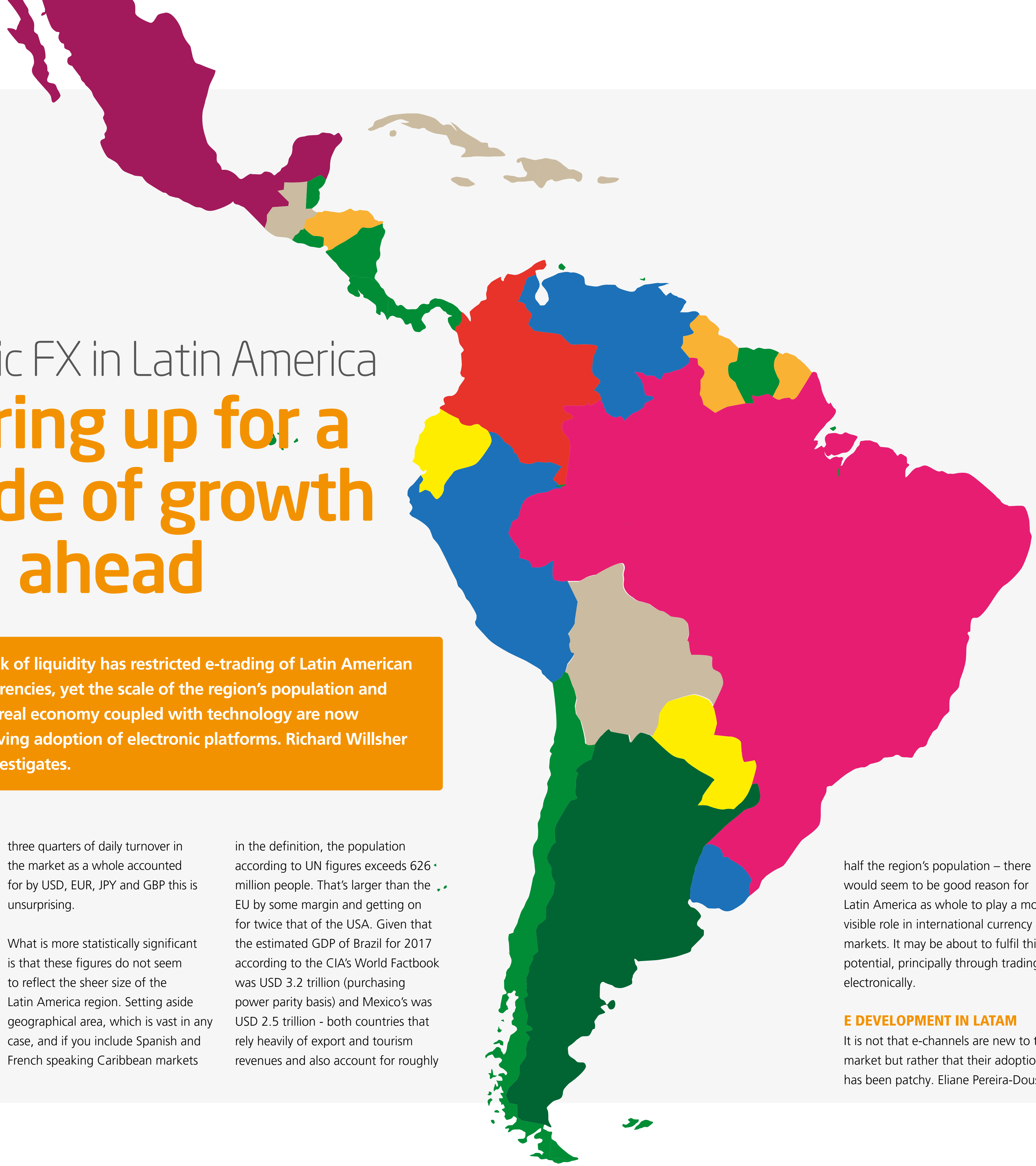


Electronic FX in Latin America

Gearing up for a decade of growth ahead

Lack of liquidity has restricted e-trading of Latin American currencies, yet the scale of the region's population and its real economy coupled with technology are now driving adoption of electronic platforms. Richard Willsher investigates.

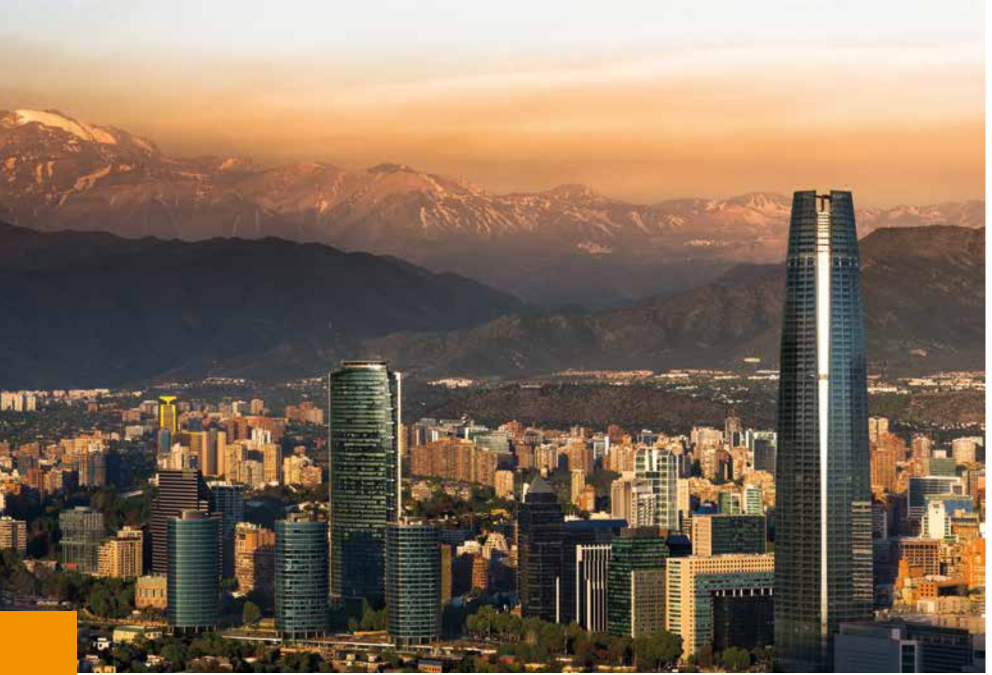
The Bank of International Settlement's Triennial Central Bank Survey of Foreign Exchange and Over-the-counter (OTC) Derivatives Markets in 2019 graphs the relatively small impact LatAm currencies have on global FX trading. The Mexican Peso (MXN) registers at 15th in the list of daily average currency turnover at USD214 billion. The Brazilian Real (BRL) is five places behind on USD72 billion. The other Latin American currencies barely move the dial, although with three quarters of daily turnover in the market as a whole accounted for by USD, EUR, JPY and GBP this is unsurprising.

What is more statistically significant is that these figures do not seem to reflect the sheer size of the Latin America region. Setting aside geographical area, which is vast in any case, and if you include Spanish and French speaking Caribbean markets in the definition, the population according to UN figures exceeds 626 million people. That's larger than the EU by some margin and getting on for twice that of the USA. Given that the estimated GDP of Brazil for 2017 according to the CIA's World Factbook was USD 3.2 trillion (purchasing power parity basis) and Mexico's was USD 2.5 trillion - both countries that rely heavily of export and tourism revenues and also account for roughly half the region's population – there would seem to be good reason for Latin America as whole to play a more visible role in international currency markets. It may be about to fulfil this potential, principally through trading electronically.

E DEVELOPMENT IN LATAM

It is not that e-channels are new to the market but rather that their adoption has been patchy. Eliane Pereira-Dousie, director for eFICC Sales Barclays New York, has a decade-long perspective on the market. "The over-the-counter (OTC) market really emerged about ten years ago and that created a lot of opportunities for e-FX trading channels. We saw the Financial and Risk Division of Thomson Reuters (which is now Refinitiv) and Bloomberg entering the region and pushing e-trading, competing for market share. Thomson Reuters was very successful with Reuters Matching specifically in Mexico where it became one of the largest channels for MXN to be traded on. Bloomberg on the other hand leveraged their synergies in the futures market, and promoted FX products on their platform.

The appetite for emerging market risk, economic growth, ease of credit and technology innovation, all gave rise



Latin America is set to play a more visible role in international currency markets which electronic trading will facilitate

to not only these trading venues but also opportunities and demand for other brokers to go into the region. Our journey in eFX started about 15 years ago. The success of our BARX FX franchise is a by product of our partnership with our local markets trading and sales desks and our LatAm corporate team. This joined force approach has allowed us to forge strong relationships in the region, keep our BARX brand relevant and push our eFX products to various client segments."

Matt O'Hara, 360T's CEO for The Americas also has a long experience of the LatAm e-trading scene, he also currently sits on the Mexican Central Bank's FX Committee. He points out that the main centres embraced the first stages of electronic trading over a decade ago. "Now," he says, "liquidity providers are seeking better ways to improve the generation and distribution of prices with pricing engines, managing risk more efficiently via auto-hedging."

"Access to trustworthy data is also important," he continues. "On the buyside, better order management via integrated tools such as execution management systems (EMS) is rapidly catching on. Electronification of the non-deliverable forward (NDF) market is now taking place and more clients are looking for better ways to manage and execute larger orders. 360T has invested heavily over the past few years to expand its liquidity pool of algo providers. We offer a variety of proprietary algo and order types permitting clients to lower the impact of large orders and reduce market noise and leakage. There has also been an uptick in firms that wish to manage and trade options electronically."

Matt O'Hara

However, Jon Vollemaere, CEO of R5 FX, the institutional liquidity pool for NDF and emerging market FX, strikes a pragmatic tone. "I've heard the comment that all FX is now done via "E" and there's no such thing as voice anymore but I don't buy that. This is especially the case in the smaller countries / economies where brokers still command the relationships and the market. I would say that a graphical user interface (GUI) isn't really eFX though there's plenty of them around."

He therefore sees plenty of scope of greater penetration of e-platforms and e-trading beyond the main centres and the main market participants across the region.

BUYSIDE AND SELLSIDE

Barclays Eliane Pereira-Dousie feels that the buyside may still be getting into its stride in the region, having been relatively slow to adapt to electronic trading. That, however, is changing. "We see a lot of large asset managers and international corporations, and pension funds specifically, having very ambitious plans and becoming more sophisticated when it comes to e-FX. For example, pension funds in Mexico, Chile, Colombia, Peru, asset managers in Brazil - they have moved to multi-dealer platforms. We have seen many of them migrate their trading to these venues as a result of a push by the regulators towards best execution.

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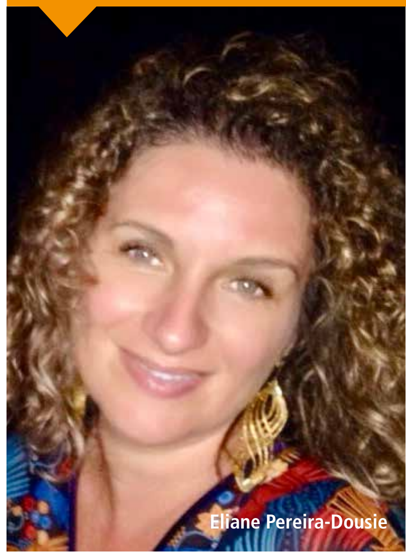


Eliane Pereira-Dousie

In this regard they are following the same path as other countries."

She adds that medium and small corporates, have been slower in adopting e-trading. Many still prefer to pick up the phone and talk to a human being. They prefer to discuss trade ideas before execution, so educating them about e-trading has an important role to play. "That being said, we see strong demand from all client segments. We have a strong Financial Institution portfolio and are well positioned to provide e-connectivity and devise tailored eFX solutions to all our clients."

REGULATION

Regulation as well as culture has a big part to play – both negatively and positively. On the one hand, "Demand is still low due to regulatory and policy restraints and culture," explains Alex Scarsini, co-founder and president of New York based Edgewater Markets LLC, the institutional currency trading venue with more than 300 institutional clients around the world. "There is also a gap in internal expertise for such products. Corporations and pension funds don't trade FX as an asset class and generally don't value e-services as much as a bank would. That segment of the market still prefers to trade over telephone or chat rooms and request for quote (RFQ.) Very few local corporates use single bank platforms. White label solutions are also still relatively few."

However, regulation and changing cultures are also upping the pace of change. Institutions, particularly pension funds and asset managers, are coming under pressure to prove best execution and adopt greater transparency. Brazil and Mexico are leading the way according to Juan Carlos Escalera head of wealth and trading LatAm at Refinitiv who also sits on the Mexican Central Bank's FX Committee. He analyses the factors for and against the adoption of electronic platforms as follows:

For:

- Price Transparency
- Demonstrating best execution from an agnostic source
- Total Cost Analysis (TCA)
- Cost efficiency in confirming and settling trades
- Implementation of Codes of conduct (Mexico only)

Against:

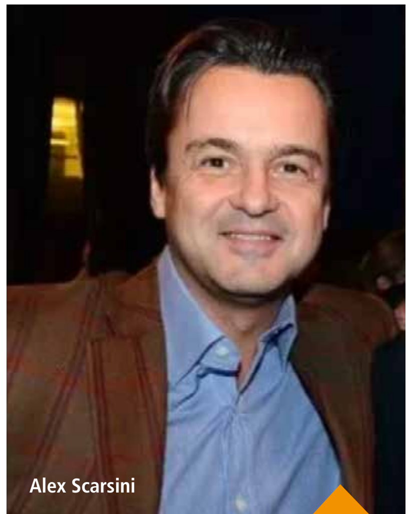
- Outdated regulations. E.g.Price engines and servers need to be in banks' data centres and based in their own jurisdiction
- Fear of technology taking over sales traders' jobs
- Regulators fear that internationalisation of trading will translate to less controls over local currency and monetary policy being dictated by external factors

Refinitiv calculates that less of 25% of the Mexican corporate market close their trades though an electronic venue, mainly due to the cultural resistance to technology specially among corporate treasuries and the sales traders that advise them. "We believe e-trading tools will eventually displace them," says Escalera, "because the benefits of e-trading are now better understood at the CFO level, changing the culture and eventually influencing the sales traders that realise that without an electronic trading tool they are simply not competitive."

The trends that look likely to win through are global adoption of standards across financial markets, the influence of major international banks and corporates and the benefits of better regulation and transparency on reputations in the global marketplace.

TECHNOLOGY

Technology and the broader benefits it brings are for many sellside and buyside firms the magnet that draws them, sometimes reluctantly perhaps, to e-trading. As Paul Aston, CEO of Tixall Global Advisors points out, "technology is the biggest disruptor."



Alex Scarsini

"Replacing the old broker model of voice or stagnant rates on rudimentary tech platforms, at high cost, is happening now."

"LatAm is one of the last remaining untapped geographical locations around the eFX globe."

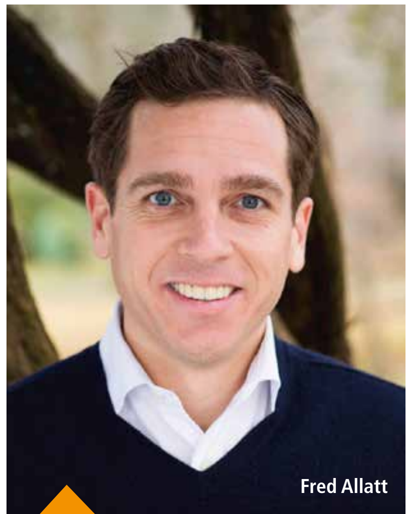
Aston, whose firm provides institutional FX liquidity and execution strategies, says that many Latin American firms are using tools that are now available to assist them meet regulatory requirements while at the same time giving them access larger liquidity pools.

Analysis of best execution, is an increasing requirement; TCA is an important component. However, accessing sufficient, adequate quality data is a challenge where markets, especially the smaller ones, have limited liquidity and where much trading is still transacted by voice or through broker channels. "I think the most challenging things in LatAm are the depth of available quotes and the number of counterparties providing quotes that can be used for accurate TCA," says Aston. Tixall uses modelling tools to gather and analyse data in order to narrow down transaction costs to the most accurate degree possible in illiquid markets.

At the same time workflow management that goes hand-in-hand with e-trading offers day-to-day practical efficiency benefits. "Most of the countries in Latin America are driving more electronification in some form," continues 360T's Matt O'Hara. "Real-time integration with accounting, order management systems (OMS), treasury and risk management systems are critical for the larger corporate and institutional clients. Compliance departments require best execution and audit trails. A robust suite of granular data analytics is also a must for the leading institutions. Multinationals and larger regional corporates are looking for better ways to manage and centralise all FX exposures."

Jon Vollemaere

Consequently businesses in the region are increasingly reaching for support from technology providers, according to Fred Allatt, Managing Director, FX Sales at INTL FCStone in New York. "We see the demand growing. This will evolve over time, depending on each customer's need's. For us we can provide multiple services electronically, so if they need a FIX (financial information exchange) connection, we have that. If they need white labels, we have it. If they're a corporate or asset manager or pension fund, we have technology that not only allows for electronic trading, but also pre and post trade functionality to net deals, get best execution, and post trade allocation, all STP'd to eliminate breaks."



Fred Allatt

"We've been making markets in NDFs for about a year on the commercial/corporate client base. We are now seeing demand for banks, brokers and hedge funds to access this liquidity."

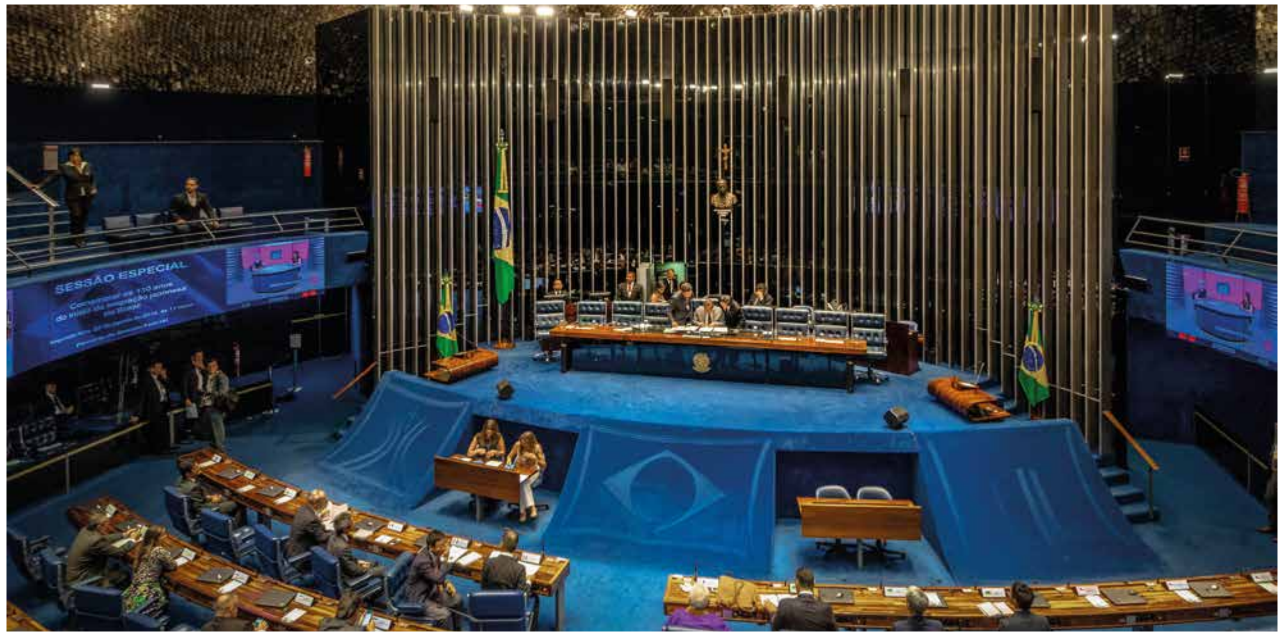
So as a still developing market for e-trading, the region has the advantage of being able to tap into a well developed global infrastructure of technologies, platforms and providers. There are still some basic technical issues to be overcome with respect to electricity supply and data connections in particular in territories that are outside of the major commercial centres and capitals. However, no one we spoke to for this article viewed these as major obstacles to the wide scale adoption of e-trading across the region as whole.

OUTLOOK

So how bright is the future looking? We asked each of our experts in turn to give us their prognosis.

"Banks in Latin America, know that electronic trading is something that's here to stay, and it's only going to grow," predicts Matt O'Hara. "They're all investing in their price-making and price construction tools, because you don't want to be the last bank that's manually pricing against an electronic, automated marketplace.

So, it's very interesting how you see that happening, and it's happening at a slightly different pace across the different countries. Mexico and Brazil are the most developed. Then you've got Chile, Peru and Colombia, that are quickly following suit. Bear in mind a lot of the banks run pan-Latin American businesses, as do the buyside clients. So, they might be domiciled in one country, but they've got branches in adjacent



There is a lot of encouragement from governments in Latin America for reform which will simplify the FX market

ones, and they all want to use the same technology to interact both internally and with outside markets. We expect e-trading to increase continue to spread and grow."

From her side, Barclays' Eliane Pereira-Dousie is similarly optimistic looking forward over the coming years. "We see huge potential and opportunities in e-FX in the LatAm region and in the LatAm product offering. There is a lot of encouragement from governments for reform, central banks pushing for transparency and looking to

"Emerging markets in Latin America offer higher yields. There might be some higher risks, but there's yield and opportunities and growth in those markets."

simplify the FX market. For example, in Brazil, there are plans to reduce red tape on cross-border payments. There are also plans to make the BRL convertible, and Chile is looking at that too. At the same time young, tech-savvy professionals are entering the workforce, and that will be likely to increase the take up of e-trading and efficiency in using it."

Juan Carlos Escalera

"CFOs and sales traders realise that without an electronic trading tool they are simply not competitive."

Given the continuing restrictions on convertibility of many of the region's currencies, led by Brazil, NDFs are likely to be a continuing feature of Latin American FX market for a while to come. However, e-trading will facilitate their use as Edgewater's Alex Scarsini explains. "The local banks' interest in seeing an efficient, more streamlined and cost efficient way of transacting NDFs electronically is certainly there. Replacing the old broker model of voice or stagnant rates on

Paul Aston

rudimentary tech platforms, at high cost, is happening now. Edgewater was the first tech provider in the region with prime in-house technology that also enables its clients to stream into the global NDF ecosystem. We saw the opportunity two years ago and opened offices in Chile to cover the region. The market is starting to embrace change."

This view is shared by INTL FCStone's Fred Allatt, "We've been making markets in NDFs for about a year on the commercial/corporate client base. We are now seeing demand for banks, brokers and hedge funds to access this liquidity. Being a leading prime of prime, it is a natural fit to provide this access for the clients who prime with us."

On a more general note R5's Jon Vollemaere in expecting e-FX trading in LatAm to show strong growth in the coming years. "It's one of the last remaining untapped geographical locations around the eFX globe," he says. "There are still many people throughout LatAm that don't know enough about e-trading and hedging who could benefit from it, due to the major fluctuations in exchange rates of their local currencies."

Finally, taking an investor perspective Tixall Global Advisors' Paul Aston adds his voice to the optimism surrounding the LatAm region. "Institutional investors, the pension funds all around the world for example, need incremental yields that are just non-existent at the moment, at least in developed markets, given quantitative easing and the competitiveness of those markets. Emerging markets in Latin America offer higher yields. There might be some higher risks, but there's yield and opportunities and growth in those markets from a lot of different economic factors.

So, the ability for those investors to be able to trade quickly, easily, with all of the requirements and metrics and risk controls that they have, they really need to go through technology. You'll see electronic platforms coming in to meet that need." "So yes," he concludes, "I think this will be driven by real-money activity, more so than by speculation, but as real money comes in, and market-makers and others who are willing to speculate on that add a big dimension of liquidity as well, so, it's all self-reinforcing."

In the final analysis, it looks like the size, wealth and economic power of the Latin American region is set to fulfil its promise in the FX market. This is already being facilitated by e-trading capabilities which will accelerate in the decade ahead.

DIGITAL ASSETS AND LATIN AMERICAN INVESTORS

Interest in digital assets is growing exponentially in Latin America. The main markets where this is taking place are Argentina, Brazil and Venezuela. In addition the Venezuelan diaspora, which has displaced in the region of six million people, is a key driver for peer-to-peer bitcoin (BTC) / local currency transactions. For these people, "It is," according to Carlos Mosquera Benatuil, CEO of Mexico City based specialist crypto currency advisory firm Solidus Group "effectively the only way of sending remittances back home."

Carlos Mosquera Benatuil

Mosquera explains that for Latin Americans, BTC and crypto assets in general are both an investment and also a hedge. "Latin Americans are highly prone to take risks by default, forced by the perpetual chaos in the subcontinent's socioeconomic environment. They're always looking for escape valves out of hyperinflation, recurring economic meltdowns and just trying to catch the next best safe haven available. So there's a chunk of the population that is looking at BTC as a hedge to their local fiat currencies and even as a long-term investment with potential extraordinary returns, the latter occurring mostly with high net worth individuals and family offices."

He adds that given the regional sentiment for this type of wealth, Solidus estimates that at least one per cent of a current potential pool of USD12 trillion may "… gravitate to crypto and mostly to BTC in the next five years. We're building the rails for that transition, focused on institutional volumes, bridging the gap between traditional finance and this new type of digital assets," Mosquera concludes.