Asian FX e-trading: beyond the tipping point

As foreign exchange trading volumes swing further towards Asia, eFX takes centre stage, writes Richard Willsher.

While voice trading is still preferred by some corporates, the move to e-forex trading in Asia has now passed the tipping point. Pressure for greater efficiency and more rigorous compliance is now accelerating take up among all sections of the market.

The latest Bank for International Settlements Triennial Central Bank Survey of foreign exchange and over-the-counter derivatives markets shows that Asian financial centres, namely Tokyo, Hong Kong SAR and Singapore intermediated 21% of all foreign exchange trading an increase from the previous 15%.

GROWTH MARKETS AND CURRENCIES

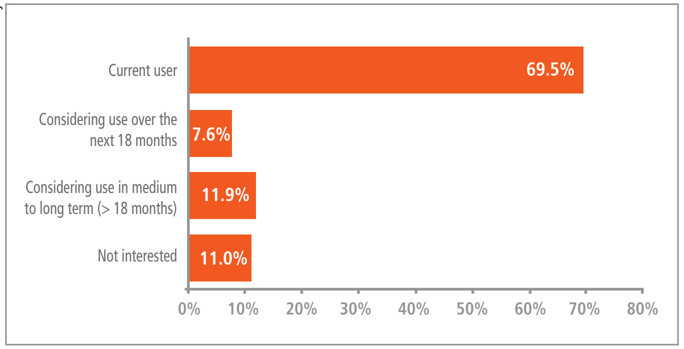
Considering these statistics, Jan Bellens, EY Asia-Pacific banking and capital markets leader observes. "The three largest Asian trading hubs, Tokyo, Hong Kong and Singapore, increased their combined share of intermediation to 21% in 2016, from 15% in 2013, underscoring the growing importance of Asia in global trade. Other currencies, such as the Korean won, Indian rupee and Thai baht, also experienced higher growth."

Thomson Reuters' head of Asia Pacific, Transactions Sales Jonathan Woodward adds, "Singapore is the big winner here. More and more volume is transacted on our platform as businesses centralise their FX & treasury operations here from other places in Asia; from Japan and Hong Kong for example, though Hong Kong is also growing."

Although these are the main growth countries, others are also rapidly embracing e-trading through both multibank platforms and single bank offerings. Thomson Reuters for example launched its matching platform in the Philippines two years ago, Malaysia was this year and they have plans to launch in Vietnam and Indonesia in the course of 2017.

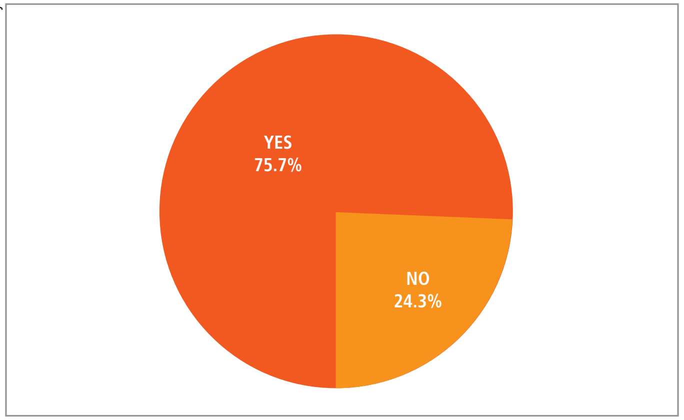
360T has seen significant volume growth in North Asia, especially in Hong Kong, Taiwan and China during the last year. They stress that they have also seen a dramatic rise in non-deliverable forward (NDF) business from North and South East Asia with volumes up "many fold" in the last six months. Bloomberg and FXSpotstream also record notable growth across the region as a whole.

Source: Thomson Reuters Asia FX survey



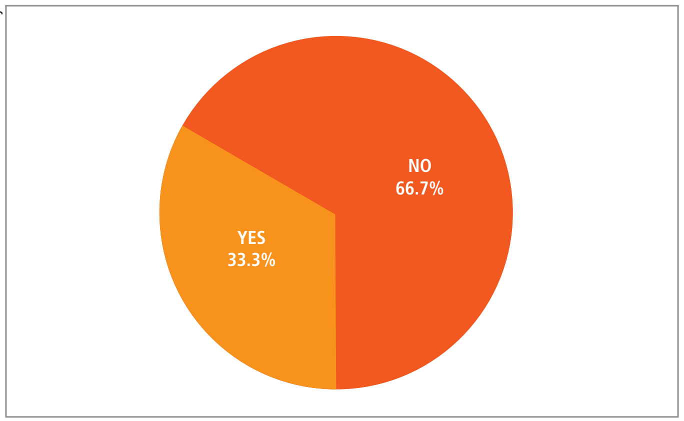
Current status with regard to trading forex on electronic platforms

Source: Thomson Reuters Asia FX survey



Is your organisation expecting growth in the use of auto-execution strategies or algorithmic trading by buy-side market participants over the next 18 months?

Source: Thomson Reuters Asia FX survey



In the future, do you think digital currencies such as bitcoin will compete for liquidity in the forex space?

In many ways regional and local banks are playing catch-up. Their offerings now need to reflect their clients' desire to become more efficient and to achieve best execution. They also recognise the need to offer local currency liquidity to the wider international market while taking international currency liquidity for their own funding needs. Central banks are also playing a role in this move according to Woodward, "Central banks want to have an electronic central market so that they get proper price discovery. Off the back of that they can then can have more transparent FX trades going on, and it forms a base price for the e-engines so that they can start automating and making their distribution more efficient for all of the regional banks. There has been a big take up by the regional banks of the pricing engines that also enables hedging and connects them to other platforms such as Thomson Reuters' FXall."

BUY-SIDE DRIVE

Buy-side demand is burgeoning and crosses all groups from asset managers, fund managers, institutional investors to corporates. Chris Davis, global VP, FX and liquidity solutions at Broadridge, a leading provider of technology and operations, communications, and data analytics, summarises the picture succinctly. "By adopting electronification, buy-side firms now gain access to the same pricing as sell-side firms and can better keep up with the demands of their businesses. This benefits all types of buy-side clients."

"By adopting electronification, buy-side firms now gain access to highly efficient pricing from the sell-side firms"

Viewed from another angle, it is as much the nature of today's markets that is behind this, according to Dickson Woon, senior business development manager at regional broker Phillip Futures. "The growing complexity of the market structure and tighter regulation require improved technology to help clients with their trade execution," he says. "Some of the advance electronic platforms are now able to provide execution strategies, execution quality analysis and offer mitigation of operational risk. Electronic platforms that provide such features add value to the buy-side investment process, which increases the alpha generated for the investment decision."

"There is increased demand from buy-side clients for comprehensive automation of their workflow across pre and post-trade allocation, best execution, and reporting..."

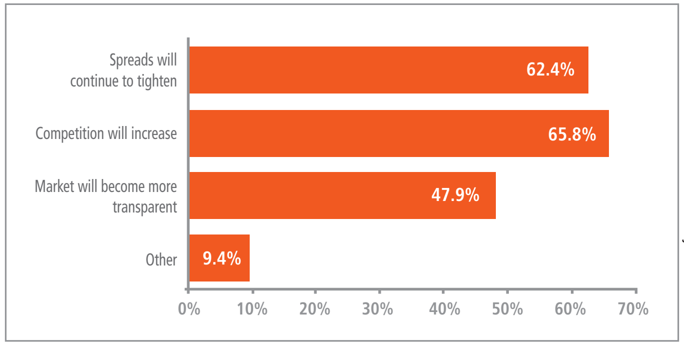
Bloomberg's head of FX electronic trading, Tod Van Name reflects similar views. "At recent Bloomberg FX symposiums held in India, Thailand, Malaysia and the Philippines, over 600 market participants from banks, investors and corporations indicated optimism about their currency markets but cited hedging against market volatility and navigating regulatory requirements as the greatest FX challenges encountered, " he says. "These challenges have resulted in increased demand from buy-side clients for comprehensive automation of their workflow across pre and post-trade allocation, best execution, and reporting. So while Bloomberg's FXGO supports trading in spot, outrights, swaps, NDFs and FX options as well as money market instruments – deposits and Islamic deposits, we also support a variety of execution styles, from RFQ to streaming. Equally importantly, we work with clients to provide solutions that satisfy local market conventions and requirements, to ensure that the adoption of new technologies is seamless, painless and transparent."

It seems likely that such needs and concerns underpin the wide scale buy-side adoption of electronic platforms evidenced by research published in January 2016 by Thomson Reuters. The survey "Seeking transparency: The outlook for foreign exchange trading in Asia" found that "69.5% of organisations polled already used electronic platforms to trade forex and 19.5% are considering the use of such venues in the next 18 months or more." The "100 forex trading organisations" that took part in the survey included professionals at "Tier 1 banks, large local banks and asset management firms, among other types of organization."

REGULATION

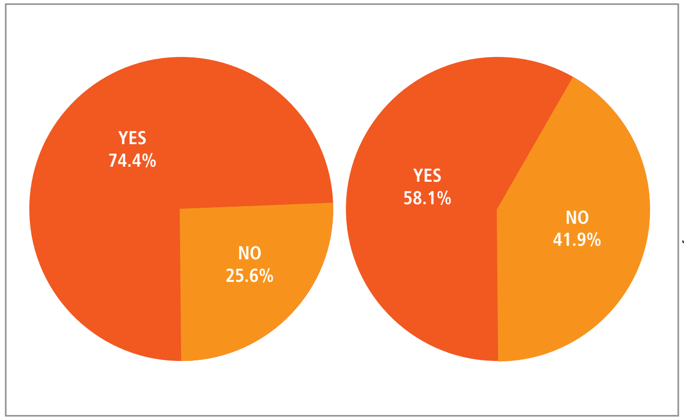
Just how this all connects back to the influence regulation across the global market in FX is having is well articulated by Jamie Salamon, COO Asia Pacific at 360T. "We are seeing a real interest in the buy-side seeking assurances from their electronic trading venues over security, stability and regulatory standing. The credit rating and regulatory stance of the platforms is now high on the agenda for buy-side firms who are looking for longer-term partnerships with full workflow solutions rather than just a short term pricing relationship. The recent purchase of 360T by Deutsche Borse Group has brought with it a very high level of regulatory oversight for the platform that is opening up new doors for us. The credit quality of Deutsche Borse, as a global CCP combined with the complementary product sets across, futures, clearing and collateral management are leading to key engagements across the real money sector."

Transparency is the standout factor arising from tighter regulation, particularly for FX derivative products. Dickson Woon at Phillip Futures says that "The tightening regulatory requirements are guiding trading community to the exchange traded model rather than the OTC environment. Though,"



Source: Thomson Reuters Asia FX survey

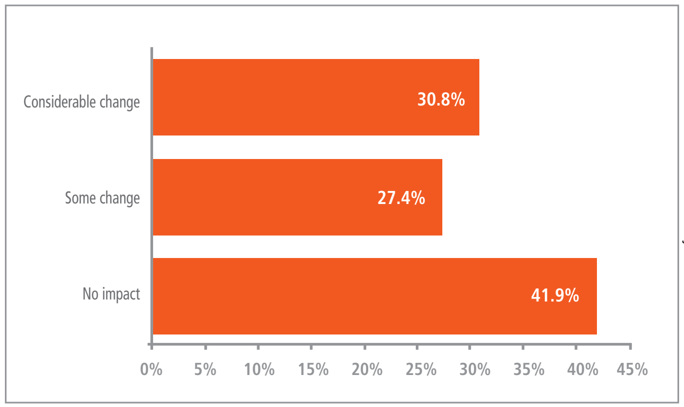
How will market developments such as electronic trading and algo trading affect the forex market in the future?



Source: Thomson Reuters Asia FX survey

Would centralised low-latency post-trade hubs benefit the forex market?

Would you participate in such a hub?



Source: Thomson Reuters Asia FX survey

How RMB internationalisation has affected respondents' business

he adds, "spot FX is already traded on exchange but it hasn't achieved much traction."

If he is right, then this will play into the hands of exchanges, particularly SGX which sits at the geographical and technology fulcrum of FX trading in the Asian theatre. KC Lam, head of IR and FX at the Singapore Exchange explains that there is more regulation coming down the pipe and this will only increase its influence and that of other such trading venues. "Globally, there will be a series of regulatory changes that may impact on the way FX transacts, the latest being uncleared margin rules. They are:

- September 2016 – Phase 1 compliance begins (US, Japan)
- March 2017 – VM "big bang" compliance (US, Japan, rest of world)
- September 2017 – Phase 2 IM compliance begins
- September 2020 – IM phase completes

Singapore, Hong Kong and Australia are in the final stages of rolling out the framework for uncleared margin rules and some clarity can be expected soon. In Asia, we can expect a race to complete paperwork, which may impact on both dealers and those on the buy-side. The cost of replacing new CSAs will be high yet this needs to be done in a relatively short period of time; most banks will likely adopt a far stricter approach for the tens of thousands of client documents that need updating. Moreover, as counterparties need to post gross initial margins to a third party, re-hypothecation is severely restricted. This requires funding, which generates a cost to the bank. We believe," he concludes, "the uncleared margin rules that are coming into force across the world will be a catalyst for driving eligible and appropriate derivatives trades towards central clearing or trading futures directly."

"Higher volumes caused by algo trading need to be managed by solutions that are scalable and need little manual intervention because they are designed as STP exception based solutions."

Chris Davis

THE TRUMP FACTOR

To what extent such regulation may be influenced by the incoming Trump administration, is an unknown. There is much speculation, though a good deal of scepticism among the market participants interviewed for this article. "Regulation similar to Dodd Frank and EMIR will provide better oversight of local trading practices, through reporting of activities on a daily or even real-time intraday basis," says Chris Davis at Broadridge. He adds, "While the election of Trump has created uncertainty around regulatory reform and what will be, companies cannot afford to take a wait-and-see approach."

However Thomson Reuters' Woodward adds a further twist to regulatory story with regard to the asset manager community. Asia as a whole is on the receiving end of significant inflows of investment funds from the increasingly highly regulated western economies. Asset managers in those countries are already MiFID compliant or will shortly be and their counterparts in Asia will be obliged to follow suit. "The regional funds are really just starting to attract the attention of international investors," Woodward explains, "but they are seeing more and more international money flowing in and that will demand best execution and MiFID compliance. They are internationalising their business and they need to get on top of all the reporting that they will

REGIONAL e-FX PERSPECTIVE

REGIONAL e-FX PERSPECTIVE

"The growing complexity of the market structure and tighter regulation require improved technology to help clients with their trade execution,"


Dickson Woon

have to do. It's not so much a matter of adopting new regulation, as taking on board the regulation that applies in countries where investors' money is coming from."

DEVELOPING TRENDS

If then regulation is in the process of defining the future landscape of FX trading in the region, new, regulated products and activities will inevitably characterize the market. For example, while spot FX accounts for a large proportion of trades globally, forwards and other derivative products now account for a large proportion of trades. At Thomson Reuters for example, spot accounts for only 25% of its global flow. The rest ranges across forwards, options and NDFs. The firm does not break down its flows regionally but Woodward says they are roughly proportionate in Asia.

"The FX market remains 'under futurized' and the market is poised to evolve and embrace products in listed world to complement the existing OTC business", according to 360T's Salamon. "We see that combining the OTC and listed worlds within Deutsche Borse group provides a great platform to launch our new FX Spot future contract. Additionally within the group we see opportunities for clearing, collateral management and cross product margining to be housed within a single venue."

PRIME BROKERS DIVERSIFY

Access to credit remains an issue for counterparties and with PB services drying up the situation is getting more acute. Giving regional players with liquidity the ability to act as credit conduits to facilitate credit lines and make markets electronically to their natural client base is a big growth area for many companies.

PB services are certainly in great demand following the

"In some ways we have helped with the improvements in localized infrastructure by including in our initial role out in 2012 a local presence in TY3 in Tokyo."


Campbell Cleland

FinTech Case Study

James Banister, CEO, FXecosystem, a leading provider of FX connectivity services describes how his organisation is gearing up to cater for demand across Asia.

Why does FXecosystem see Asia as a growth market for its specialist FX services?

Our expansion in Asia has been driven by demand from our European and American institutional and local retail FX clients wanting to access better infrastructure and connectivity in Asia. To service this growing demand we have invested heavily in our global network to offer our clients ultra-low latency network connectivity. Our new Headquarters in Singapore and Point of Presence (POP) in Singapore (SG1) and Hong Kong (HK1) underpin our expansion in the region.

Do infrastructure bottlenecks still remain in Asia?

We are not experiencing bottlenecks in the region. We use a number of different software tools to monitor our network including FXeco-eye – our real-time network and flow operational monitoring and data visualisation tool which provides a graphical overview of the data flow. With FXeco-eye, clients can drill down to a granular data level in order to troubleshoot any potential network, application and connectivity issues before they disrupt business critical flows.

How will FXecosystem help FX trading firms in Asia maintain service and reliability levels?

We have instigated a new network operating centre (NOC) and engineering facility in Asia, this combined with expertise at FXecosystem in London, ensures we can deliver the very best 24x7 global network support.

How will FXecosystem protect against network security and cyber threats in the region?

We are investing in new specialist NSFOCUS Threat Intelligence (TI) software to further protect our systems, providing complete visibility into the global IT threat landscape.

How does FXecosystem enable companies looking for low latency pathways into regional FX trading venues in Asia?

Our Meet-Me-Room ™ (MMR) eco-world enables clients to have a single point of entry to connect to FX participants. Banks and brokers trading across Asia, London, New York, can connect to this MMR offering over 70 different venues.

In what ways is FXecosystem positioning itself to become a leading provider of services for regional FX players?

In addition to our strengthened global network, we have a new monitoring product which will be launched in Q-1 2017 to enable retail clients to have real-time network and flow monitoring, previously only available to institutional clients.


James Banister

Retail FX in Asia

Luis Sanchez, CEO of BMFN provides

What factors are strongly influencing the current growth of retail FX trading across Asia?

Education is particularly important. The more that retail traders and investors understand about the market, the more interested they become and the better they are able to trade. One particularly strong trend we have noticed in China is that now that the equity market is not as attractive as it was previously, FX has become an intriguing asset class to become involved with.

Luis Sanchez

What trading products and instruments are particularly popular with retail investors in the region?

In FX EUR, JPY and GBP are popular trading currencies for Asian retail traders. They also like CFDs. Their interests span multiple asset classes however, so stocks, metals and oil are also on their list.

What issues generally influence retail regional traders when they look for a suitable margin FX broker to work with and what attributes are considered particularly important?

A broker must be properly regulated. The place of regulation and the type of license it holds are important. Speed of service and execution are vital. Personalised service matters. Many countries are technologically advanced, so they expect advanced functionality, on mobile devices and that trading spreads are tight.

Do all countries in the Asia offer the same opportunities for online retail FX trading or are some becoming "hotspots" of future growth and trading activity more than others?

BMFN has 12 offices worldwide. Our main Asian activity is currently in China, where our business is growing rapidly.

Clearly, elsewhere in Asia markets can differ widely. Japan has a long-standing reputation for the size and sophistication of its retail trading community. The major financial market centres of Singapore and Hong Kong offer the degree of technology infrastructure support that traders need but we fully expect more of the smaller markets to become more active in the coming years.

withdrawal by the world's major, traditional lenders. "There has been a surge in FX prime brokers and 'prime of primes' in the market and serving the Asian market is their focus," says Chris Davis. "Broadridge FXL provides a market leading solution to many of these participants processing FX, NDFs, CFDs, metals, vanilla and exotic options. Higher volumes caused by algo trading need to be managed by solutions that are scalable and need little manual intervention because they are designed as STP exception based solutions."

Campbell Cleland APAC head of sales and new business at FXSpotstream endorses this view. "Since we launched our business close to 5 years ago, we have seen a continued improvement in the products, pricing and technology offered by our liquidity providers. In some ways we have helped with the improvements in localized infrastructure by including in our initial role out in 2012 a local presence in TY3 in Tokyo. Also, as more trading moves to automated execution the buy-side continues to develop their use of algorithmic execution and the number of such offerings is increasing to address the increase in demand."

Meanwhile, R5 the emerging market currency exchange venue has commenced trading in Singapore, following regulatory approval. This will add to the competition for FX volume in the region. Saxo Bank has announced the launch of their FX prime brokerage with a cross collateralization facility in Tokyo as well as London and New York, bringing further choice to the prime brokerage scene. In Singapore SGX' newly announced partnership with EBS will offer what they describe as "one-stop access to cleared and non-cleared OTC and listed derivatives for Asian currency pairs." They see the FX block futures capability that they

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Jamie Salamon

will now offer as being a way of helping FX prime brokers optimize their client offering without total reliance on bank credit.

However, among developing trends, the elephant in the FX trading room is the increasing role of the Renminbi as major trading currency. The huge increase in Hong Kong based turnover graphed by the BIS triennial survey is largely down to the growth CNY / CNH. The continuing internationalization of the RMB, is leading to new product innovation in the currency.

This is already the case at SGX, which has become one of the leading international clearing centres for CNH and for related futures contracts. It advises that its USD/CNH futures contract "is now the most liquid listed contract with over US$440 million per day traded in November, compared with US$167 million in the same month last year." It looks increasingly likely that, with each passing year, the RMB will come to dominate the Asian currency markets, perhaps in due course rivalling the majors in size and the variation of trading opportunities of offer.

CONCLUSION

In summary then, it is clear that e-trading has come to dominate Asia's FX market. This is particularly the case in Hong Kong, Singapore and Tokyo where the bulk of turnover is transacted on the best technology infrastructures but smaller, newer centres are becoming more e-enabled. These include Taipei, Seoul, Bangkok, Kuala Lumpur, Jakarta and Manila, albeit at different speeds and in differing ways.

New products and service offerings are being introduced rapidly in the battle for volume and market share. This is being fought between local and international financial services firms, multibank and single bank platforms and buy-side firms are seizing the opportunities for best execution for both commercial and compliance reasons.

The Asian FX scene is changing fast. It will come as no surprise if in our next Asia regional perspective we reveal that more technology and product advances have been made here, perhaps on the back on further large scale shifts in trading volumes from London to Asia.

> "Globally, there will be a series of regulatory changes that may impact on the way FX transacts, the latest being uncleared margin rules."


KC Lam

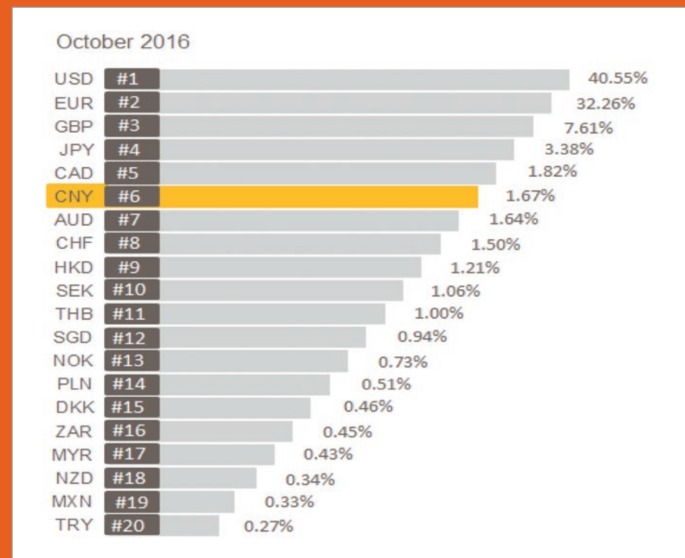
CURRENCY WATCH

RMB now sixth most used currency for global payments

According to recent SWIFT data, the RMB was now in the top six of world payment currencies by value with a share of 1.67%.

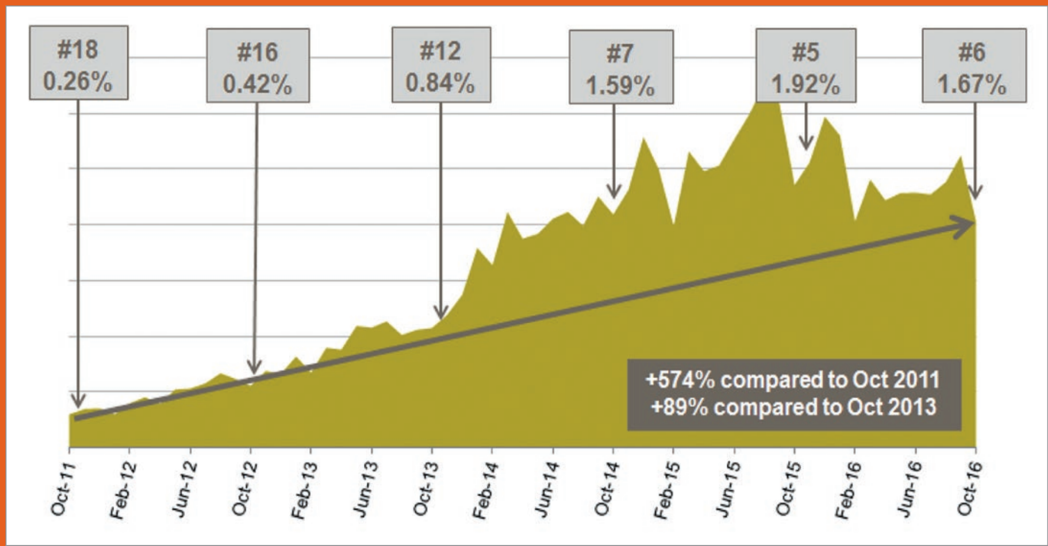
Just three years ago, in August 2013, the RMB was ranked at position #9 with a share of 0.84%. In the last three years, the RMB overtook several currencies, including the SEK, HKD and CHF. Despite the fact that RMB is in the top six currencies the gap compared to JPY remains high and it is difficult to predict if and by when the RMB might move to a higher position. It overtook JPY with a record high share of 2.79% in August 2015 then fell back, likely due to the devaluations of the RMB that took place in that month. As from then, the RMB usage has been negatively impacted by the volatility in the Chinese market and the slow-down of Chinese economy. Overall, in the month between July and August 2016, global RMB payments increased in value by 4.81%, while payments across all currencies increased in value by 7.21%.

Asia-Pacific, and more precisely Hong Kong, is still by far the leader in offshore RMB payments. The next biggest contributor to global RMB payments by value is Europe, with the United Kingdom the largest centre in this region. When looking at RMB adoption, SWIFT data shows that Asia-Pacific represented 44.9% of all payments with China/ Hong Kong in RMB in 2016 (January – August 2016), compared to 46.6% in the same period last year. Europe follows with 30.6%, a slight increase compared to last year. Africa and the Middle East are also showing strong adoption, mainly driven by the United Arab Emirates; however, the overall value is relatively small compared to the other regions. On 21 September 2016, the People's Bank of



Source: SWIFT Watch

RMB's share as an international payments currency
Customer initiated and institutional payments. Messages exchanged on SWIFT. Based on value.

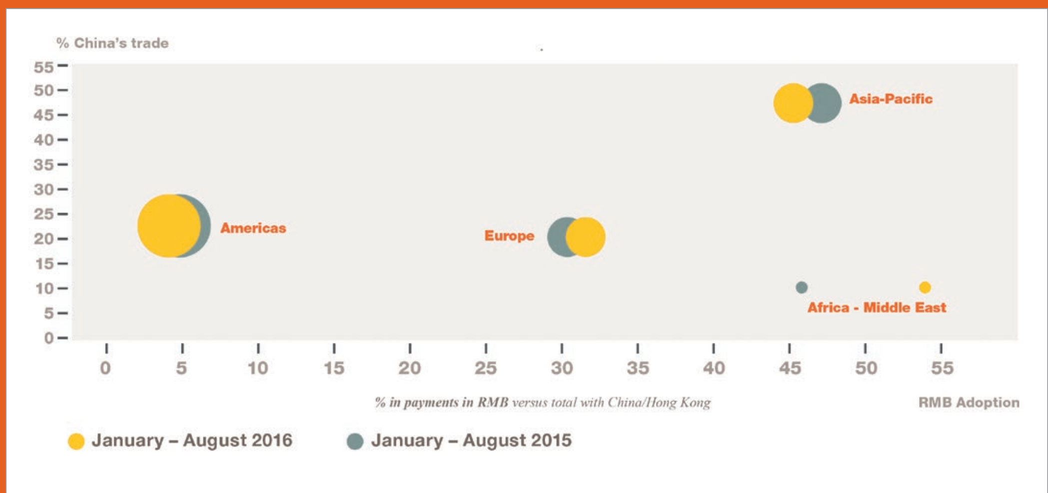


Source: SWIFT Watch

Payments in RMB

Customer initiated and institutional payments

China appointed Bank of China as the first yuan clearing bank in the United States. SWIFT's October 2016 data shows that only 3% of all payments by value between US and China/Hong Kong are done in RMB. The appointment of this new clearing centre will most probably strengthen its position on the RMB.



Source: SWIFT Watch

Evolution RMB usage with China/Hong Kong per region

Payments sent and received by value

On 25 March 2016 SWIFT and CIPS signed a memorandum of understanding (MoU) to commence strategic cooperation. The MoU sets out plans to develop CIPS using SWIFT as a secure, efficient, standardised and reliable channel to connect CIPS with SWIFT's global user community.

Source: SWIFT Watch

CIPS VERSUS CNAPS

China National Advanced Payment System (CNAPS) is China's domestic RTGS for RMB payment.

Cross-border Interbank Payment System (CIPS) serves as a cross-border RMB payment infrastructure, providing clearing and settlement services for cross-border trade, investment, financing and other cross-border business.

Moving forward, CNAPS will continue handling domestic RMB payments whilst CIPS will be the platform to only process the cross-border RMB payments.

CIPS is operated by China International Payment Service Corp. (CIPS Co.). CIPS Co. was incorporated on July 31th, 2015 in Shanghai. It takes full charge of the operation, maintenance, participant management and business expansion of the CIPS, under the supervision and administration of People's Bank of China.

CONSTRUCTION OF THE CIPS IS CARRIED OUT IN TWO PHASES:

- In the first phase, which has been live since Oct 2015 with 20 onshore direct participants and 176 indirect participants, real-time full-amount settlement is adopted to increase the speed of payment and reduce the credit risk;
- In the second phase, which is planned to go live by end of 2017, a more liquidity-saving hybrid settlement mode will be employed to increase the liquidity efficiency of cross-border and offshore RMB clearing and settlement;
- In phase two, CIPS is also looking at interconnecting with several more China FMIs and extending its operating time to cover more time zones, as well as constantly improving its standards and services portfolio to enable broader participation from overseas community.