



# Delivering electronic FX trading channels to key Emerging Markets

With Rick Schumacher, Product Manager at Wall Street Systems, Aiyana Currie, Product Manager at Charles River Development, Carl Martin, Group Technical Director at Eurobase International and Mike Thrower, Global Head of Sales and Marketing at Cognotec.

## Why are the Emerging Markets becoming so important for many FX technology vendors?

**Schumacher:** Emerging markets are a good source of growth and positioning for the future. For example, many studies believe that the BRIC (Brazil, Russia, India and China) countries will be four of the six largest markets within 25 years. 25 years is a long way off, but this is where significant growth will occur. Many markets have less regulation, better liquidity, yet still have good volatility which is important for traders.

**Currie:** Technology vendors must support their clients' demands for emerging markets capabilities. They are experiencing an onslaught of global investments (in both real assets and currency) at much greater relative rates than developed markets. Capturing this volume, and subsequent potential revenue, is a key driver to the growing importance of regional technology investments. At the same time, governments in these regions uniquely control the types of investments that can be made, which narrows the scope and drives up demand for those investments. A good example is Taiwan, where the global investment community is eagerly awaiting the potential flow into the forward market.

**Martin:** Vendors are always looking for new and relatively untapped markets, however as banks look to deploy new

technology in this space, vendors are presented with a unique opportunity to meet these requirements. Banks in established e-markets in general employ software that is getting quite dated, new market opportunities often provide an opportunity to install cutting edge software, which makes life easier for the vendor, as there are less legacy system issues to overcome.

**Thrower:** Institutions are looking for value and growth across all





EM banks are looking to protect and grow their franchise through excellence in service delivery and close client relationship management in local markets.

**What do you think are the main challenges currently facing vendors in meeting the e-commerce service provision requirements of financial institutions operating in the key Emerging Markets?**

**Schumacher:** One area that doesn't receive as much attention is language considerations – in many countries it is difficult to do business in English. This is particularly true in some of the smaller Eastern European countries. Vendors need a local presence in some countries (or at least a partner that is closely working on their behalf) for language purposes as well as understanding business custom and convention. There is also a small pool of qualified resources in the local markets to support this business. While that pool is slowly growing, demand is outpacing supply. We believe that this will provide further impetus for rapid growth in ASP services.

**Currie:** Vendors must understand how new money flows are driving regulatory, compliance, audit, and other requirements that challenge existing technology infrastructure. Emerging markets are 10-15 years behind developed markets in

technological terms. They therefore require structural and philosophical changes, such as moving from paper-based to technology-based workflows that, in many cases, eliminate process steps. For example, Mexican compliance workflows are typically performed the day following a transaction. The concept of pre-trade compliance, such as initial currency and counterparty exposure tests, is literally foreign.



**Rick Schumacher**

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**Martin:** In the e-commerce space the challenges generally boil down to the same two key issues, speed and flexibility. Speed in that, without it e-FX is simply too risky. Emerging Markets mean more currencies that need pricing, margining and managing, not to mention the associated regulatory issues and any local customs.

A pricing system that works well for a handful of major currency pairs may well struggle with the addition of new currencies and the associated cross currency pairs. The profile and

aspects of the FX market; this includes retail margin trading, expanded channel management, algorithmic trading, API connectivity to the buy side and now also EM and technology plays a critical role in enabling them to differentiate their offerings. That said, we see two dynamics at play for those targeting EM; tier 1 banks that have come to dominate the G10 space are now seeking to expand to other currencies and into EM, whilst more regional and specialist



behaviours of these currency pairs may well upset the algorithms of the distribution systems, which is where the flexibility comes in. More and more e-commerce systems will be employed to meet a diversity range of business opportunities. Banks sometimes feel they have a simple choice to either buy from a vendor and save costs, or build in-house for a more customised system. In truth, however, Banks can save costs and have a customised solution by selecting a modern system with flexibility built in. In this way Banks can deliver the uniqueness they seek whilst fitting into an overall framework.



**Aiyana Currie**

*“Emerging markets are 10-15 years behind developed markets in technological terms.”*

**Thrower:** Firstly, there are specific product and functional requirements which vendors must address to enable their clients to gain access and grow the EM businesses. Most notable of these are Non Deliverable Forwards (NDFs) and functionality to handle onshore/offshore trading activities. Also important in many

EM businesses is the treatment of tax. Secondly, in many markets, the driver isn't necessarily purely FX trading as an asset class. Often, FX trading in EM is linked to other investment and funding activities – and therefore having a cross asset capability is critical.

**Many Emerging Markets such as the so called BRIC regions of Brazil, Russia, India and China have recently seen spectacular economic growth. Are you concerned that the technology and communications infrastructure of many of these regions has not kept pace with their economic achievements and consequently this presents a potentially serious bottleneck on future e-service provision?**

**Schumacher:** Not particularly. Technology and communications are important, but they will more or less keep pace with demand. In many emerging market countries, telecom and broadband usage is as good as many western countries. Instead, the key to the growth in these markets is dependent on three things: diverse economic development, political stability, and information disclosure. As long as those three fundamental issues are addressed appropriately, then the markets will naturally become more liquid and continue to grow.

**Currie:** While some global players in these regions have kept pace with e-servicing demands and can adapt more quickly, other still have daily issues with simple communications such as email and the internet. This creates obvious challenges for other e-services that require reliability and real-time

connectivity between counterparties. Emerging Markets' technology and communications infrastructure must become reliable and highly available if these markets are to adapt liquidity networks and FX vendors on a large scale, as an alternative to telephone dealing.



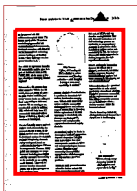
**Carl Martin**

*“The lack of standardisation is a problem in the mainstream markets, let alone the emerging ones.”*

**Martin:** It's true that in these regions problems can and do arise more often, but remember vendors and service providers are targeting these areas. While there will clearly be a time lag and some growing pains, the improvements will get there increasingly fast as they work to follow the lead of the established markets.

In fact it is often the lesser problems, such as the cost and safety of travel to these areas, which prove to be the hold-ups. Local knowledge can be hard to come by and commands a premium.

**Thrower:** Trading in FX as in all markets is increasingly focussing



on latency and sub 100 milliseconds response times. The latency needs of the FX markets are challenging even the best communications infrastructures in developed countries, with financial institutions and their technology partners looking at co-locating servers. These challenges are even greater therefore in EM.

**How much of a problem from the FX connectivity point a view is a lack of standards such as FIX, TWIST, XML etc in many of the less developed Emerging Market regions?**

**Schumacher:** No more so than other countries. Within the FX world, there are plenty of point-to-point choices available, and many western banks are willing to fund connectivity at their own expense. We are starting to see considerable uptake in utilizing FIX, which will help lower FX connectivity costs, and various flavors of XML (e.g. FpML) will continue to be adopted

**Currie:** Generally, once a market is ready to trade electronically, the protocol selected is based on the global standard most widely used in developed markets. For example, Malaysia is beginning electronic equity trading and, based on market trends, has chosen FIX over its own protocols. However, many global asset managers are not yet interested in dealing these higher volatility currencies electronically – so the standards are not seeing much demand. There will be pressure based on the market players, but it does not appear to be a consistent issue.



**Mike Thrower**  
*“Often, FX trading in EM is linked to other investment and funding activities – and therefore having a cross asset capability is critical.”*

**Martin:** The lack of standardisation is a problem in the mainstream markets, let alone the emerging ones. With so many connectivity options available, most serious market participants need a diverse range of connectivity. In Emerging Market regions there is an extra dimension, in that initially skill shortages may limit growth, however with today’s mobile resources these issues will rapidly diminish.

As mentioned earlier, the Banks in these regions have less baggage when they start the project. This gives them more choices than their counterparts in established regions and consequently they can be more selective. Choosing a good connectivity Gateway with a comprehensive e-Solution engine can help alleviate a lot of the problems.

**Thrower:** Such protocols are slow to handle the less mainstream flows commonly associated with

EM such as NDFs, and can therefore cause problems. That said, financial institutions and their technology partners are continuing to use proprietary protocols or adaptations of the standards to achieve end to end connectivity in EM. So business drivers and market innovation is driving integration forward regardless of standards.

**What’s driving the increasing demand for use of the e-channel, particularly for online trading purposes, in many Emerging Market regions and what pressure is this placing on sell-side Institutions?**

**Schumacher:** Spreads – perceived opportunities to make money particularly when there’s volatility. Banks feel pressure to ensure that pricing engines are correct and also feeling competitive pressures on profitability per ticket – thereby creating a desire for increased volume.

**Currie:** Several key factors are driving the increased demand for e-channel use in the Emerging



**Rick Schumacher**  
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Markets. The availability of functionality in developed markets such as streamlined executions, convenience, efficiency and straight through processing are notable. So too, is connectivity to numerous counterparties and transparency of market rates. And, given increased accessibility to multiple and timely sources of liquidity – within one platform – the sell-side is feeling pressure to provide tighter spreads at a more rapid pace.

**Martin:** Banks are continually looking for new revenue pools. This means that as soon as a new area surfaces there is a queue of overseas institutions waiting to prey on the more profitable areas. Domestic markets may offer less exciting investment opportunities to buy-side players in these areas. To consolidate their position sell-side institutions in these areas need to play catch up to diversify and expand. To become a leader in their local niche market, it is essential that the infra-structure to provide e-trading to their clients is up and running.

**Thrower:** Whilst in developed markets the use of the internet has been growing gradually to take over from more traditional channels such as the phone and brokers, in EM, participants are simply jumping a few steps in the evolutionary cycle and simply embracing e-channels as the de facto method of trading. For sell side institutions, EM are putting pressure on many aspects of the application stack:

- market rate management systems need to be adapted to handle the specific market conventions in EM, for example trading in the Turkish markets is same day spot until 1pm and then T+1 thereafter.
- as stated above, handling of specific product types is also causing sell side firms to enhance their applications along the whole workflow, from pricing, thru trading to risk and settlement
- furthermore, it is the nimble that survive; so large monolithic systems infrastructures do not lend themselves well to responsive, fast moving EM
- finally, liquidity in EM is not as deep as in G10 markets and so sell side pricing and trading applications need to take this into consideration at the design stage

**Do you expect to see increasing interest in and use of FX delivery models such as White Labelling and Application Service Provision, in many Emerging Markets?**

**Schumacher:** Due to increasing demand for eFX services and lack of qualified local resources to support these, we are already seeing increasing interest in ASP solutions and expect this to be big. Uptake of white labelling will be much slower, since a number of regional banks are dominant in these

countries and have a large, loyal customer base. In some countries, there is a lack of trust when foreign (Western) banks move in. This may change over time, but white labelling will be slow to pick up.

**Currie:** Likely, yes as technology can be more accessible with these models and additionally attractive to regional banks that do not specialize in this area. However, some of these banks prefer tighter controls in-house.

**Martin:** Inevitably, there will be a number of smaller players who will favour the lower setup costs of these models. As mentioned earlier there is often a lack of the required skill sets and these models help to address that. The ability to concentrate on their core markets, whilst providing a comprehensive service to their client base, will make white-labelling and ASP models a serious option for some banks. Larger banks, traditional FX providers and global players, however, will look at solutions which put them more "in the driving seat".

**Thrower:** We are already seeing this. Our Tier 1 banking clients are white labelling our technology solutions into EM – this is giving EM participants a real leap in trading technology evolution. Also time to market is critical and the ASP model is well suited for getting trading partners up and running within very short timeframes.

**What criteria are banks and other FX sell-side Institutions operating in the developing Emerging Markets likely to use when deciding on whether to build their own e-trading and e-commerce infrastructure and services or buy in the necessary technology expertise and solutions?**



**Schumacher:** Banks and other FX sell-side institutions will ask the following questions: Does the institution have the local expertise and available resources to build and support a full-service platform? Are there vendors in our particular local market that have a solid understanding of the unique qualities of our market? Is the price right to build? Do we have a unique competitive advantage that we can offer / protect by building rather than buying?



**Carl Martin**

*"The two main problems with in-house builds are speed to market and the difficulty of seeing the wider picture."*

**Martin:** Today it's a very tough call, as the e-trading markets have matured and there is a lot of expertise and solutions out there. From a solutions standpoint, there are not many banks who can really build it themselves successfully, but for those with large experienced development operations it is an option. The two main problems with in-house builds are speed to market and the difficulty of seeing the wider picture. In-house technologists are far more likely to favour the tried and tested solution rather than pushing the envelope

and they always take longer to produce. Clients are always in a hurry and they want access to the best solution at the cheapest price. The banks have to meet their client's needs before someone else does. Banks need to retain their client's business and this will weigh heavily in favour of buying rather than building.

**Thrower:** The buy vs build paradigm is continually being assessed by financial institutions and their technology partners. The share of banks technology spending allocated to external third party providers is expected to grow from 50% of total spend to 80% of total spend over the next 3 years according to research undertaken by Client Knowledge. The challenge for firms like Cognotec is to meet that opportunity with flexible, scalable, functionally-rich solutions that address both the challenges of a \$3trillion per day market and the nuances of important new markets such as EM.

**Looking to the future, which Emerging Markets do you think are likely to be most significant in terms of driving up e-volumes and stimulating further development of e-FX products and services?**

**Schumacher:** Where the liquidity and volatility can be found, and where there is market transparency, diverse economic growth, and political stability. Eastern Europe may surprise people – based upon its proximity to Western Europe and particularly as some of those countries are slated for EU membership which will see them moving to the Euro in the next five to six years.



**Mike Thrower**

*"..in EM, participants are simply jumping a few steps in the evolutionary cycle and simply embracing e-channels as the de facto method of trading."*

**Currie:** As mentioned earlier, Taiwan is poised to grant access to its currency forward market. Other countries of interest to Charles River Development's buy-side clients include: Brazil, China, Mexico, Turkey, and Korea.

**Martin:** Asia-Pacific region will initially have the most significant influence in terms of driving up e-volumes. As can be seen from the recent setbacks in the major stock indices, China only has to sneeze and the world catches a cold. Eastern Europe, South America and Southern Africa will continue to play an important role.

**Thrower:** In the past 6 months we have seen our clients given increased focus to several EM; probably most interesting among these have been Latin America, the Middle East and China. These markets seem to be adopting e-channels very rapidly and seem to be the primary battle grounds in 2007.