Regional e-FX perspective on Asia

By Richard Willsher

Electronic trading across Asia continues to become more widespread and is increasing rapidly by volume. But, as Richard Willsher discovers, the countries and customers of the Asian theatre are so varied that it would be a mistake to see it as a single market where one size fits all.

Research published by Greenwich Associates in March 2014 found that in the previous year, the total volume of FX traded in Asia, ex-Japan executed through electronic systems increased. However this growth failed to keep pace with the overall growth FX trading volume conducted by any method. This illustrates the growing appetite for FX trading across the region but also that not all geographical areas can support the technology required for fully-fledged e-trading.

A spokesperson for the Monetary Authority of Singapore points out that Asian markets have been more voice-brokered, particularly in emerging Asian FX, as compared to the more advanced markets in London and New York. According to a report by Greenwich Associates, the share of G10 cash currencies trading executed electronically is 79%, significantly higher than 56% for emerging markets.

Asian markets have been slower to adopt e-trading due to a variety of factors including the heterogeneous make-up of the Asian marketplace and the differing levels of development among Asian country markets. However, this could change. Over the past 12 months, the average share of emerging market currency cash trading volume executed electronically increased to 56% from 52%. Following the G20 regulatory reforms in the OTC derivatives market and end clients' demand for greater transparency, we can expect an accelerated migration of FX in Asian markets to electronic trading platforms and exchanges.

Jamie Salamon, 360T's chief operating officer for Asia Pacific explains that, "Asia, has a large number of very different regulatory and client driven demands for FX which is reflected in the different evolutionary stages we see in FX e-trading across the region. For example clients in India are very different from the types of clients we see in Japan or Australia. What we have seen at 360T is the accelerated growth of pockets of business in Asia, in particular the streaming of onshore INR is gathering momentum with demand coming directly from the smaller Indian banks and also through larger Indian banks who have white labelled our platform to offer streaming INR quotes to their branch and corporate client base."

At the same time others, such as BNP Paribas' global co-head of e-markets Luke Waddington, notes that there is

Jamie Salamon

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still a healthy voice execution business in Asia. "So the challenge," he says, "is how do you put electronic tools such as total cost analysis and best execution around that. That's a very interesting dynamic that is quite different to other regions."
That said, the general trend is towards greater use of electronic trading due to the steadily spreading impact of regulation. "Like much of the western world, Asia's financial markets are feeling the impact of extensive regulatory reform," says Paul Tivnann - global head of foreign exchange and commodity electronic trading at Bloomberg L.P. "The associated demand for increased transparency coupled with the desire for improved price discovery, more efficient operational processes and better execution will continue to drive the accelerated adoption of electronic trading in Asia. China's remarkable growth story also looks set to continue, with rapid growth in renminbi (RMB) settled cross border trade and a progressive march towards internationalisation but this trend is not unique to China, it has broad relevance across the Asia region."

RMB TRADING EXPLODES

The growth of RMB trading is widely hailed as a remarkable phenomenon.

> "Now it's about putting the e-tools around the relationship and that doesn't mean just the execution."

But at the same time it has become widely traded on e-platforms and so is a test case of how a currency can rapidly migrate from the voice to the electronic channel.

"Right now, in the Asian time zone, CNH is probably the second most traded currency after USD/JPY," comments Jason Wang, vice president of FX at FlexTrade. "When the market first started, it hardly did more than 500 million a day in volume for about six months after it launched. Back then it was very much a voice brokered market. Today, the volume has exploded and it gained further momentum after it went electronic. Who doesn't trade with China these days? So, who wouldn't need CNH?"

BNP Paribas' Luke Waddington adds, "A major development has been the ability to trade RMB directly against other currencies such as AUD and NZD and EUR without going through the USD. This means that people are going to be accounting across borders with their major trading partners and

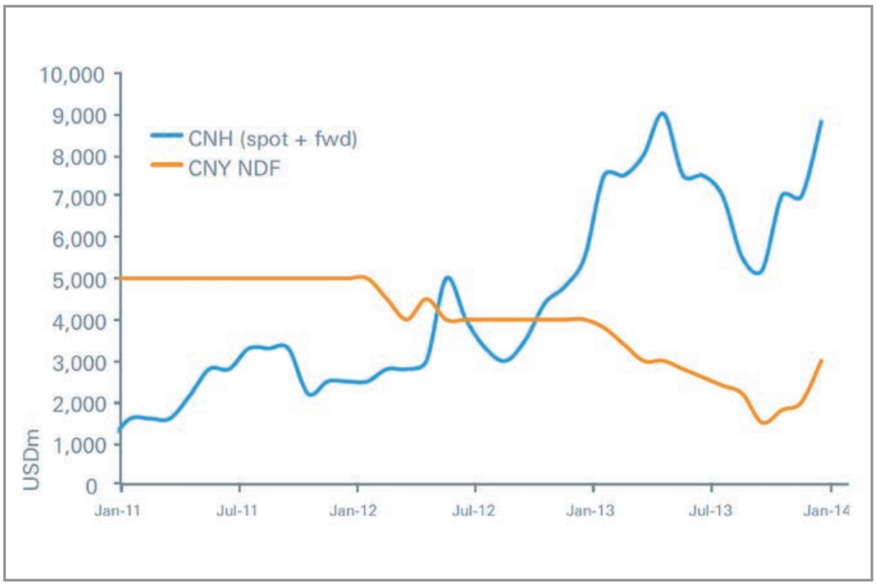

Luke Waddington

this will spur cross border currency trading with China in a significant way. This is proper, underlying commercial business, not institutions or speculative money."

"CNH business has grown many fold at 360T in the last 12-18 months," says Jamie Salamon. "It is one of the top traded currency pairs on our platform in Asia and interest from our corporate clients in continental Europe is also growing."

At Bloomberg Paul Tivnann says, "The Chinese yuan now comprises 2.2% of all global foreign exchange turnover and offshore RMB trading on Bloomberg is up 400% YTD. Offshore deposits of the RMB have grown to over RMB 4 trillion. The development of offshore clearing hubs in Singapore, Taiwan and, most recently, Seoul will further facilitate the trading of RMB within Asia. Cross-border trade settled in RMB is growing rapidly, with initiatives such as the RMB Qualified Foreign Institutional Investor (RQFII) and the Stock Connect programme serving to increase its use as an investment currency. Meanwhile, "dim sum", or offshore, bond issuance remains strong."

Source: Deutche Bank



CNH FX market average daily trading volume

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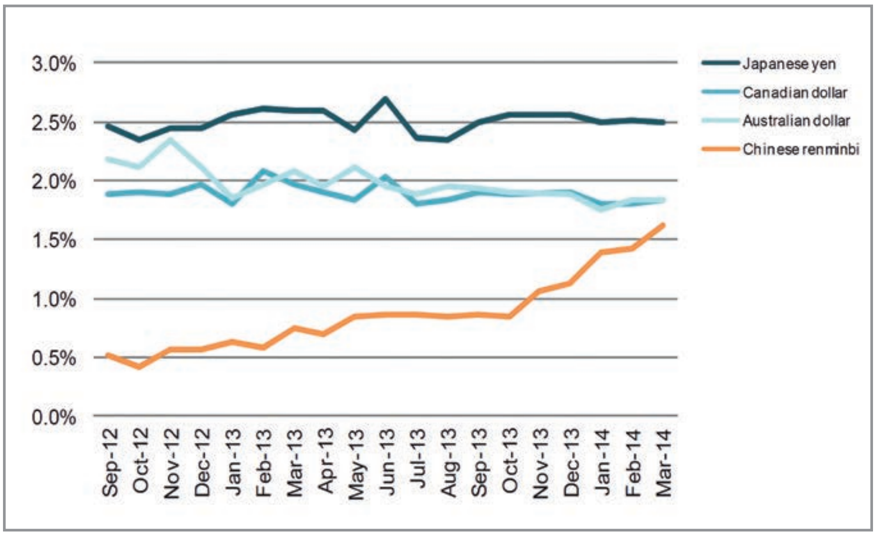
"Internationally, central banks are re-allocating reserve holdings to include RMB, facilitating global trading. Significantly, in October 2014, the UK government issued its first RMB-denominated bond, becoming the first western country to do so. All of these initiatives and efforts will underpin growth in RMB denominated flow in the market and on Bloomberg," he says.

The growth of RMB as a real-world currency, underpinned by trade and other transactions rather than speculation, points to the way of which buy-side clients' needs are now amounting to mass migration to e-trading platforms.



Source: SWIFT, Aite Group

Percentage of Global Payments by Currency, September 2012 to March 2014

BUY-SIDE DEVELOPMENTS

State Street's head of electronic trading and clearing, Asia Pacific, Hu Liang notes that their buy side client base falls broadly into two categories, institutions, asset managers and hedge funds and then brokers. State Street does not deal directly with retail customers. Hu Liang says that although Asia has, as yet, no Dodd Frank or EMIR type regulation to take into account, nonetheless institutional clients are preparing themselves as if they did. At the same time, in response to client demand, State Street's geographical focus has now moved beyond its main traditional markets of Singapore, Hong Kong, Japan and Australia. It now includes South Korea, Taiwan, Malaysia, Thailand and Indonesia. The smaller regional markets are embracing the general evolution towards global regulation with State Street providing guidance, advice and reporting services as value adds to its Currenex platform.


Paul Tivnann

> "Regulation will bring unprecedented transparency to OTC derivative markets through pre and post trade visibility requirements, central clearing and, in some cases, execution mandated in regulated environments"

On the brokerage side due to the withdrawal of some prime brokers from the market, brokers have become more concerned with risk management. Moreover they are particularly concerned to balance their internal credit risks with external ones maintaining a much tighter grip on their own and their clients' capital requirements. 360T's Jamie Salamon points out that asset managers have often tied their FX execution to their custodians or looked to execute the FX element of their business passively, using only one or two bank providers. "This has led to them receiving some very wide spreads as they become wholly reliant on a small number of providers for their pricing. Increasingly, the asset managers are wanting to offer best execution, or certainly better execution, for their FX business and so look to full technology solutions such as ours to offer competitive pricing and full processing of trades through their complex fund set ups.

Corporate clients across the region," continues Salamon, "still use phone dealing with their bank sales people but for many liquidity providers with smaller sales forces this is not a scalable solution, so they look to platforms to provide the ability to price corporates. And from the corporate treasurer's view point they can get best execution through requesting prices from a number of banks simultaneously through a platform, The post trade STP and processing that platforms offer is also more effective and reduces risk compared to manual deal entry that phone dealing requires. Institutions like regional banks are looking to aggregate liquidity and offer pricing to their own branch network or client base. while on the retail side investors now have access to some of the tightest pricing in the market, they will use a number of techniques to execute including mirror trading, social trading and algos."

> "CNH is probably the second most traded currency after USD/JPY. The volume has exploded and it gained further momentum after it went electronic. Who doesn't trade with China these days? So, who wouldn't need CNH?"

FROM OTC TO EXCHANGES

It would be easy to assume that FX transactions were limited on the OTC side to spot and forward of the most common currency pairs and on-exchange, to a limited range of standardised products. However as FlexTrade's Jason Wang explains, there is much more than this going on in Asia.

"For the OTC channels, almost every FX product you can think of is being traded," he says. "From your regular interbank spot transactions to payments in an exotic currency, like the Papa New Guinea Pound for the money changer, to dual currency options for the private banking clients. However, for the exchanges the product range is a lot more limited due to the need to have standard contract definitions and settlement terms. Asia is home to some of the biggest remittance businesses, which includes remittance back to India, China and the Philippines. We also happen to have some of the largest manufacturers of televisions, LED screens, ship builders, textile and clothing manufacturers, who need to pay wages in local currencies but transact using other international currencies such as the USD or EUR."

Wang also says that, "The exchanges provide the more 'regular' FX contracts that relate to what their existing clientele needs, mainly as a means of hedging against some of the contracts that's being offered already. For example, if the exchange lists a product that is actually the variation of the Chinese Market Index, it becomes a natural demand to offerUSD/CNH on that same exchange."


Jason Wang

"The same can be said for offering USD/INR if you are offering a product similar to what the domestic Indian exchanges is offering. I personally do not think that more retail investors are moving to trade FX on exchanges. Simply put, my broker clients that offer both exchange products and OTC margin FX make more money through OTC margin FX. As such, the tools available for OTC margin FX become more fanciful and available for the retail client. OTC margin FX market is already 24 hours, whereas exchanges operate on a more limited basis. The two offerings are worlds apart, although it looks quite similar on the outside."

From the exchange point of view, the range of products on offer is constantly growing. The Singapore exchange (SGX) has positioned itself as the region's leader and, as a spokesperson for Singapore's Monetary Authority explains, the rapid rate at which products are being added. They state that, "In October 2014, the SGX launched RMB FX (USD/CNH and CNY/SGD) futures. Transactions in both futures contracts achieved a first day volume exceeding RMB 1 billion in notional value. Trading was robust with active participation from a diverse pool of counterparties. The RMB FX futures contracts complement the increasing number of RMB investment products available in Singapore and broaden the suite of pan-Asian exchange-traded products available here."

Direct currency trading between the CNY and SGD commenced on 28th October 2014 on the China Foreign Exchange Trade System platform. This will lower FX transaction costs and promote greater use of the two currencies in cross-border trade and investments.

Also in the exchange space, the SGX has launched a suite of Asian FX futures since November 2013: AUD/USD, AUD/JPY, USD/SGD, INR/USD, KRW/USD, KRW/JPY, CNY/USD, USD/CNH, USD/JPY, THB/USD…

The market has been increasingly drawn to trading FX derivatives on exchanges because of regulatory reforms, to increase price transparency and reduce counterparty risk in derivatives markets. There are cost efficiencies associated with futures due to different regulatory treatments between the OTC market and exchange. For example, there are lower margin requirements for futures and there is no need to carry out trade reporting to trade repositories as is the case for all OTC derivatives. In addition, exchanges are transparent trading platforms that are regulated by home regulators.

DIVERSE FX MARKET

An overview of OTC and on-exchange products illustrates the diversity of the Asian FX market. But it also shows that different pace at which various parts of the market are moving. The general move to e-trading is on the one hand being accelerated by the increasing number of electronic platforms and offerings. On the other it is being inhibited by customers' attachment to voice trading and, outside of the major markets of Hong Kong and Singapore, the lack of data infrastructure. Meanwhile, where e-services can be delivered it may be a case of carefully persuading clients of the additional value they can gain.

At BNP Paribas the process begins with the dialogue between the bank and customer and develops from there.

Source: Deutche Bank

	Avg daily volume	Avg ticket size	Vol bid offer spread	Tenor
In late 2010				
CNH option	USD10m	USD5m	2	1M to 1Y
NDF option	USD3bn	USD50m	0.2	1M up to 7Y
Onshore CNY option	Not traded	Not traded	Not traded	Not traded
2013				
CNH option	USD7bn	USD50-100m	0.1-0.2	1W up to 10Y
NDF option	USD3bn	USD50-100m	0.1-0.2	1M up to 10Y
Onshore CNY option	USD5m	USD5-10m	1	1M to 1Y

The evolving RMB FX option market

"I think the thing that will change is that tools will enhance the substance that goes into those conversations," Luke Waddington explains. "The days of having a generic market commentary between a sales person and a client are starting to go. If the client has a voice dialogue, what he wants is some very high quality content in there. He wants to know when is the best time to execute. Should I execute algorithmically or on the phone? Could you prove to me which would be best execution? Could you give me some colour on the overall regulatory conditions, in a quick and efficient way? This is where the technology comes in and we start to put very good tools around driving substance into the trading channels. Then the option is there to do away with the voice channel and replace it with an e-channel. In the past e-trading was all about moving the client from the voice channel to the e-channel, now it's much more subtle. Now it's about putting the e-tools around the relationship and that doesn't mean just the execution."

This approach points to more specialist, tailored services. These include STP transaction processing, total cost analysis, measuring best execution and as Luke Waddington notes, research services.

On the institutional side State Street's Hu Liang notes that institutional demand for algorithmic tools has burgeoned for many of these reasons. "They are being used to control block trades, to gain full transaction transparency and to be able to demonstrate best execution. The uptake has been quite widespread and rapid. However we are also aware that use of algos on the retail side has also grown," he says.

Bloomberg's Paul Tivnann adds, "Many regional firms are investing in technology, ranging from risk

The Singapore exchange (SGX) has positioned itself as the region's leader

management to price distribution solutions, to cater for the ever increasing appetite from clients to trade electronically. Addressing post trade operational inefficiencies around confirmation matching and settlement is also high on the agenda to aid reduction in potential settlement errors."

Luke Waddington again takes a technology point of view. "I see what is going on is that the technology has been around for some time and people are now saying, how can we apply that now to meet the needs of our clients. So there is a lot of work going on to see how we can apply existing technology and make the offering better. Regional players are asking how they can specifically deliver to their clients and put in new client technologies into that space. You are looking at a market structure change, with some players looking at whether they are an agent or a principal – and that is an interesting shift. And then lastly the way that you put technology around the whole process, not just the client side or the trading side – you put it round the whole front and back of that chain and deliver it in. This is exciting and the real beneficiaries will be the customers and the experience they have with their bank."

Meanwhile at 360T Jamie Salamon has a slightly different take. "Algo trading is still limited in Asia within the institutional and corporate client base. I see the benefits from using algos being very strong but the reality is that the client side adoption so far has been limited. What we do see though is an increasing use of our price making module where regional banks can utilise our low cost, fully hosted basket of algorithms to create pricing flows for clients and internal users to access. This enables faster time to market for trading firms who wish to service their client base and monetize flows more effectively through use of algos".

"FX in Asia is increasingly dependent on credit," he says. "The number of active bank prime brokers in the region has declined over the last couple of years and the allocation of credit is becoming a precious commodity. So the larger PBs who remain within the market are able to pick the clientele to service with less PB competition and all the while banks are looking at smaller clients with a much sharper focus on the cost of capital , KYC, etc . This leaves an increasing number of clients who need liquidity but are unable to get it unless the PBs extend their appetite for credit, I see the emergence of 'prime of prime' facilities to bridge this gap as a growing trend."

This view is echoed by Dickson Woon, Forex Manager at Phillip Futures. "The exit of a couple of primary banks in FX prime-brokerage has created a void in the space. Many smaller brokerages that intend to engage prime services are left with fewer choices and higher entry barriers in terms of requirements. We are beginning to see larger brokerages assume the role of the bank offering prime services (Prime of Prime). Due to this change in landscape, larger FX providers are investing in infrastructure, diversifying level of services providing one-stop shop concept. We are however, sceptical on the vibrancy of the transformation as it may give rise to credit standing problems, particularly due to the non-bank background Prime of Prime." The message here is clearly "watch this space."

RETAIL

The big story in retail FX trading across the region has been the reduction in leverage available to Japanese traders. This has brought firmer regulation to the massive Japanese retail market that many had regarded as dangerously over leveraged. This has however opened up opportunities in other parts of the retail market as Jamie Salamon of 360T explains.

"Australian based retail brokers look to be continuing to increase their influence over the region. The decreasing leverage available in Japan has led to a few operations doing more business elsewhere. The nervousness of regulators about the retail business has dampened some of the business in locations and Australia seems to be a beneficiary of this now.The professional nature of some of the retail institutions who are able to run risk means that the 24 hours trading desks are much more professional in their demand for liquidity, risk management and execution."

Jason Wang of FlexTrade adds, "The big thing affecting retail FX trading in the region is deleveraging. Most of the regulators have chosen to increase the margin requirements from 1-2% to 4-5%. This is to make it more aligned with the futures markets, and to avoid over-leveraging, which forces the retail trader to do more prudent risk management. However, with the lack of movement in the traditionally speculated pairs, such as the EUR and the JPY during the first eight months of 2014, many have turned to trading spot gold, which is also commonly provided by most margin FX Brokers in the region. A number of brokers have said that as much as 50% of their revenue comes from their retail clients trading the yellow metal. However, this isn't the same trend as Japan, which does not offer spot gold for its retail market as it is more of a commodity, and thus, not regulated by the Japan FSA."

Hu Liang

"Two or three years ago the top, most sophisticated brokers were accounting for about 25-30% of their turnover via mobile. Now, this proportion has risen to 60% with astronomical figures being transacted on mobile devices month by month."

The other major trend in retail is the move to mobile trading. "Having recently been in both Japan and Singapore one thing that has struck me is the speed of mobile adoption," says State Street's Hu Liang. "Two or three years ago the top, most sophisticated brokers were accounting for about 25-30% of their turnover via mobile. Now, this proportion has risen to 60% with astronomical figures being transacted on mobile devices month by month. So we have developed a number of mobile solutions that we offer to brokers for i-Phone, Android, i-Pad and so forth. I suspect that at some time in the future this may spill over into the institutional space. (Note the Special Report article in this edition of e-Forex)

WHAT NEXT – TECHNOLOGY AND REGULATION

State Street has decided that offering new technologies and capabilities will be a key differentiator in electronic FX markets. So much is it committed to this idea that it has established its own technology division in the US, called State Street Global Exchange, in cooperation of MIT and Stanford University. The purpose is to be first movers with new technologies and add these to their customer offering.

Meanwhile regulation is widely expected to condition change in the market going forward. "Regulation will bring unprecedented transparency to OTC derivative markets through pre and post trade visibility requirements, central clearing and, in some cases, execution mandated in regulated environments," says Bloomberg's Paul Tivnann. "This in turn should

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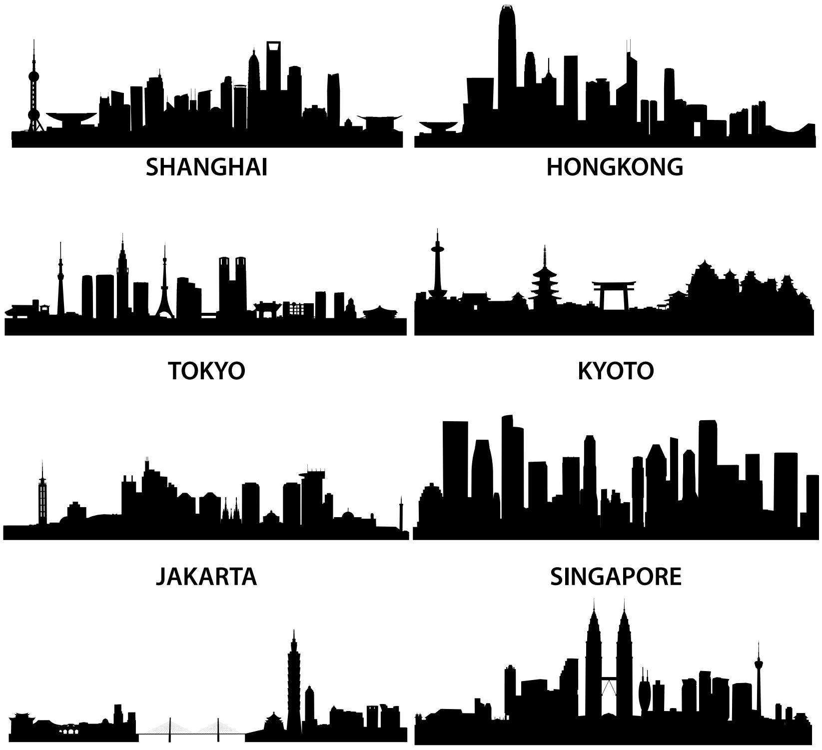
increase confidence in the markets and attract interest and liquidity. In terms of where liquidity collects and its accessibility, much will depend on the consistency of the application of these regulations, both pan-Asia and on a global scale."

Meanwhile at 360T's Jamie Salamon adds, "The growing clearing mandates will bring more electronic execution of products like NDFs and FX options on to multibank channels. This has remained the sweet spot for single bank platforms so the ability to offer more multibank liquidity should allow more banks to participate in the electronic flow that has so far been dominated by a few larger bank providers. At 360T we have colo facilities in NY4, LD5 and TY3 this infrastructure enables providers to cross connect, reduce latency and create global liquidity networks but it also increases the pricing granularity to many different client types. The capacity of the colo facilities allows huge scope for many different pricing structures, which means that the client gets a more appropriate price tier from their banks and the executions therefore get better for the clients."



Regulation will eventually reach into every corner of the Asian market

There seems to be no doubt among market practitioners that regulation will eventually be universal and global and reach into every corner of the Asian market. The big question, to which no one has the answer, is when this will happen across such a diverse region.

CONCLUSION

It would seem to be the wish of the major single bank platforms and the global multibank portals to standardise e-FX trading in Asia, as quickly and efficiently as possible. However the nature, traditions, technological inconsistencies and local currency restrictions across the patchwork of different countries leaves this currently looking a remote possibility. However what does come across loud and clear when talking to those leading and developing e-trading operations in the region is the scale of the opportunity. The appetite for trading FX is undoubted and is reflected in the growing annual turnover numbers each time a new piece of research is released.

The remaining issue is how to translate voice trading to e-channels, and, how to justify to clients why e-FX would be to their advantage. At the same time those regional banks with longstanding relationships can now buy the technology more cheaply than ever before to enable them to convert their client base and compete with the big international players. Therefore the Asian e-FX scene remains a lively battleground where the eventual winners and losers are difficult to predict.

Dickson Woon

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