UBS

ECB Operations Managers Group

‘Obstacles preventing greater automation and efficiency in the confirmations and payments area’

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Agenda

- The Foreign Exchange Market - Overview
- Foreign Exchange Products
- Obstacles and challenges - Confirmations
- Obstacles and challenges - Payments
- Concluding thoughts
- Q&A

The Foreign Exchange Market – Overview

- The ‘FOREX’ Market is the largest and most liquid market in the world with an average daily volume typically in excess of $6.6 trillion (BIS Survey April 2019)
- This is in excess of all the world's stock markets combined!
- One of the few true 24 hour markets with many firms adopting follow the sun models
- Market is characterized by geographical dispersion and activity in all centers by a multitude of participants including major interbanks, central banks, buy-side firms, corporate treasurers and high net worth individuals
- Market closest to the ideal of 'perfect competition’ given number of participants, low barriers to entry and deep liquidity available
- The high volume and rather homogenous nature of the product lends itself to higher levels of automation both from a confirmation and settlements perspective which is why FX is well ahead of other asset classes in achieving >98% straight through processing (STP) rates
- Achieving and maintaining such elevated STP rates requires much effort and focus but also a deep understanding of the various FX products and how clients trade them

Foreign Exchange Products

Spot

- An exchange of currencies at an agreed rate
- Typically settle two days after trade date
- Some currency pairs settle same day or value tomorrow e.g. USD/CAD; USD/MXN

Outright Forward

- An exchange of currencies at an agreed rate on a future date
- Settle outside of Spot window
- 1 week, 2 week, 1 month, 3 month, 1 year etc.

Vanilla Options

- Underlying currency pair (EUR/USD)
- Call (right to buy); Put (right to sell)
- American, European Style
- Expiry Date, Strike, Notional
- Premium payable to seller

FX Swap

- One currency swapped for another for a period of time
- Near leg (Spot) and Far Leg (Forward) executed simultaneously
- Companies use them to avoid foreign exchange risk
- Liquidity management tool

Exotic Options

- In Options – come alive
- Out Options – option disappears
- Kick – barrier hit when spot moves in the money
- Knock – barrier hit when spot moves out of the money
- Digitals – Receive payout if above or below level
- Combinations – Straddles/Strangles/Butterflies
- Double no touch
- Forward starting
- Strip options

Non-Deliverable Forward

- In Asia and LATAM several currencies have restrictions related to offshore trading (KRW, CNY, ARS, COP, BRL, INR)
- Low liquidity or limited access in local currency market
- The non-deliverable forward contracts are cash settled since it's not possible to deliver the local currency
- On an agreed future valuation date, the parties calculate the increase/decrease in value of an agreed notional amount, by comparing the agreed rate at trade date with the spot rate taken from an agreed rate source. The net difference is then settled in the deliverable currency

Obstacles and challenges - Confirmations

- Confirmation dispatch and matching timeliness – ideally all FX trades would be confirmed within 2 hours of execution using standardised message types and electronic channels. However, delays require extensive chasing and escalation. Worth noting that **Principle 46** of the FX Global Code also encourages market participants to 'confirm trades as soon as practicable after execution…'
- Counterparty onboarding – fund allocations only known after initial trade execution. Where an allocation is made to a new account then this might result in dispatch delays whilst set up is completed
- Non adherence to SWIFT standards – where firms deviate from Swift standards it negates the possibility of auto-matching and necessitates the need for rules to be created where possible
- Paper matching – without an MCA there is a need to continue sending long form confirmations which typically involve longer review and turnaround times given dependency on review and dual signatories
- Bespoke requests – some counterparts will have specific requirements which require manual intervention e.g. removal or addition of specific confirmation language

Obstacles and challenges - Payments

- Netting – Where PVP settlement mechanisms are not used, it’s the norm to bi-laterally net transactions for each value date. Agreeing net settlements will involve using e’mail, telephone or vendor portals which can all involve manual intervention

- Missing SSIs – Not all standard settlement instructions will necessarily be in place from day 1 which creates settlement exceptions whilst the correct SSIs are sourced

- Multiple SSIs – Some counterparts may have multiple nostro agents per currency which prevents automatic settlement
- Allocations – similar to confirmations, if the onboarding process only starts on trade date then settlement complications may arise

- Payment splits – in some EM markets there is a preference to split notionals down in size to better improve payment velocity and avoid liquidity traps. Where this takes place there will be a need to also share this information with cash management areas and the other counterparty to ensure timely reconciliation and avoid funds being rejected

- Bespoke requests – client requirements such as switching between gross and net settlements can also negate the benefits of having a fixed settlement method

- DVP Settlement – on occasion there might be the need to ensure the buy currency has been received prior to release of sell currency. This will also necessitate the need for manual review and prevent auto release given willingness to only deliver once paid (DVP)

- HVP filters – Some institutions will have high value payment filters in place. Where notionals exceed a certain limit a secondary review may be required

Concluding thoughts

- ‘What gets measured gets done’ – does every firm monitor and measure their own STP rates?
- Are we measuring performance the same way?
- Are we calling out poor performance?
- Is there a trade off between client satisfaction and greater automation?
- Are the two mutually exclusive or two sides of the same coin?
- Are current processes able to meet T0 expectations?