best Practice
in Foreign Exchange Markets

5th edition

Inside:

- Current state of the market
- Minimizing and managing trading risk
- Trading strategies
- Changes in the forwards market

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FXall® What's Your Edge?

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Introduction

Change Continues in the FX Market

In recent months the foreign exchange market has undergone significant changes impacting all market participants. In this period of uncertainty, the focus returned to risk management and control, which remain critical and sometimes undervalued elements of our business. This handbook, which has been published by *Euromoney* and FXall for five years, is broadly read by FX traders at all types of institutions – more than 30,000 copies were printed and distributed in 2008. We believe that highlighting the critical challenges that every organization is facing and sharing ideas will enable the industry to evolve. To keep our markets vital, we all must be committed to continually improving our trading and workflow processes to be more effective and minimize risks.

In this year's edition of the Euromoney/FXall Best Practice in Foreign Exchange Markets Handbook, we hope to bring you insights into the new challenges facing institutional foreign exchange market participants. In this current environment, best practice remains a priority. In our article on minimizing and managing trading risk, we look at the tools available for traders to maximize their effectiveness and reduce their market impact. Selecting the right strategy for the specific circumstances is increasingly critical to both finding and demonstrating best execution. We also look at how anonymous ECN trading has changed and the impact on active traders as they look to relationships with their banks to get greater access to liquidity. Additionally, dislocations in the forwards market have changed how the market prices risk and the potential for settlement and clearing challenges. The benefits of automation and best practices with straight through processing, control and compliance should not be lost for deals that have moved to the phone.

Price discovery and liquidity were impacted during this period, causing both the buy and sell-side to re-think their trading strategies and execution styles, with a return to more straightforward products. As participants reevaluate their counterparties, there has been a return to the value of relationships. Naturally this shifts the emphasis back to selecting the right partners and trusting the organizations with whom you interact. Now more than ever, it appears that having the right relationships is everything.

We believe that our industry is well-served by an ongoing focus on all aspects of best practice. At FXall, we are committed to delivering best practice to our clients and contributing to the ongoing dialogue in the industry.

Best regards,

Phil Weisberg, CFA
Chief Executive Officer, FXall

A new world in FX

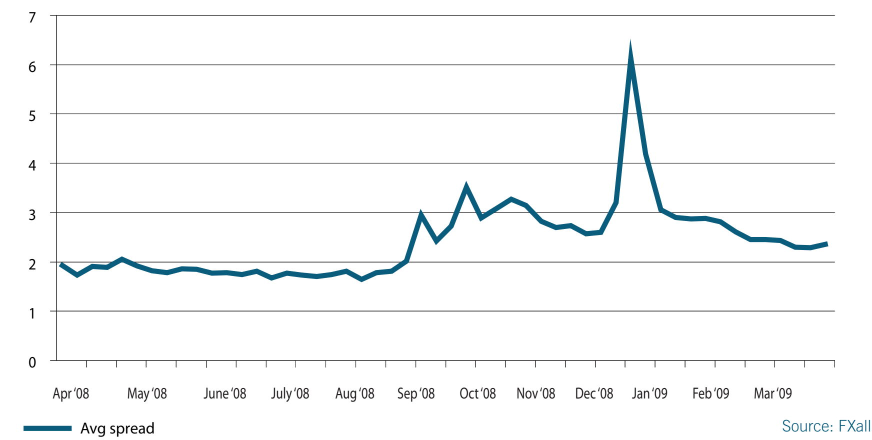
The FX market has shown resilience in recent months but has emerged changed from all the turbulence, with new participants and new trading strategies in evidence

The global foreign exchange market, like all financial markets, has experienced a year of unparalleled turbulence and change. Fortunately, the market was extremely resilient and managed unanticipated settlement challenges to experience its highest volumes ever. However, some of the structures, trading in spot and forwards in particular, underwent changes.

As a consequence of the market's breakdown, its composition has changed and some hedge funds retreated from market-making, reversing a trend that many thought unstoppable. As volatility came back with a vengeance, it was necessary to adopt new trading strategies and all market participants have been forced to adapt – or scrap – their approach to take account of sharply different market conditions.

Following the market changes in September and October 2008, prices became harder to obtain and for a time liquidity disappeared in some of the largest and most mainstream products, such as euro/dollar forwards. Where prices were available, the cost of trading was substantial. At the same time, intraday volatility ballooned. Euro/dollar is now capable of moving 100 basis points within 15 seconds – a level of volatility not seen in a decade. Both liquidity and volatility have improved somewhat from fourth-quarter 2008 levels, but they are still above historical norms. Liquidity is expected to remain constrained for at least the remainder of this year.

Historical Bid/Ask Spreads in EUR/USD in Points (April 2008 - March 2009)



Source: FXall

The chart above shows the bid/offer spread in EUR/USD for the last 12 months

Minimizing counterparty risk

There are multiple ways to minimize risk. Banks are more carefully evaluating counterparty risk to review their credit relationships and adjust spreads accordingly. Investors are similarly evaluating their counterparties and distributing their trading relationships more broadly to reduce their concentration risk. There is now an industry-wide imperative to manage counterparty risk.

That increased focus on risk management is demonstrated in the move by market participants to reverse a longstanding trend towards consolidation of bank relationships. The rationale for consolidation was previously straightforward: clients focused on the top five or so banks to get the best pricing by making their relationships more valuable. Now it is impossible to predict the top five banks – some banks that previously would have been left out have been shown to be important and others that were important have disappeared.

"Until September, 2008 had been a great year for performance for the FX market," says Sang Lee, managing partner at Aite Group. "Then things went wrong. Crucially, the predictability of the market ceased and spreads widened. Some people just shut up shop completely for a while – because they simply couldn't cope with what was happening in the markets."

Consequently, market participants have now adopted a more flexible attitude towards counterparties given the constant change in the market. As importantly, control has become central to everyone's interaction with the market. People need to understand their exposure and risks at all times – there is no longer the freedom to manage by exception: it must be by rule.

"Until September, 2008 had been a great year for performance for the FX market. Then things went wrong. Crucially, the predictability of the market ceased and spreads widened. Some people just shut up shop completely for a while."

More generally, everyone in the FX market has now adopted a 'what if' attitude – questions that would once not even have been considered are now commonplace. For example, operational risk has never been that significant an issue for many market participants. Now people consider the implications of sending a payment by mistake to a bank about to fail – and how they can prevent that happening.


Justyn Trenner, CEO, ClientKnowledge

Consequences of volatility

Perhaps the most immediate repercussion of the massive increase in FX volatility in September and October 2008 was that trading strategies based on normal expectations of volatility failed. For many hedge funds that used historical volatility patterns to create trading models, there was an immediate need to re-tool their algorithms to adjust their performance.

Justyn Trenner, CEO and principal at ClientKnowledge, notes that "there is a degree of consensus that a return to the low volatility seen in markets in the past decade is unlikely in the foreseeable future. Instead, the market may revert to the more longstanding condition of relative instability, which prevailed in decades prior to the last one – even if there is a new cycle of lower volatility in the immediate future."

A second, more general, outcome of the increase in volatility is that people sought the reassurance of telephone broking. Overnight there was a move to telephone broking for several trades because volatility in some markets exceeded the capabilities of the technology. That does not mean that electronic trading is not viable. Indeed, even if adverse market circumstances remain in place for some time, there is no likelihood of the attractions of electronic trading diminishing. The reasons for this are twofold.

Firstly, all clients continue to need methods to ensure and prove best execution to demonstrate their control and compliance. Secondly, clients are looking to move away from a concentration of risk and need to take advantage of features like full audit trails and time stamps. Electronic systems are invaluable for managing workflows and handling all aspects of trading and deliver efficient systems for managing sophisticated processes.

Investors demand control

In today's market, recent events have accelerated the need for improved controls. Increasingly investors are under more scrutiny than ever to ensure they are getting the right price and demonstrating their trading and reporting processes are transparent

Today the spotlight in foreign exchange has shifted to focus on efficient trading and better control. As recently as two years ago, market participants tended to have a fixed style of trading, such as streaming prices or cross currency netting, and a set of procedures, such as getting a manager to sign off on trades, built around that choice. Consequently, when it came to determining how efficiency could be improved, clients' goals were fairly straightforward. Now through electronic trading, there are multiple ways to trade that can help investors meet their needs.

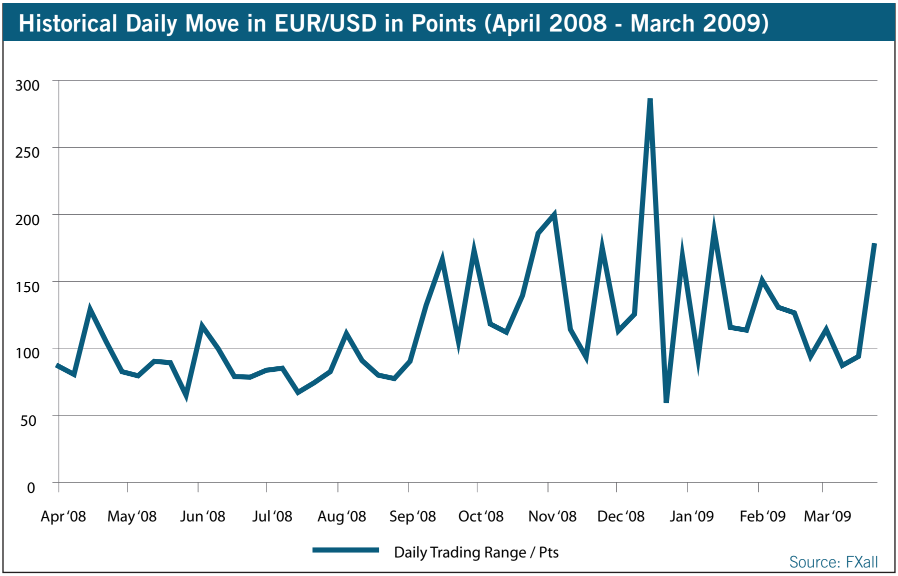
Previously clients would focus on how platform providers could support their chosen trading strategies. Clients simply wanted to know how a platform could make their selected strategy work more efficiently using its functionality. Increasingly now the functionality of different systems has become less important as the market has matured. Clients are becoming more interested in whether they are executing trades the right way – through the most effective practices and most efficient trading tactics – and are looking for solutions that support their trading processes.

Price meets best practice

The most obvious question about execution is whether the price a market participant receives is the best one. However, this is only part of the story. In equities, price is central because volatility is so dramatic (see the following chart). But despite the substantial increases in volatility in FX, volatility is still nowhere near the level seen in equities – a fact reflected by asset managers' focusing more on trading performance in equities than in FX.

So what matters in FX execution other than price? Anecdotal evidence suggests that the ability to demonstrate best practice – either to management within a firm or to clients – is crucial. More generally, the goal of using trading information is not just to push spreads down, but to help customers understand their existing trading practice. By comparing this to their goals, improvements can be made and then measured.

Such issues are particularly pertinent in the current market environment. Now more than ever, participants need to find ways to generate efficiency and – especially in the case of investors – ensure that they are delivering value to their clients. Using trading tools that can analyse trading behaviour and suggest improvements is a timely response to market turbulence.



The chart above shows the historical daily move in EUR/USD in points for the last 12 months

Evaluating execution strategies

Regardless of the trading methodology employed, it is important to look at performance. Multiple approaches are now available to evaluate execution strategies, including transaction cost analysis (TCA) and cross currency netting (CCN). TCA looks at a client's trading activity and allows it to benchmark its performance against other trading strategies or different FX venues. It is still a relatively new idea in FX, having come from the equities market where it is already well established.

It is important to understand that TCA does not simply focus on price, as the lowest transaction cost in the form of bid/offer spread does not necessarily imply the best execution – although it is of crucial importance. In the equity market, in addition to price, TCA takes into account the price impact resulting from a trade and the risks associated with any lag between the decision to trade and its execution. However, in FX there is generally greater liquidity than in equities, so unless an order is vast it is unlikely to move the market. TCA has been embraced by a number of banks to partner with their clients in demonstrating they are fulfilling best practice requirements.More generally, it is important to remember that it is impossible just to parachute TCA from the world of equities into FX and expect it to function – the two markets work too differently.

Consequently, it has been necessary for a unique FX-specific model of TCA to evolve that takes account of issues specific to FX. These issues might not, at first glance, appear to be important, but could result in clients changing their strategies. In one instance, an FX market participant only recognized through TCA the extent to which it was constraining itself by waiting until the end of the day – when its processes were complete but when the market was least liquid – before executing. This realization allowed it to change execution strategy to shift the time of trade delivery and work more closely with its banks in sharing information about specific execution requirements.

The role that TCA can play in FX is significant. The asset management industry in particular needs to find a way to talk to end investors about how they execute foreign exchange. TCA analytics allow clients to establish that they are doing the right thing and have a clear understanding of why they are executing specific trades in certain ways.

"TCA analytics allow clients to establish that they are doing the right thing and have a clear understanding of why they are executing specific trades in certain ways."

Cross Currency Netting (CNN)

The FX e-commerce revolution at the beginning of this decade enabled asset managers with relatively simple requirements to get the fastest and most efficient execution with straight through processing (STP) and the opportunity to prove best execution. Those sorts of clients were quick to move to e-commerce platforms with rate engine pricing because of the price transparency – and ease of proving best execution – it provided to them.

For other clients with larger transaction sizes and plenty of cross currency trading, a similarly simple solution has been hard to find because their exposures are that much more complicated. For example, a UK fund manager managing funds for a Canadian client that is moving funds from yen equities into euro equities generates a lot of Canada/yen and euro/Canada trades even though the amount of Canadian dollars remains small.

CCN reveals a client's true exposures and can potentially save significant sums on execution costs. By working with sales teams at banks, it is possible to get better prices by decomposing the risk into more liquid currency pairs. CCN can also play a major role in risk management. In the example above, orders would be broken down into trades against the US dollar, as it is the most liquid

> “Clients want to be able to pick any balance of trading styles and change them over time – according to their portfolio or market conditions – without moving to a different provider.”

currency. This would effectively eliminate the Canadian dollar leg of the trades.

Asset managers have in recent years increasingly tried to net their currency positions internally, or with the assistance of a bank, before executing the largest, most crucial trades on the telephone, using various systems to capture the details and enable minor currency trades. However, the process has always been cumbersome and manually intensive. Any application of CCN should retain the STP and other automation benefits associated with simpler offerings.

Different products for different situations

One of the most notable features of the market environment in the months since its dislocation last year is the willingness of market participants to consider new ideas. The idea that a client chooses either a CCN product or a multi-bank request for proposal product and never switches has vanished. Instead, clients want to be able to pick any balance of trading styles and change them over time – according to their portfolio or market conditions – without moving to a different provider.

Indeed, it is likely that in the future different styles of trading will be used in a complementary way. Ideally, clients should be able to review their portfolios on a given morning and determine whether the level of cross currency netting is sufficient to use a CCN tool or alternatively if it should just be traded using a rate engine. That level of choice is where the market wants to get to – trading characteristics should ultimately mirror trading requirements.

Managing the mix

In response to developments in the ECN market and more generally in FX in recent months, clients are demanding tools that do not require them to choose between an anonymous ECN and relationship banks. All clients now need to balance anonymous orders with on-demand pricing direct from banks. They recognize that banks are increasingly willing to show more interest and tighter prices to their best customers. It’s important for clients to have the right trading tools to determine when and how to execute in this market to remain flexible and adaptable as needed.

Back to the future

The lure of electronic communication networks has faded in recent months, with banks concentrating available liquidity in areas from which they have most to gain

Electronic communications networks (ECNs) were until recently widely seen as the future of FX trading. The traditional bank model of FX liquidity provision in the over-the-counter (OTC) markets was generally seen as having run its course. The assumption was that bank liquidity would increasingly be directed towards ECNs, while new liquidity providers such as hedge funds would play an ever larger role as market-makers.

However, Sang Lee, managing partner at Aite Group, says that "concerns about ECNs taking further share from direct sales by banks seem to have eased. There is a growing understanding between banks and a wide variety of client types. The friction that had been growing between banks and, in particular, proprietary trading shops – which in some instances saw clients removed from some platforms – has lessened. Banks have made a huge effort to improve their technology so that they can better interact with clients and both parties have recognized the importance of strong relationships for the long term. This realization that trading is not a zero-sum game is a fundamental change that can be expected to endure even when, or if, trading volumes and markets return to more normal conditions."

Some observers have long noted that the attractions of ECNs, when not used professionally, were illusory. For example, for clients whose goal is simply to get the job done and understand and control the risks they were taking, breaking trades up into small chunks and sourcing orders makes little sense. Essentially, to get value from ECNs clients need to act like professional FX traders and work the position.

Nevertheless, the perceived attractions of ECNs appeared to have an unstoppable momentum. Part of the reason was that, in addition to the liquidity provided by banks, ECNs proved attractive to savvy hedge funds in Chicago, which found a way to compete with banks as market-makers in FX, which added further to liquidity.

Now the allure of ECNs has faded. In 2008, the gradual movement of liquidity to ECNs and the growing importance of some hedge funds to market-making may have halted and reversed.

Setbacks for ECNs

Liquidity on ECNs has suffered substantially in the past six months for two main reasons. Firstly, banks have become less willing to provide liquidity overall and have consequently prioritized where they make their liquidity available. Those venues in which they receive the least overall benefit from liquidity provision – ECNs – have suffered accordingly.

Banks have always had a divided position towards ECNs, which were originally created to serve the bank market. While they welcomed the opportunity to access flow, they resented the ability of clients to sweep the book by breaking orders into multiple small trades to try to achieve better pricing, which placed banks in a difficult position. Most importantly, banks are inevitably less likely willing to offer liquidity to anonymous users of ECNs than they are to identified clients that they are familiar with.

A second significant impact on ECN liquidity in recent months is that the hedge funds that entered the FX as market-makers have largely fled in the wake of increased volatility and reduced liquidity. While the collapse in credit markets and the reduction in leverage available played a part in their decision, they had reduced risk appetite and instead preferred to take advantage of opportunities when they saw them.

Consequently, banks' significance in the market is as great as that at the beginning of the decade and they play a unique role in serving clients and making markets. Volumes of discretionary active trading are down as much as 40%, but bank volumes are now increasing because they can make prices. Justyn Trenner notes: "The sell side has learned the benefits of internalizing client flow to the greatest degree possible to hold down costs and lower Sharpe and information ratios. Moreover, the prospect of moderate returns with low risk is now more appealing than the alternative of high risk and potentially high returns."

At the same time as ECNs have suffered from reduced liquidity, clients' trading strategies have also changed. In short, the dilemma about whether it pays to put in the work and divide up trades into smaller orders to get cheaper pricing has become much easier to resolve as liquidity has reduced.

The breakdown in liquidity and substantial rise in volatility in many markets means that, for large trades, risk transfer has become essential. Trenner adds that, "the sell side is now being paid a premium for warehousing risk in a way it was not in the low volatility period before the collapse of Lehman Brothers. Previously, its focus was on trading because that was what it got paid for: now it gets paid for credit intermediation and consequently there is the possibility of greater profitability in both spot and forward markets. This change is also evident in the scale of leverage available."

High volatility means it is no longer a safe bet to extend the period over which a client trades. Now investors want to know that when a trade is priced it is done – not that it is being done in $10 million blocks over half an hour, with all of the market risk that entails. The main consequence of the increased importance of risk transfer in the FX market has been to give new value to bank relationships.

All change in the forwards market

New perceptions of the risks in the forward market have brought with them a new way of working, with awareness of counterparties' creditworthiness becoming paramount

In October 2008 much of the FX forward market ceased to exist. For some clients no pricing was available. For others, trading was simply prohibitively expensive. While the situation has improved somewhat since, volumes have still not returned to pre-crisis level and are not expected to for some time. How and why did this happen and how will it impact the development of the market?

The FX market has traditionally been an over-the-counter (OTC) market, with limited exchange-based volume, meaning the majority of volumes are between principals that provide credit to one another on a commoditized basis. Given a two-day settlement period for spot trading, participants have been historically unconcerned about this market risk exposure – it is this unique characteristic that made the FX market as liquid as it was.

"In the past, the benign environment meant that there was the luxury of not considering forwards as deliverables. Now there is a recognition of forwards as essentially a lending product. Consequently banks need models to deal with it – not just because a counterparty might not deliver but, as importantly, because lending of any type ties up a bank's precious capital," says Justyn Trenner.

Until 2008, volatility of major currencies was generally extremely low – so low that banks were happy to show a fixed width of spreads for futures trades. "Most people thought it was riskless to hedge spot using futures," says Philip Weisberg, chief executive officer at FXall. "But when volatility increased sharply the stable basis between futures and cash disappeared."

As the events of September and October 2008 revealed, the failure to differentiate between the spot market and the forward market was a significant error because the risk on a forward is much greater than on spot. A forward that might settle in six months, would historically have been priced the same for all customers, regardless of whether they are a good or bad credit. "Until recently, streaming forward prices made it easy to pull down a price on any date. Now there is not a forward curve but a forward dotted line. A full range of dates is no longer publicly available. For the sell side that means that a reliable model is required for price – you can't simply follow what everyone else is doing," notes Trenner.

A new approach to forwards

In the past, a forward rate reflected interest rate differentials. Now the rates at which banks deposit and lend vary hugely; even government bonds cannot be seen as a reliable reference point for a 12-month swap. Instead, banks are now considering forwards and swaps as loans – as they carry significant counterparty risk – and pricing them accordingly.

While it is possible to hedge the risk that a counterparty cannot deliver in six months, such a trade is hard, if not impossible, to unwind. In an environment where a major currency – such as sterling – can move 50% over six months, the risk is substantial. Similarly, while there is a broad recognition in the market that in the event of a bank failing and being nationalized trades would still be made good, the overall shift in the market is towards differentiation between the creditworthiness of customers.

As Trenner observes, "there has been a dramatic change in buy-side behaviour: a third of clients have changed at least one major FX provider in the past year. This reflects concerns about counterparty credit, the availability of liquidity and the aggressive strategies of a handful of banks to expand market share in the face of a changing market." He continues, "Hedge funds have to be pickier about the strategies and instruments they use for risk management. Most obviously, they have curtailed their use of forwards because of the lower leverage available and instead are using options – which do not expose the provider to credit risk – or futures, which are exchange traded and therefore less risky. At the same time, there has been a growth of bilateral lines with banks rather than prime brokered lines, meaning hedge funds have to pay more for their liquidity."

Jim Kwiatkowski, head of sales for the Americas at FXall, says that "Banks are gradually extending credit on a client-by-client basis, but companies in troubled sectors may find it difficult to get credit and use the forwards market. Bank relationships have never been more important as market participants look for liquidity."

"Now there is a recognition of forwards as essentially a lending product. Consequently banks need models to deal with it."

Trade processing still important in a manual world

The changes that have occurred in the forwards market since September – reduced liquidity and a less commoditized product – have unsurprisingly prompted people to trade over the telephone, especially for large crucial trades. However, despite the shift to more manual pricing, it remains important to retain the benefits of straight through processing (STP) and control and compliance.

Sang Lee, managing partner, Aite Group

"We believe that when liquidity is thin, clients shouldn't drop out of an efficient automated world into an inefficient manual world," says Neill Penney, global head of product strategy at FXall.

It is imperative that a client's electronic trading system supports the ability to send and book details of a trade based on a price agreed on the telephone. "Those trades should then flow back through the bank and customer's STP channels as usual – into the order management system and through the confirmation processes," explains Penney.

"Despite the huge changes in the market since September, longer-term trends such as the increasing use of electronic trading – especially in spot – and the broadening of participation in the FX market look set to continue, even though they may have been derailed briefly. Similarly, the huge growth in volumes we've seen in recent years is certain to continue, with significant consequences for the back office operations of clients and banks. Decreasing trade sizes inevitably mean a higher number of tickets and a greater challenge for the back office, which is being exacerbated by market fragmentation," says Sang Lee, managing partner at Aite Group.

FXall solutions deliver an edge

After a period of momentous change, FXall has put in place a set of solutions to help clients gain an edge in the new world of FX trading

In the new world of FX since September 2008, a number of key themes have become apparent.

- Changes in liquidity provision mean that trading strategies and execution decisions need to be more closely considered – and flexible – than in the past.
- Control and compliance have moved up the agenda – not just for their own sake but also because of changed trading patterns.
- Working with the right vendor is essential in an increasingly uncertain financial environment.

FXall has taken steps to address these factors. "We recognize that the pace of change in recent months has been momentous even by the standards of an industry used to rapid development and has consequently led people to reconsider how and why they do things in certain ways," says Philip Weisberg, chief executive officer at FXall. "As a consequence, we've developed a comprehensive solution set that includes trading, straight through processing and compliance tools to help each of our clients and providers get an edge in this new market."

Tools that improve trading effectiveness

As volatility has increased and liquidity has become scarcer, execution has become tougher. Orders now require finesse and expertise to execute, as well as a deep understanding of the execution alternatives available. Constructing an analytical framework in which to make decisions about FX trading can be challenging because information is not as readily available in FX, so investors need assistance to find the right information and the right way to use it.

Transaction cost analysis (TCA) tools help clients get control of this information. By aggregating client data, which remains confidential, industry benchmarks that are unavailable from other sources can be constructed to provide background knowledge for clients about acceptable trading ranges or the right price for transferring risk.

"Customers have lots of different ways of doing things – the important thing is to find the right way for the customer at the right time and that's where we help," says Weisberg. FXall has basic reports for validating best execution and indicative quotes give clients a frame of reference for their trading. Custom analytics can provide insight around issues specific to efficient trading strategies to provide clients with a consultative approach to evaluate their execution processes.

FXall recognizes that clients demand not only functionality, but a sophisticated toolset to help them understand their trading and how it works in the current market.

Kevin P McMahon, head of technology and operations at ING Investment Management, says, "Given changes in our investment strategies, having FXall embedded in our investment process has allowed us to contend with increasing volumes, mitigate operational risk via STP and secure optimal execution quality in a seamless manner. Moreover, FXall TCA provides robust capabilities to quantify the execution value added during our best execution reviews."

Helping clients select the right strategy

FXall has always offered multiple execution alternatives – from benchmark orders to batch to RFQ – which are all available to clients in a single application. Consequently, it is well placed to offer independent advice. "FXall has the data and analysis capability, as well as the trading platform to help clients align how they use the trading tools with the market and their objectives," says Neill Penney at FXall.

For example, an average asset manager does not have access to data that demonstrates the pricing implications of breaking a trade into two parts executed 10 minutes apart rather than executing a single order. "To help them understand risks like that," says Penney, "we bring knowledge about the broader market environment that would otherwise not be cost effective for them to obtain."

At times, customers want to control the execution themselves and in other situations they want to collaborate with their bank salesperson. FXall now offers an Aggregator, designed for active traders, that was built with the recognition that banks can be reluctant to service split trades from clients because of the risk of the market moving against them. "They would rather win an entire $10 million trade and price it competitively than win $2 million and charge more," notes Penney.

To this end, FXall's new system only offers full amount trading and actively prevents clients from making multiple trades across different venues by locking out the traded currency pair for a set period depending on the size of the trade. Banks benefit from knowing they will not be swept, and clients benefit from better pricing. An important principle of the system is to give banks the last look on a trade and full control over whether they continue to trade with that counterparty. In addition, banks can choose to provide liquidity to an individual client only using one system to prevent multiple orders for the same trade.

Larger clients in particular, such as hedge funds, require the flexibility to trade rolls, forwards and non-deliverable forwards – for which request for proposal is a suitable tool – in addition to spot. By having all these tools consolidated within one trading platform, it becomes easy for clients to make an instant decision on the best way to trade.

Customers also employ FXall's cross currency netting (CCN) function to consult with their bank or custodian to determine the optimal trading strategy within a fully automated process that has a complete audit trail. Clients can identify principal risks within a currency portfolio, so these can be efficiently transferred to their chosen provider with details automatically processed by an integrated workflow and straight through processing capability.

Control and compliance

In a market where the execution strategies have changed and will continue to fluctuate between direct bank relationships and voice trading to direct ECN access, the centrality of control and compliance remains. Technology facilitates a growing variety of execution alternatives, which when coupled with the trend towards expanding relationships, make compliance more difficult.

Similar changes in the hedge fund world are also focusing attention on control and compliance. After the market dislocations, hedge funds realized that they needed multiple brokers. As hedge funds expand the number of prime brokers they work with to reduce counterparty risk, their settlement and custody business has become more complicated. It is therefore essential to have efficient trade booking so that an output can be provided for straight through processing and risk management.

Following regulatory changes, such as MiFID and Sarbanes-Oxley, that reinforced the need for controls, focus on audit trails and compliance has only increased. Market turmoil and the demand for performance and accountability have caused a flight to quality and are driving a push for greater transparency. Larger hedge funds may emulate traditional long-only asset managers, which inevitably have more established processes, highlighting the importance of having formalized controls and processes for both investors and regulators. Having spent years building control and compliance functionality into its products for asset managers, FXall is well placed to benefit from this trend.

Choosing the right vendor

With counterparty risk a major issue in the foreign exchange market, other aspects of risk management are now at the fore. Companies are returning to their core business and are revisiting many traditional standards used to evaluate their partners, whether for trading or technology solutions. They want to make sure that they are working with a partner that is going to be around for years to come.

Customers are demanding several elements from their core vendors and partners: critical business mass; a strong balance sheet; a robust infrastructure; a responsive and service-oriented staff; and a strong capital base. Trust, accountability and a commitment to ongoing investment are other hallmarks of reliable partners. Concerns about the financial stability of technology vendors have become a focus as customers evaluate new technology partners.

"We've gone back to a position where people want to see our balance sheet and put us through the strict vendor approval process," explains Weisberg. "The company has a strong cash position and no debt." FXall is a private company with a strong corporate governance model, solid financials and a stable record. FXall is audited by PricewaterhouseCoopers and makes its financial information available to any clients wishing to see it.

Phil Weisberg, CEO, FXall:

"Our interests are aligned with clients: we only benefit if a client benefits."

Trust is essential

FXall is a trusted partner that understands the needs of banks and clients. Clients are increasingly concerned about potential conflicts of interest. In the past, size was some reassurance about the stability and honesty of a market participant. But now investors want to understand how an overall web of relationships works between firms and how it compounds risks.

Uniquely positioned to reassure clients in this area, FXall does not have any conflicts so it does not have to manage any. "We don't trade and compete with our clients for liquidity," says Weisberg. Moreover, no one at FXall is allowed to trade foreign exchange. "Our interests are aligned with clients: we only benefit if a client benefits. Our objective is to grow volumes and the only way to do that is to meet the concerns of both sides of a trade and make sure they feel they got a good deal," says Weisberg.

FXall®
What's Your Edge?

contacts

FXall gives institutional clients an edge in foreign exchange trading as the leading independent electronic platform. We deliver the expertise, resources and commitment of a neutral platform with the broadest suite of FX trading solutions that combine execution tools with end-to-end workflow management and straight through processing. Our flexible tool set delivers the right execution strategies and liquidity in all market conditions for over 800 institutions globally. FXall has been voted the #1 multibank and independent platform in the annual Euromoney polls from 2002 through 2009. FXall's offices in New York, Boston, London, Tokyo, Singapore and Sydney serve the needs of active traders, asset managers, corporate treasurers, banks, broker-dealers and prime brokers.

For more information on FXall, visit **www.fxall.com**

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