The e-Forex Interview

The e-Forex Interview

With Richard Estes, Head of Global Markets e-commerce, The Bank of New York

Richard – BNY was a pioneer in eFX offerings with the launch of iFX Manager in early 1999. Is being first-to-market always advantageous or are there any drawbacks?

Being first-to-market offers a couple of advantages. One, we have been able to influence the evolution of eFX within the industry through the way we designed certain trading functionality ahead of others. This is one of the major reasons FXall used our technology as the basis for its trading platform. Two, it has enabled us to move past product design and concentrate on system performance and client service, which in the end matter most to clients adopting eFX.

As the largest custodian in the world, BNY has a substantial client base of investment managers, and pension funds. How important was it, in developing iFX Manager, to be able to leverage your experience of global investment transaction processing amongst these clients?

It was extremely important. As a major custodian, we understand the entire trade lifecycle, not just the brief interaction between client and trading desk to execute a trade. This is why iFX Manager is designed so differently from the dealing systems of most other banks. As a result, iFX Manager has been acknowledged by the industry press as the best FX site for fund managers as well as the best in FX STP for two years running.

You've said in the past that an online FX system requires more than just getting the technology right, it's about building a whole new business. What impact does this approach have on the client side?

It has a big impact on securing new client business. When clients elect to use iFX Manager, they are not just getting an FX trading system with great functionality designed specifically for them. They are also getting quality client service through user training, assistance on interface design and implementation, 24-hour help desk, and online support tools. All of this requires the marshalling of various resources within BNY to provide this quality support.

Given that single bank trading systems have had a longer history of incorporating client feedback, how significant an advantage in operating performance has this given them over the multi-bank platforms?

While we are at a stage where both single-bank systems and multi-bank portals are robust enough to operate with virtually no service disruptions 24 hours a day, one key differentiator remains the richness of functionality that single bank systems enjoy over the multi-bank portals. Banks have been able to focus on providing the specific functionality that their clients demand, whether it be prime brokerage for hedge funds or order management for fund managers. The portals, meanwhile, have had to ensure that each bit of new functionality is widely demanded by the buy-side (and thus warrants the capital investment to develop), and can be supported by a majority of its provider banks. This evaluation and coordination process has resulted in the portals acting more deliberately.

Do you think that participation in a multi-bank web-site is a reasonable substitute for developing a proprietary FX web-site?

I do not. Most banks have a number of clients who trade predominently or exclusively with them. As such, it does not make much economic sense for a bank to pay membership and brokerage fees to a multi-bank portal just for the purpose of trading with one's captive clients. Plus, it makes a bank vulnerable to the ultimate viability of a portal – any bank that used Atriax this way was severely injured in its development of its eFX business.

Would you subscribe to the view that the "jury is still out" on whether the multi-bank FX portals can operate a viable long term business?

Despite the great functionality provided by FXall, Currenex, and FXConnect, none of them have proven that they can operate a profitable eFX business that links buy-side and sell-side together. They can only do so if they acquire a critical mass of buy-side users, price their services cheaply enough to maintain sell-side participation, and aggressively manage their cost base. Of the three, FXConnect has an advantage, because it also serves as State Street's single bank system, and therefore will continue to receive the funding needed to maintain it for State Street's clients.

iFX Manager automates the complete order management process of FX trades and thus improves post trade efficiencies. Will the provision of improved post trade services such as in operations and settlement, be a key area of differentiation between banks?

It is. Clients are seeking to have complete STP of the entire trade lifecycle, which includes both front office and back office functions. This includes automatic notification of third-parties who settle and account for trades on the clients' behalf, as well as automatic matching of trade confirmations. Banks who can offer these additional services stand to gain a greater proportion of a client's business, due to the elimination of operational obstacles that still require clients to use certain banks for a portion of their FX trading.

Most agree that it is only through the efficiencies of STP that the long term benefits of eFX will be felt. However, STP can mean different things to different clients. What key elements have your clients identified that need to be incorporated into a satisfactory definition of STP?

"STP" means the automation of the entire trade lifecycle. That means that the FX trade requirement must be created within a client application, then exported to a trading platform, priced electronically, exported back to the client application, enriched with settlement details, and confirmed and reconciled – all performed automatically with no rekeying or repairing of data.

Are there any particular areas that BNY plans to improve in your STP offerings?

We continue to focus on automating pre- and post-trade functionality. One area will be the launching of an online module for trade confirmation and management of standing settlement instructions. Another will be steamlining the way clients connect to our API, so that it becomes even simpler and quicker.

End-to-end STP is considered by many to be a holy grail for the Fund Manager. Now that it's becoming attainable what remains to hold up the widespread penetration of eFX amongst the Fund Management community?

Fund managers are now beginning to embrace eFX en masse. Three years ago most took a wait-and-see attitude. Now, a majority of them are either using eFX or considering doing so. For the late comers, it is a matter of evaluating the mature single-bank systems and the remaining multi-bank portals and determining which one (or ones) best suits their needs. It also then means making a commitment to integrating their systems to the chosen system(s) by their IT department to achieve STP.

A recent Global Investor survey suggests that many more investors are concentrating their business with a smaller number of banks. Do you think electronic trading is a key driver of this consolidation trend and will precipitate increasing sell-side pressures?

Electronic trading may ultimately bring a concentration of business with the top banks. Once a client makes the commitment to trade electronically, and invests time and capital into systems integration, it will insist that its banks support eFX. A bank that does not do so risks being dropped by the client because it will become too inefficient to trade with that bank.

Many believe the eFX market is at a relatively youthful stage of its evolution. Do you agree with this and that the real growth in eFX is yet to come?

While many large fund managers, corporations, and broker-dealers now trade FX online, most end users of FX still do not trade electronically. This is because many smaller banks have not yet invested in eFX. These banks may develop eFX offerings through cheaper vendor-provided systems based on an ASP model. Alternatively, they may white-label the eFX system of a larger, established eFX bank, with the requirement that they source liquidity from that bank. This will broaden the ability of any bank to offer eFX to its clients.

Separately, there is a whole new wave of opportunities in the bundling of eFX with other bank products – namely real-time FX accommodation trading. Examples of this include cash management and brokerage, where a client can initiate a payment or securities trade and execute the required FX simultaneously online from a single screen. This is a change in paradigm from the current means of eFX, which is based on FX being traded directly with a bank's FX desk and separately from the underlying activity that generates the FX need. This indirect use of eFX, which leverages the existing infrastructure built by the banks, will lead to new growth in demand for FX.