CAPLIN

Mood changes in the FX market 2023

Towards the end of each year, I like to look back and see what has changed in the world of FX. Sometimes it's world events related, and the resulting impact on volatility. Other times, the theme has been mainly focused on regulation and how it will affect client and bank behaviour. In most years, one way to get a handle on these themes is to attend one of the many conferences that have started to re-emerge after the Covid winter.

To be honest, there is a certain sense of déja vu experienced as you settle down in the auditorium of a venue at the start of another FX conference. Certainly, you don't attend these things for the carb-laden catering, or the slightly grim coffee. And, at the start, the FullFX Conference held in London in early November looked as if it was going to follow the same pattern as countless others. If truth be told, as a vendor attendee (rather than as a speaker), it's not even the prospect of the sessions that gets your pulse racing. It's the opportunity to speak to many current and prospective clients, all confined in the same space for a brief point in time, and ask them what's keeping them up at night. So when the ratio of banks to vendors is heavily weighted towards vendors (as they're the ones who foot the bill) and the location is the City of London, which tempts bank attendees to pop in for a session or two, and then duck out, sometimes there's no alternative than to actually sit and listen to all the sessions.

Over cocktails afterwards, the two sessions the attendees I spoke to seemed to enjoy the most were the whistle-stop tour of AI given by Caplin's CEO John Ashworth (no, honestly!), and Uncle Colin's 'For FX' Sake' trip down memory lane with guest speakers, appealing perhaps to the new and the old in the market, in that order.

Yet there was something slightly different about the tone of this conference that gave me pause for thought. In previous conferences, there are normally fewer, longer sessions that feature topics like the economy, emerging market currencies, liquidity in NDFs etc, all weighty subjects on their own. But getting caught up in the undergrowth around these larger trees makes it harder to see the forest, and it was the changing nature of that forest which struck me during this conference.

More, shorter sessions, with smaller panels seemed to force an economy of thought as the panellists had to make their respective points more succinctly. And the overriding theme this year was one of technology based solutions to problems. Here are some examples:

- **FX & AI:** How to promote transparency, how to balance enhanced AI driven performance with the need to be able to explain it to management, avoid cataclysmic meltdown and/or a Luddite revolution.
- **Changing face of execution:** How to resolve the dilemma in that lining up 5 banks in competition and taking the best price is rarely a demonstration of 'Best Execution' given market impact and information leakage, especially for larger trades and institutional investors.
- **P2P:** Blair Hawthorne's 'pitch' for a large size peer-to-peer block matching algorithm, Loop FX, looked at a new solution for large deals that minimised slippage, reduced spread and where all participants benefitted.
- **T+1:** Solutions to a problem that will affect all large banks especially custodians come May 28th 2024.

And so on, through swaps automation, post trade risk reduction, changes and partnerships in the options world, need for better, cleaner data, adoption of the Global Code, Smart Clearing....even the session of Crypto focused less on Crypto as an asset class per se, and more for the need for DLT based payment solutions to settle tokenised 'real world assets'. This was an FX conference and yet the focus was almost entirely technology related.

Now it's clear that many of these topics, whilst undoubtedly interesting, may not be strictly relevant to the current business models of some of the smaller regional banks. They can just carry on with 'business as usual' certainly in the medium term. Or can they?

Upon reflection, I draw several conclusions from this conference.

1. The ecosystem around the FX business is changing more rapidly than we think (or would like to think).
2. That world is already split into those large institutions – banks and non bank LPs – who invest heavily in technology and strive to stay ahead of the curve, and those that don't. This trend will continue and even accelerate. Smaller banks who deny the existential threat from alternative providers – other banks, fintechs, brokers, phone companies – are deluding themselves (brace for the howls of protest). As a side note, the UK Government's Future of Payments Review report, published on November 22nd 2023 highlighted the role that technology is playing in re-thinking the whole payments space and how we as consumers transfer money.
3. Single Dealer Platforms will need to reinvent themselves as Solutions Delivery Platforms, with more interoperability (think Open Banking) and greater ease of integration into/with 3rd party corporate packages like QuickBooks, Xero etc for SMEs and optional plugins for more sophisticated clients.
4. The old SDP vs MDP debate rarely gets a look-in especially since the costs and the information leakage inherent in MDP methodology mean that for much of the FX market flow, the MDP route is neither accessible (only one bank relationship) nor desirable (excessive signalling of large trades). Transparency, competition laws and unbundling will make it easier to switch between providers.
5. At some point soon, the 'lazy' avenue of just executing at the standard FIX will be called out by real money investors keen to pare down execution costs. Better algos and new solutions like Loop FX will challenge it.

It's true that for many of the smaller banks, the challenges posed above are not strictly relevant to their current client workflow – a minor regional bank is unlikely to be overly bothered by T+1 settlement or P2P block matching. Yet advances or changes in one sector often feed through to others – think algos, mobile, derivatives and regulation.

How does this affect technology vendors as their legs get caught in the brambles around the first tree of that forest? Clearly, every vendor is different, with different product sets, a different specific target audience, at a different stage of company development. Yet some common principles should apply, since we're all solutions providers, and to offer an effective solution, we have to first diagnose the nature of the problem we might be able to solve.

Banks aren't great at talking about their problems, certainly not externally and, from my experience, even less so internally. But unlike a wild organically expanding forest, the one we're facing is more like a man-made plantation: huge, diverse, initially impenetrable, but something that should have a structure, a purpose, a plan for the short, medium and long terms. It's just that all too often the trees at one end of the forest don't know how they relate to the trees at the other end, or even that the other end exists.

In the short term, as a vendor and technology partner, it's important to redouble our efforts to find out what keeps our clients awake at night, and even more so to try and expand the circle of contacts/decision-makers to whom we speak inside those banks. With smaller banks, there will be tactical solutions to solve workflow bottlenecks rather than simply a new SDP to facilitate execution – FX as payments, ease of integration, cross asset sales cooperation, information dashboards are all part of that process. This is dealing with the 'known knowns'…

For larger banks, the 'known unknowns' will dominate the discussion – what will the pressure on Risk Weighted Assets do for the current credit model of FX? How will they manage to compete against ever more powerful rivals, in terms of investment spending, market data and intelligence? How will CBDCs affect their business models in the longer term? How do departments that have historically competed for resources learn to share effectively when each department's ROI is being continuously assessed?

And then there's the 'unknown unknowns' which, by definition……

To be part of the discussion, we need to earn the right to a seat at the table, which means encouraging clients to see us as thoughtful partners in their business development plans. Demonstrating that you have worked with clients on solving problems, and have delivered measurable results is not easy if, as a vendor, your short term aim is simply to 'make a sale'. However, if you take the time to establish a position of trust, and to understand the complex situation your client is undoubtedly facing, then, if your solution is genuinely a good fit and you've shown curiosity, innovation and a willingness to go the extra mile, you will have earned the right to take the conversation further.