FX·Week

News : Global FX Division establishes FXPB

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The Global FX Division (GFXD) of AFME/SIFMA/ASIFMA announced the formation of a working group to focus specifically on the challenges and issues surrounding global FX prime brokerage (FXPB) and to implement over-the-counter FX clearing for clients.

The participants of the new group, co-chaired by Citi, Deutsche Bank and JP Morgan, comprise a number of the global prime brokerage firms already actively involved with the GFXD.

"As we build out the Global FX Division, it is becoming clear there is real benefit in having a co-ordinated global body to respond to regulation and work to implement best practices and technology solutions for the FX clearing industry," said James Kemp, managing director at AFME's GFXD in London. "We expect the new FX prime brokerage group to look at key issues such as client clearing models, electronic communications networks best practice and also to represent end-client needs. We anticipate we will be working closely with regulators and central banks."

AFME's GFXD, launched in June this year, now comprises 21 members, accounting for more than 85% of the FX market.

The increasingly competitive market for FXPB continues to lower the barriers to entry to trade foreign exchange. Reflecting this, last week the Bank for International Settlements' (BIS) triennial FX survey confirmed the 'trading activity with other financial institutions' category overtook transactions with reporting dealers for the first time this year.

Other financial institutions encompass non-reporting banks, hedge funds, pension funds, mutual funds, insurance companies and central banks, said the BIS. Turnover by this category grew by 42% to $1.9 trillion in April this year from $1.3 trillion in April 2007. Meanwhile, the BIS reported a 20% increase in FX turnover to $4 trillion in April from April 2007 (*FX Week*, September 6).

Josh Levy, managing director at Tactical Asset Management in New York, attributed the 20% increase in FX turnover to the faster take-up of FX traded as an asset class. "The FX market has grown explosively, as has the number of participants, ranging from small- to medium-tier asset managers, hedge funds, commodity trading advisers and active retail professional traders," he said. "Additionally, each of these new participants is trading more frequently, on average, with the advent of computer-driven trading programs."

He said retail FX aggregators, such as FXCM, are taking advantage of prime brokerage services offered by banks. "The barriers for entry to FX prime brokerage have definitely gone down," he said.

Jeff Feig, global head of G-10 foreign exchange at Citi in New York, said the retail sector has grown dramatically in the past two BIS cycles, driven largely by real-time margining technology and tighter bid/offer spreads.

Meanwhile Kevin Rodgers, global head of FX derivatives at Deutsche Bank in London, said that hedge funds are increasingly trading FX, as it is being viewed more and more as an asset class.

OTC FX instruments – June 2010 versus June 2007

The BIS survey also looked at growth in the positions of over-the-counter foreign exchange instruments encompassing outright forwards, FX swaps, currency swaps and FX options. Growth was moderate at 9%, compared with an increase of 83% in notional amounts outstanding of currency instruments between 2004 and 2007.

Options outstanding fell 12% to $12 trillion or 19% of the total outstanding of total FX instruments by the end of June, versus 24% in 2007. Dealers suggested this was due to an increase in options prices since 2007 but also because of the impact of higher volatility levels.

"Flat volumes are a direct reflection of reduced leverage of options accounts resulting from the much higher volatility level," said Simon Nursey, global head of FX options trading at BNP Paribas in London. "Average volatilities (implied and realised) in early 2007 were less than half the level they are today. So today an option user needs to transact half the notional to achieve the same risk and the same alpha as three years ago."