

Electronic FX: As Global Markets Normalize, Slow But Steady Growth

May 2010

Global foreign exchange markets continued their migration to electronic execution last year as e-forex trading volumes increased amid a decline in overall FX trading activity.

Customer electronic foreign exchange trading volumes increased 7% from 2008 to 2009. While this growth pales in comparison to the 25% expansion in 2007–2008, the fact that electronic trading systems were attracting business while the overall market was contracting suggests that market participants continue to actively shift trading volumes to the platforms from other channels.

Worldwide foreign exchange trading activity spiked during the crisis-plagued years of 2007 and 2008. Over the most recent year, volatility has subsided and markets have returned to some degree of normality. Stabilization of global markets led to a 6% decline in total FX volume from 2008–2009. This contraction, coupled with growth in electronic trading, pushed the share of total foreign exchange trading volume executed electronically to 58% in 2009 from 54% in 2008.

Over that period, electronic trading volumes increased 16% in the Americas and by 44% in Asia, while remaining essentially flat in Continental Europe and falling nearly 10% in the United Kingdom. Electronic trading systems

now capture 53% of total foreign exchange trading volume in the Americas — up from 48% last year — and 61% in Europe — up from 59%. The shift to electronic execution has been even more pronounced in Asia. In Japan, e-trading increased to 63% of total FX volume in 2009 from 42% in 2008, driven by a huge increase in volume among retail aggregators. Across the rest of Asia, electronic platforms attracted half of total foreign exchange trading volume, up from 40% last year.

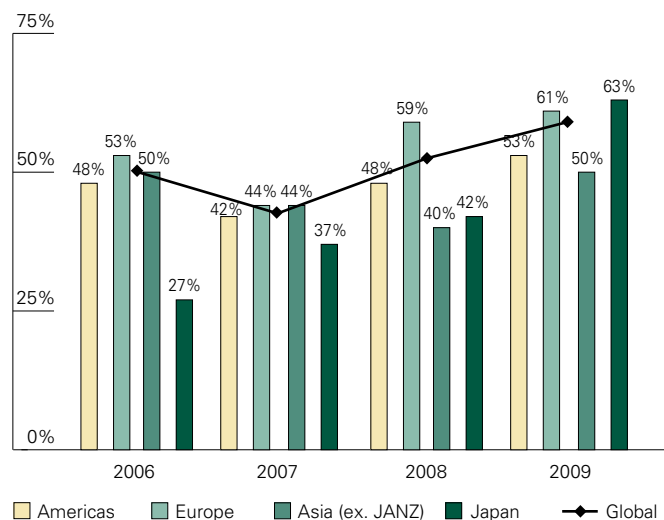
“Last year’s growth had two main drivers,” says Greenwich Associates consultant Peter D’Amario. “Around the world, but particularly in the Americas and Asia, electronic trading systems are attracting new customers. At the same time, existing users are increasing the share of their total foreign exchange trading volumes conducted via electronic execution.”

Systems Attracting New Customers in Americas, Asia

Globally, the proportion of active FX market participants using electronic trading systems increased to 61% in 2009 from 57% in 2008. While usage was essentially flat across Europe and Japan at about 70% and 40%, respectively, e-trading systems in other regions were attracting relatively large numbers of new customers. In the Americas, 60% of market participants traded FX electronically in 2009, up from 54% in 2008. Growth was also strong in Asia excluding Japan, Australia and New Zealand, where usage climbed to just more than half of market participants in 2009 from 46% the prior year.

Meanwhile, the proportion of FX market participants reporting that they have no plans to trade foreign exchange electronically at any point continues to erode. Worldwide, about one third of FX market participants fall into this category of eFX holdouts — down from 35% in 2008. Among corporates, the group of holdouts dropped to 42% in 2009 from 45% in 2008. Even in regions where until very recently relatively large shares of market participants were reluctant to log on, holdouts are being converted. In non-Japan Asia the share of market participants saying they do not plan to use electronic trading declined to 42% in 2009 from 46% in 2008. In Canada that share fell to 53% from 64%. Only in Japan did the group of holdouts hold steady from 2008 to 2009 at 56–57% of FX market participants.

Percentage of Total FX Volume Traded Electronically



Note: Based on responses from 1,497 top tier corporates and financial institutions in 2009, 1,437 in 2008, 1,780 in 2007, and 1,663 in 2006.
Source: 2010 Global Foreign Exchange Study

Across all these regions, new e-trading customers last year included both corporations and financial institutions. In 2008, only 45% of corporate FX market participants traded electronically. In 2009, that share jumped to half. Usage rates among financials increased to 71% in 2009 from 68% in 2008. More than 90% of banks active in FX markets now trade electronically, and the share of fund managers and pension funds using eFX increased to 62% in 2009 from 57% in 2008.

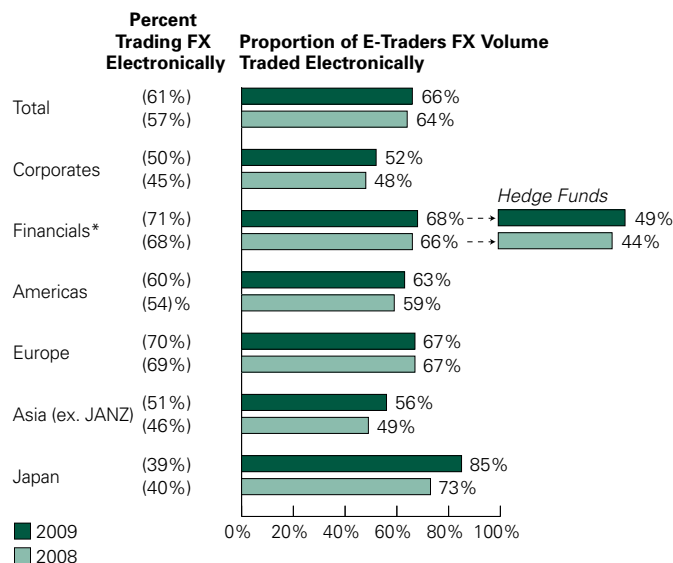
Although electronic trading platforms acquired few new users among the world's most active FX market participants — of which almost 85% already trade electronically — usage rates increased among other participants both large and small. In the former category, among market participants trading \$10 billion to \$50 billion in FX volumes every year, electronic trading usage jumped to 71% in 2009 from 65% in 2008. Similar growth was seen among participants in the \$1–10 billion category and a more modest increase in usage was reported among more infrequent users of foreign exchange markets.

Electronic Traders Ramp Up Volumes

In addition to business from new customers, electronic trading volumes were inflated last year by the growing share of total trading volume allocated to electronic systems by existing users. Current users of e-trading platforms executed two-thirds of overall FX trading volume electronically in 2009, up from 64% in 2008. Corporate users of eFX increased the share of total FX volume directed to electronic systems to 52% in 2009 from 48% in 2008, while existing financial e-trading clients upped electronic execution to 68% of their total volume from 66%.

Electronic Systems Gaining Customers and Trading Volumes

Electronic Execution



Note: Based on responses from 1,497 top tier corporates and financial institutions in 2009 and 1,437 in 2008. *Financials includes banks, fund managers/pension funds, hedge funds/CTAs, and insurance. Source: 2010 Global Foreign Exchange Study

In Europe, existing users of e-trading systems executed a constant two-thirds of their total trading volume electronically in 2008 and 2009. In the Americas, however, existing users increased e-trading to 63% of total volume from 59%, and in Japan, users upped the share of their total volume done electronically to 85% from 73%. Elsewhere in Asia, electronic trading volume among existing e-traders increased to 56% of total volume in 2009 from 49% in 2008.

Hedge Fund Falloff

The increase in electronic trading volume last year is all the more impressive in light of a reduction in activity among hedge funds. Although hedge funds have not traditionally been heavy users of electronic trading systems relative to banks and other large financial institutions, they were among the most important drivers of booming foreign exchange trading volumes in the years leading up to the global crisis, and as such, contributed significant amounts of new trading business to electronic systems.

Through 2008, electronic trading systems were capturing almost half of hedge fund FX trading volumes. That share dropped to 44% in 2009, as the total amount of electronic trading volume generated by hedge funds dropped 15%. During this period the share of hedge funds using electronic trading systems was steady to even slightly higher. However, hedge funds that employ electronic trading cut back significantly on their use. “Hedge fund users of electronic trading systems executed 38% of total FX trading volume electronically in 2009, down from 44% in 2008,” notes Greenwich Associates consultant Tim Sangston.

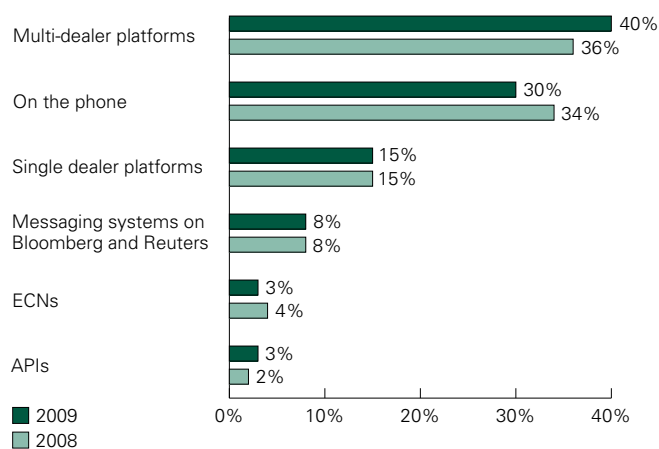
Multi-Dealer Systems: The Dominant FX Channel

Multi-bank electronic systems are gradually emerging as the dominant channel for global foreign exchange trade execution. For several years Greenwich Associates has tracked the progress of multi-bank platforms as they became increasingly attractive alternatives to single-dealer platforms. By 2008, it had become apparent that multi-dealer systems, with some exceptions and temporary blips in the trend, had surpassed proprietary platforms as market participants' channel of choice — at least in terms of use and volumes. The 38% of total market trading volume executed via multi-bank platforms in 2008 was not only more than double the share executed on single-bank platforms, it was also slightly larger than the 34% of overall FX market trading volume conducted by telephone. (Note: All volumes discussed in this report are based on customer trading activity; the use of single-bank platforms is higher in inter-bank trading.)

Over the past 12 months, multi-bank systems appear to have seized trading volume directly from telephone-based trading. While the share of total volume executed on multi-bank platforms increased to 40% in 2009 from the 38% in 2008, the share executed via phone transactions decreased to 30% from 34%. Single-bank systems were

Multi-Bank Systems Replacing Telephone as Primary FX Trading Channel

Proportion of Volume by Channel Among Online Traders



Note: Based on responses from 1,497 top tier corporates and financial institutions in 2009 and 1,437 in 2008. Source: 2010 Global Foreign Exchange Study

flat at 15% of total volume over the period. Multi-bank platforms have captured even larger shares of overall volume in some regions and among certain types of investors. Multi-bank systems account for 47% of total trading volume in the United States, 48% among corporates around the world and 52% among fund managers/pension funds.

Hedge funds execute the smallest share of total volume on multi-dealer platforms, at just 22%, while using single-dealer systems for more than a quarter. Single-dealer systems also attract larger shares of trading volume from the most active FX market participants and — at the other end of the spectrum — infrequent users of foreign exchange. Among market participants generating more than \$50 billion in annual FX trading volumes, single-dealer systems capture 19% of total volume. These systems also attract 18% of total volume from market participants — mainly corporates — that generate less than \$1 billion in annual trading volume.

“These results suggest an emerging market structure in which multi-dealer systems are used as a primary channel for execution on a day-to-day basis by many market participants — in tandem with telephone transactions — and single-dealer systems are used on a more specialized basis by hedge funds and large financials executing sizeable or particularly complex transactions, and by small corporates who may trade infrequently and are content to execute trades with their primary banks without much

in the way of multi-dealer price discovery,” explains Greenwich Associates consultant Woody Canaday.

It is becoming increasingly apparent that the telephone, which has reigned as the dominant channel for FX trading for decades, is losing ground to electronic execution of all types in every major market around the world. Less than 30% of FX trading volume is now done by phone in the United States, and in non-Japan Asia that share has fallen to just 21%. In fact, in Asia, telephone transactions have been surpassed by messaging systems on Bloomberg and Reuters as a means of conducting FX trades, with these systems capturing 23% of overall volume. “We fully expect this trend to continue as electronic trading platforms continue to attract new customers and market participants already experienced in electronic trading allocate increasing amounts of business through electronic systems,” says Greenwich Associates consultant Frank Feenstra.

GA consultants Peter D’Amario, Tim Sangston, Woody Canaday, and Frank Feenstra specialize in the foreign exchange markets globally.

Methodology

Greenwich Associates conducted in-person interviews with 1,497 top-tier users of foreign exchange services at large corporations and financial institutions on market trends and their relationships with their dealers. Interviews were conducted in North America, Latin America, Europe, Asia, and Japan between October and November 2009.

The findings reported in this document reflect solely the views reported to Greenwich Associates by the research participants. They do not represent opinions or endorsements by Greenwich Associates or its staff. Interviewees may be asked about their use of and demand for financial products and services and about investment practices in relevant financial markets. Greenwich Associates compiles the data received, conducts statistical analysis and review for presentation purposes in order to produce the final results.

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