MillTechFX
by Millennium Global

Navigating The Opaque But Evolving World Of FX Execution

The MillTechFX FX Strategy Report: A Guide For UK Businesses

Inside You'll Learn How To:

Enhance Transparency & Counterparty Diversity

Navigate FX dealings with confidence & complete transparency.

Embrace Automation for Efficiency

Explore automation to achieve cost savings, reduce risk, & streamline FX processes.

Prioritise ESG in Decision-Making

Recognise the growing importance of ESG in counterparty selection & strategic decision-making

Prepare for Future Challenges

Stay ahead of evolving market dynamics with technology-driven solutions.

Summary

Foreign exchange (FX) risk management has risen to the top of the agenda for many senior finance decision-makers at corporates throughout 2023.

Although volatility has decreased since peaking towards the end of 2022, it is still a persistent threat due to a combination of rising interest rates, high inflation and geopolitical uncertainty.

Sterling hit a 15-month high in July, proving to be the best-performing major currency against the US dollar in 2023, rising 6.6%. In September, it dropped to three-month lows against the dollar.

Having reached a two-decade high against other major currencies in September 2022, the US dollar slid to a nine-month low in February 2023 and continued to dip until it rebounded again in September 2023. Meanwhile, the euro hit a six-month low in September 2023 after the ECB raised interest rates to a record high.

All of this movement is having **an impact on corporates' bottom lines** and can make it difficult for corporate treasurers to predict what's next.

Apple, Getty Images and United Parcel Service noted that dollar volatility was lowering profit margins, as goods become more expensive for customers abroad.

According to Kyriba's July 2023 Currency Impact Report which looks at data from the earnings calls of 1,200 publicly-traded North American and European companies, **the collective quantified negative impact of currency movements was $22.5 billion in the first quarter of 2023.** While this is a 25.5% decrease from the fourth quarter of 2022, it still demonstrates the sizeable impact of currency movements.

Firms are likely to welcome the lower volatility in recent months, but it hasn't gone away completely and they must not become complacent. With uncertainty set to stay, **how can corporates adapt FX risk management strategies to stay ahead of the curve?**

Censuswide conducted a survey on MillTechFX's behalf of 250 senior finance decision-makers* at UK corporates to provide the answer to this question and more. The findings offer a unique window into corporates' views on FX, how they're adapting their FX risk management practices and their priorities in the year ahead:

Lack of transparency in FX – Our research revealed the majority of UK corporates believe there is a lack of transparency in the FX market. The FX market has been seen as **historically opaque due to hidden costs**, an inability to compare the market and better pricing for bigger firms.

Adapting to lower volatility – Unlike the turbulence we saw in 2022, the FX market has calmed so far this year with volatility dropping. A slim majority of UK corporates feel that risk has dropped and the number that hedge FX risk has also dropped. That said, **senior finance decision-makers continue to prioritise FX risk** and plan to hedge more of their exposure in the year ahead.

Counterparty diversification – The banking crisis was a huge wake-up call to corporates across the globe, highlighting the risks of relying on one or two banking partners. As a result, the majority of UK corporates surveyed said they are looking **to diversify their FX counterparties.**

Automation drive – The majority of corporates are exploring new technology and platforms to automate their FX processes. The key driver is **cost savings**, followed by **eliminating silos** 29%, **operational risk reduction** 28% and **simplicity** 25%.

ESG's continuing rise – ESG continues to be an important priority for UK corporates with most respondents stating it's an important factor in counterparty selection and that it's grown in importance in the past year.

Looking ahead throughout the rest of 2023 and beyond, we believe getting the right processes in now and implementing alternative technology-driven solutions that can help manage FX risk more effectively will be key in navigating the challenges that lie ahead.

Part 1

FX has a transparency problem

Our research revealed that 62% of UK corporates believe there's a lack of transparency in the FX market.

The FX market has historically been seen as opaque for several reasons:

Hidden costs

Pricing transparency is a recurring problem as FX costs are typically hidden in the spread. The transaction cost on any given trade can be calculated as the difference between the rate traded at, and the mid-market rate at that point. For example, if a corporate buys €5m of USD at 1.1890 and the mid-market rate at the time was 1.1860, the transaction cost on the trade would be 0.25%, or €12,500. This is not an explicit cost as the treasurer won't receive an invoice for this amount; rather, **it's a hidden implicit cost.** Let's make no mistake though: **it's just as much of a cost.**

Best pricing for bigger firms

One of the main issues in the FX market, in our opinion, is that **clients are provided rates in different capacities depending on what kind of client they are** – a concept called "tailored pricing". As a result, the best rates are reserved for institutions that transact the highest volumes, meaning mid-sized corporates and asset managers are often neglected and struggle to get the best possible deal. A 2019 paper from the ECB found that **banks were overcharging small corporate customers** for FX services, charging hedging rates **as much as 25x higher** than their bigger, more sophisticated customers.

Inability to compare the market

For corporates who trade FX for payment or hedging purposes, FX can be seen as second-order: they transact in FX not because they 'want to', but because they 'have to' due to international business activities. It is thus often **operationally inefficient** for them to set up and **manage multi-bank relationships.**

Our research also found that, on average, UK corporates only have three FX counterparties. Staggeringly, **only 1% had more than five FX counterparties.**

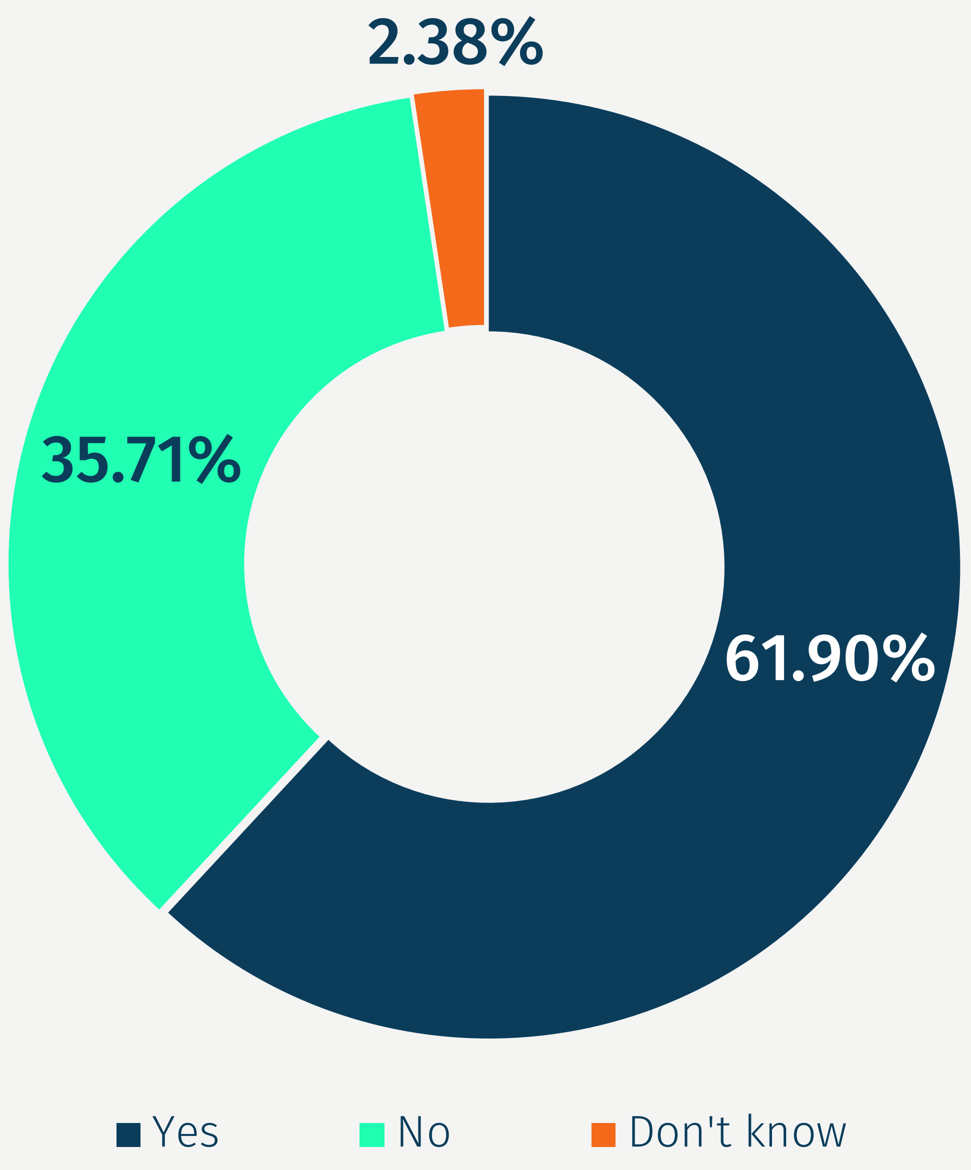
Relying on two or three counterparties can make it extremely difficult to compare the market as when executing trades, corporates are often beholden to limited sources of liquidity. At any given time, they may not be able to trade at the best available rate as **they have no other access points to the market.**

Aside from a lack of transparency, other FX operational challenges included demonstrating best execution (38%), manual processes (32%), onboarding liquidity providers (32%), execution (29%) and getting comparative quotes (28%).

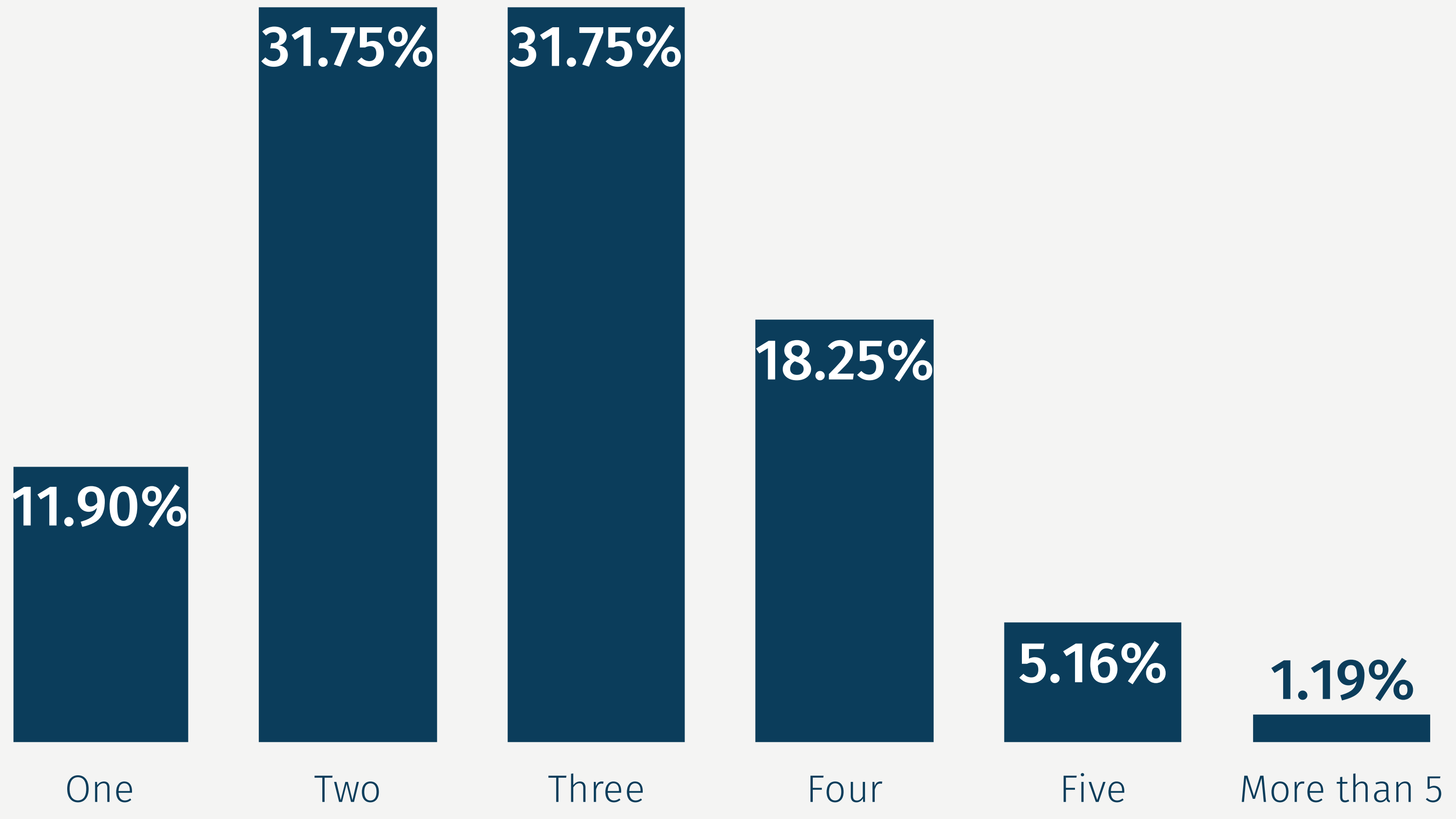
Firms with 500+ employees reported demonstrating best execution as their biggest challenge. In our experience, many large corporates may already have multiple sources for pricing, so the fact that larger firms find demonstrating best execution most challenging suggests that best execution encompasses factors beyond just having multiple counterparties. These may include getting a transparent view of execution costs and performing counterparty due diligence, which corporates may find difficult due to time and cost constraints.

Interestingly, **59% of respondents said that FX costs had risen in the past year**, with 12% stating they had risen significantly.

Do you think there's a lack of transparency in the FX market?

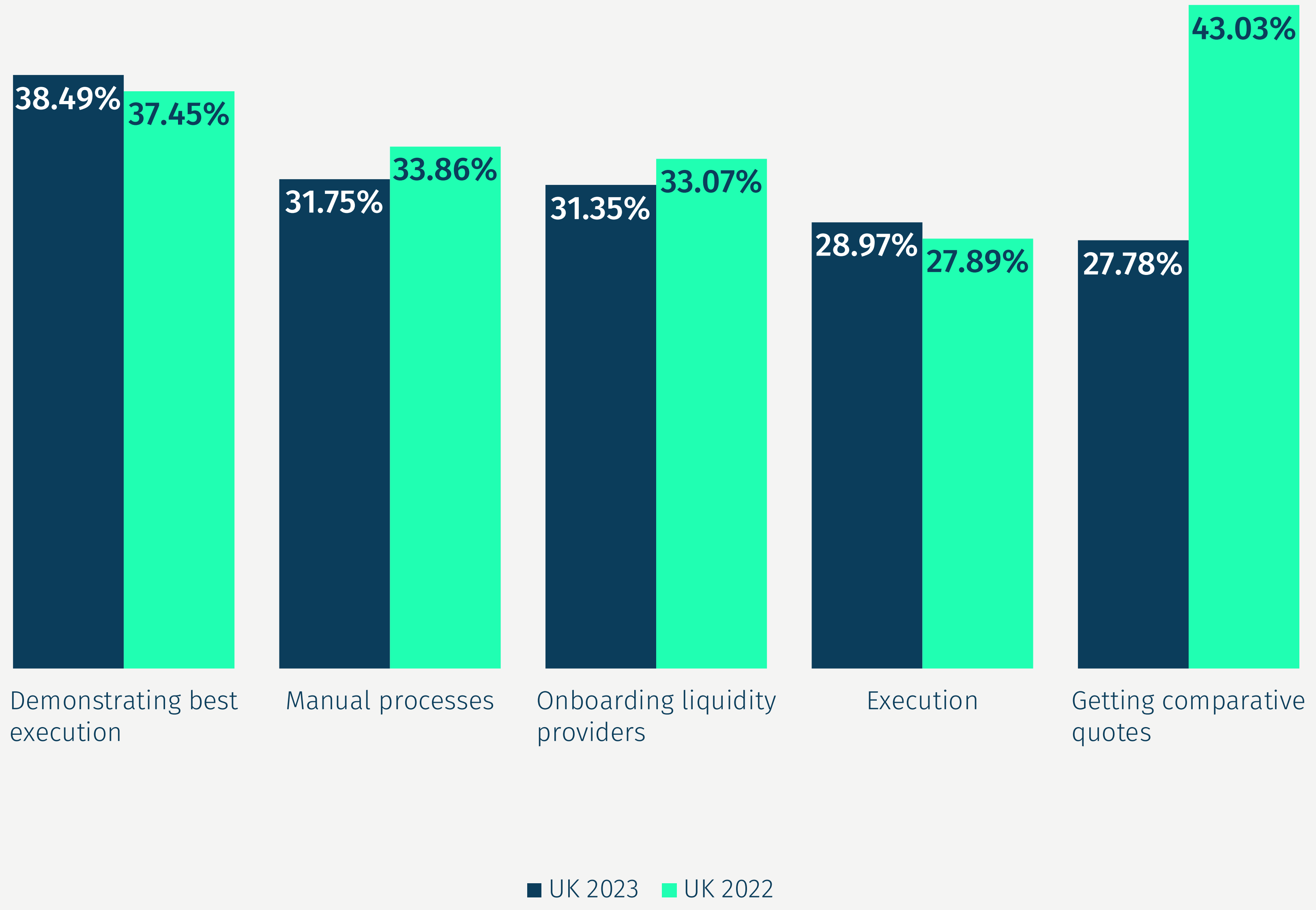


How many FX counterparties do you have trading relationships with?

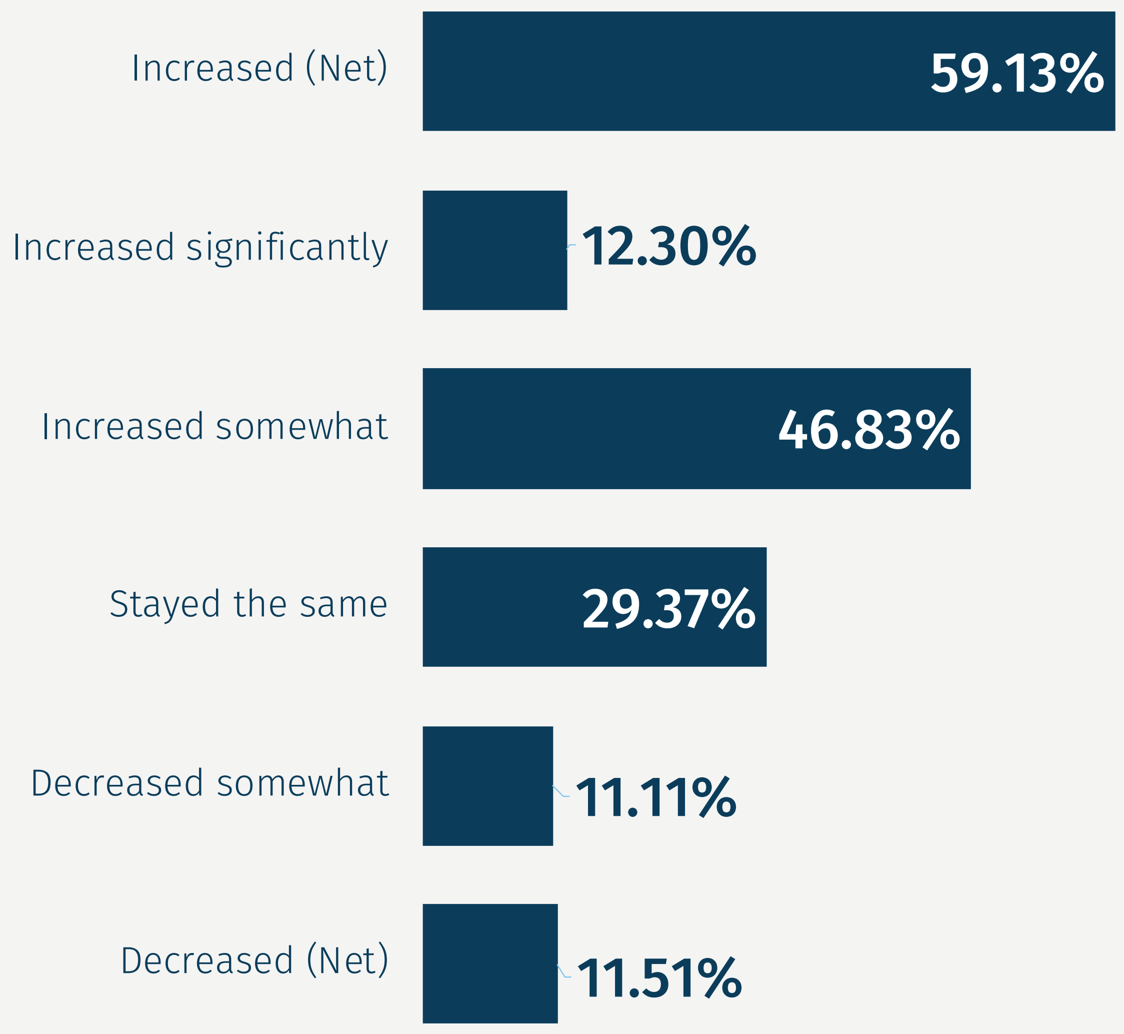


Mean: 2.77

What are the most challenging aspects of your FX operations, if any?



In the past 12 months, have your FX costs:



Part 2

Adapting to lower volatility

Although currency volatility has decreased since peaking towards the end of 2022, it is **still a persistent threat** due to a combination of rising interest rates, high inflation and geopolitical uncertainty.

Much of the recent focus has been on whether volatility will resurge in the coming months, but the more important factor at play is the uncertain economic outlook itself.

Hedging currency risk is one of the primary ways that firms can mitigate the risk posed by this uncertain financial climate, and while there will always be some that don't hedge their FX risk at all, the majority do to protect their bottom lines.

69% of UK corporates stated their bottom lines were affected by GBP volatility. 50% of corporates were affected positively, compared to 19% which suffered a negative impact.

In line with reduced market volatility, a slim majority (52%) experienced decreased FX risk in the past six months, while **33% experienced increased risk.**

The data also revealed **a drop in the number of UK corporates hedging their FX risk**. In 2022, 89%[1] of UK corporates hedged their FX risk but in 2023, this fell to 70%. Of those that don't hedge, 67% are now considering doing so, compared to 89% in 2020.

Despite 59% of respondents stating that their hedge ratios increased in the past year, **the average hedge ratio dropped** from 50-59%[2] in 2022 to 40-49% in 2023. Corporates in North America had a higher average hedge ratio of 50-59% . The **higher hedge ratio seen amongst North American corporates** compared to those in the UK may potentially be a reaction to the well-documented strong FX headwinds that North American firms experienced towards the end of 2022. In addition, since exporters in North America may typically be more exposed to currency movements than importers, the higher hedge ratio amongst North American corporates suggests that many may have sought to lock in the gains created by a weaker US dollar in 2023.

Average hedge lengths dropped from five months in 2022[1] to four months in 2023, suggesting firms are looking for flexibility to adapt to the changing market, rather than locking in a rate for a long time.

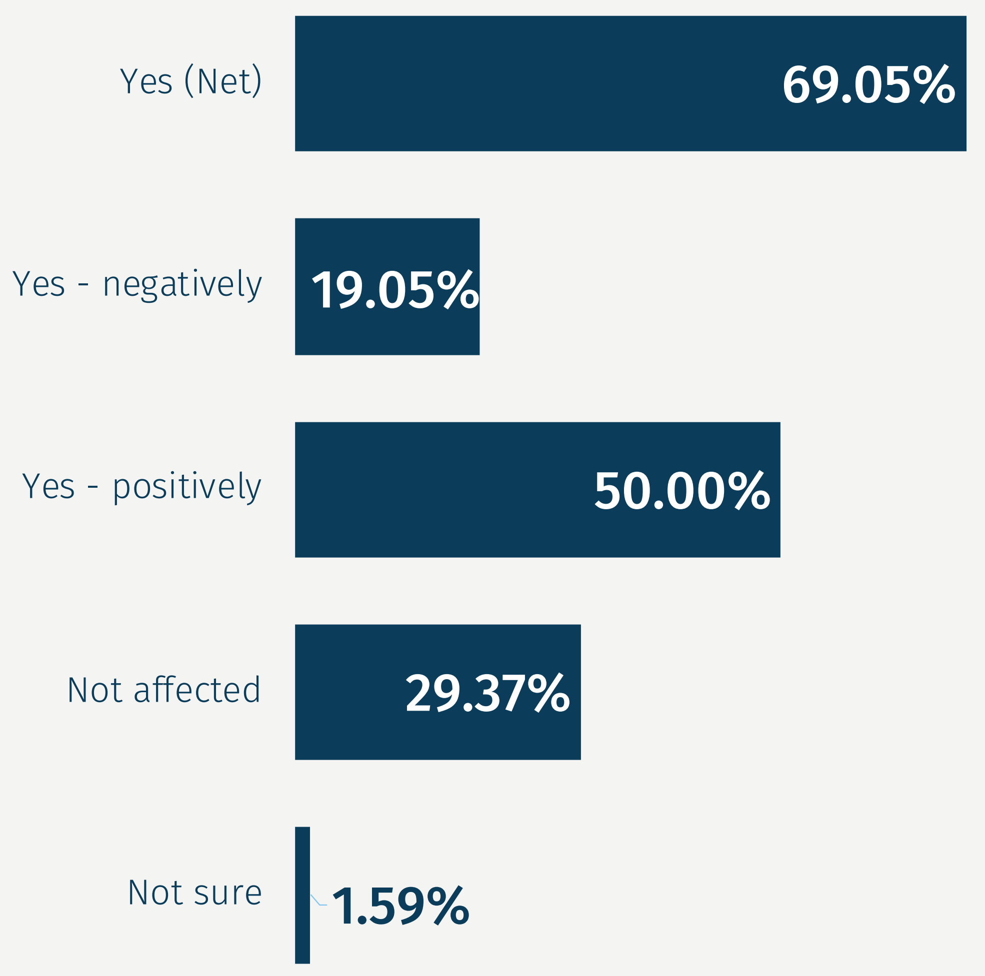
Even though there is widespread acceptance that volatility has dropped in recent times, **CFOs and treasurers are still prioritising risk management. 41% plan on increasing their hedge ratio**, while 40% plan on increasing their hedge windows.

This suggests that CFOs are moving to hedge more of their FX risk **to protect their bottom lines** from currency movements

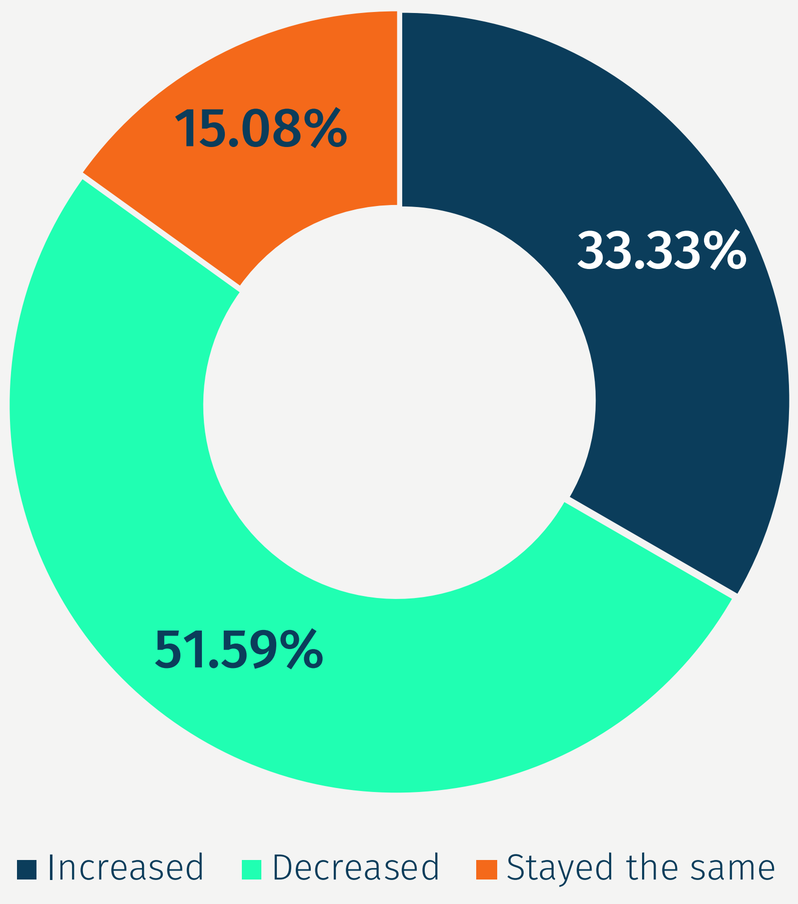
[1] MillTechFX CFO FX Report 2022 – The intensifying challenges corporates

[2] MillTechFX North America CFO Report 2023

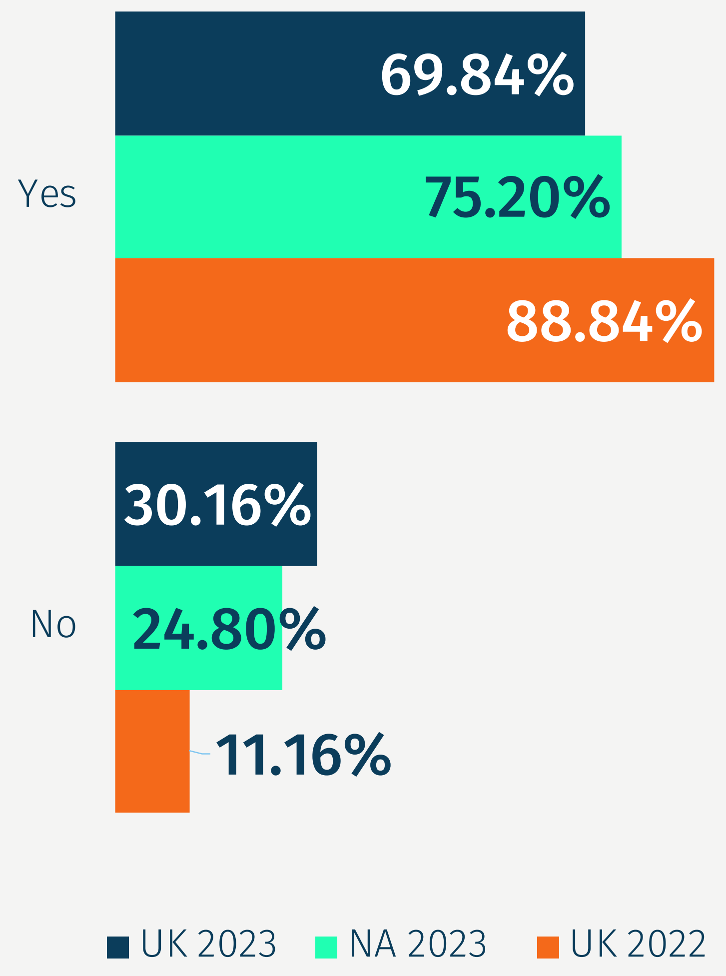
Has your bottom line been impacted by GBP volatility?



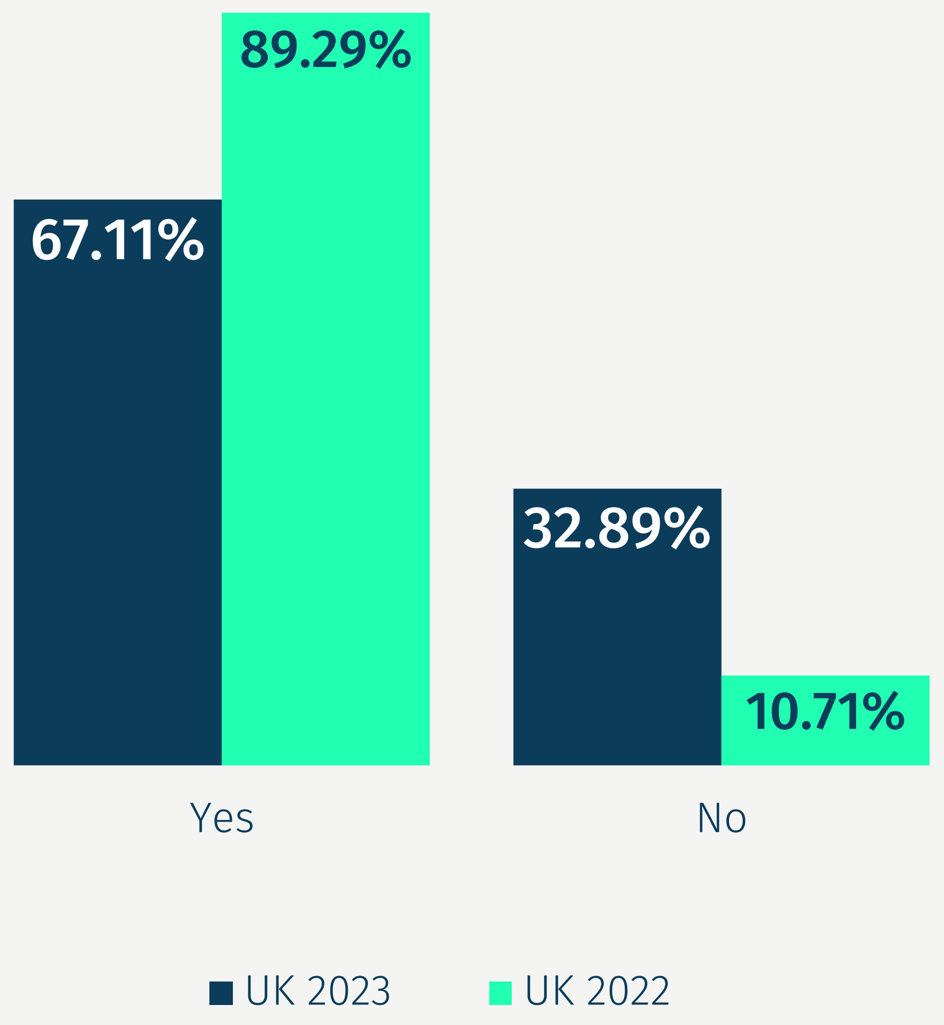
Has your FX risk increased or decreased in the past 6 months?



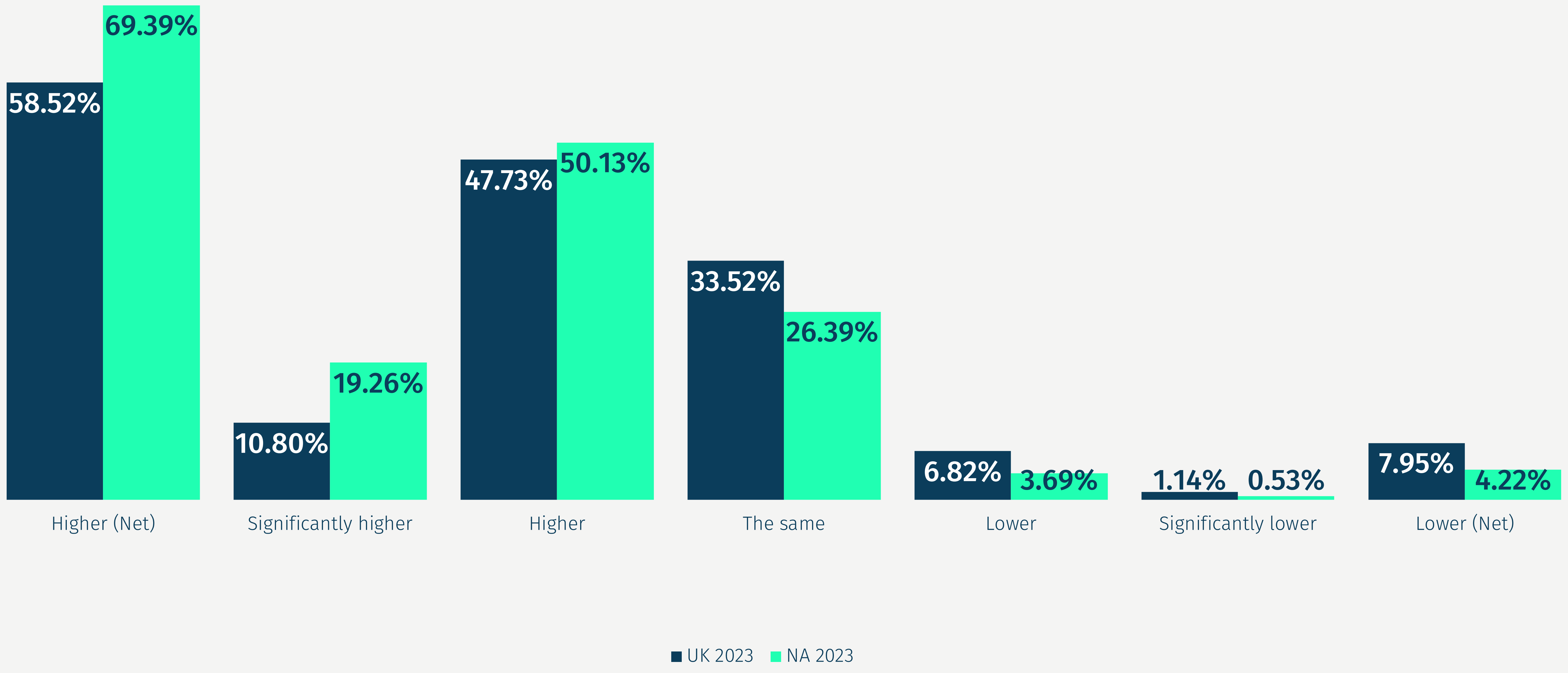
Do you hedge your forecastable currency risk?



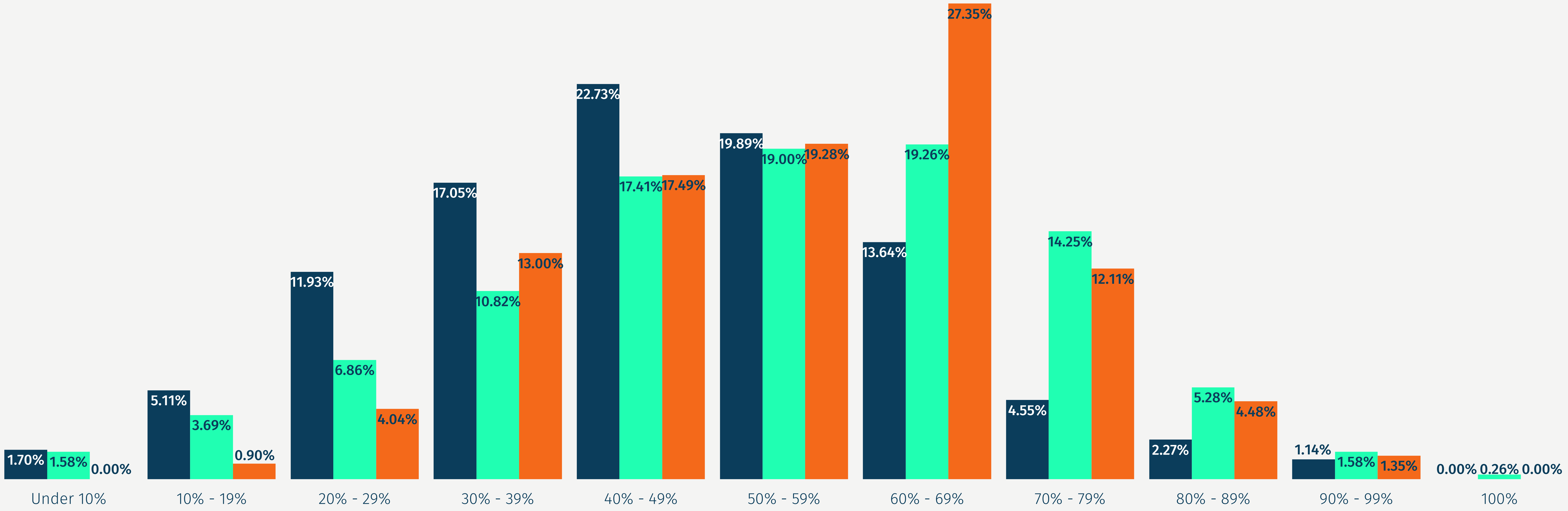
Are you now considering hedging given market uncertainty over the past 12 months?



How does your hedge ratio compare to last year?



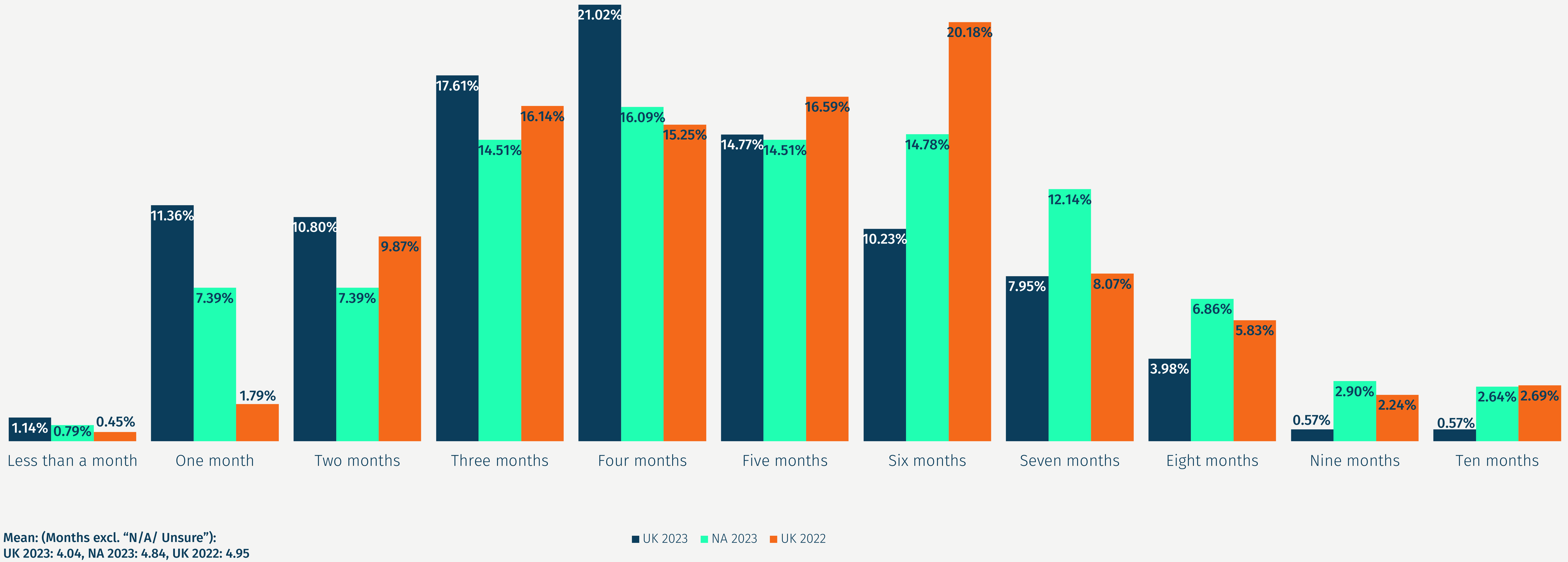
What is your current hedge ratio?



Mean: (% excl. "Not sure"):
UK 2023: 45.76, NA 2023: 53.39, UK 2022: 55.62

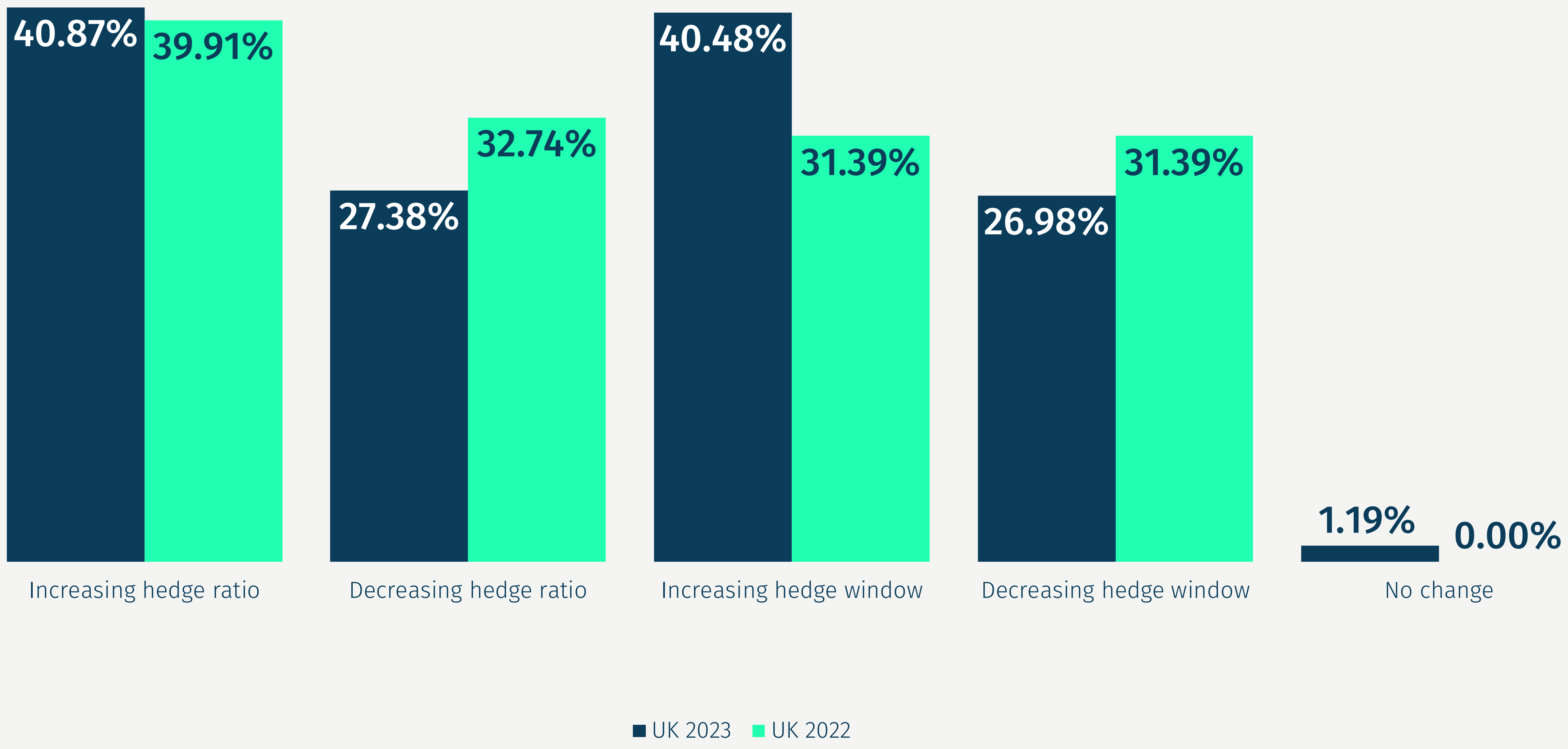
■ UK 2023 ■ NA 2023 ■ UK 2022

How far out, on average, do you currently hedge FX risk? *Respondents who hedge their forecastable currency risk



Mean: (Months excl. "N/A/ Unsure"):
UK 2023: 4.04, NA 2023: 4.84, UK 2022: 4.95

How are you primarily adapting your hedging to lower volatility in the FX market?



Part 3

Counterparty governance

The collapse of Silicon Valley Bank, UBS's takeover of Credit Suisse and the closure of Signature Bank has shone a light on many vulnerabilities in the banking industry, particularly **the risks associated with only having one or two banking partners.**

It is now widely known that a bank's failure can cause serious short-term liquidity issues. Should a banking counterparty no longer be able to function as an FX provider, then this **can affect vital expenditures such as payroll and supplier invoices**, even if it's only for a few days. Other risks include:

- **In-the-money FX hedges** – if a firm has open FX forwards with a failing counterparty and those positions have a positive mark-to-market (i.e. they make a profit if they were to be sold back into the market today at the prevailing spot rate), then the firm might be **at risk from not realising that mark-to-market gain.**
- **Loss of collateral** – if a corporate has had to post collateral with their counterparty to book an FX forward, then that **collateral may be at risk, in a similar way to cash deposits.**
- **Not being able to maintain the FX hedge** - crucially, there is a risk that any pre-existing forward contract will not be honoured. If the purpose of that forward was to mitigate the effect of FX volatility on a portfolio of foreign currency assets, then **fund level returns could be negatively impacted.**

Whilst the banking sector has seemingly stabilised since the turmoil of the Spring, senior finance decision-makers at UK corporates are taking lessons from the crisis on board.

Our research revealed that **73% of UK corporates are exploring diversifying their FX counterparties.** This was even higher in North America where 80%[4] of corporates reported looking to add more FX counterparties, showing that the crisis was more acutely felt in that region.

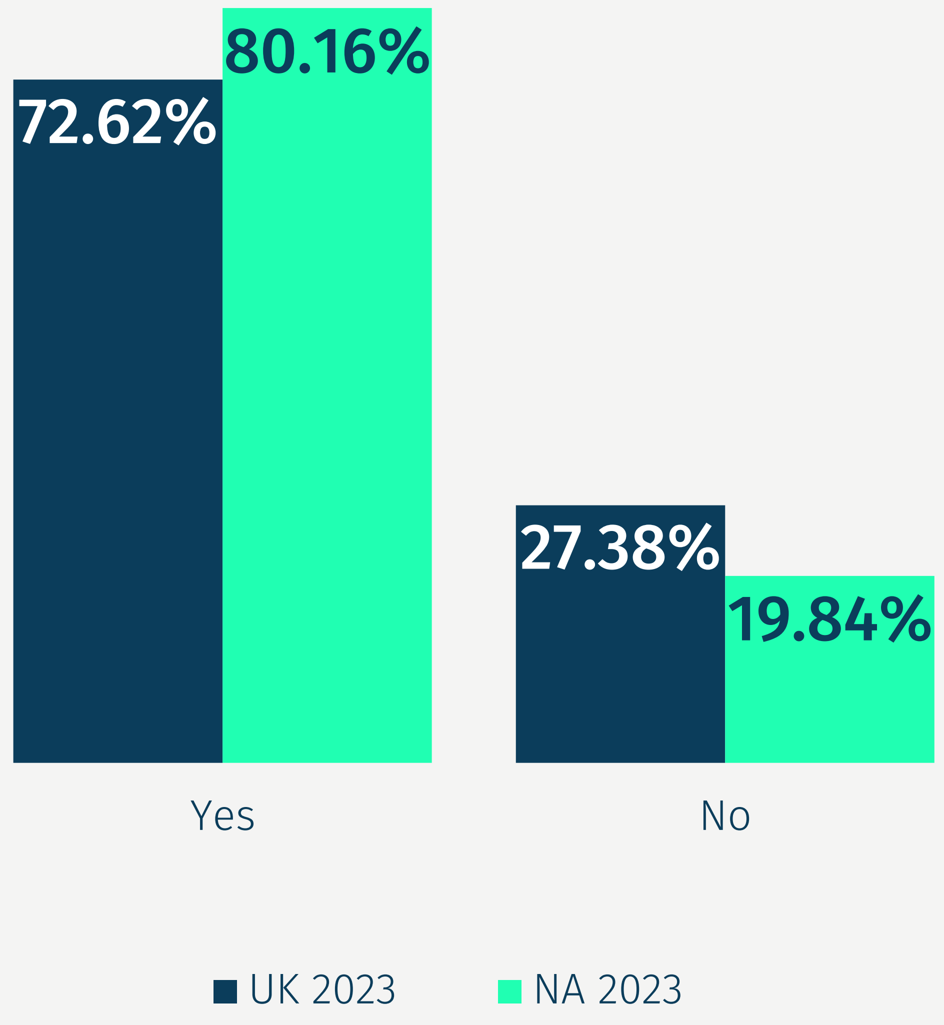
As well as enhancing risk management, **having multiple counterparties can also have a positive impact on pricing.** Due to the opacity of the FX market, it can be incredibly difficult to compare prices without having access to multiple banks. At any given time, they may not be able to trade at the best available rate as they have no other access points to the market.

Getting competitive quotes from multiple counterparties can enable corporates to compare the market so they can ensure they **get the best rate and achieve best execution.**

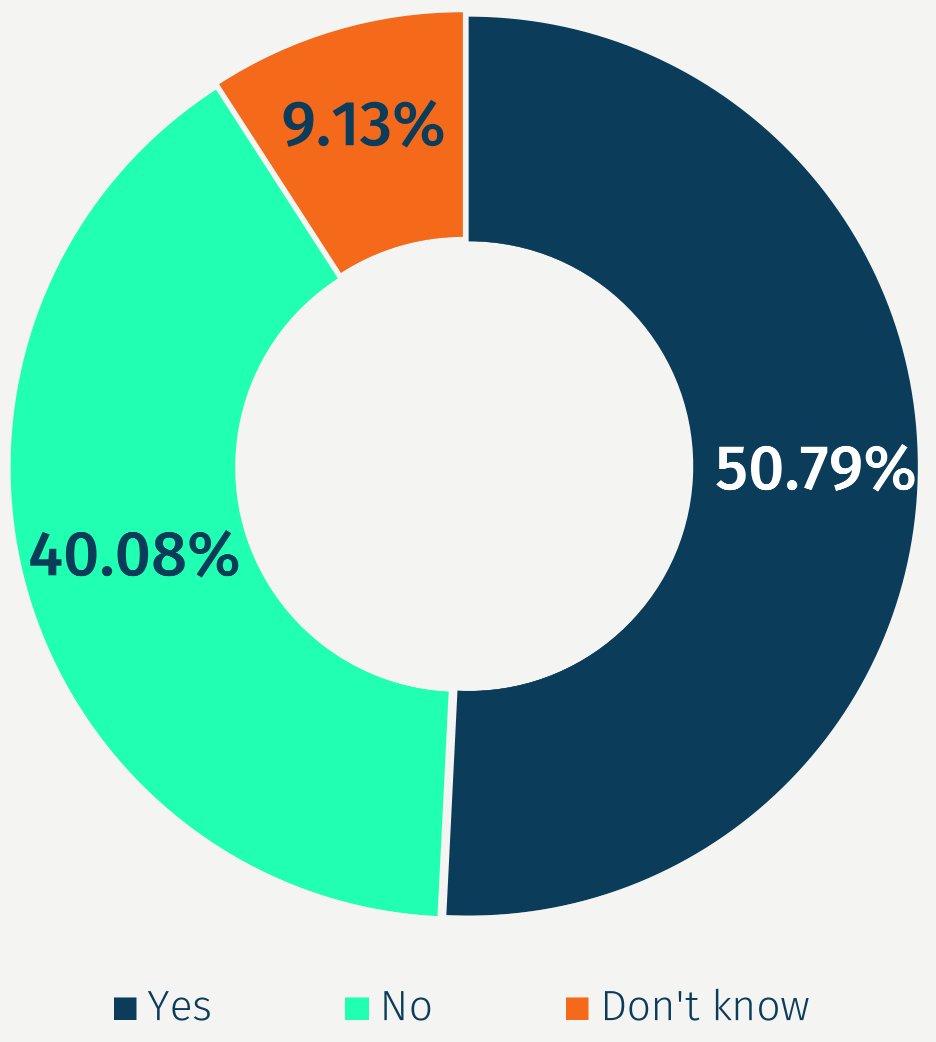
Only 51% of UK corporates regularly monitor their FX counterparties' credit ratings. We believe that corporates should consider establishing a robust counterparty risk evaluation framework that considers a range of risk factors. These include monitoring realised and unrealised profit and loss for each counterparty, credit rating from reputable rating agencies, credit default swaps as well as regular counterparty review and monitoring activities.

[4] MillTechFX North America CFO Report 2023

Have you looked to diversify FX counterparties since the recent banking crisis (involving banks such as Silicon Valley Bank, Credit Suisse, First Republic Bank and Signature Bank)?



Do you regularly monitor your FX counterparties' credit ratings?



Part 4

Automation drivers

For many corporates, FX processes can be manual, cumbersome and time-consuming.

FX price discovery can often involve multiple phone calls, emails, or online platforms to log in to just to get comparative quotes from your counterparties. Because the market is constantly moving, price discovery often requires a team of people calling, emailing and logging in simultaneously before they can collectively decide who offered the best quote.

As a result of these challenges, CFOs at corporates are beginning to consider moving away from traditional providers and legacy infrastructure.

Instead, **many are embracing automated, tech-enabled solutions which digitise the FX process** from initial price discovery right through to reporting at the end of the trade lifecycle.

Our research found that **75% of senior finance decision-makers at UK corporates are looking into new technology/platforms to automate their FX operations.** This is a slight drop from 89%[5] in 2022 and 78%[6] in North America, potentially suggesting that over the past year, more businesses have begun to implement technology into their FX operations and therefore less are looking into new technology-driven solutions. This may also be a sign that against a backdrop of rising interest rates and turmoil in the banking sector, treasurers may have prioritised other areas such as servicing debt, deploying cash reserves in the most efficient manner and counterparty diversity over automation.

The top drivers for automation are cost savings (31%), **eliminating silos** (29%), **operational risk reduction** (28%), **simplicity** (25%) **and efficiency gains/customer demand** (24%). The top driver for treasurers was eliminating siloes. This is unsurprising, as for treasurers, in particular, it is imperative than any new infrastructure can communicate with other treasury systems to streamline workflows and automate manual tasks. This in turn can help eliminate human error and create a more scalable treasury function.

[5] MillTechFX CFO FX Report 2022 – The intensifying challenges corporates

[6] MillTechFX North America CFO Report 2023

The benefits of automated digital solutions include:

Centralised price discovery - Automated solutions enable firms to compare prices from multiple liquidity providers on a single marketplace. Not only does this bypass onerous phone calls and email exchanges, but it also allows firms **to get the best available price and lock it** in with the simple click of a button.

End-to end-workflow - Post-trade execution processes can be fully automated, from settlement to onward payment, regulatory reporting or sharing trade data with third parties. This **saves much-needed time** and **resources**, enabling firms to focus on core business matters.

Transparency - By embracing digitization, firms can benefit from complete transparency through **real-time reporting** and **FX transaction cost analysis (TCA)**. TCA can be used to help firms understand how much they are being charged for the execution of their FX transactions, in addition to demonstrating good governance to internal stakeholders.

Fast onboarding - Rather than spending months (even years) setting up multiple FX facilities with different counterparties, a digital FX marketplace can enable firms to **begin transacting within weeks.**

However, the automation journey isn't plain sailing. The biggest headwinds UK corporates face are legacy tech (38%), lack of expertise (33%), finding the right partners (30%), cost (30%) and time to implement (28%).

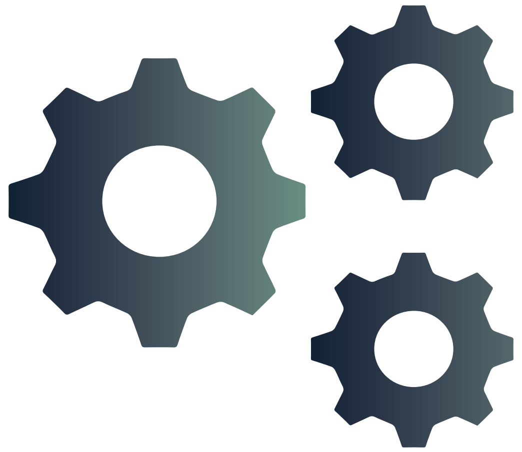
Outsourcing

We're also seeing an increasing number of firms looking to outsource their FX workflow, from calculating the FX position to execution, margining and settlement.

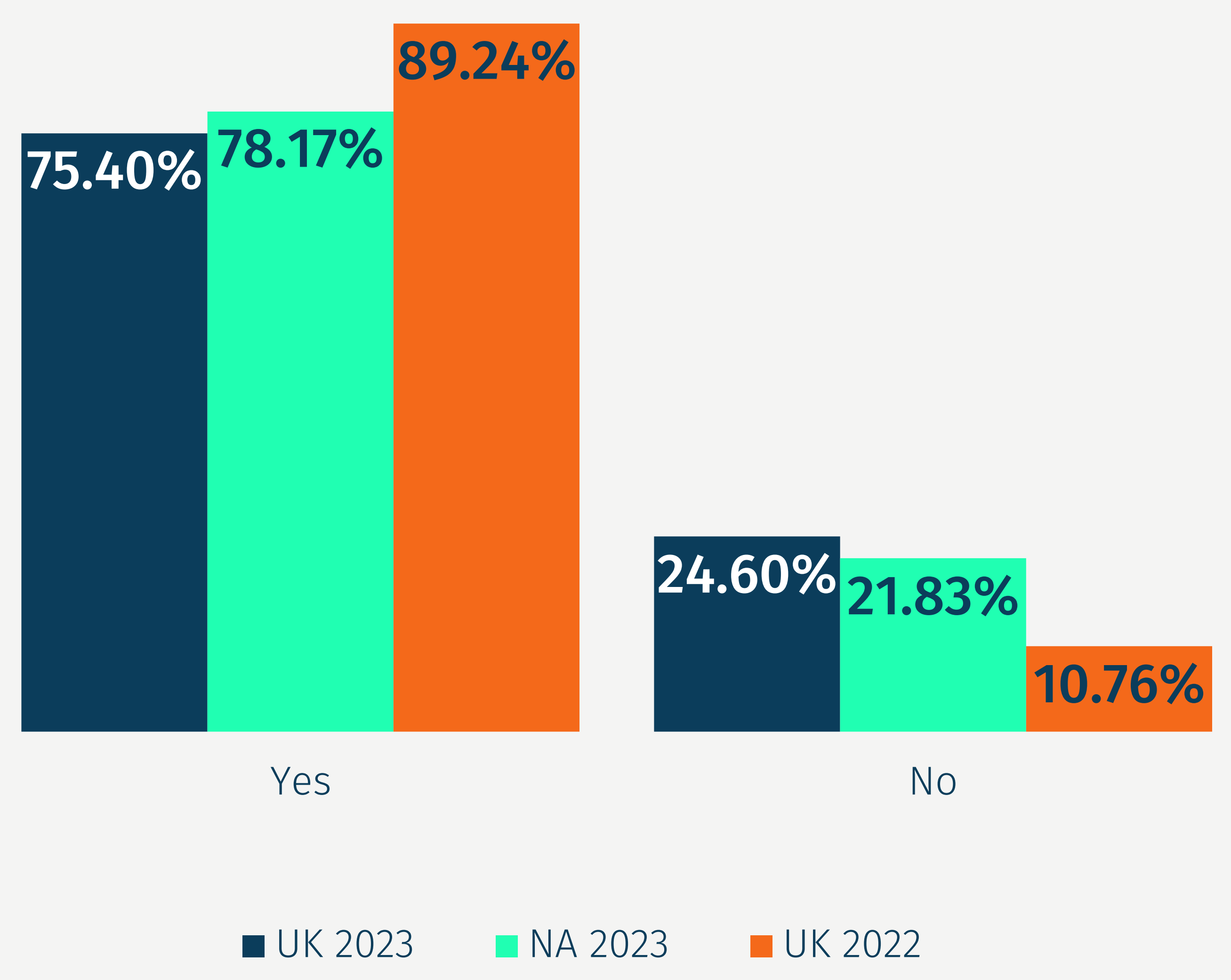
The numerous parties involved combined with the opaque nature of the execution process often create huge administrative burdens for corporates, eating up time and resources. Likewise, the time-consuming and costly nature of onboarding new liquidity providers can outweigh the benefits that these partnerships bring.

Outsourcing **frees up resources for more effective use elsewhere**, enabling firms to dedicate more time to core business matters. The end product is also more likely to be of higher quality, leading to improved execution and saving money in the long run.

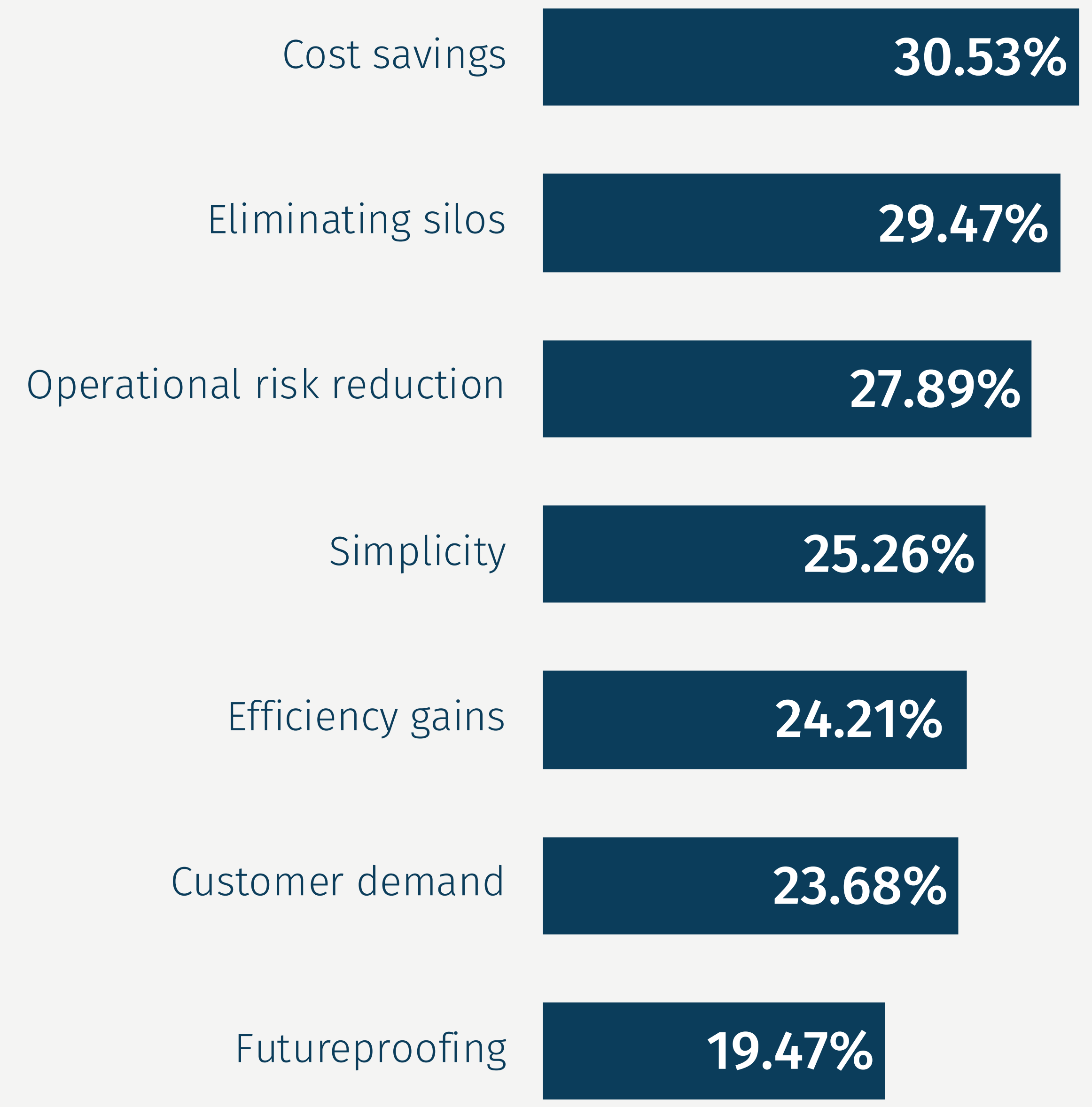
However, there are still some barriers to outsourcing for many corporates. **In 2022, the biggest barrier was trust but this year's research revealed that integration is the biggest challenge**. Other barriers include onboarding a new partner (27%), high costs (24%), maintaining tight governance (24%) and lack of control (23%)



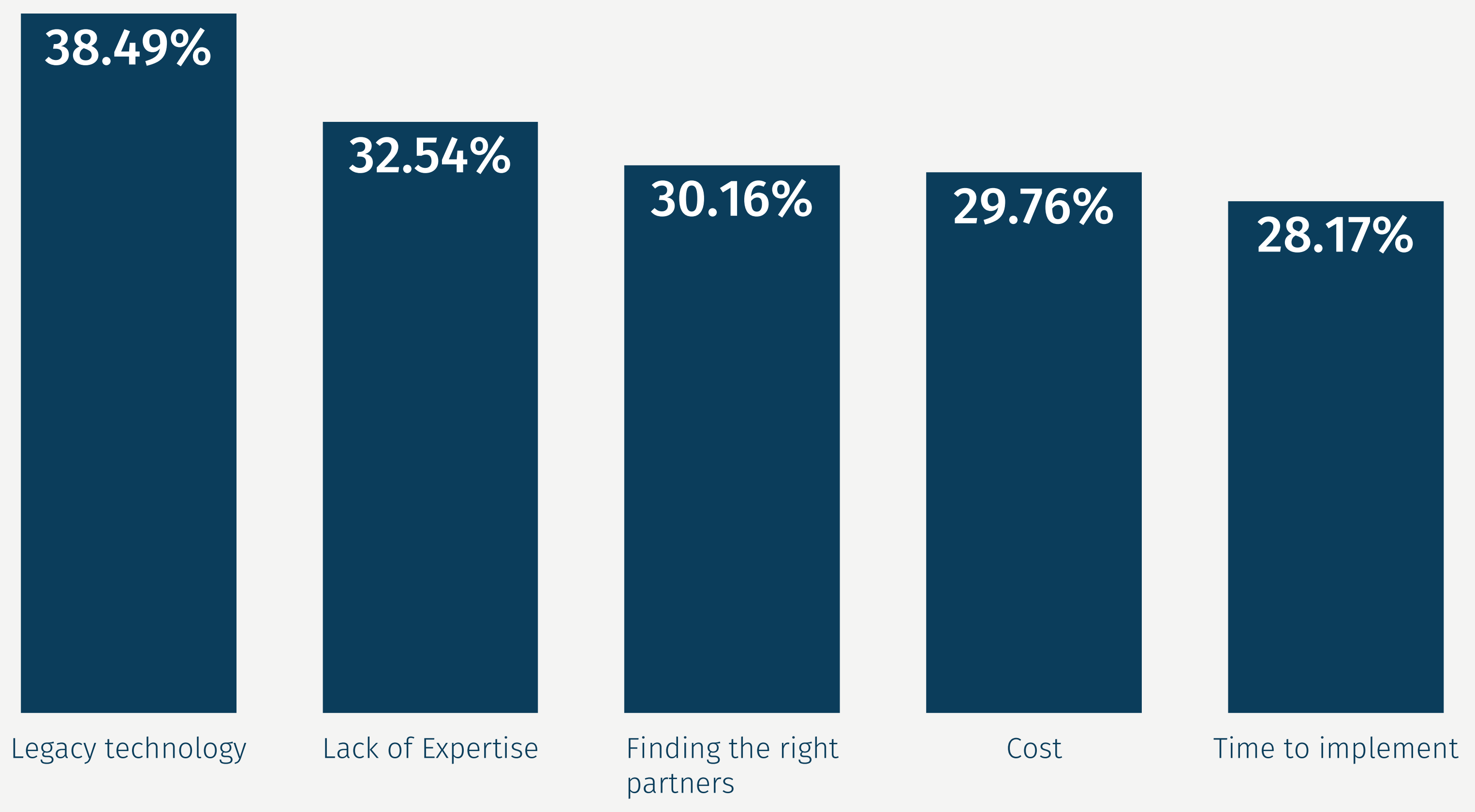
Are you looking into new technology/platforms to automate your FX operations?



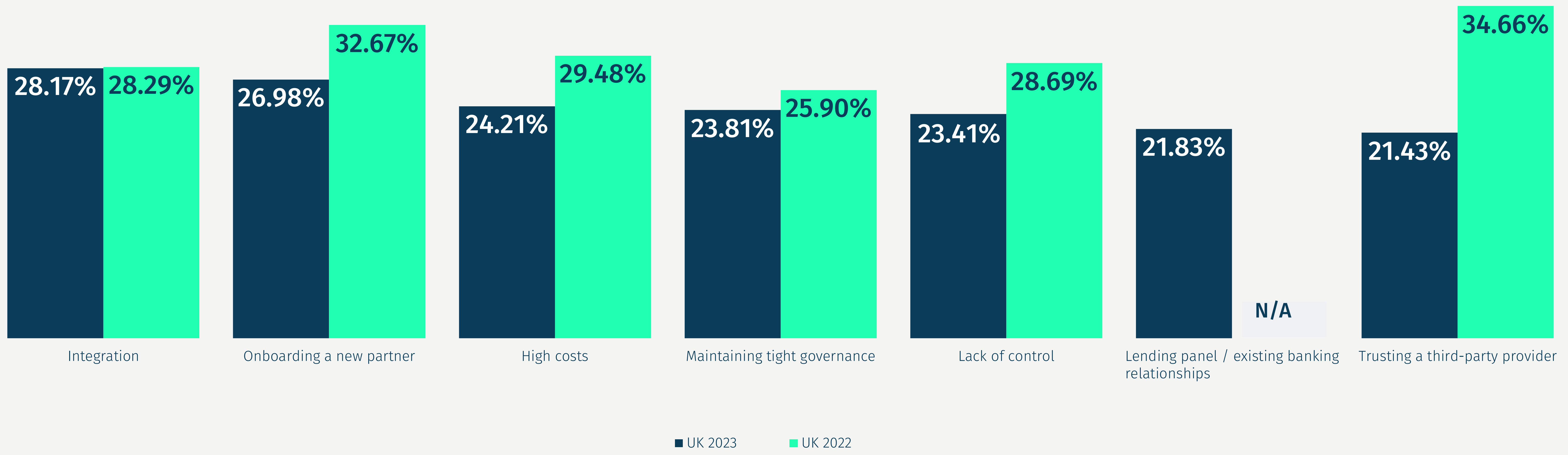
What are the key drivers behind the aim to increase automation in your business?



What are the biggest barriers to automating your FX processes?



What are the biggest barriers to outsourcing your FX execution to the right partner?



Part 5

ESG grows in importance but at a slower pace than North America

Driven by pressure from investors, governments and consumers, ESG criteria are now central to the decision-making process for many businesses. Our survey found that the trend has also begun to play an increasingly important role in FX.

85% of senior finance decision-makers at UK corporates said that **ESG credentials affect their selected FX counterparties.** Interestingly, 77% of larger corporates surveyed (250 employees+) said ESG has grown in importance in the past, compared to 69% of the smaller corporates, perhaps showing larger firms are taking the lead on the ESG front.

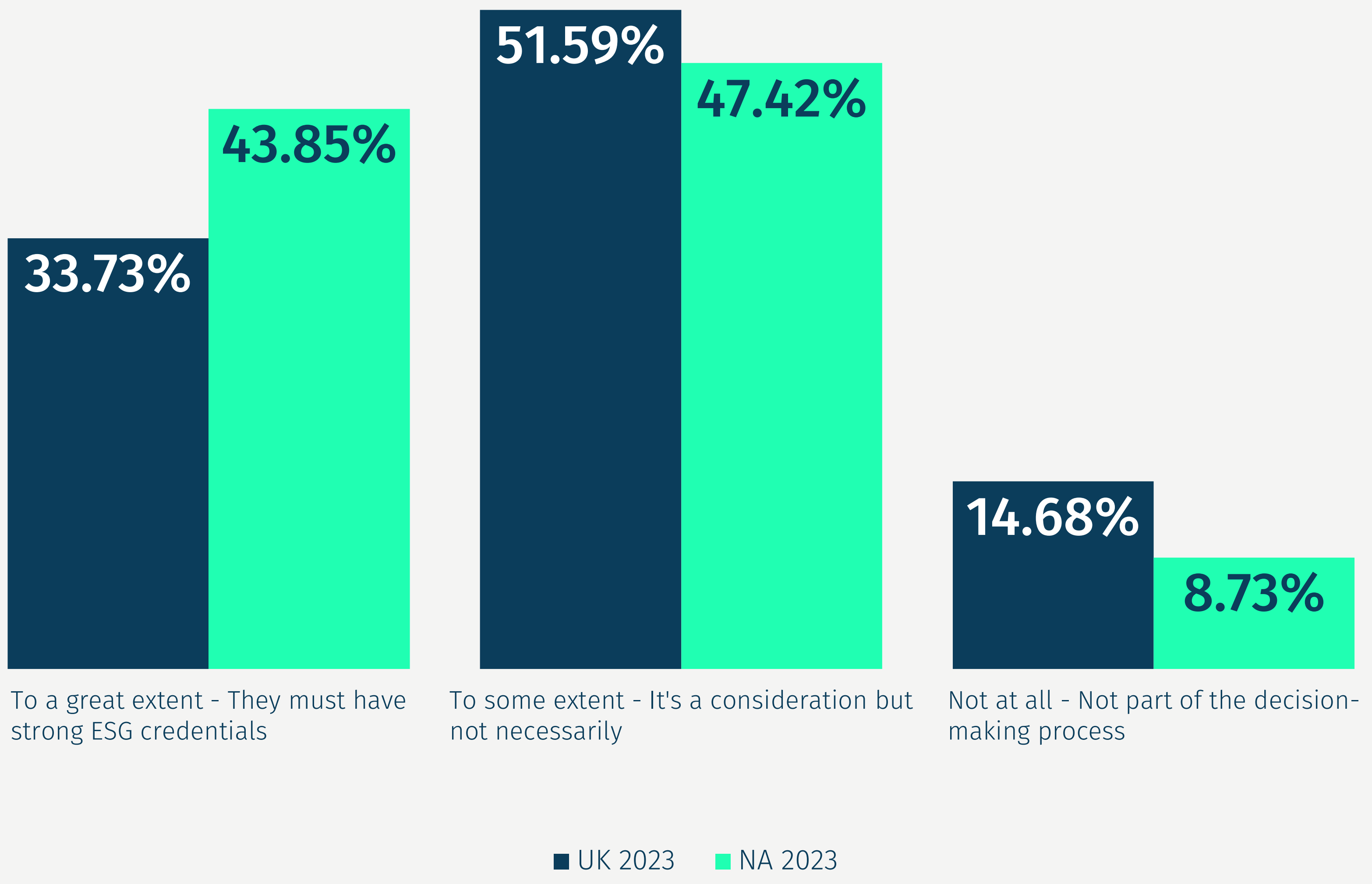
As businesses become increasingly driven by ESG criteria, **corporates must have the right processes in place to meet this demand.**

When transacting in FX, firms can take the following steps to enhance their ESG credentials:

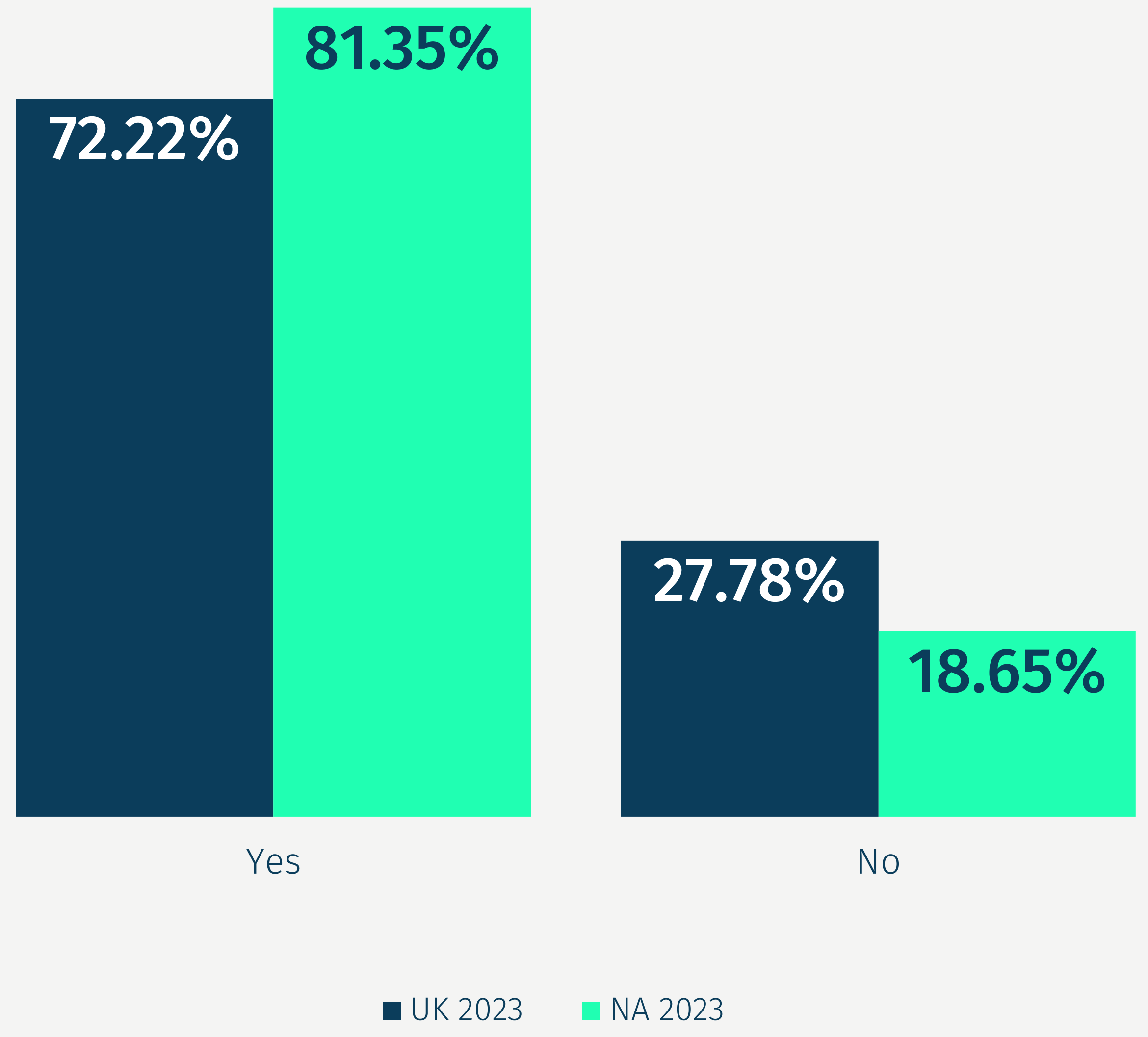
Adopting the Global FX Code (GFXC) - The BIS Foreign Exchange Working Group published this in 2017 to set out best practices across the wholesale FX market and is beginning to embed the code into firms' ESG practices. Its members recently supported the possibility of a partnership with rating agencies so that anyone who signs the code can be recognized as having fulfilled the governance element of their ESG commitments. **Signing up to the code is therefore a key step** for firms seeking to be a good corporate citizen and demonstrate their ESG credentials.

Consider ESG credentials of partners - It's not just a company's own infrastructure that reflects strong ESG credentials but also that of any partner or affiliate organization. When transacting in FX, we feel firms should **seek to use FX providers which adhere to internationally recognized ESG standards**, such as the Principles for Responsible Investment (PRI).

To what extent does ESG credentials impact your selected FX counterparties?



Has ESG grown in importance to your business over the past year?



Conclusion

It is likely currency volatility will be prevalent over the next year, meaning the management of FX currency risk should be considered a top priority for treasurers across the UK and beyond.

Fortunately, there are several ways corporate treasurers can improve their FX risk management infrastructure and protect their firms' bottom lines in these turbulent times:

Transaction Cost Analysis (TCA) – TCA was specifically created **to highlight hidden costs and enables firms to understand how much they are being charged** for the execution of their FX transactions. Ongoing, quarterly TCA from an independent TCA provider can be embedded as a new operational practice to ensure consistent FX execution performance.

Comparing the market - Having the ability to put trades up for competition is central to **ensuring access to the best price, which is key to effective hedging.** However, many treasurers are hampered by their inability to access Tier 1 FX liquidity, meaning they often rely on a single bank or broker to meet their hedging requirements.

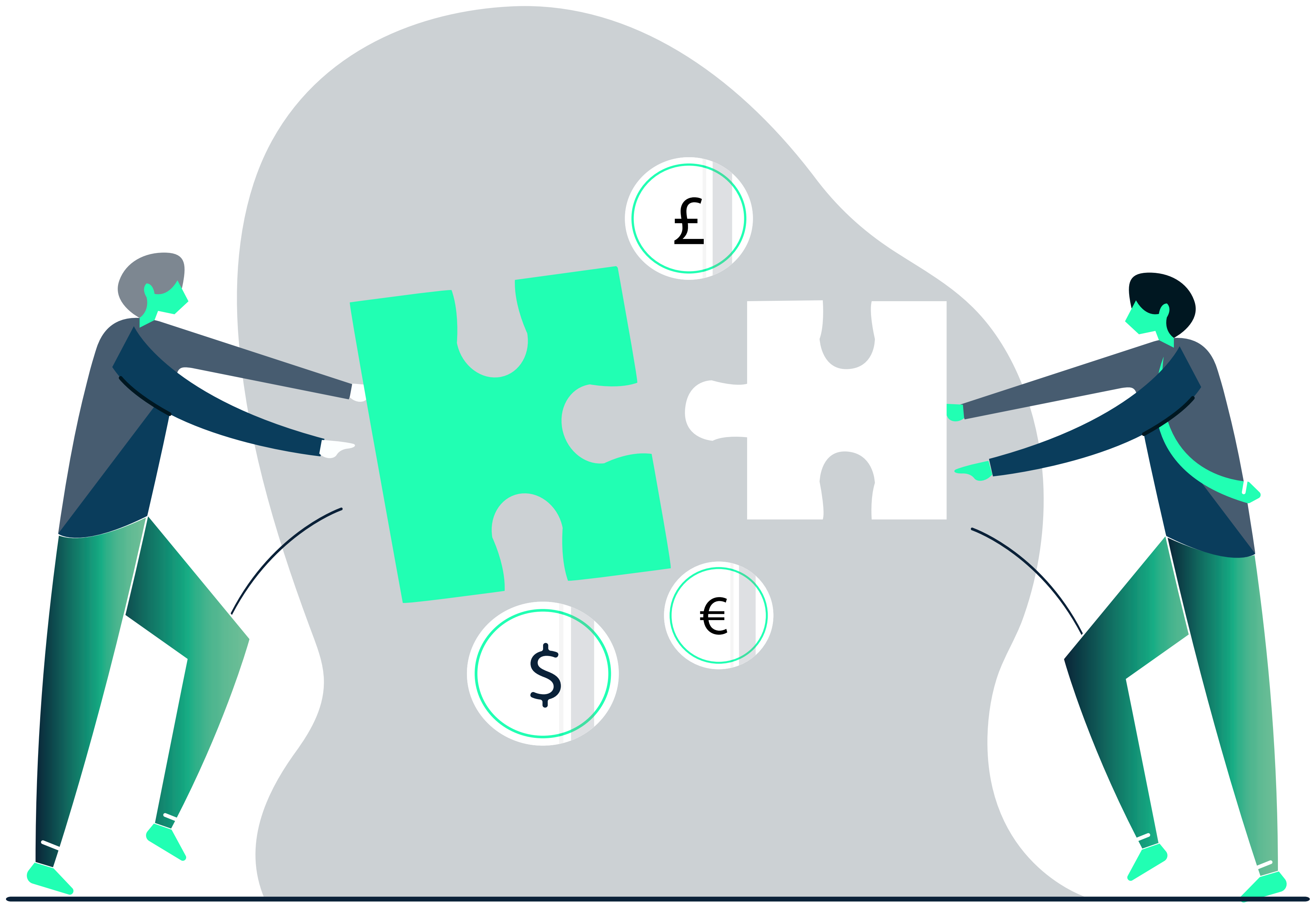
We believe that CFOs should seek alternatives to the traditional single bank-based approach. Instead, they should look for solutions that enable them access to live rates from multiple banks and execute at the best rate, all whilst reducing the operational burden traditionally associated with this kind of market access.

Outsourcing - There is a growing recognition that outsourcing does not necessarily mean a loss of control, less transparency or reduced quality of FX activities, but **when using the right partner outsourcing can improve transparency and execution quality.** Outsourcing can therefore enable firms to dedicate more time to core business matters, which is all the more important amidst inflationary and volatility pressures.

Strong governance - FX is one of the largest and most liquid markets in the world, but also one of the most complex. Setting up and onboarding new FX counterparties, centralizing price discovery and navigating the post-execution phase requires a team of people and often have their own complications. **Harnessing solutions which can enhance transparency and governance can help corporates improve the cost, quality and transparency of their FX execution.**

Diversification of liquidity providers – Recent events in the banking sector show that reliance on one or two counterparties can be an extremely risky strategy, as **the loss of a major FX counterparty could render firms unable to trade**. We believe corporates should begin exploring technology-driven alternatives to the single bank-based approach that enable them to transact in FX in a way that addresses risks associated with a single point of failure.

Automation - Despite the rising threat of currency movements, many firms continue to rely on manual processes like phone and email to execute FX trades which may make it harder to mitigate the impact of currency volatility. Harnessing automated solutions can offer **end-to-end workflow, greater transparency** and **faster onboarding**, helping finance departments streamline their FX functions.



How MillTech FX can help

MillTechFX is an FX-as-a-Service (FXaaS) pioneer that enables corporates to access multi-bank FX rates via an independent marketplace.

MillTechFX's market access, pricing power and operational resource enable it to deliver a tech-enabled integrated solution that delivers transparency, cost reduction and operational burden reduction for senior finance decision-makers at corporates.

It is end-to-end at no additional cost, offering easy and quick onboarding, multi-bank best execution and hedging management, and connectivity into clients' bank accounts, internal systems, administrators or custodians.

FXaaS represents the evolution of currency management through automation, integration, and validation:

Easy and quick onboarding – Rather than spending months (even years) setting up multiple FX facilities with different counterparties, firms can sign up to a multi-bank marketplace and transact within weeks with up to 15 Tier 1 counterparty banks.

Best execution and hedging management – Clients benefit from multi-bank access without having to manage multiple relationships and processes. They can transparently compare and execute FX rates from multiple providers on a single marketplace and ensure best execution with a simple click of a button.

Cost savings – MillTechFX has saved clients up to 70% on their execution costs

Transparency – MillTechFX offers a fixed fee service, including third-party Transaction Cost Analysis (TCA) to ensure total cost transparency.

To speak to us directly please reach out to our Head of Corporate Solutions, Jason Gaywood at jgaywoood@milltechfx.com or request a free TCA here.

Find out more on **https://www.milltechfx.com**

*The AUM, managed by Millennium Global Investments Ltd as at 31st December 2022, is a combination of USD 17,869 million in notional AUM for unfunded managed accounts, and USD 115 million AUM in funded vehicles. **The 2022 annual traded volume refers to all Millennium Group activity. Millennium Group comprises Millennium Global Investments Limited, Millennium Global (Europe) SAS and Millennium Global Treasury Services Ltd.

*This white paper examines the data and results of a survey conducted by Censuswide on MillTechFX's behalf conducted between 18 August and 31 August based on a survey of 252 CFO's, treasurers and senior finance decision-makers in mid-sized corporates (described as those who have a market cap of £50mil up to £1 billion), in the UK.

*The full list of job titles surveyed and included within this report is as follows: Accountants, Chief Financial Officers (CFO) Financial Analysts, Financial Accountants, Financial Consultants, Financial Manager, Analysis Managers and Treasurers.