MillTechFX
by Millennium Global

MillTechFX CFO FX Survey 2022

The intensifying FX challenges for **Fund Managers**

Summary

Volatility has dominated the foreign exchange (FX) market so far in 2022, driven by high inflation, rising interest rates and geopolitical issues.

The FX challenges for CFOs are intensifying with the rising threat of currency movements negatively impacting their investment returns. A series of market-moving events in recent years has placed the importance of having a FX strategy firmly back in the spotlight.

However, many fund managers have traditionally struggled with a number of issues when it comes to their FX setup.

The first pain point is **establishing an FX infrastructure that achieves best execution.** Fund managers tend to only work with a small number of counterparties for their FX due to the operational overheads associated with setting up multiple banking relationships and this could mean they're not achieving best execution. Best execution is not only a fiduciary responsibility, but the downstream benefit of a competitive FX execution environment can be significant cost savings.

Secondly, fund managers might be subject to **various operational inefficiencies throughout the end-to-end trade process.** FX processes are manual, cumbersome and time-consuming for many fund managers. Price discovery alone can take multiple phone calls or e-mails and after a trade has been booked there's numerous steps in the post-trade workflow too such as settlement, payments, regulatory reporting, mark-to-market reporting and sharing trade information with administrators. Manual processes are highly inefficient and susceptible to human errors which might place a greater drag on operational resources.

Transparency and governance over cost management is another major issue for fund managers. Transaction costs can be hidden in the FX spread, typically calculated as the difference between the traded rate at the point of execution and the mid-market rate at that time. Furthermore, as they struggle to get quotes from multiple liquidity providers, they struggle to compare pricing.

Finally, **FX forward contracts can be a significant drain on capital** for alternative investment managers, with many banks requesting collateral to be posted upfront (initial margin) and on an ongoing basis (variation margin). This can lead to a cash drag on the funds, with AUM being held back to meet a margin call instead of being invested.

With this in mind, Censuswide conducted a survey on MillTechFX's behalf* of 250 senior finance decision-makers at fund managers to review where they are on their FX journey and where they would like to get to.

The 'MillTechFX FX Survey 2022: The intensifying FX challenges for fund managers' explores how important FX is for fund managers, how much resource they dedicate to FX, challenges they face and solutions they are exploring.

Significance of FX: Fund managers' exposure to FX risk has grown in recent years due to increasing cross-border investments, meaning FX has become a key consideration for the majority of fund managers.

Resourcing: There is still a reliance on inefficient, manual processes and this has forced many fund managers to dedicate significant time and resources on their FX operations.

FX challenges: Despite dedicating a large amount of resources to FX, fund managers still struggle with various issues including securing credit lines, forecasting exposure, demonstrating best execution and getting comparative quotes.

Automation drive: The vast majority of senior finance decision-makers surveyed are exploring new technology and seeking to embrace digitisation in a bid to streamline operational processes. Some are also exploring outsourcing to free up resources, but trust remains a major barrier.

ESG: The bulk of respondents said that either their FX counterparties must have strong ESG credentials or at the very least it's an important consideration.

Ultimately, the research has highlighted that it is more important than ever that those trading in FX gain a transparent view of their execution setup, streamline their operational workflows and implement hedging strategies in order to carefully manage their currency exposures.

Part 1

Significance of FX

For asset managers 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.

This FX exposure comes from:

Foreign currency assets – The more jurisdictions a fund manager's strategy allows for, the greater the number of investment opportunities. However, considering annual movements even in G10 currency pairs can be significant, FX rate movements have the potential to completely erode long-term value creation efforts or create complications pre-acquisition and pre-disposal. Fund managers commonly implement short-dated hedging to lock in rates during the purchase or sale of an asset, whilst others may even consider hedging asset value throughout the entire hold period.

Management fees – It is not uncommon to see fund managers raise a fund in one currency but have offices outside the jurisdiction of their fund's base currency. This means the fund manager receives their management fees in one currency but then has to pay for certain fixed costs, such as salaries and offices, in one or potentially multiple different currencies. FX rate movements can place a greater strain on management fee income and for that reason fund managers commonly look to lock in exchange rates on expected fee income for as long as possible.

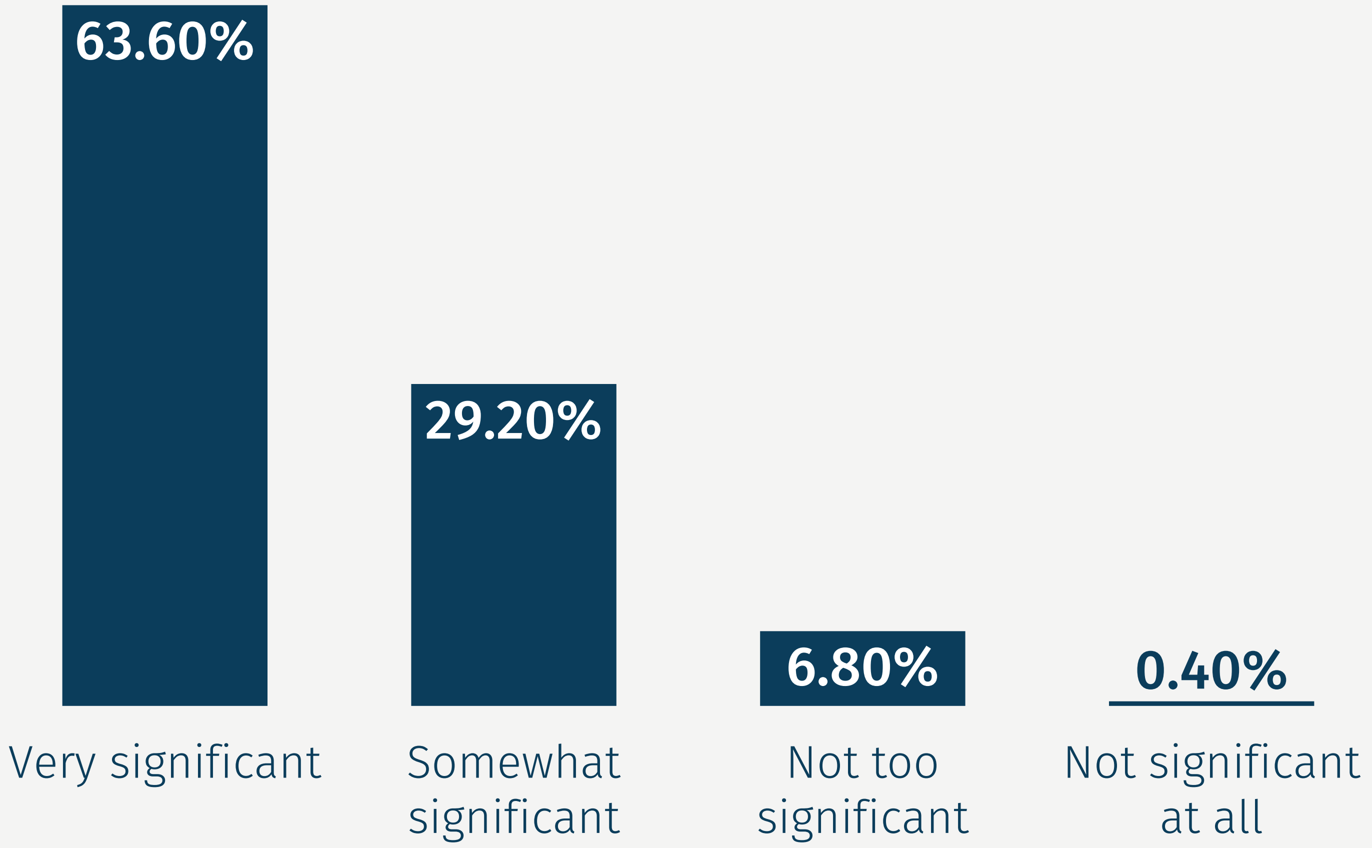
Investor Capital – As a fund manager matures, it becomes increasingly likely that they may see foreign currency investors commit capital to their funds. Some managers may take the stance of letting their investors manage their own FX risk, whilst others are more accommodative and implement share class hedging. Share class hedging takes FX risk off the table when investors are considering which funds to commit to and, in that way, can be a useful tool for managers to broaden their investor base and make their funds more marketable overseas.

Indirect, portfolio level FX exposure – As a fund manager grows its portfolio, their investment team may have to overhaul how their portfolio businesses manage their FX exposure. A fund manager may look to align their own set-up and processes with those of their underlying portfolio and hold them to the same high governance standards.

Our research found that their FX exposure has increased in recent years. 70% of respondents said that the number of cross border investments in their firm had increased over the past five years, while 66% experienced an increase in non-base currency investors in their funds.

Overall, our research reinforces the importance of FX with 93% of respondents stating that FX was significant to their business.

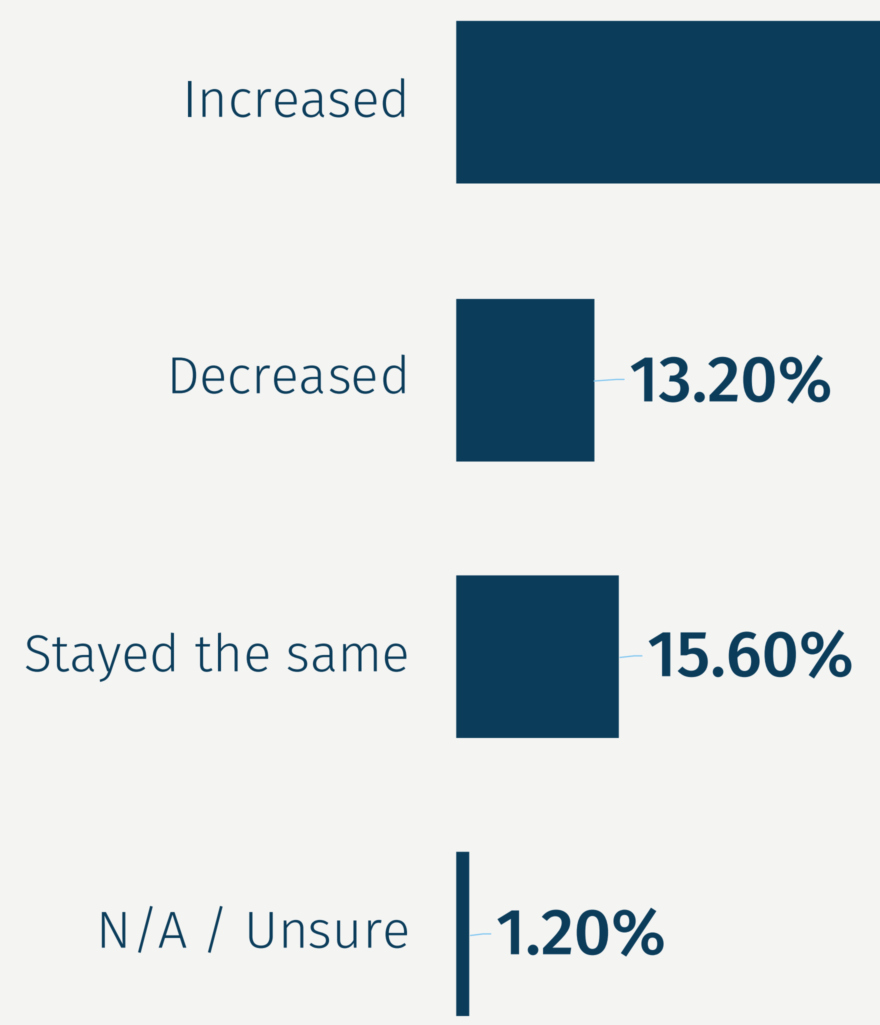
How significant, if at all, is foreign exchange (FX) to your business?



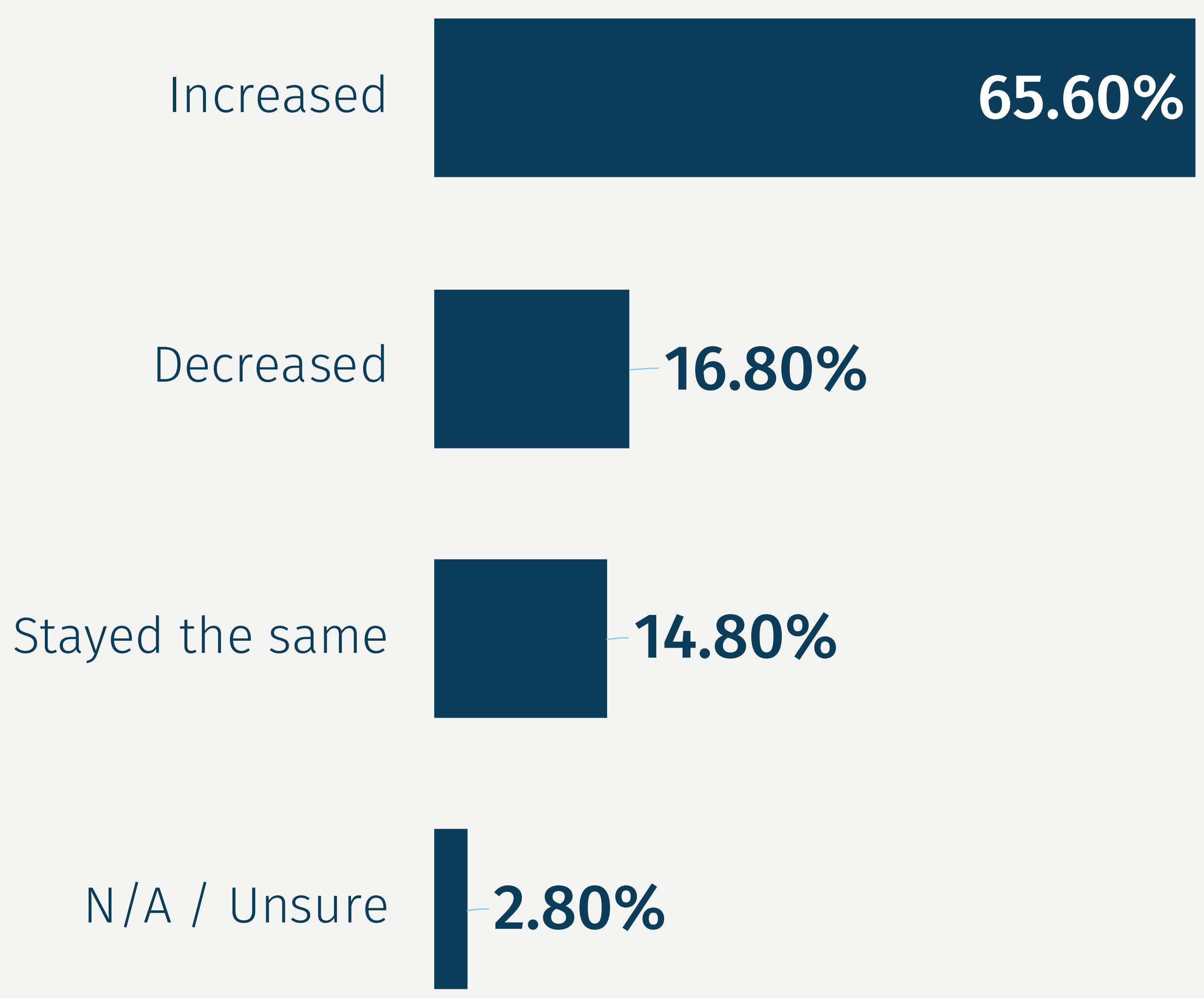
Where does your FX exposure arise?

1. Investor share classes
2. Management fees
3. Foreign currency assets
4. Within the portfolio companies

In the past 5 years has the number of cross border investments in your company?



In the past 5 years has the number of non-base currency investors in your funds?



Part 2

FX resourcing

For many fund managers, FX processes are 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 requires a team of people; calling, emailing and logging in simultaneously before they can collectively decide who offered the best quote.

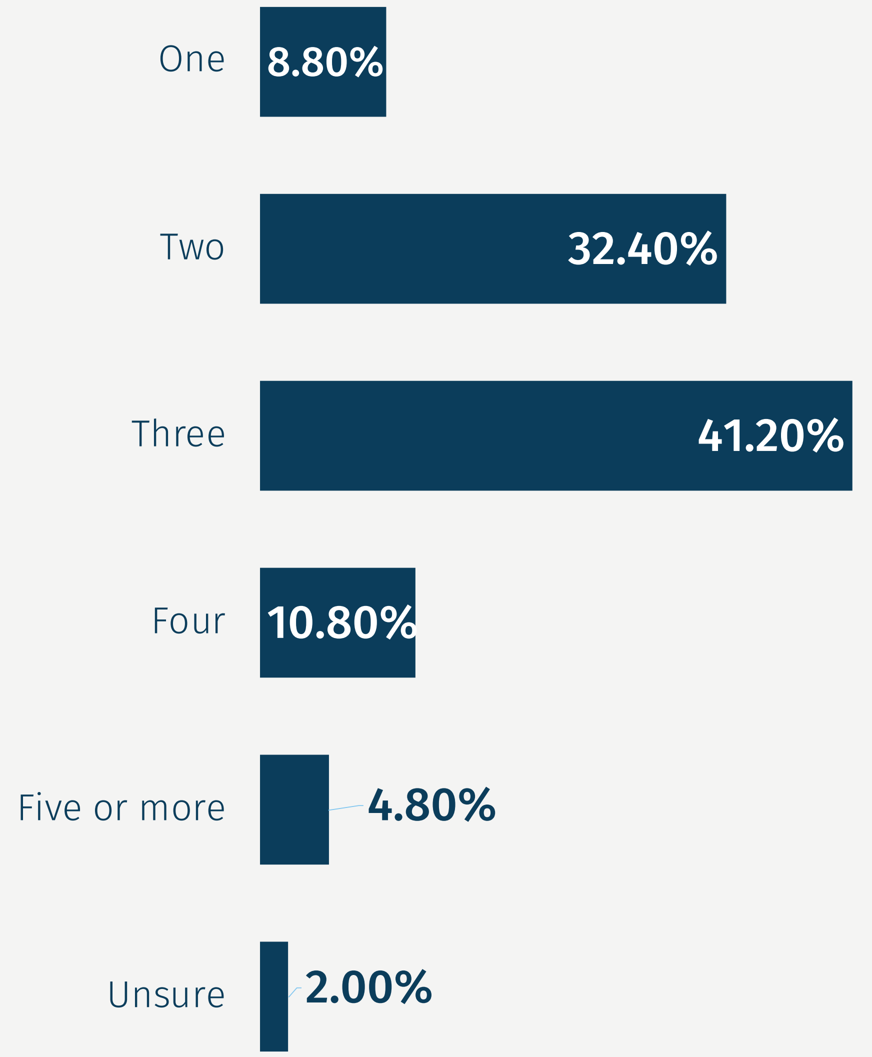
Price discovery is just the first step in the traditionally long-winded process of booking and settling an FX trade. Finance professionals may have to get approval from different layers of seniority, wait for trade confirmations which usually arrive via email, process settlement, enter payments details and, in some instances, share trade information with third parties such as administrators or regulators.

All of this internal, manual and siloed communication is extremely inefficient. And this is just for one, single trade. Many organisations execute tens or hundreds of trades every month with different products and mechanics. This entire process can place a huge drain on time and resources, with our research finding that over half of fund managers task three or more people with FX related activities.

On average, it took them nine months to set up their current FX execution infrastructure.

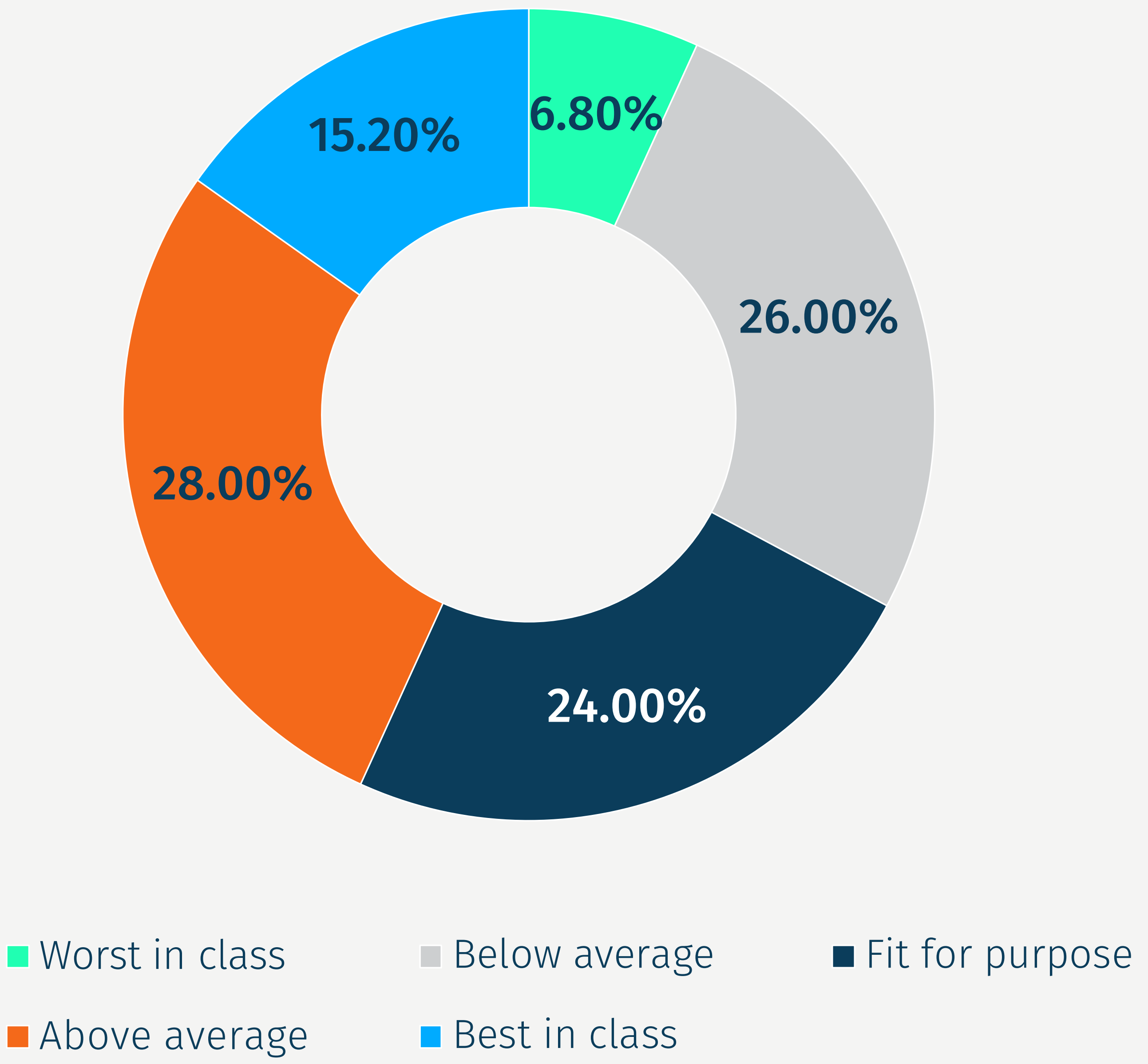
Despite the resources dedicated to setting up and maintaining their FX processes, only 15% said their setup was best in class, while 33% said it was either below average or worst in class.

How many of your team are tasked with FX related activities?

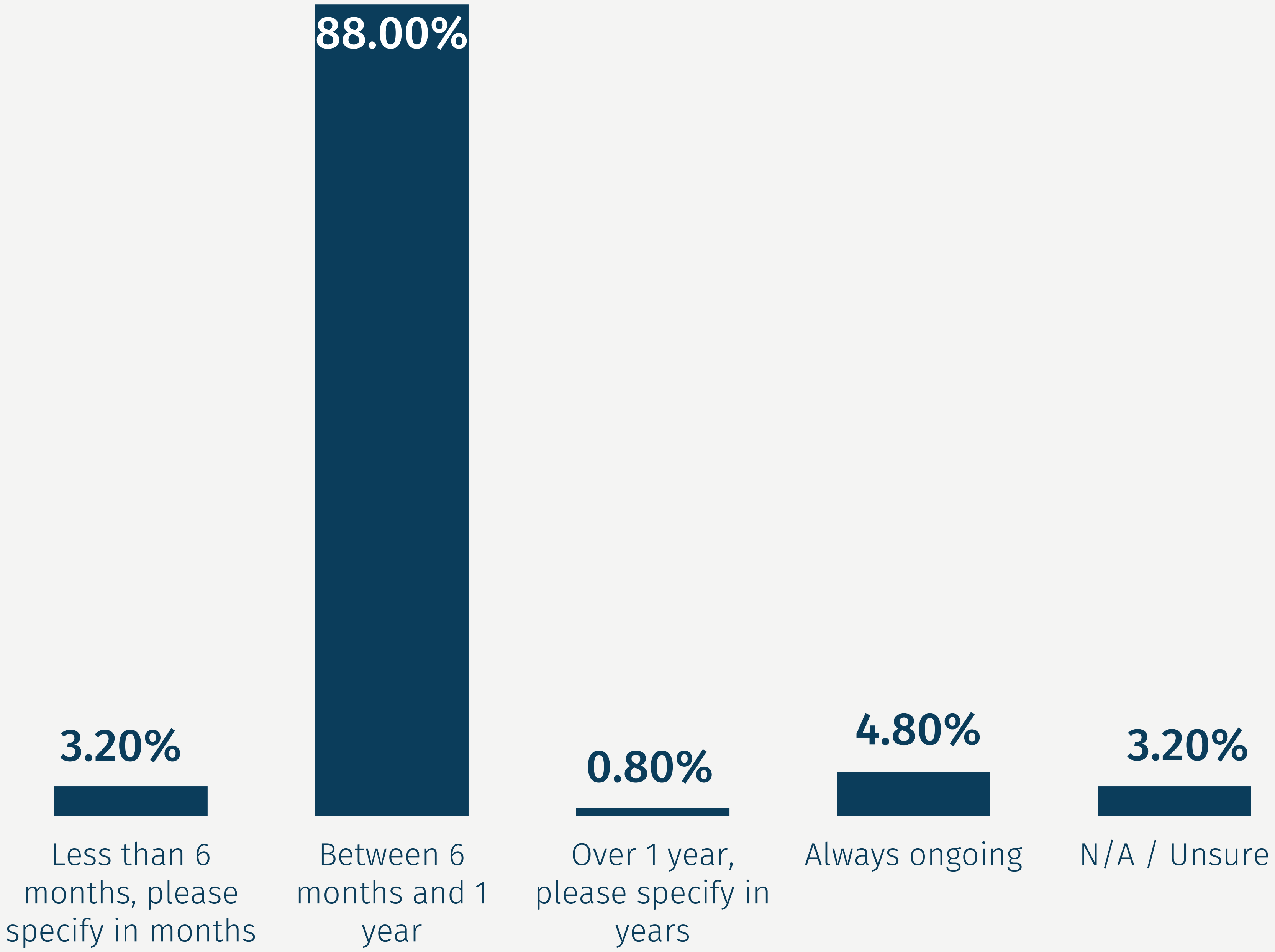


Mean number of employees (Excluding "Unsure"): **2.70**

How would you rate your current FX setup?



How long did it take to setup your current FX execution infrastructure?



Part 3

FX challenges

So, if FX is so significant to fund managers and they dedicate a large amount of resources, what's preventing them from having a best in class setup?

The biggest challenge senior finance decision-makers at fund managers face when dealing with FX is fragmented service provision (35%). Despite 55% of fund managers wanting to access most or all financial services in one place, it has historically been difficult to integrate these services into a singular solution. The resulting fragmentation has created an ongoing operational overhead for fund managers, increasing the risk of errors.

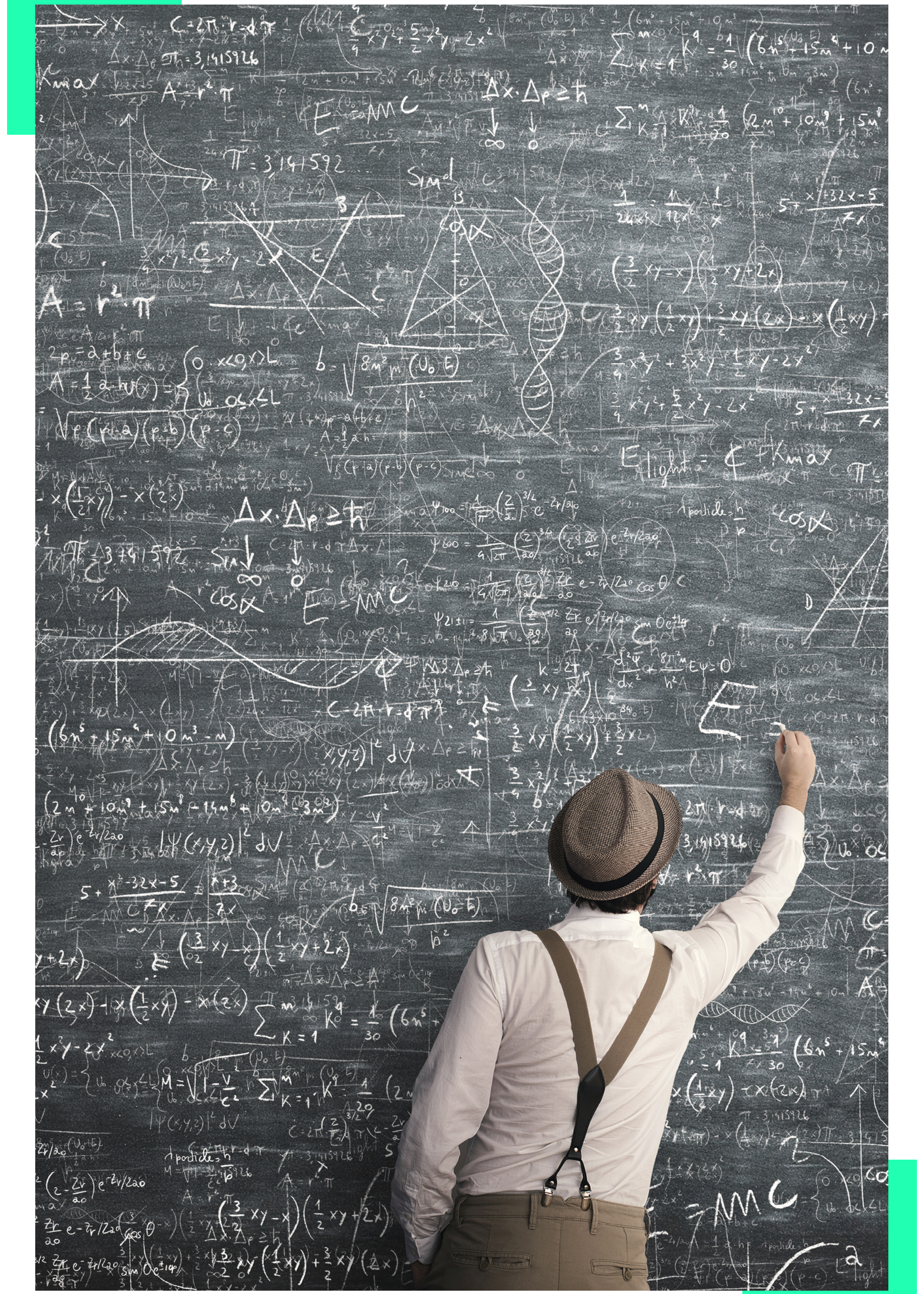
This was followed by securing credit lines (34%), cost calculation (33%) and forecasting exposure (28%).

When it comes to their FX operations, the biggest hindrances facing fund managers are demonstrating best execution (43%) and getting comparative quotes (40%).

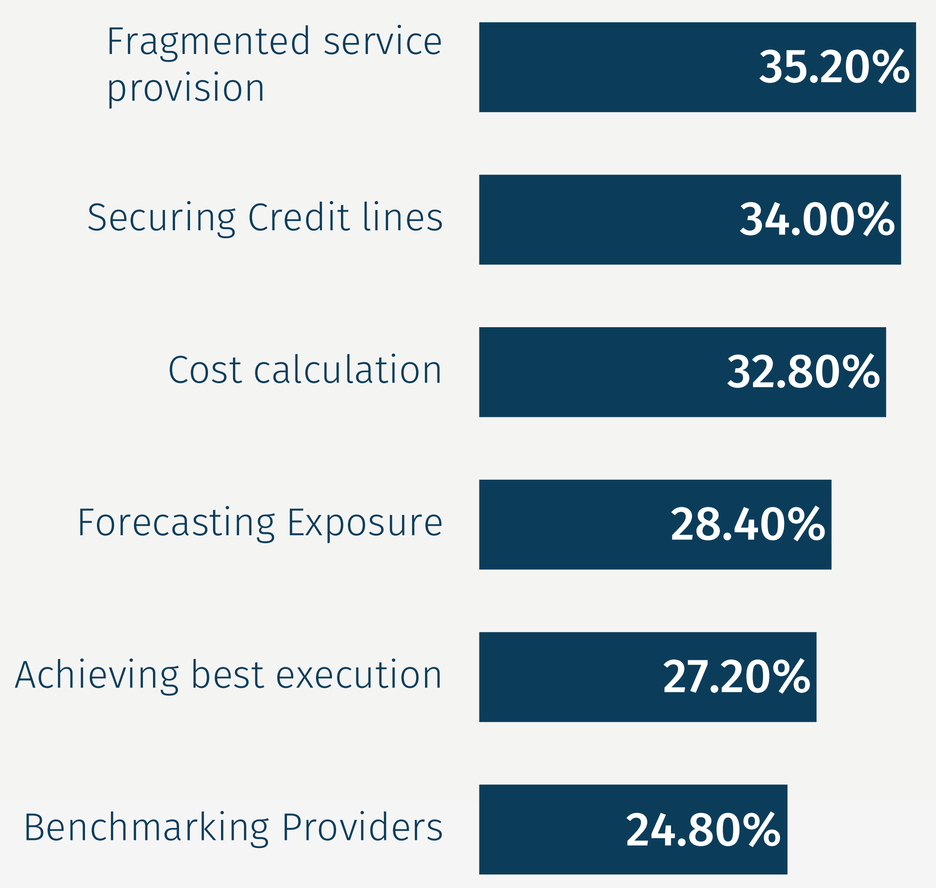
These two are inextricably linked. Due to the difficulty of comparing the market, they struggle to work out whether they are getting the best deal, making demonstrating best execution very difficult.

A key component of best execution is having access to multiple liquidity providers and many fund managers are falling at the first hurdle. Our research found that onboarding new liquidity providers (36%) was the fourth biggest challenge for when it comes to FX operations

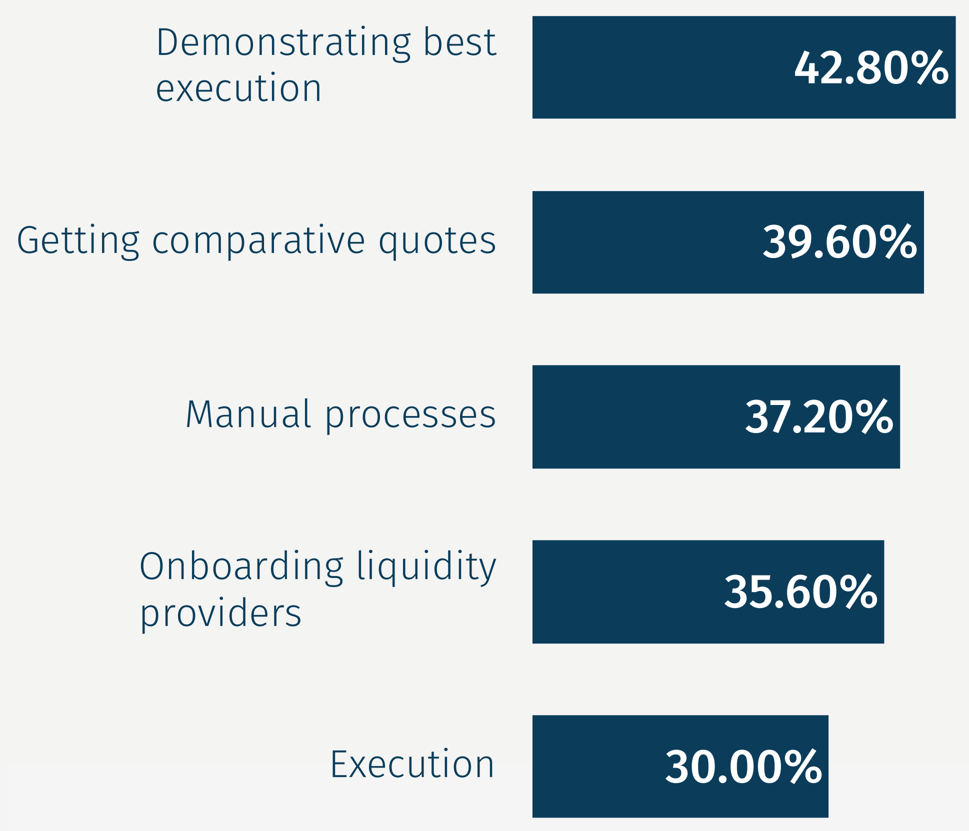
A reliance on inefficient, manual processes (37%) was the other major challenge they face.



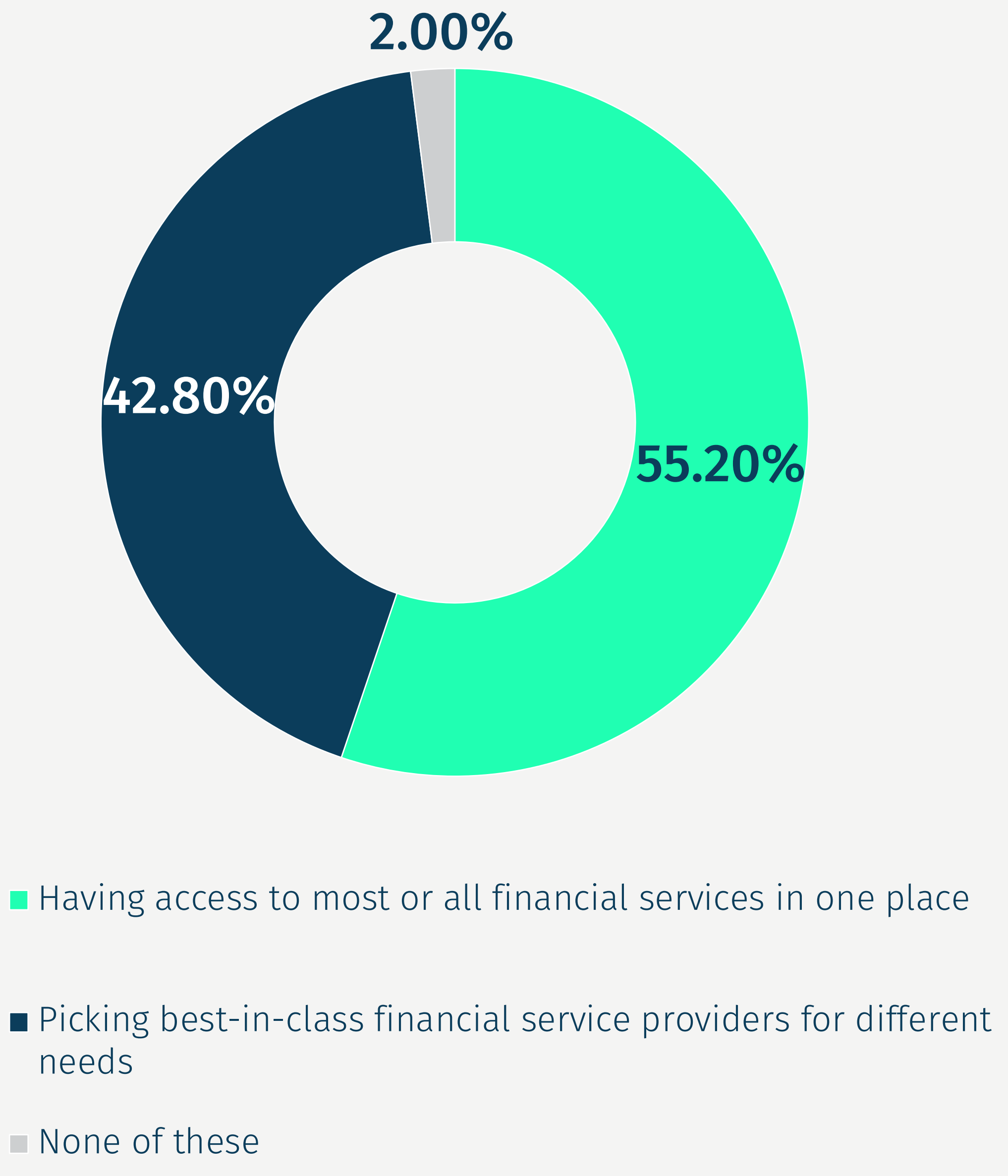
What are the biggest challenges you face when dealing with FX, if any? Tick up to 2



What are the most challenging aspects of your FX operations, if any? Tick up to 2



Which of these is more important, if any?



Part 4

Increasing interest in automation, outsourcing and ESG

One of the most prominent trends in the FX market, expedited by the Covid-19 pandemic, has been the notable increase in organisations seeking to embrace digitisation as a way to streamline operational processes.

As a result of this and the challenges mentioned above, many fund managers are exploring moving away from traditional, cumbersome FX processes and instead are embracing simple, tech-enabled solutions which digitise the end-to-end FX process from initial price discovery right through to reporting at the end of the trade lifecycle.

84% of senior-finance decision makers surveyed said they were looking into new technology and platforms to automate their FX operations, while outside of costs and credit rating, 32% said automation of manual processes was the most important factor in terms of FX management.

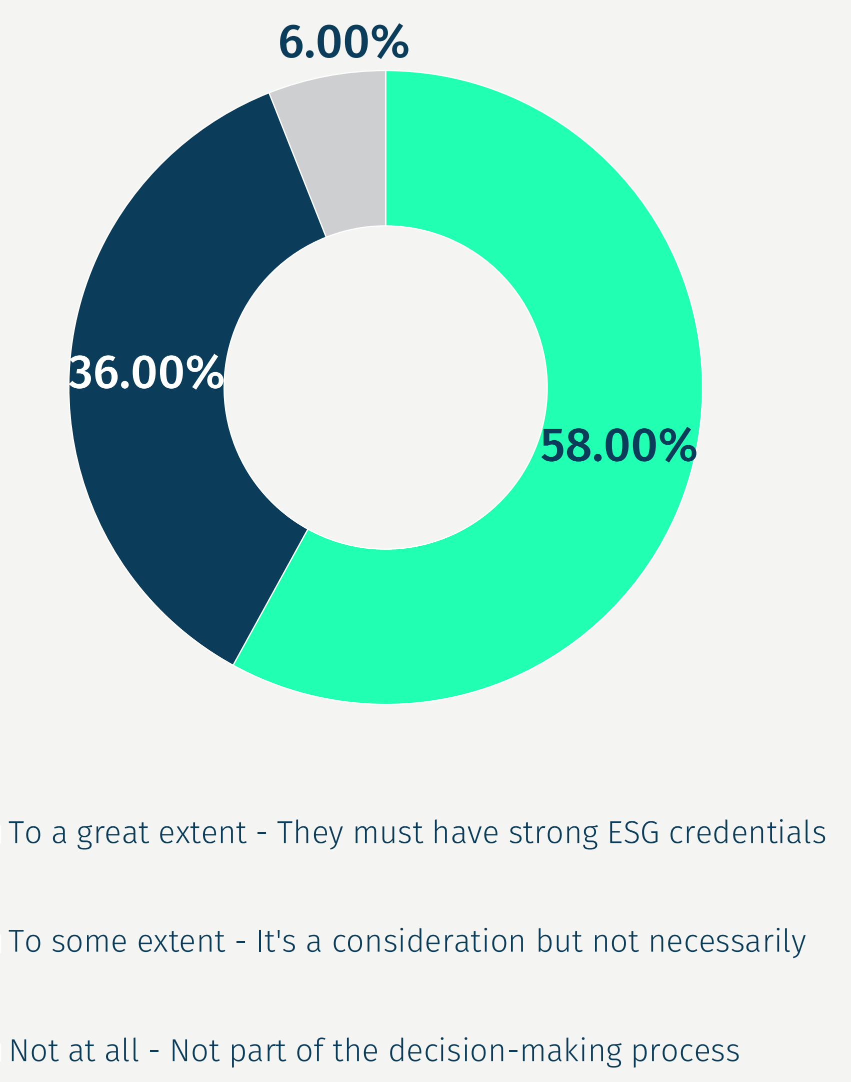
The numerous processes involved in FX create huge administrative burdens for fund managers, eating up time and resources. Likewise, the time-consuming and costly nature of onboarding new liquidity providers can outweigh the perceived benefits that they bring.

When using the right partner, outsourcing frees up resources for more effective use elsewhere and can lead to improved execution, enabling firms to dedicate more time to core business matters.

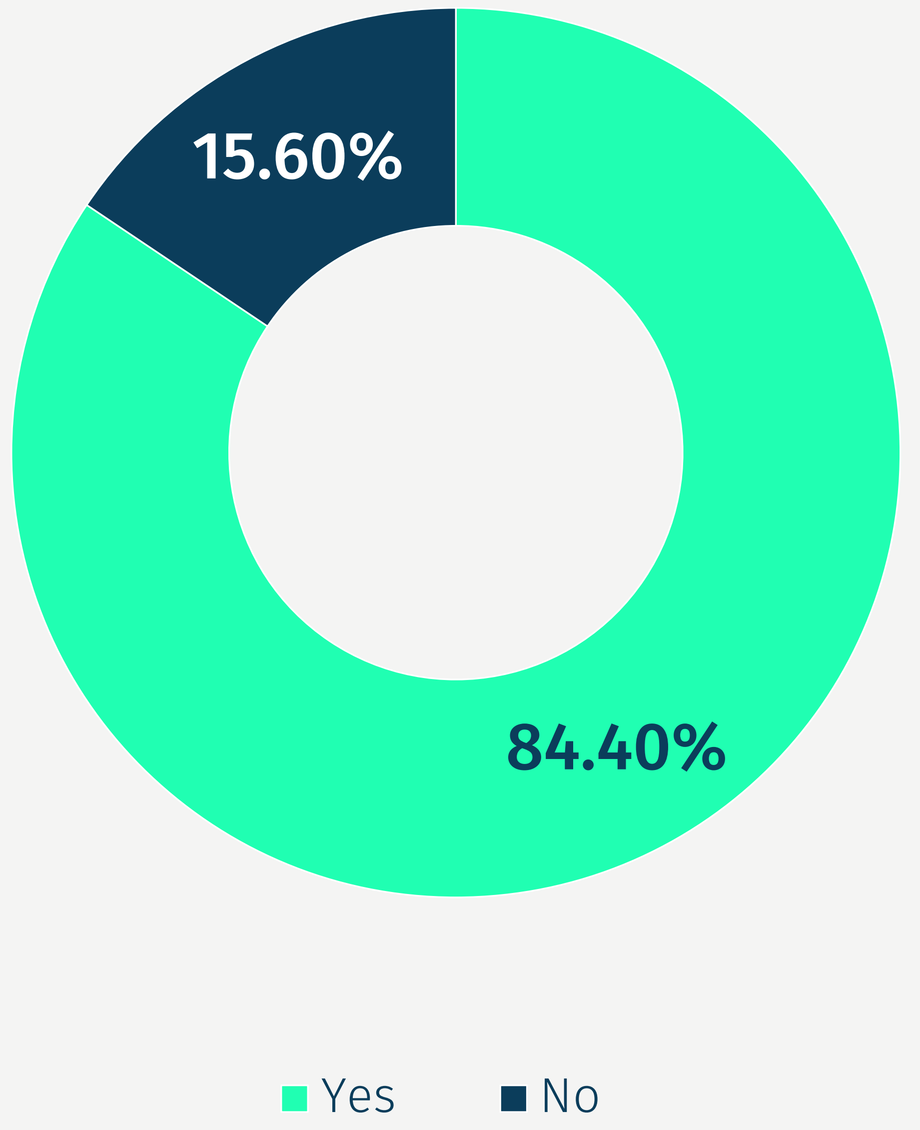
There are still some barriers to outsourcing for many fund managers. These include a perceived lack of control (41%), high costs (36%) and integration (35%).

Interestingly, 58% of fund managers said that their FX counterparties must have strong ESG credentials while 36% said that it was an important consideration. Only 6% said it wasn't part of their decision-making processes.

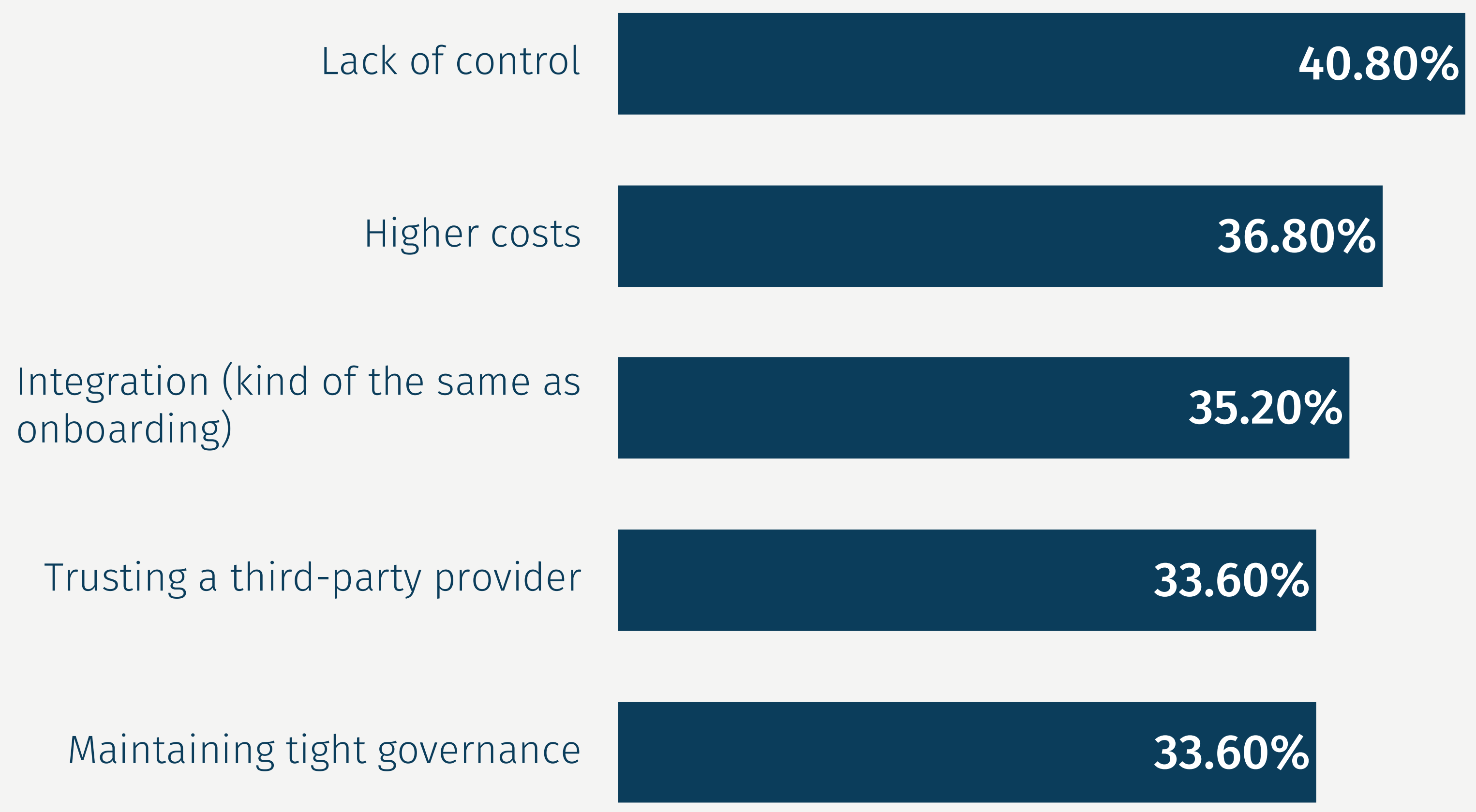
To what extent does ESG credentials impact your selected FX counterparties?



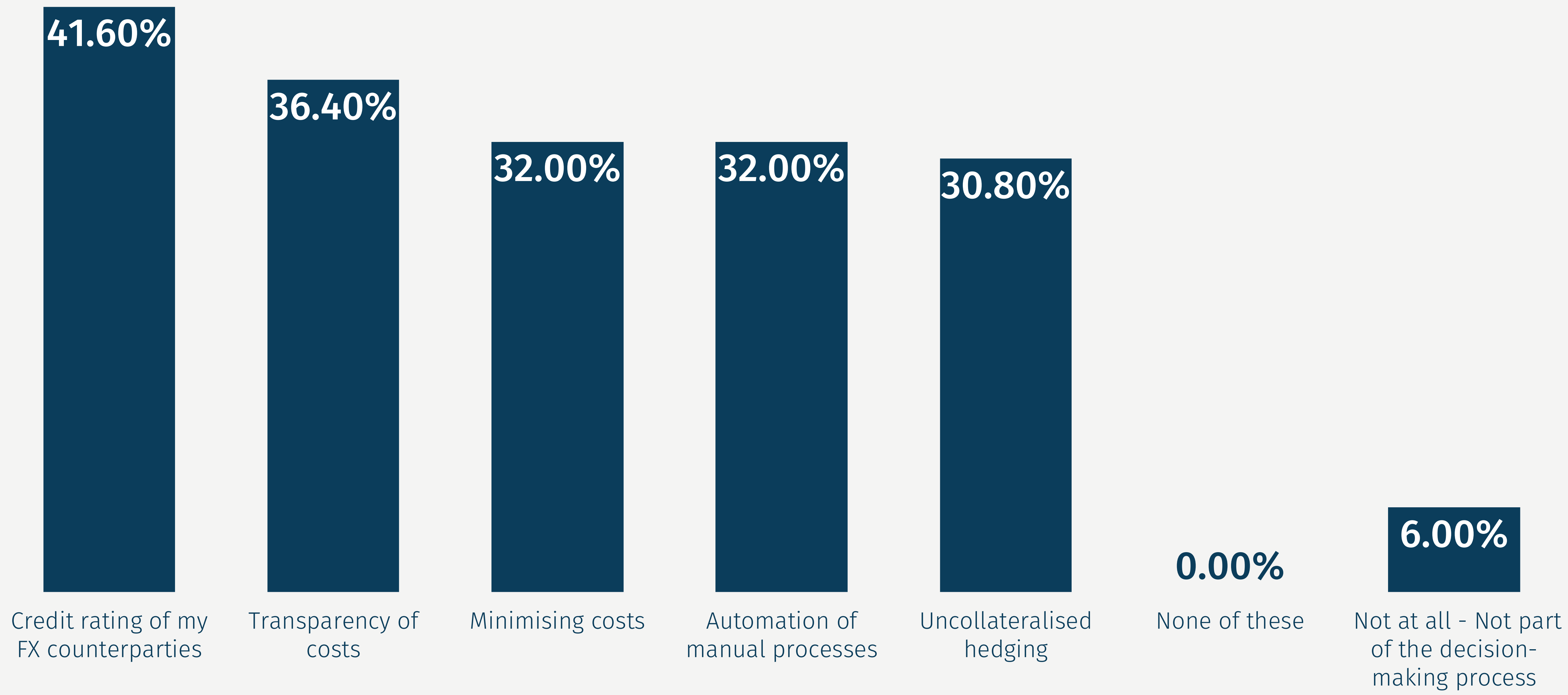
Are you looking into new technology/platforms to automate your FX operations?



What are the biggest barriers to outsourcing your FX execution to the right partner, if any? Tick up to 2



Which of the below, if any, are the most important? Tick up to 2



Conclusion

The unpredictable and often volatile nature of currency markets means that the management of FX currency risk must be a top priority for fund managers.

Fortunately, there are several ways fund managers 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 CFOs can be hampered by their inability to access multiple liquidity providers, meaning they often rely on a single bank or broker to meet their hedging requirements.

A new generation of fintechs is tackling this problem, enabling treasurers to access rates from multiple tier-1 banks whilst reducing the operational burden 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, and when using the right partner can actually 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.

We believe that CFOs should seek alternatives to the traditional single bank-based approach. Instead, looking 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.

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 enables 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 80% 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 Institutional Solutions, Joe McKenna at JMcKenna@milltechfx.com or request a free TCA here.

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

*The AuM managed by Millennium Global Investments Ltd (MGIL) as at 30/09/2022 and is a combination of USD 16,311 million in notional AuM for unfunded managed accounts and USD 108 million AuM in in funded vehicles. The 2021 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 Limited.

*This data refers to a survey conducted by Censuswide on MillTechFX's behalf between June 2022 – July 2022, based on a survey of 250 CFO's, treasurers and senior finance decision-makers at asset management firms.

*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.

MillTechFX is the trading name of Millennium Global Treasury Services Limited (MGTS). MGTS is authorised and regulated by the Financial Conduct Authority (FRN 911636) and is a company registered in England and Wales with company number 11790384. The registered address is Cleveland House, 33 King Street, London, SW1Y 6RJ, United Kingdom.