

## The New City Initiative (“NCI”)

### The Changing Face of Foreign Exchange: Hidden Cost or Undiscovered Treasure?

***In an opinion paper published today, the NCI looks at the current challenges and opportunities that confront institutional investors from the increased regulatory scrutiny of foreign exchange, and how these can bring direct business benefits. The full paper is available on the NCI website at [www.newcityinitiative.org/publications](http://www.newcityinitiative.org/publications).***

FX is a necessary part of any asset management business that invests internationally and the costs associated with pricing FX transactions are often unclear or unknown. The NCI paper attempts to quantify the extent and significance of this problem by reviewing the size and the mechanics of the global FX market and the European fund industry.

The paper also reviews the impact of recent and future regulation such as MiFID II, which is regarded as a positive influence, particularly in areas such as best market practice and transparency. The paper explores the positive benefits these could bring to institutional investors and asset managers and focuses on some of the immediate actions needed to improve the FX investment processes.

**Commenting on the role of foreign exchange within asset management, Toby Illingworth, Executive Director of the New City Initiative, said:** *“The pursuit of FX transparency and best market practice will deliver direct benefits to Institutional investors, most of which only use FX as an integral and necessary transaction in their investment process. It is estimated that mispricing of FX transactions comes at a cost of at least EUR1.5bn a year to the European fund industry, so by eliminating this there is an automatic and immediate uplift in fund performance and, ultimately, fee income and profitability. Clients will in turn receive a higher return on their assets and an improvement in the quality of service through better transparency and market practice.”*

**He continued:** *“These new regulatory changes are a unique opportunity for asset managers to upgrade their business model, their FX operational processes and improve efficiency to reduce investment costs and improve fund performance. That can only be good for building strong business relationships.”*

A summary of the paper and its recommendations to both regulators and asset managers is provided below.

#### SUMMARY

- **Mispriced FX transactions cost the European fund industry and their underlying clients EUR1.5 billion per year, on a conservative basis.**
- **A conservative estimate shows that \$590 billion of FX transactions related to institutional investments is at risk of being mispriced on a daily basis.**
- Recent events demonstrate there is a potential to misprice client FX transactions. It is clearly the responsibility of institutional investors and asset managers to ensure they receive the best FX pricing and best execution from their banks, at all times.
- The London 4.00pm FIX carries too much influence and is a flawed method of execution. The interests of banks and clients are conflicted.
- Market activity around the FIX is irrational and generates a spike in volatility resulting in an increase in market spreads. Trading FX at the London 4.00pm FIX is predominantly one directional skewing market pricing and adding a false premium to market pricing.

## NCI RECOMMENDATIONS

- Regulators should communicate clearly and in a cohesive manner any new regulations and directives to the market using local associations and trade bodies as points of contact for follow up seminars and workshops.
- Regulators should not operate a “One size fits all” methodology to impose new regulation. Differentiate requirements as to size and type of activity and use a gradual implementation process. Start with systemic risk institutions and move through the spectrum.
- Regulators should clearly state and stick to their timelines helping to avoid confusion.
- Investors and asset managers must review internal trading strategies and practices to comply with regulatory requirements, business objectives and best market practice.
- Investors and asset managers should use MiFID II to improve transparency and clarity in their FX process, specifically the trading strategy and market practice with banks. Create a competitive advantage by demonstrating to clients their best interests are being protected.
- There is an urgent need for institutional investors and asset managers to use independent FX transaction cost analysis (TCA) in their investment process. Use TCA data to make informed decisions to improve trading strategies and practices and reduce trading costs and inefficiencies.
- Investors and asset managers should access and utilise consultants with FX market expertise, experience and knowledge to maximise the benefit of new technology and trading venues.

The full paper is available on the NCI's website at [www.newcityinitiative.org/publications](http://www.newcityinitiative.org/publications).

### About the New City Initiative:

The New City Initiative (NCI) is a think tank that offers an independent, expert voice in the debate over the future of financial regulation. Founded in 2010, NCI counts amongst its members some of the leading independent asset management firms in the City and the Continent. The NCI gives a voice to independent, owner-managed firms that are entirely focused on and aligned with the interests of their clients and investors. Over the last decade, an old fashioned “client-centric” approach has enabled entrepreneurial firms in the Square Mile and beyond to emerge as a growing force in a financial industry dominated by global financial giants. Now, more so than ever, these firms play a key role in preserving the stability and long-term focus of the financial sector, which is of benefit to society at large. Today New City Initiative is comprised of 49 leading independent asset management firms from the UK and the Continent, managing approximately £400 billion and employing several thousand people.

### Core aims:

- To serve as an independent, expert voice in the debate over financial reform;
- To restore society's trust in the financial sector;
- To promote the values and practices of European owner-managed firms which align their interests with those of their clients; and
- To raise awareness of the positive, stabilising contribution small entrepreneurial firms make to the economy and society as a whole.

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