

THE
INVESTMENT
ASSOCIATION

SUB-CUSTODIAN TIMESTAMPING FOR FX TRADES

AN INVESTMENT ASSOCIATION¹
GUIDE TO BEST PRACTICE

February 2020



BACKGROUND

As frequent participants in FX markets, the Investment Association's (IA) members are keen to ensure that FX markets function well and continue to serve the interests of investors. In order to do this, and to meet their obligations to their clients, they require sufficient data to allow them to monitor the results and effectiveness of their FX trades.

One such category of data is timestamps. When trading, an asset manager will look to receive from their counter-party, at the very least, a timestamp for when the order was received, and when it was executed – these will be provided, ideally, on a millisecond basis.

This data is vital in helping investors meet their obligation with regard to best execution and other regulatory and supervisory requirements, as well as to manage their own FX risk and hedging activities.

Asset managers will often delegate their FX trading to a custodian who then trades on their behalf. This may be done for a variety of reasons, including to take advantage of a custodian's expertise in this area, or to benefit from a multinational custodian's trading advantages in third countries. In such instances, a custodian trading on behalf of asset managers should provide their clients with the relevant timestamps for a given trade.

In some instances, a client will delegate a trade to a custodian that requires a trade to occur in an emerging market jurisdiction where that custodian does not have a local desk. In this instance, a custodian will delegate the trade to a local sub-custodian, who performs the trade on their (and therefore the custodian's client's) behalf.

¹ The Investment Association (IA) is the trade body that represents UK investment managers, whose 250 members collectively manage over £7.9 trillion on behalf of clients. Our purpose is to ensure investment managers are in the best possible position to:

- Build people's resilience to financial adversity
- Help people achieve their financial aspirations
- Enable people to maintain a decent standard of living as they grow older
- Contribute to economic growth through the efficient allocation of capital

The money our members manage is in a wide variety of investment vehicles including authorised investment funds, pension funds and stocks & shares ISAs. As part of this activity they are also frequent participants in FX markets. The UK is the second largest investment management centre in the world and manages 36% of European assets. The UK is also the world's largest forex market, with daily average FX turnover of \$2.86 trillion according to the Bank of England.

CONCERNS RAISED REGARDING TIMESTAMPING IN FX MARKETS

Over the past year, our members have raised concerns that in many instances where a trade has been delegated by their custodian to a sub-custodian, they are not receiving back timestamps at anywhere near the level of accuracy required.

For example, they may receive timestamps that are accurate only up to the nearest minutes, or even, in some cases receiving only the day on which a trade takes place.

This lack of precision makes accurate analysis of the quality of a given FX trade very difficult, which in turn has a negative impact on ability of asset managers to manage risk for themselves and their clients. Given the speed at which FX markets move, it has been noted by members that any timestamp that is more than a few seconds wide makes effective transaction cost analysis effectively impossible.

It is therefore vital that this issue is addressed.

This paper will therefore look to identify where local market structural and regulatory issues may genuinely impede precise time-stamping, and then set out a series of best practice recommendations addressing:

- Engagement between clients and custodians
- Transparency of custodians' approach to trading, sub-custodian appointment, and time-stamping in emerging markets; and
- Custodians regularly reviewing and applying commercial pressure to their sub-custodians to ensure, where possible, that data provision is improved.

OPERATIONAL APPROACHES POTENTIALLY AFFECTING TIME-STAMPING

Certain aspects of a custodian's workflow may impact the way in which timestamps are provided.

For example, some custodians will net orders they transmit to a sub-custodian. Others will automatically generate a SWIFT message on the back of a trade message. This may impact whether

a sub-custodian is able to provide a timestamp for a specific trade to be passed on to a specific client.

In this instance, neither approach is necessarily better or worse than the other, but custodians should ensure clients are fully aware of their workflow and how it may impact how timestamps are provided.

LOCAL MARKET STRUCTURAL AND REGULATORY IMPEDIMENTS TO ACCURATE TIME-STAMPING

The IA is aware that in many jurisdictions there may exist market structural or regulatory barriers that may impede the provision of accurate time-stamping. Such issues may include, but are not limited to:

- Regulations requiring the use of a local sub-custodian, potentially limiting a custodian's oversight over the trade
- A lack of liquidity which requires large orders to be sliced into multiple trades, potentially making provision of a timestamp or timestamps more difficult.
- Additional reporting requirements which may lead to delays in providing timestamping following execution
- A lack of e-trading, which limits the ability to provide precise time-stamps
- Currency trades requiring the involvement of the central bank, who may not provide accurate timestamps, or any timestamps.

In terms of custodian ability to provide accurate timestamps to clients, we can divide currencies into three different categories.

FREELY CONVERTIBLE CURRENCIES

Freely convertible currencies are usually highly liquid, have prevalent e-trading, and should give custodians no difficulties in providing highly precise timestamps to their clients.

RESTRICTED OR PARTIALLY RESTRICTED CURRENCIES WHICH MAY CREATE SOME BARRIERS TO ACCURATE TIMESTAMPING

In some emerging markets, there may exist limits to e-trading capabilities or local regulations or restrictions which may lead to:

- Restrictions on data transmission;
- Lower liquidity requiring orders to be sliced into multiple trades;
- Reduced liquidity requiring the involvement in certain instances of a central bank
- Delays in the execution of trades or the provisions of timestamps; or
- Timestamps that are in some instances not up to the millisecond.

However ultimately barriers to accurate timestamping, while present, should not critically impair accurate timestamp provision. Examples of such jurisdictions include (but are not limited to)²:

- | | |
|-----------------|----------------|
| • Abu Dhabi | • Namibia |
| • Bahrain | • Oman |
| • Bermuda | • Pakistan |
| • Brazil | • Peru |
| • Botswana | • Philippines |
| • BulgariaChina | • Qatar |
| • Chile | • Saudi Arabia |
| • Colombia | • Serbia |
| • India | • South Korea |
| • Indonesia | • Taiwan |
| • Jordan | • Tanzania |
| • Kenya | • Thailand |
| • Kuwait | • Tunisia |
| • Kazakhstan | • Uganda |
| • Malaysia | • Uruguay |
| • Mauritius | • Vietnam |
| • Morocco | • Zambia |

² Correct at the time of writing.

RESTRICTED CURRENCIES WITH SIGNIFICANT BARRIERS TO ACCURATE TIMESTAMPING

Some jurisdictions will have market structural issues so severe (for example, widespread lack of e-trading or reliable local counterparties) or regulations and restrictions that significantly limit the ability of custodians and sub-custodians to provide accurate timestamping.

This is particularly true in jurisdictions where the local central bank is the sole source of liquidity. In such instances a central bank may not provide a timestamp, or orders may be handled on a bulk basis which makes determining the point of execution for an individual trade difficult.

Examples of such jurisdictions include (but are not limited to)²:

- Argentina
- Bangladesh
- Egypt
- Ghana
- Iceland
- Malawi
- Nigeria
- Ukraine
- Zimbabwe

AVAILABILITY OF INFORMATION

Alleviating all issues with timestamping in certain jurisdictions is beyond the ability of the buy or sell-side by themselves. It is important that central banks and the Bank for International Settlements are aware of these concerns, so that they can be addressed.

Acknowledging and notwithstanding the above, from conversations with leading custodians the IA has learned that in most instances precise timestamping data should be readily available. The fact that this information is often not available to clients is therefore a matter of deep concern for our members.

BEST PRACTICE RECOMMENDATIONS FOR CUSTODIANS

In order to help alleviate these concerns, the IA's FX Committee³ has drawn up a set of recommendations to improve the transparency of custodians' approach to trading emerging market currencies and providing timestamps, as well as improve the availability of data from local sub-custodians:

ENGAGEMENT BETWEEN CUSTODIANS AND CLIENTS

During conversations between custodians and IA members it became clear that there often appeared to be a gap between what clients expected to receive in terms of data, and what custodians had agreed to or were able to provide.

RECOMMENDATION

Custodians and their clients should engage regularly to ensure custodians are aware of the level of client expectations, and clients are aware of what limits exist to a custodian's ability to provide up-to-the-millisecond timestamps.

TRANSPARENT EMERGING MARKET CURRENCIES POLICY

IA members have expressed concern that in some instances their custodians were unable to provide written policies demonstrating their approach to trading emerging market currencies.

RECOMMENDATION

Custodians should provide their clients, at the beginning of a commercial relationship and henceforth on client request or after any material change, with a written policy that clearly spells out their approach to trading individual emerging market currencies and currency pairs. This policy should include:

- Key information on trading and execution policies, including whether trades are netted and at what time trading is expected to occur;
- Where delegation to a sub-custodian may occur, and the process for choosing and reviewing sub-custodians;

- Approach to timestamping – what timestamps are provided, at what level of precision, how they are provided if an order is sliced into multiple trades and if there are any local regulatory or market structural issues that may hamper the ability to provide accurate timestamps or any timestamp at all.

DATA TRANSMISSION

IA members have faced issues where data is provided to them by their custodians in a non-machine readable or non-consistent fashion, which impacts their ability to conduct an effective analysis of the information received.

RECOMMENDATION

Information provided should be machine-readable, and should be provided in each instance to individual clients according to the same pre-agreed fashion.

LEVERAGING COMMERCIAL RELATIONSHIPS WITH SUB-CUSTODIANS

Clients do not have direct access to or commercial relationships with most sub-custodians, and therefore cannot bring commercial pressure to bear on these entities to improve the timestamps they receive. It is important to emphasise that local market or regulatory difficulties should not be used as a catch-all excuse for explaining away deficiencies in timestamp provision, and it is up to custodians to ensure they have the necessary policies in place and are engaging with their sub-custodians to ensure, to the best of their ability, that clients receive the data they need.

RECOMMENDATION

Custodians should ensure all sub-custodians are aware of the level of data they are expected to provide, and should leverage the commercial relationships they have with those sub-custodians to apply commercial pressure where the provision of such data is below expected levels.

³ Comprising senior FX representatives from a number of the IA's member firms.

GLOBAL FX CODE OF CONDUCT

The IA is supportive of the FX Global Code of Conduct. In the context of the Global FX Committee's ongoing review of the Code and their goal of improving disclosure within FX markets, we would welcome the Global FX Committee's support for this work, and for the Committee to consider the inclusion of principles relating to custody and sub-custodian FX practices within the Code.



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