News

Regulatory equivalence and technological advancements are factors influencing Asian FX market growth, finds GFMA and KPMG joint report

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A joint study of the Asian foreign exchange (FX) markets by the Global FX Division (GFXD) of the Global Financial Markets Association (GFMA) and KPMG has found that market participants face challenges due to the rapid global technological changes and diversity of regulations in place. Technological advancements are providing new entrants with the ability to compete with traditional market participants and requiring existing market participants to invest in new technology to upgrade their services or build partnerships with fintech firms. Whilst regulatory harmonisation is unlikely to be achieved, there are opportunities for greater regulatory equivalence (also known as substituted compliance) as a means to overcome the diversity in regulations and promote the future growth of the Asian FX markets.

In contrast to the global FX market which has contracted since 2013, the Asian FX market has grown rapidly in recent years with average daily FX volumes traded in the region climbing 20 percent between 2013 and 2016 to USD 1.16 trillion. This is in spite of the fact that the region is comprised of diverse currency markets that are shaped by various and, at times, competing forces, from global regulation to local capital controls, according to the joint report titled *The Asia Pacific FX Markets: Opportunities for Growth*.

A key growth opportunity for the regional FX market is regulatory equivalence, the report highlights. Many international banks as well as local players seeking to build a regional platform have found it challenging to implement standard strategies and technology models given the diversity in local currency restrictions and differences in how regulators have implemented global standards, such as the G20 reforms.

“Over the coming years, further regulatory changes are expected to present challenges,” said John Ball, Managing Director, GFXD for Asia Pacific.

“There is now an opportunity for regulators in the region to work together to ensure future regulatory changes are implemented in a harmonised way, or prioritising substituted compliance, thereby promoting growth and ensuring greater operating efficiency for the Asian FX market.”

Additionally, the study outlines how technological innovations are creating new opportunities for both fintech firms and traditional FX market participants.

Technology driven transformation can help the traditional market participants drive greater internalisation and generate greater efficiencies. It has also enabled technology firms with low overheads to compete with the traditional market participants, eliminating some market distinctions. However, those market participants that have invested heavily in proprietary systems are likely to need to build partnerships with fintech firms to benefit from new technologies.

"Technological innovation allows banks to be more proactive as opposed to reactive and may also help banks to ease the burden of increased regulation, for example, in respect of surveillance related requirements," says Tom Jenkins, Partner, Head of Financial Risk Management, KPMG China.

"Post-trade transaction processing, currently a significant cost for financial institutions, will be streamlined by the use of block chain technology. But it is expected to take at least five years for this to move beyond proof of concept implementations to market-wide use."

The roles of different classes of participants in the Asian FX market are also expected to evolve. In the future, a smaller number of banks and non-bank liquidity providers (NBLPs) will be capable of providing market liquidity given the ever-increasing costs of complying with capital requirements, the changing regulatory environment and utilising technological developments.

NBLPs, whose historical focus has been on liquid G10 currencies, are expected to expand their activity in the region's more liquid currencies and NDF markets, thereby taking market share from established participants. Local banks may struggle to offer multi-jurisdictional services to their clients without alliances with global players.

"Some market participants may change the way they participate in the region's FX markets, for example moving from the role of market maker to price taker, and in some in certain circumstances consider adopting an agency model," the GFXD's Ball concludes.

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About GFMA

The Global Financial Markets Association (GFMA) represents the common interests of the world's leading financial and capital market participants, and speaks for the industry on the most important global market issues. The GFMA's mission is to provide a forum for global systemically important banks to develop policies and strategies on issues of global concern within the regulatory environment.

The Global Financial Markets Association (GFMA) brings together three of the world's leading financial trade associations to address the increasingly important global regulatory agenda and to promote coordinated advocacy efforts. The Association for Financial Markets in Europe (AFME) in London, Brussels and Frankfurt, the Asia Securities Industry & Financial Markets Association (ASIFMA) in Hong Kong and the Securities Industry and Financial Markets Association (SIFMA) in

New York and Washington are, respectively, the European, Asian and North American members of the GFMA.

About KPMG China

KPMG China operates in 16 cities across China, with around 10,000 partners and staff in Beijing, Beijing Zhongguancun, Chengdu, Chongqing, Foshan, Fuzhou, Guangzhou, Hangzhou, Nanjing, Qingdao, Shanghai, Shenyang, Shenzhen, Tianjin, Xiamen, Hong Kong SAR and Macau SAR. With a single management structure across all these offices, KPMG China can deploy experienced professionals efficiently, wherever our client is located.

KPMG is a global network of professional services firms providing Audit, Tax and Advisory services. We operate in 152 countries and regions, and have 189,000 people working in member firms around the world. The independent member firms of the KPMG network are affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. Each KPMG firm is a legally distinct and separate entity and describes itself as such.

In 1992, KPMG became the first international accounting network to be granted a joint venture licence in mainland China. KPMG China was also the first among the Big Four in mainland China to convert from a joint venture to a special general partnership, as of 1 August 2012. Additionally, the Hong Kong office can trace its origins to 1945. This early commitment to the China market, together with an unwavering focus on quality, has been the foundation for accumulated industry experience, and is reflected in the Chinese member firm's appointment by some of China's most prestigious companies.

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