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## IFC invests in portfolio compression service for EM FX

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Competition has become intense in the FX portfolio compression business in recent months, but until now the focus has been on more liquid G10 currencies.



This is now set to change as the [International Finance Corporation \(IFC\)](#), part of the World Bank, partners with portfolio compression service LMRKTS to help expand its activities in to emerging market (EM) FX.

Portfolio compression is still a relatively new phenomenon in FX, but it has [become big business in short order as banks attempt to improve their capital efficiency](#) by eliminating redundant bilateral and multilateral counterparty exposures.

By improving their risk profiles through compression, banks free up capital, which they can then use to lend to small and medium-sized businesses, says Andi Dervishi, global head of fintech investments at IFC.

However, while compression services have so far focused on developed markets, [New York-based LMRKTS](#) "can have an even bigger impact for emerging-market banks where regulatory pressure and increased capital needs are compounded by the illiquidity of local markets", he adds.

LMRKTS will launch its EM compression service in the third quarter this year for cash as well as FX options, with Motive Partners, a private equity firm focused on financial technology, acting lead investor, alongside IFC.

EM exposures will be compressed in bi-weekly runs, in contrast to LMRKTS's G10 compression service, which is live and runs monthly. This recognises the distinct liquidity characteristics of EMs, where flows are far less concentrated in the hands of the top five or six dealers, says Lucio Biase, CEO at LMRKTS.

"Emerging-market exposures are the main driver of the standard initial margin model for foreign exchange," he adds.

## Shift in focus to cash-flows

Banks are now concluding that compression will play a vital role in managing their capital exposures, wherever they trade.

"If we can prevent one trade break by reducing counterparty exposure, the resulting saving pays for our service to that bank for a year," says Biase.

And while there are a number of providers offering the service, LMRKTS believes it is different, seeking to abandon the position-based approach of the first generation of compression systems.

"We wanted to look more holistically, which means looking at the underlying cash-flows," says Biase.

"Changing the focus from the trade to the cash-flows is a paradigm shift and applies not only to our approach in FX but also in the rates products our clients are testing," he adds.

LMRKTS, having begun operating in 2016, compressed \$1 trillion of gross notional in FX in a feat it achieved in just three runs last year. Its first commercial run reduced gross notionals by \$430 billion with just six parties, five currencies and two months of maturities, equating to savings of more than \$70 billion per party per run.



Lucio Biase, LMRKTS

Biase believes that because LMRKTS service has been designed specifically for FX, it has an advantage over the competition, which was originally designed for rates and later adapted for currencies, he says.

The LMRKTS team has years of experience in the FX market. Biase worked in Lehman Brothers' back office in 1999, where he was responsible for exposure to EM counterparties in places such as Russia, Mexico and East Asia. It was here, he says, that he first had the idea that some of these exposures could be compressed.

Helping with the sale and design of the system is Andy Coyne, LMRKTS's interim head of FX, who was CEO at Traiana and has been involved in FX prime brokerage. Sandeep Karkera, who helped build Susquehanna's programme trading system between 2003 and 2009, serves as chief technology officer. Hilary Park, a former Goldman Sachs, Morgan Stanley and Credit Suisse prop trader, who worked with Biase at Marathon Asset Management, is chief security officer.

The team is relatively small, keeping costs down and allowing it to price competitively. Larry Summers, the secretary of the Treasury under president Bill Clinton, acts as adviser, alongside Andy Brown, former CTO at UBS, and Andy Brindle, the one-time global head of credit derivatives and Americas head of equity derivatives at JPMorgan.

## Starting with the big guns

So far, LMRKTS has eight signed-up bank clients for its G10 offering, but it says it is close to adding two or three more. Hitherto, it has focused on larger institutions because of the heavier concentration of their flows: according to the Office of the Comptroller of the Currency, which reports only on US organizations, 80% of FX forwards exposure is concentrated in the hands of the top-tier dealers.

In G10, LMRKTS has preferred to limit its compression runs to a relatively small number of counterparties and currencies. Each run looks to eliminate trades typically in five or six currencies, which will vary between cycles depending on the exposures of the banks in that particular cycle.

LMRKTS's Biase says: "The more parties there are in a run, and the more currencies you include, the more onerous the trade count can become, and we want to limit the operational hassle for our clients.

"There's a trade-off and there comes a point at which adding more currencies may not deliver a sufficient benefit to justify it."

Alex McDonald, CEO of the Wholesale Markets Brokers' Association (WMBA), says the industry will benefit from healthy competition and more innovation emerging in the compression space.

"Given the increasing cost of balance-sheet capital, it empowers the market to decide if it wants to have pre- and post-trade deal flow in the same place," he says. "It may now be interesting to have a compression service for the buy side and non-financials, as well."

David Clark, chairman of the WMBA, says it is important that a compression service designed for the top-tier banks is plug and play.

"For these entities, this is less about trading than overall balance-sheet management," he says. "Banks are more concerned about managing their capital and liquidity than which platforms they use, and want to take advantage of compression opportunities."

The LMRKTS team had made the same observation and has designed its system to be light touch, using processes its customers are familiar with to make it easier for them. It sits on top of existing infrastructure, requiring no software to be downloaded. Customers employ an execution venue to arrange, submit and book trades, with Tradition acting as its third-party execution partner.

This is another way in which LMRKTS distinguishes itself from its competitors. [TriOptima's compression service](#) uses Icap, of which it is a subsidiary.

"We believe it is better to have an independent partner managing execution, rather than trusting the Chinese wall of a large interdealer broker," says Biase.

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