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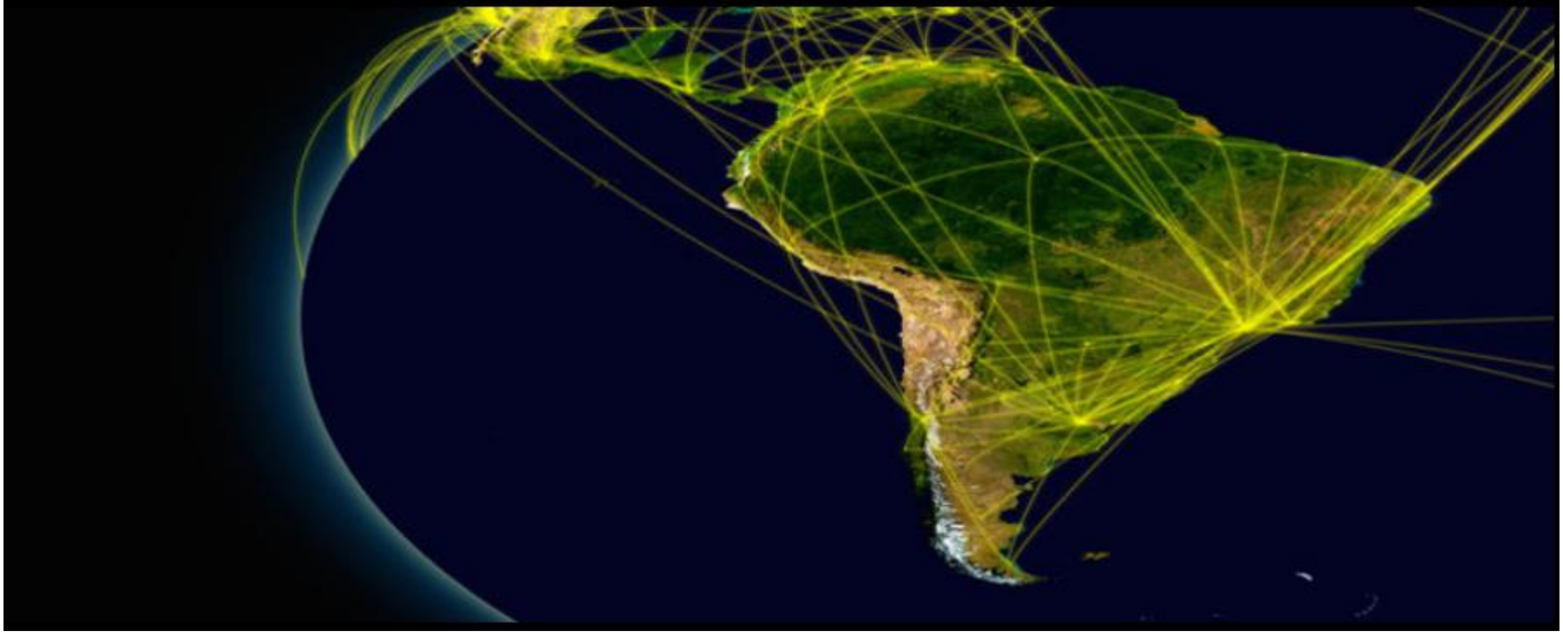
Edgewater: Making a Play in LatAm

Galen Stops | October 25, 2018 | 12:00 AM



Edgewater Markets recently hosted an event in Lima, Peru, to celebrate the continued roll out of its new LatamFX.Pro platform. Galen Stops attended the event and sat down with the firm's senior management to discuss why they're making such a strong push in Latin America.

In a nutshell, the central thesis behind Edgewater Market's Latam strategy is that their technology can be used to convert the NDF market into an NDF trading platform and thereby enabling local market participants to aggregate, consume and distribute FX rates more efficiently.

"Right now, local players are interacting with one another in a limited capacity, and they also have very limited ability to distribute their rates to the global marketplace," says Alex Scarsini, cofounder and president of Edgewater. "At present, these local participants access the market via bilateral relationships with tier one banks over totally inefficient and outdated voice and chat methods. Our goal is to enable the region – via technology and credit disintermediation – to more efficiently access the entirety of the market."

Edgewater is looking to effectively replicate what the firm has done in Mexico, where it has spent the last three years building out the business, with a staff of 20, a local matching engine launched in Q3 2016 and sees over $1 billion in trading volumes per day.

There are clear differences between the Mexican FX market and those in the rest of Latam, however. For starters, the Mexican peso is a deliverable currency, whereas the rest are non-deliverable.

“The challenges and opportunities in Latam are quite unique to each country, but we’re applying the same strategy of offering better software solutions and enhanced access to credit that we used in Mexico,” says Robert Sanchez, a managing partner at Edgewater, who has been spearheading the company’s growth plans in Mexico and Latam.


Alex Scarsini

Although the business challenges vary from country to country in Latam, Scarsini argues that the experience of building the Mexico business has left Edgewater uniquely positioned to expand into this market.

“I think the reason why no one’s really come to this region before is because it’s perceived as being somewhat of a small market, which is not entirely inaccurate. There are not hundreds of potential clients for our product, there are dozens. Had we not had a very successful business operation in Mexico, it wouldn’t have made sense for us to start here in Latam right off the bat. I can’t imagine a competitor coming in here and trying to establish market share without having prior experience in the region,” he says.

Decentralised Relationships

Central to all of this, is the LatamFX.Pro platform that Edgewater launched earlier this year, an electronic trading platform dedicated to Latam currencies and NDFs. In Mexico, there are now 20 financial services firms live on the platform, nine active users from the rest of the Latam region, and in the US, the aggregation process with clients is starting.

In recent years, there has been much talk regarding the electronification of NDF markets, and there is clearly a strong rationale behind this – short-dated NDFs are commoditised enough in many currencies that it makes sense to put them on a platform and stream prices electronically. Yet despite this, the actual pace of this change has been relatively slow.

“I think that one of the reasons that everyone’s been talking about electronifying NDFs, and that it has not happened that quickly, is because the local Latam banks that are the purveyors of NDF liquidity just didn’t have the right technology solutions. You can build whatever product you want, but if your participant bank doesn’t have the technology solution to stream those prices into your best-of-breed front-end system, then at the end of the day, there’s no product,” says Scarsini.

He adds that a lot of these banks simply don’t have the necessary incentives to go out and develop these technology solutions, but notes that in recent years the growth of multibank platforms has shifted perspectives in this regard.


Robert Sanchez

“The relationship is being decentralised. It is no longer bank one trading with bank two, it’s bank one accessing prices from 20 different banks at the same time in a very transparent manner. I think that this model is being tested in the region and local banks are recognising a need to develop tools to enable them to access this multibank market so that they can access liquidity globally as opposed to having to call a tier one bank to ask for a price and trade bilaterally. As a result, they look to us as a partner to help them develop these capabilities,” says Scarsini.

Another challenge for electronifying the NDF market in Latam is accessing and developing credit.

As Scarsini puts it: 'You have to have this credit component solved, and while credit is plentiful in G10 spot FX, when it comes to the NDF market, it's a little more difficult but certainly more achievable when the right technology solution is in place."

So how has Edgewater looked to solve this credit challenge?

"Once local banks have the technology to electronically stream or publish prices (in the same manner that the rest of the G10 global market does) then it will make sense for them to look to match their interest locally as well and not just via bilateral relationships with tier one banks abroad. This will translate into more competitive and efficient execution and further incentivise local banks to develop larger credit relationships with one another. To date, lending out one's balance sheet regionally has not been common for a Latam bank, but we are now helping them understand how to optimally access markets by leveraging the prime broker and prime of prime models," Scarsini explains.

As evidence Scarsini points to Mexico, where he claims that Edgewater has unlocked roughly 50% of the credit being used by its clients today by disintermediating local players with one another and thereby adding deeper liquidity in the local market.

"We've become experts in terms of finding credit," adds Sanchez. "We obviously have prime broker partners ourselves, but we also help the local banks with their credit solutions. Take Mexico, for example. There are a handful of banks that have sizeable lines to bulge bracket PBs, but they don't necessarily use those limits. Through our tech solutions we enable them to "lend out" those lines internally to smaller, credit constrained regional banks. This has certainly made the USD/MXN marketplace more efficient."

It is worth pointing out, the LatamFX.Pro is an open ended platform, meaning that users are not restricted by just having a credit line with Edgewater's prime broker, they can still trade bilaterally.

A Delicate Balancing Act

An important issue facing Edgewater Markets, as it expands in Latam, is how it balances the relationships it has with the local banks and the tier one banks, both of which it relies on as partners. This is why the senior staff at Edgewater are all very keen to clarify exactly what parts of the FX market they are, and are not, disrupting with their current expansion.

"Notwithstanding the commoditisation of the space, this is still an OTC market where relationships will continue to be important," says Jose Antonio Buenaño, managing director, head of South America, at Edgewater. "There's still a need for traditional voice trading or chat, that's not going away, especially in this region, and especially for higher margin products" agrees Sanchez. "However, there is a growing segment of $1 million to $10 million trading in one-month NDFs, which is prime for electronic streaming delivery."

It's not just the technology that is crucial to success in Latam though, also important to Edgewater's strategy for the region is the "boots on the ground" concept.

In September 2017, the firm launched its new South American operation based in Santiago, Chile with Buenaño at the helm. Prior to that, Felipe Alanis joined the Mexico office as head of electronic solutions in December 2016. Both have been instrumental in building out the Latam business thus far. Edgewater is looking to continue expanding in the region and may eventually come close to matching the 20-person headcount that it has in Mexico, to other parts of Latam.

Skovran Schreder

“Today, we have offices in Chicago, New York, London, Singapore, Mexico City and Chile. Sometimes people wonder why we have so many offices, but when we make a commitment to a region we are there to stay: we set up physical offices, we have people on the ground who understand the local market, understand the market conditions and understand what type of technology solutions they need. As a result, our plan in the next 24 months is to increase our headcount in Chile and we’re in the process of determining whether we need to have offices in other countries in the region as well,” says Skovran Schreder, co-founder and CEO of Edgewater.

Buenaño echoes the point about the importance of local support and expertise, stating that when he was working on the banking side in Chile and experienced issues with a piece of vendor supplied technology, it often took a long time before support staff would reach out with a phone call. By contrast, he says that Edgewater works hard to differentiate itself by offering immediate technical assistance, on a 24/7 basis, to its partners in the region.

Creating a Latam Playground

Ultimately though, the Edgewater senior management are counting on their ability to solve inefficiencies in Latam regional FX trading to sell their platform and grow the business.

“There’s a clear recognition, all the way from top management to the traders on the desk, that access to liquidity is inefficient in Latam, and what we’re doing is giving these clients solutions that make it easier for them to manage their exposures, access liquidity and price clients more efficiently,” says Scarsini.

With much of the sales effort in the Latam region already done, Sanchez says that the focus for Edgewater, over the next 12 months, will primarily be on software development.

Taking a longer-term view, however, Scarsini adds: “What we’re trying to do in the region is to create an efficient and competitive marketplace, a singular pool of liquidity where local participants can come in via credit and via the tools that we give them, to execute their flow much the same way the G10 spot market interacts today. This will take time and, like in any nascent exchange, when you have just a limited number of players it’s not that significant, but if all of a sudden you have 25 or 30 players crossing bids and offers amongst themselves, then you have created a playground that other global institutions will want to access.”

Galen Stops