Irish Results of the BIS Foreign Exchange and Interest Rate Derivatives Survey 2013

Aisling Menton

Abstract
The Central Bank of Ireland participated in the most recent survey of global turnover in foreign exchange and over-the-counter single-currency interest rate derivatives. The survey is coordinated by the Bank for International Settlements every three years, and Ireland has participated since 1995. The survey results for Ireland show a sharp fall in turnover in both foreign exchange and interest rate derivatives since the last survey in 2010. There are two driving factors behind the decline between 2010 and 2013. Firstly, the landscape of the Irish banking sector has changed dramatically; banks have exited the Irish market, through liquidation or wind down. There has also been significant restructuring of the Irish banking system, with deleveraging of overseas assets. Less cross-border exposure reduces the need for hedging of currencies or interest rate risks. In contrast, the results of the global survey indicate that April 2013 was one of the most active months in trading of foreign exchange derivatives, partly due to a regime shift in monetary policy by the Bank of Japan.

1 The author is a Senior Economist in the Statistics Division of the Central Bank of Ireland. The views expressed in this article are solely the views of the author and are not necessarily those held by the Central Bank of Ireland or the European System of Central Banks. The author would like to thank Maura Finne for her help with the survey.
1. Introduction

Ireland participated in the 2013 Bank for International Settlements (BIS) survey of foreign exchange and over-the-counter (OTC) interest rate derivative markets. This article presents the results for Ireland, and compares these with global results, published by the BIS.

The 2013 survey shows a sharp decline in turnover in derivative products in Ireland, in contrast to global trends of strong growth in turnover in April 2013 over April 2010. After increasing in the 2007 and 2010 surveys, there was a sharp fall in the daily average turnover of foreign exchange derivatives in Ireland in April 2013 and an even sharper fall in interest rate derivative contracts. The turnover in foreign exchange derivatives peaked in 2010, whereas turnover in OTC single-currency interest rate derivatives was highest in 2004. Global trends in April 2013 showed a significant increase in turnover in both categories of derivative contracts. The fall in the Irish data can be attributed to a number of factors: a fundamental change in the composition of Irish banks’ balance sheets, including significant deleveraging of their foreign operations; and a change in the dealer population, with some banks that participated in the previous survey either moving their sales desks out of Ireland, or exiting the Irish market completely. This exit was only partially offset by new entrants in the market. Conversely, the high turnover levels recorded for April 2013 in the global survey reflect a particularly active period in global foreign exchange trading arising from a regime shift in monetary policy by the Bank of Japan, which led to yen depreciation. Controlling for this, however, global turnover would have still increased by 25 per cent (Rime and Schrimpf, 2013).

Section 2 of the article provides a brief overview of the survey methodology. Sections 3 and 4 present more detailed breakdowns of foreign exchange and OTC interest rate derivative markets, while Section 5 examines how trades are conducted. Section 6 concludes.

2. Survey Methodology

The BIS Triennial Survey of foreign exchange and OTC interest rate derivatives markets was introduced in 1989 and is a comprehensive source of information on global derivative markets. The 1989 survey covered foreign exchange derivatives, and this was extended in 1995 to include OTC interest rate derivatives. The 2013 survey covered 53 jurisdictions and 1,300 reporting agents. The Central Bank of Ireland surveyed 19 credit institutions operating foreign exchange and OTC interest rate derivatives sales desks in Ireland. Survey participants provided details of their gross turnover for the 21 business days in April 2013, broken down by instrument type, counterparty and currency. Turnover data provide a measure of market activity, and can also provide a rough proxy of market liquidity. Turnover is defined as the gross value of all new deals during a given period and is measured in terms of the nominal or notional amount of the contracts. The country of turnover was based on the location of the sales desk, and all transactions were reported in US dollar equivalents.

Chart 1: Average Daily Turnover in Foreign Exchange Derivatives in Ireland, 2001-2013

Source: Central Bank of Ireland.
To allow more in-depth analysis of the global derivative market, the BIS introduced a number of enhancements to the reporting framework in the 2013 survey. For example, the currency pairs collected were expanded to include a number of emerging market currencies in response to their increased importance in global markets. A more detailed counterparty category breakdown was also reported, reflecting the growing importance of the broad and varied other financial institutions sector. Finally, the execution method table was reorganised along the lines of voice against electronic and indirect against direct methods.

3. Foreign Exchange Derivatives Turnover

After peaking in April 2010, average daily turnover of foreign exchange derivatives by Irish reporting agents declined by 26 per cent between 2010 and 2013.\(^2\) Average daily turnover dropped from US$13.9 billion in April 2010 to US$10.3 billion in April 2013, driven mainly by a fall in activity in foreign exchange swaps (see Table 1). In contrast, the global results showed an increase of 35 per cent between the two periods, driven mainly by spot transactions. The fall in derivative activity in Ireland is down to a number of factors. Firstly, there was a restructuring of the Irish banking market, and some significant institutions exited the market between the two periods. Secondly, some institutions, while maintaining a presence in Ireland, moved their derivative sales desks abroad between the surveys. While this change in the reporting population accounts for much of the fall in turnover, a decline is still evident when controlling for these changes. This decline in activity is most likely due to a reduction in demand for derivatives as the banking sector underwent a period of retrenchment. Foreign exchange exposures declined in both the loan and deposit books, debt security issuance fell, and banks deleveraged their holdings of foreign branches and subsidiaries.

Despite a fall of 41 per cent between the 2010 and 2013 surveys, foreign exchange swaps remain the most actively used derivative instrument by Irish market participants. Foreign exchange swaps are used by credit institutions to manage funding costs across different currencies and reduce foreign exchange fluctuations. Funding in US dollars became scarcer during the crisis, and European banks found it more difficult to fund their US dollar assets, partly as money market funds cut their exposure to European banks (ECB, 2012). Market participants used foreign exchange swaps as a way of replacing this funding need. Credit institutions resident in Ireland have been shrinking their balance sheets and their foreign portfolios have been central to this process. As Charts 2a and 2b show, the non-euro component of Irish-resident credit institutions’ balance sheet has been declining, hence the requirement for foreign exchange hedging has also reduced. In June 2010, non-euro assets accounted for over one third of total assets; this had declined to just over a quarter by end-2013. The BIS Consolidated

<table>
<thead>
<tr>
<th>Table 1: Average Daily Turnover of Foreign Exchange Contracts in Ireland</th>
</tr>
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<tbody>
<tr>
<td><strong>US$ million</strong></td>
</tr>
<tr>
<td>Instruments</td>
</tr>
<tr>
<td>Spot</td>
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<tr>
<td>Outright Forwards</td>
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<td>Foreign Exchange Swaps</td>
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<td>Currency Swaps</td>
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<tr>
<td>OTC Options</td>
</tr>
<tr>
<td><strong>Total Foreign Exchange Contracts</strong></td>
</tr>
</tbody>
</table>

Source: Central Bank of Ireland.

\(^2\) Data are adjusted for local double counting. Local double counting arises because transactions between two reporting entities are recorded by each of them and are therefore reported twice. To derive a representative measure of the overall market size, it is necessary to halve those transactions that were collected twice.
Banking Statistics also show the extent of the deleveraging of their consolidated group balance sheets undertaken by domestic Irish banks. Chart 3 shows claims by Irish-headquartered banks on residents outside of Ireland. As these banks downsized their ownership of foreign banks, the size of foreign claims on their consolidated balance sheet declined. This would explain the reduction in the need for foreign exchange derivatives for hedging currency risk.

Average daily turnover in spot transactions fell marginally between 2010 and 2013, from US$3.9 billion per day to US$3.7 billion per day. Spots recorded the lowest negative growth rate between the two surveys, at 5 per cent. While the results of the global survey found that foreign exchange swaps were the most actively traded instrument, spot transactions were the largest contributor to turnover growth in the 2013 global survey.

The remaining instruments – outright forwards, currency swaps and OTC options – accounted for 20, 2 and 0.1 per cent of turnover in foreign
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Box 1: BIS Survey Transaction Definitions

The survey collected data on the following types of transactions:

**Foreign Exchange Transactions**

**Spot transactions:** Single outright transactions involving the exchange of two currencies at a rate agreed on the date of the contract for value or delivery (cash settlement) within two business days.

**Foreign exchange swaps:** Transactions which involve the actual exchange of two currencies (principal amount only) on a specific date at a rate agreed at the time of the conclusion of the contract (the short leg) and a reverse exchange of the same two currencies at a date further in the future at a rate (generally different from the rate applied to the short leg) agreed at the time the contract is agreed (the long leg). Short-term swaps carried out as ‘tomorrow/next day’ transactions are included in this category.

**Outright forwards:** Agreements for delayed delivery of financial currencies or commodities in which the buyer agrees to purchase and the seller agrees to deliver, at a future date, a specified instrument or commodity at a pre-agreed price or yield. Forward contracts are generally not traded on organised exchanges and their contractual terms are not standardised.

**Currency swaps:** Contracts which commit two counterparties to exchange two streams of interest payments in different currencies for an agreed period of time and/or to exchange principal amounts in different currencies at a pre-agreed exchange rate at maturity.

**Currency options:** Option contracts that give the right to buy or sell a currency with another currency at a specified exchange rate during a specified period.

**OTC Single-Currency Interest Rate Derivatives**

**Forward-rate agreements (FRAs):** Interest rate forward contracts in which the rate to be paid or received on a specific obligation for a set period of time, beginning at some time in the future, is determined at contract initiation. An FRA is an instrument that enables a borrower or lender to fix in advance the interest costs or earnings on a future transaction.

**Interest-rate swaps:** Agreement to exchange periodic payments related to interest rates on a single currency; can be fixed for floating, or floating for floating based on different indices. This group includes those swaps whose notional principal is amortised according to a fixed schedule independent of interest rates. Interest rate swaps developed so that parties to the swap could exploit their comparative advantage in accessing different markets.

**Interest-rate options:** Option contracts that give the right to pay or receive a specific interest rate on a predetermined principal for a set period of time. Included in this category are interest-rate caps, floors, collars, corridors, swaptions and warrants.

Exchange derivatives contracts, respectively. Turnover in outright forwards was relatively stable over the two surveys, even though the reporting population declined. In contrast, the global survey showed average daily turnover of outright forwards increased by 43 per cent. Currency swaps and OTC options bought and sold are not used widely by Irish reporting entities. Use of currency swaps peaked in April 2007, at 7.4 per cent of turnover, but their use has declined since then. With a foreign exchange swap, the foreign exchange risk is
removed from the balance sheet during the short leg of the swap, whereas with currency swaps, some risk is retained as a currency swap is an agreement to exchange streams of interest payments. Currency swaps accounted for just 1 per cent of net-net\(^4\) daily average turnover in the global survey in April 2013. The ECB’s Euro Money Market Survey shows that in 2012, there was an overall decline in turnover of currency swaps, as the EUR/USD rate was quite volatile and bond market issuance was lower (ECB, 2012).

The survey also breaks down turnover by counterparty sector (as described in Box 2). Reporting dealers remained the most actively used counterparty for trades conducted (Chart 4). In contrast to the results of the global survey, trading with other financial institutions\(^5\) (OFIs) actually declined in importance. However, the fall in average daily turnover with other financial institution counterparties was less than that recorded for reporting dealers. Trading with non-financial customers increased to 35 per cent of total turnover in 2013. Most of this increase in non-financial customers was due to the trading activity of one institution, and may not reflect a longer-term trend. Conversely, non-financial customers accounted for only 9 per cent of global turnover in April 2013. Reporting dealers are the prevalent counterparty across most instrument types, but other financial institutions are used more frequently in trading currency swaps and outright forwards.

The 2013 survey collected for the first time a more detailed breakdown of the type of institutions in the OFIs category. As mentioned earlier, trading with OFIs was the driver of growth in turnover in the recent global surveys. This trend is most apparent in the main financial trading centres, including London and New York (Rime and Schrimpf, 2013). As a result of the growth in trading with OFIs, the BIS

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4 Adjusted for local and cross-border inter-dealer double counting.
5 The counterparty other financial institutions includes non-reporting banks. Therefore, this definition is different from other financial intermediaries as defined in international statistical manuals, such as ESA95.
introduced a more granular breakdown of the sector to allow for better analysis. As Chart 5 shows, in Ireland 92 per cent of OFIs are non-reporting banks. Non-reporting banks are banks that do not have derivative sales desks. These are typically smaller banks which do not engage in market making and use larger banks as intermediaries for their derivative trading activities (Rime and Schrimpf, 2013). There is no geographic or local breakdown of this category, but it is reasonable to assume that most trading takes place on a cross-border basis. The next largest counterparty sector is institutional investors, which includes pension funds, followed by hedge funds and proprietary trading firms. Institutional investors differ slightly from hedge funds in their investment strategies, horizons and primary motivation for trading, and this is reflected in the instruments which they trade (Rime and Schrimpf, 2013). In the 2013 results for Ireland, institutional investors used more outright forwards and foreign exchange swaps (Chart 6). Institutional investors frequently transact more in the foreign exchange market, where they may have business needs for foreign exchange payments in addition to any foreign exchange rebalancing in their portfolios. In Ireland, institutional investors use outright forwards to hedge international bond portfolios. The 2013 survey results show that hedge funds had a greater use of foreign exchange swaps and spots. Specialised hedge funds may also be more active in the algorithmic and high-frequency spot market (Rime and Schrimpf, 2013).
Box 2: Detailed Description of Counterparties

Reporting Dealers
Financial institutions that participate as reporters in the Triennial Survey. These are mainly large commercial and investment banks and securities houses that participate in the inter-dealer market and/or have an active business with large customers, such as large corporate firms, governments and non-reporting financial institutions; in other words, reporting dealers are institutions that actively buy and sell currency and OTC derivatives both for their own account and/or in meeting customer demand. In practice, reporting dealers are often those institutions that actively or regularly deal through electronic platforms, such as EBS or Reuters dealing facilities. This category also includes the branches and subsidiaries of institutions operating in multiple locations that do not have a trading desk but do have a sales desk in those locations that conduct active business with large customers.

Other Financial Institutions
Financial institutions that are not classified as reporting dealers in the survey. These are typically regarded as foreign exchange and interest rate derivatives markets end users. They are subdivided into the following categories for the first time in the 2013 survey:

Non-Reporting Banks
Smaller or regional commercial banks, publicly owned banks, securities firms or investment banks not directly participating as reporting dealers.

Institutional Investors
Institutional investors such as mutual funds, pension funds, insurance and reinsurance companies and endowments. Primary motives for market participation are to trade foreign exchange instruments e.g. for hedging, investing and risk management purposes.

Hedge Funds and Proprietary Trading Firms
(i) Investment funds and various types of money managers, including commodity trading advisers which share a combination of the following characteristics:
- they often follow a relatively broad range of investment strategies that are not subject to borrowing and leverage restrictions, with many of them using high levels of leverage;
- they often have a different regulatory mandate than “institutional investors” and typically cater to sophisticated investors such as high net worth individuals or institutions; and
- they often hold long and short positions in various markets, asset classes and instruments, with frequent use of derivatives for speculative purposes.
(ii) Proprietary trading firms that invest, hedge or speculate for their own account. This category may include, for example, specialised high-frequency trading firms that employ high-speed algorithmic trading strategies characterised by numerous frequent trades and very short holding periods.

Official Sector Financial Institutions
Central banks, sovereign wealth funds, international financial institutions of the public sector (BIS, IMF, etc.), development banks and agencies.

Other
All remaining financial institutions (e.g. retail aggregators) that cannot be classified in any of the four above-mentioned sub-categories for other financial institutions.

Non-Financial Customers
Any counterparty other than those described above, i.e. mainly non-financial end users, such as corporations and non-financial government entities. May also include private individuals who directly transact with reporting dealers for investment purposes, either on the online retail trading platforms operated by the reporting dealers or by other means (e.g. giving trading instructions by phone).
The geographical analysis for Ireland shows that over 93 per cent of trading is with foreign counterparties, up from 91 per cent in April 2010 (Chart 7). The share of local counterparties has remained small since peaking at 13 per cent in 2001. However, the results of the global survey highlight a sharp move towards locally concentrated trading since 2010, reversing the trend of expanding cross-border business evident since 1998. Global cross-border foreign exchange transactions fell to 58 per cent of total turnover in 2013. This does not necessarily mean that trading has become less international; rather it could reflect that trading activities are becoming centralised in major trading centres, such as London or New York, including for reporting entities whose head office might be located elsewhere [BIS(b), 2013].

The US dollar remained the most important currency in foreign exchange derivatives turnover in Ireland, accounting for one side in 76 per cent of all currency pairs, as shown in Chart 8a. This is an increase since the 2010 survey, when the US dollar accounted for 70 per cent. The euro marginally dropped its share, falling to around 66 per cent of one side of all pairs, from 69 per cent in 2010. The Japanese yen remained a small part of the Irish foreign exchange derivative market at just 8 per cent. The results of the global survey show an increase in turnover of derivatives involving Japanese yen in April 2013 due to changes to the monetary policy regime in Japan.

Currency pairs with sterling on one side remained a significant part of turnover for Irish reporting agents, as would be expected given the strong financial and economic links between Ireland and the UK. The Central Bank of Ireland collected a more extensive range of currency pairs in 2013 than in previous years, including compulsory reporting of emerging market currency pairs, such as US dollar against the Mexican peso. These currencies were previously classified in the ‘Residual’ category (Chart 8b), and not identified separately. Currency pairs, which did not include US dollar, euro or Japanese yen on either side accounted for only 2 per cent of turnover.

In previous surveys, it was noted that currencies popular in carry trades, such as the Australian Dollar and New Zealand Dollar, had been traded increasingly. This trend has been reversed in the 2013 data. Carry trades occur when a trader looks to exploit interest rate differentials by selling a currency with a low interest rate, and purchasing a currency with a higher interest rate. Interest rates in Australia and New Zealand were over 7 per cent and 8 per cent in 2008, respectively, and remained elevated until 2011 when a series of official interest rate cuts commenced. Returns on currency carry trades were quite unattractive in the run-up to the 2013 survey (Rime and

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6 The total proportion of currency pairs will sum to a total of 200 per cent, as the two currencies on either side of each pair need to be reported. So, for a USD/GBP pair, both USD and GBP are reported.
Schrimpf, 2013) as they rely on stable interest rates to be profitable. Volatility in interest rates or exchange rates makes currency carry trades less attractive from a risk management perspective.

Similar to 2010, the US dollar was the dominant currency in 2013, being on one side of a currency pair for most instruments, as shown in Table 2. The exception was currency swaps, where the euro replaced the US dollar as the predominant currency in the 2013 data. Currency swaps are used to secure cheaper foreign debt by borrowing at the best available rate, and to hedge against exchange rate fluctuations. For currency swaps the other side of the euro currency pair was, in most cases, sterling.

In terms of the maturity profile of foreign exchange derivatives, data are collected for outright forwards and foreign exchange swaps. As can be seen from Chart 9, there was little change in the maturity profile over the two surveys, but there was some increase in the share of longer maturities of between seven days and one year, which rose from 48 per cent in 2010 to 50 per cent in 2013. The over one year category was more prevalent in 2013, but still accounted for just over 3 per cent.

In the global results, the 2013 survey also showed a tendency towards slightly longer maturities of foreign exchange swaps and outright forwards. For instance, 56 per cent of outright forwards initiated in April 2013 had a contractual maturity between seven days and one year, compared with 52 per cent in the earlier survey.

Market concentration changed significantly between the 2010 survey and the 2013 survey. In 2010, nine institutions accounted for around 95 per cent of total turnover. In
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2013, just seven institutions accounted for the same proportion of turnover, indicating that the market in Ireland has become more concentrated. A characteristic of the survey methodology is that the data are collected with reference to a relatively narrow window (i.e. one calendar month) and with a low frequency (i.e. every three years). This introduces a risk that the time period covered in the survey may not be representative of broader trends in the derivatives market. To offset this risk, respondents were also asked about market conditions during the survey month (April 2013) and how these conditions compared with the preceding six months. The results show that market conditions in April 2013 were considered normal by most respondents. When compared with the preceding six months, half of respondents said turnover was normal, whereas the other half noted that turnover decreased over the six months.

### 4. OTC Interest Rate Derivatives

Average daily turnover of OTC interest rate derivatives recorded a sharp decline from US$7 billion in 2010 to US$2.9 billion in 2013 (see Table 3 and Chart 10), largely due to a number of significant institutions ceasing operations in Ireland. Interest rate swaps recorded the most significant decline in US dollar terms, but still accounted for 99 per cent of total turnover. This is due to the almost total elimination of forward rate agreements (FRAs) as an interest rate derivative used by participants in the Irish market. While most of the decline in the use of FRAs was due to institutions leaving the reporting population, those remaining also recorded a sharp decline. The proportion of FRAs in previous Irish surveys dropped dramatically with the introduction of the euro, (Menton, 2008). FRAs are mainly used for managing short-term interest rate risk. The downturn in the use of

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### Table 2: Main Currency on One Side of Pair by Instrument in Ireland

<table>
<thead>
<tr>
<th>Year</th>
<th>Instruments</th>
<th>USD</th>
<th>Euro</th>
<th>JPY</th>
<th>Remaining</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>Spot</td>
<td>64,363</td>
<td>14,270</td>
<td>1,527</td>
<td>2,431</td>
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<td></td>
<td>Outright Forwards</td>
<td>35,896</td>
<td>10,862</td>
<td>276</td>
<td>926</td>
</tr>
<tr>
<td></td>
<td>FX Swaps</td>
<td>98,146</td>
<td>45,941</td>
<td>937</td>
<td>6,627</td>
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<td></td>
<td>Currency Swaps</td>
<td>2,726</td>
<td>1,934</td>
<td>0</td>
<td>10</td>
</tr>
<tr>
<td></td>
<td>OTC Options</td>
<td>972</td>
<td>402</td>
<td>137</td>
<td>55</td>
</tr>
<tr>
<td>2013</td>
<td>Spot</td>
<td>62,033</td>
<td>13,632</td>
<td>1,269</td>
<td>1,108</td>
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<td></td>
<td>Outright Forwards</td>
<td>35,523</td>
<td>6,875</td>
<td>540</td>
<td>57</td>
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<tr>
<td></td>
<td>FX Swaps</td>
<td>66,397</td>
<td>17,625</td>
<td>280</td>
<td>2,570</td>
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<td></td>
<td>Currency Swaps</td>
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<td>4,804</td>
<td>0</td>
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<tr>
<td></td>
<td>OTC Options</td>
<td>95</td>
<td>39</td>
<td>4</td>
<td>1</td>
</tr>
</tbody>
</table>

Source: Central Bank of Ireland.

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![Chart 9: Maturity Profile of Outright Forwards and Foreign Exchange Swaps in Ireland, %](chart9)

Source: Central Bank of Ireland.
FRAs is probably also related to the success of the euro interest-rate swap market. In more recent times, use of FRAs has fallen due to stable overnight interest rates and a general low interest rate environment, which have reduced hedging needs (ECB, 2012). However, in the global survey, FRAs accounted for the largest increase in activity. This outcome in the global survey was somewhat surprising, given the stable interest rate environment, with record lows, and no expectation of future interest rate increases (BIS(b), 2013).

Interest rate swaps can be used to lower funding costs, and hedge against changes in value of debt securities issued. The decreased use of interest rate swaps can be explained by a decline in non-euro deposits, lower customer demand for interest rate swaps, lower use of overnight indexed swaps in cash management and lower proprietary trading volumes. The winding down of assets of subsidiaries of foreign banks located in Ireland also contributed. The decrease in interest rate swaps coincided with the substantial fall in the issuance of debt securities. In Ireland, the overall volume of debt securities issued has fallen, and this has been most pronounced for issuance in non-euro currencies.

The results from the global survey show that single-currency interest rate derivatives went up slightly between the two surveys, notwithstanding the environment of generally low and stable interest rates and the impact of major regulatory reforms of the OTC derivatives markets [BIS(b), 2013]. The higher cost component caused by regulatory requirements (i.e. trade repository, additional capital and central counterparty clearing fees) and additional margin requirements (following ratings downgrades or long-term yield decreases in some cases for the fixed-rate payer) may have been the drivers of this decline (ECB, 2012). The increase in the global results was, however, the lowest recorded since the inception of the interest rate part of the survey in 1995.

Other banks with sales-trading desks (i.e. other reporting dealers) remained the most commonly-used counterparty in the interest rate derivatives (IRD) market, and increased their share from 79 per cent in 2010 to 98 per cent in 2013, as shown in Charts 11a and 11b. Other financial institutions, which had accounted for around 20 per cent of turnover in 2010, declined to just under 2 per cent in 2013. Similar to the Irish foreign exchange derivatives market, this is in contrast...
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to the results of the global survey, where OFIs accounted for over half of turnover, and recorded a 44 per cent increase compared with 2010.

An increase in dealing with local counterparties was a feature of the results of the 2013 survey. The proportion of local counterparties fluctuates from survey to survey, as can be seen in Chart 12. However, the same trend was observed in the results of the global survey, where trading in OTCs has become more local.

Irish reporting agents reported transactions with only a small number of base currencies in the interest rate derivatives market (Chart 13). Data was reported for just six of the 40 possible reporting currencies. The euro market recorded the highest turnover in the OTC interest rate derivatives market, accounting for just over three quarters of all activity. As detailed in Section 3, euro-denominated assets account for approximately 75 per cent of Irish-resident banks’ balance sheets, so interest rate derivatives appear to be managed in line with this currency split. While euro and sterling
recorded an increased share in turnover, other currencies such as the Swedish krona and the Canadian dollar declined. FRAs denominated in sterling, accounted for only 1 per cent of total turnover (see Chart 14). It is clear that Irish reporting agents are not trading actively in the emerging-market currencies, in contrast to the increasing importance of these currencies in the global results – particularly for the Brazilian real, the South African rand and the Chinese renminbi.

5. Electronic Trading

There has been a change over the past decade in how foreign exchange market participants interact and trade with each other, largely due to the introduction and development of new methods of trading. Traditionally, most business was conducted via direct trading (i.e. verbal contact). Advances in technology means that a greater proportion of indirect methods are now in use, both electronic and voice. The increased proportion of turnover from electronic trading reflects growth in the number and variety of trading platforms now available. Electronic trading systems also reduce trading costs and other barriers to entry while enhancing pricing transparency (Menton, 2008).

Reporting of the execution method of foreign exchange turnover was amended in the 2013 survey to provide breakdowns between voice and electronic, and between direct and indirect. This makes comparison with previous years more difficult. The Irish results show that trading occurs almost evenly between voice and electronic methods, and again between direct and indirect methods. While the importance of electronic trading has increased, voice is still a very common method of trading. Direct voice continued to account for one third of all turnover in 2013. Outright forwards are mostly executed via voice and directly, as they are not traded on organised exchanges and pricing of these instruments can be more complex. Conversely, 48 per cent of foreign exchange swaps were
traded electronically and indirectly in 2013. This compares with 39 per cent executed either through electronic broking or electronic trading systems in 2007.\footnote{This figure may understate the extent of electronic trading used, as data was collected differently in 2007.}

Reporting dealers favour indirect over direct execution methods as Chart 15 shows. OFIs marginally prefer direct voice trading. Non-financial customers prefer voice methods most of which are indirect.

In the global results, electronic trading is predominant with a share above 50 per cent for all counterparty types. Spot transactions have the highest fraction of trades conducted electronically, reflecting their simple and standardised structure relative to other derivatives instruments.

**Box 3: Execution Method of Foreign Exchange Transactions**

Reporting institutions were asked to provide information on the execution method (notional amounts) used to settle their foreign exchange turnover transactions. The execution methods are defined as follows:

**Voice–Direct:** Executed over the phone, not intermediated by a third party.

**Voice–Indirect:** Executed over the phone, intermediated by a third party (e.g. via a voice broker).

**Electronic–Direct:** Executed over an electronic medium and not intermediated by a third party, of which:

- Single-bank proprietary trading systems are electronic trading systems owned and operated by a bank (e.g. Autobahn, BARX, Velocity, FX Trader Plus); or
- Other direct electronic means such as Reuters Conversational Dealing, Bloomberg.

**Electronic–Indirect:** Executed over an electronic medium, intermediated by a third party electronic platform (e.g. via a matching system), of which:

- Reuters Matching/EBS, which are major electronic trading platforms that have historically been geared towards the inter-dealer market;
- Other electronic communication networks, such as multi-bank dealing systems which include Currenex, FXall, Hotspot, Bloomberg Tradebook, etc.; or
- Other indirect electronic means, if any, that do not belong to either of the two sub-categories above.
6. Conclusion

The article presents Irish and global results of the most recent BIS Triennial Survey of global turnover in foreign exchange and over-the-counter single-currency interest rate derivatives. The survey results for Ireland show a sharp fall in turnover in both foreign exchange and interest rate derivatives since the last survey in 2010, which contrasts with increases for both categories globally. There are two driving factors behind the decline in turnover in Ireland between 2010 and 2013. Firstly, there was a restructuring of the Irish banking market, with some significant institutions exiting the market or moving their sales desk out of Ireland. This was in line with international trends for centralising activities in the major financial centres. Secondly, there was a reduction in derivative activity as the banking sector underwent a period of retrenchment. This retrenchment was most concentrated in the foreign portfolios of domestic banks, thereby reducing the need for hedging of foreign currency and interest rate exposures. Similarly, a restructure of the domestic banking market also contributed to falls in OTC interest rate derivative activity. Derivative transactions in Ireland in 2013 were concentrated in a small number of base currencies, contrary to global trends, where emerging-market currencies increased in importance. Similar to previous surveys, the dollar remained the predominant currency in foreign exchange derivatives, accounting for one side in three quarters of all currency pairs. Electronic trading has also gained in importance, reflecting an increase in the number and variety of trading platforms, although this increase does not apply to all derivative products. For instance, outright forwards are still executed primarily through direct voice methods.
Bibliography


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