

USE CASE

FX Settlement

How Baton Systems' **Core-FX** helps minimise FX settlement risk, improve liquidity management, and reduce operational costs



“Market Participants should reduce their Settlement Risk as much as practicable, including by settling FX transactions through services that provide PVP settlement where available¹.” (Principle 35, FX Global Code, July 2021)

More trading and increased activity in a wider range of currencies, has meant more settlement risk – an issue which the Bank for International Settlements (BIS) highlighted in its 2019 Triennial Survey. Data collected for the survey showed that approximately USD 8.9 trillion worth of FX payments was at risk on any given day².

In July 2021, following an extensive consultation, the Global Foreign Exchange Committee (GFXC) published amendments to the FX Global Code of Conduct to state that:

“Whenever practicable, Market Participants should eliminate Settlement Risk by using settlement services that provide payment-versus-payment (PvP) settlement... If a counterparty’s chosen method of settlement prevents a Market Participant from reducing its

Settlement Risk (for example, a counterparty does not participate in PVP arrangements or does not agree to use obligation netting), then the Market Participant should consider decreasing its exposure limit to the counterparty, creating incentives for the counterparty to modify its FX settlement methods or taking other appropriate risk mitigation actions³.”

How, then, can the FX industry drive towards the elimination of settlement risk across as broad a universe as possible?

Baton Systems has the solution.

“Approximately USD 8.9 trillion worth of FX payments was at risk on any given day.”

¹ https://www.globalfx.org/docs/fx_global.pdf

² https://www.bis.org/publ/qtrpdf/r_qt1912x.htm

³ https://www.globalfx.org/docs/fx_global.pdf

THE CHALLENGE

All active FX banks face an increasingly common set of challenges:

- 1) To reduce settlement risk, and ultimately achieve PvP for their full portfolio of trades.
- 2) To reduce operational costs and friction, in the face of ever-declining yields.
- 3) To reduce use of intraday liquidity which, for major banks, has an annual cost of hundreds of millions of dollars, with FX being a key driver.

Banks are increasingly looking to deploy distributed ledger technology (DLT) to deliver reductions in cost and liquidity usage. Additionally, solutions with long-term strategic value are being sought, generally with a focus that straddles existing product boundaries. These can pave the way for the next generation of payments and settlement processes, which are bound to use new technology components. The focus, therefore, is not just on the immediate use case, but also firmly on the longer term.

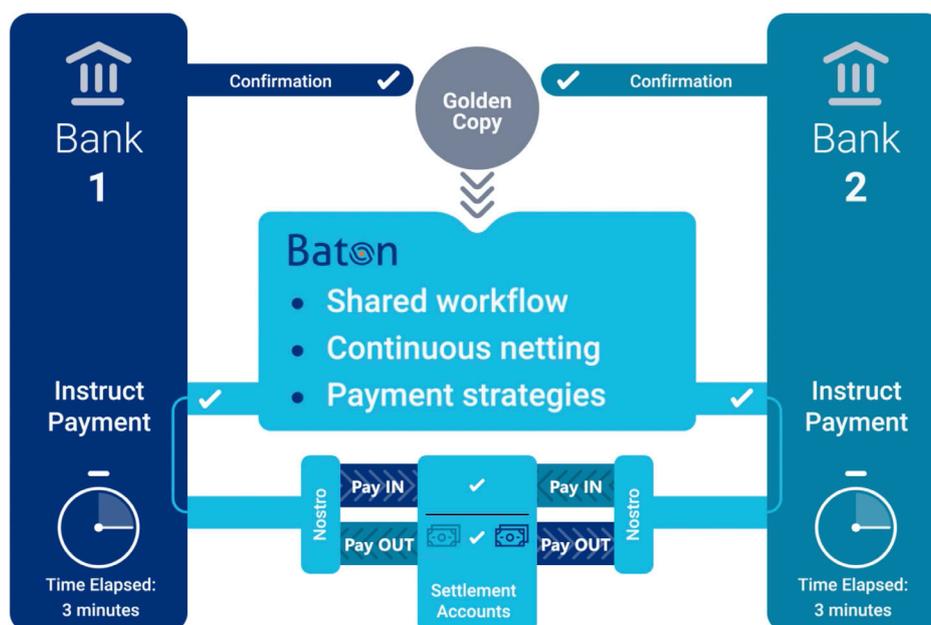
WHY BATON SYSTEMS?

The Baton Core-FX platform is proving to be transformational for banks, enabling them to take control and dramatically reduce operating costs and risk exposure for FX settlement and cash management.

The key to Baton's process is the use of an immutable and cryptographically secure, shared permissioned ledger and automated, rules-based workflows, that allow assets to be moved in a synchronised and orchestrated manner from the point of trade matching right through to settlement. The ledger is supported by the Baton Rulebook which provides settlement finality and certainty. The settlement takes place using real money, held in real accounts at commercial banks, it doesn't rely on tokenisation or on access to central bank accounts.

This approach enables firms to achieve zero-friction settlements with a solution that can integrate seamlessly with pre-existing core ledgers, payment gateways and messaging systems.

“Core-FX has facilitated the settlement of trillions of dollars.”



HOW IT WORKS

Banks trade with each other over multiple ECNs as well as by voice. There is usually no shared view of all transactions between two firms. Baton's clearing and settlement gateway consumes or creates a golden copy of each transaction immediately following execution.

Netting:

The platform continuously nets transactions, creating netting groups where the counterparties, currency pair and value date are common. These netting groups are then settled according to customisable rules agreed by the counterparties. These rules can be time-based or threshold-based.

Settlement:

Once the payment process is initiated, the Baton Core-FX platform automatically generates an instruction to be sent via each bank's payments platform. This instructs payment of the relevant amount from the nostro account to a specially designated settlement account. These settlement accounts are for the benefit of the settlement participants, with ownership of the funds within them being determined by the Baton ledger. At this stage, the settlement

process has been initiated but there has been no change of ownership of funds; the funds in the settlement account can only be deployed for use by the Baton workflow. Once Baton recognises that the settlement accounts are in receipt of all of the required funds, the Baton ledger performs a simultaneous change of ownership. Settlement finality is enforced through the application of Baton's Rulebook.

Once exchange of ownership is achieved, the counterparties can withdraw their proceeds from the settlement account into their respective nostros, or choose to leave some or all of the funds in the settlement account to meet an upcoming obligation.

All ledger activities are acknowledged, encrypted and notarised, and fully transparent to the Settlement Participants.

All in 3 minutes:

The entire settlement process is completed in approximately three minutes, providing certainty as to when the settlement will complete.

HOW ITS DEPLOYED

The Baton platform can process 32,000 transactions per second per node, and is highly scalable. Baton's rules-based shared ledger platform is SaaS based and can be quickly and securely deployed through the cloud using a single tenant architecture. Baton is SOC2-Type 2 compliant and operates a separate infrastructure for each financial institution.

The platform has been developed in consultation with Tier 1 banks, central banks and regulators and has been built to meet the very specific interoperability, extensibility and customisation requirements of large financial institutions.

IN BRIEF

Baton's 90-day Methodology



THE EVALUATION PROCESS

Baton's 90-Day Methodology is a process offered to potential clients to help them to understand the efficiencies offered by the technology.

Firms are given the opportunity to test the Baton platform without any integration, to simulate the settlement process using their own test transactions, netting preferences, and splitting models. This allows them very quickly to experience the benefits which can be achieved.

The 90 day Methodology allows potential clients to obtain a degree of familiarisation with Baton's product whilst simultaneously developing an implementation plan.

During the evaluation period, clients have the opportunity to test and re-test various features and configurations, typically running multiple tests through the platform in order to better analyse its funding benefits.

Over the course of the evaluation period, the Baton and client teams are able to build a working relationship that can help kick start the onboarding process. Integration points and configurations can be agreed upon, allowing for ease of implementation post-evaluation.

RESULTS

Reduction of settlement risk is a high priority for all firms, and is reinforced by commitment to the FX Global Code. By deploying Core-FX, banks are able to realise the benefits of material incremental reduction of settlement risk (and therefore capital usage) as well as greater control over intraday liquidity usage.

With the adoption of a unified process and straight-through processing, firms are able to streamline workflow and reduce manual processes from the point of matching all the way through to settlement, thus reducing operational costs and risk.

“The Baton platform can process 32,000 transactions per second per node, and is highly scalable.”

Book a demo: www.batonsystems.com/core-fx



About Baton

Baton Systems is revolutionising the entire front-to-back post-trade process, introducing interoperable and connected digital market infrastructures from trade matching through to settlement.

Empowering financial institutions to take control with automated, rules-based workflows, access to real-time information, and on-demand settlement, Baton is redefining what post-trade processing should look like: fully connected, friction-free, flexible and transparent.

Founded in 2016 by Silicon Valley technologists and capital market specialists, Baton's solutions are now being used by several of the world's largest financial institutions to facilitate the movement of billions of dollars of cash and securities on a daily basis.

Find out more at www.batonsystems.com