BII Insights

Pre-Agreed Spreads over the Interbank Mid-Market Rate

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BII has been innovative in helping clients obtain written agreements for Pre-Agreed FX Spreads, or Margins, over the true Interbank Mid-Market Rate. These rates can come from systems such as Bloomberg, Reuters, or others that have quality historical FX data. Most primary currencies have a tight bid/offer price, and historical pricing, so it is easy to have the mid-market price on a historic trade to use as the Bank's Cost of FX. On secondary, smaller markets, or emerging market currencies, the Bid-Offer spread may be 2,3, 4 or 6 Bps. However, banks are skilled traders and buy within the Bid Offer range, to replenish their FX inventory. So, even when a client is buying a secondary currency, or an emerging market currency, they should not have to pay for the difference in the Bid/Offer spread. If one has an agreement for a Pre-Agreed spread at 5Bps or 10 Bps that should be calculated over what would be commonly known as the true interbank mid-market rate.

When a client negotiates for a Pre-Agreed FX Spread, they should have it be for both spot and forward FX transactions. Of course, Forward trades have some additional element of risk. Banks may try to increase a markup for Credit Risk, especially if there is a long dated Forward, for example. However, on the front end when a Client enters into a Pre-Agreed Spread Agreement it should be understood, and in writing, it is to take into account credit exposure and using a credit line.

It is notable that written agreements that provide Pre-Agreed spreads will have conditional language, or outs, which say they have exceptions to that Pre-Agreed Spread for Credit or Operational issues. The intention is if the company Credit has had significant deterioration, or if it is an especially long dated forward, there may be something extra for Credit. However, in most cases, the Pre-Agreed spread should cover the credit risk, and there should not be an add on.

In summary, when a Pre-Agreed Spread is negotiated with a Bank, the Client should look for the Bank to hold to that Spread, being 5Bps, 10Bps, 20Bps, or whatever, and if there is an Algorithm to set the Spread, it should be clear the markups will be without surplus, or extra markups for credit, or Bid/Offer spreads. A key role of the FX Rate Integrity® review service is to highlight the bank's compliance to the Pre-Agreed Spread Agreement. In some cases, if a Bank is over the Pre-Agreed spread there can be refunds. In other cases, a Client may allow for Excess Markups for relationship purposes. However, either way it is important for a Client to know how well their Bank is doing with compliance to the Pre-Agreed Spreads that have been Negotiated.

Learn more about **FX Rate Integrity®**

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