# HORIZON
from
SKADI

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## May 2023 Edition

- **Currency restrictions:** When investors run for the exits, we explain the operational implications.

- **Volatility in the Gilt market returns:** We highlight areas of weakness.

- **Forward looking:** Are you prepared for the next instrument which could turn negative?

## The month in review

**Credit tightening in Turkey**
Turkey restricted access to credit during the country's election run off. The inconclusive election results prompted the implementation of new regulations which tightened credit conditions. Some banks almost halved cash withdrawal limits, as well as repayment periods, on credit cards. Credit cards in Turkey are widely used as they charge a third of the interest incurred on bank loans. Some corporate loan extensions may have also been postponed. Turkey took these steps to maintain economic stability.

History has shown that countries facing economic instability can prohibit the withdrawal of funds altogether. SKADI's Operations SME Dave Bridges explains: *"Back in 2001, when Argentina ordered a limit on cash withdrawals (nicknamed Corralito), foreign investors found that a key route they had used to take funds out of the country was now reduced. Working in the corporate actions department, we saw a dramatic increase in the number of conversions, as investors utilized this permitted pathway, of converting local equity positions into ADRs, as a way of legitimately continuing to take funds out of Argentina."*

Events such as these can surface rapidly. Volumes can increase. Windows of opportunity can abruptly close. Clients can become more demanding. Operational staff are presented with an urgency to act. However, there is heightened opportunity for operational risk, fraud, and money laundering.

**Gilt market reacts to UK inflation data**
On 25$^{th}$ May stronger than expected UK inflation figures stoked concerns of continued interest rate hikes. The yield of the 2-year Gilt yield soared to its highest level since 29$^{th}$ September, rising 60 bps during the week. Fears of a repeat of the forced selling witnessed by Liability Driven Investment (LDI) funds late last year were unfounded however.

In a timely move, the FCA published a paper addressing vulnerabilities they had observed at LDI managers, during last September's sell off. The paper states that LDI liquidity buffers *"proved entirely insufficient for September's conditions"*. The FCA now wishes to see buffers set for each individual sub-fund. In their view this would mitigate, rather than contribute to, stresses in the market.

In November's edition of Horizon we observed that manual payment processing in the LDI market, with its numerous steps, exacerbated pressures during the September rout. It is a timely reminder for institutions to continue to reduce manual processes where possible, or be ready for surges in transaction volumes and margin calls. The changes proposed by the FCA could help from a market risk standpoint but, while manual processes remain prevalent, they could lead to increased operational burden.

**Lebanon**

News surfaced that the Financial Action Task Force (FATF) is likely to add Lebanon to the "Grey list". Countries on the Grey list are compelled to work with FATF to improve their effectiveness to prevent money laundering and terrorism financing. South Africa and Nigeria were added to the list earlier this year.

Client due diligence and payment screening functions should anticipate tightened controls and enhanced due diligence around Lebanese transactions.

**Forward-Looking**

As the month of May draws to a close and we start to look forward (rather optimistically in the UK) to a warm and dry summer ahead, we have been witnessing increased volatility in the European natural gas market. Front-month Title Transfer Facility (TTF) futures fell 10% to settle at $26.78 per MWh on Thursday 25th May, taking prices back to pre-energy crisis levels after weeks of steady declines.

A combination of much weaker demand, mild winter, high renewable power generation and strong inventories have led to recent warnings that natural gas prices could fall below zero in parts of Europe later this year. When oil prices turned negative in April 2020 there were system and control failures at institutions despite prior warnings issued by the CME weeks earlier.

In September 2022's edition of Horizon we warned of the risk which would be posed by the GBP/USD rate breaching parity. In the end the breach did not occur, but the warning still holds. There exists the potential for simple trading and processing errors to occur as a result of negative pricing of European natural gas later on this year. Functions should get ready now…

**Laundering funds via Wholesale markets**

Skadi's MD Nic Corry and Skadi's operations subject matter expert David Bridges discuss some of the red flags for money laundering through markets…

Click here to watch the discussion.

## Index for previous Horizon editions

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| **October 2022** The challenges that exist for hedging interest rate risk in a rising interest rate environment | **November 2022** Marking into year end, areas of focus for control functions | **December 2022** Explained in this edition: How do back-to-back bookings and settlements work? |

### The SKADI Podcast

The Rogue Trader Trilogy is here!

Click here to listen to our financial experts discuss the three largest cases of rogue trading: Nick Leeson of Barings, Jerome Kerviel of Soc Gen and Kweku Adoboli of UBS.

We will be discussing the lessons learned from these catastrophic cases, and what risks of rogue trading exist today in the wholesale financial markets!


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