"A well-adopted PvP service for the six to ten largest deliverable currencies, which currently do not benefit from PvP protection, would mitigate the vast majority of the current market FX settlement risk."

Keith Tippell

pressure has intensified given that market practices are moving toward faster settlement times and T+1.

"When compared to the full population of daily FX settlements, the numbers of those being split/shaped remains small, and due to liquidity reasons may be more concentrated in emerging market currencies," states the paper.

"However, if the market moves toward faster settlement timelines, including more same-day (T+0) settlements, splitting payments could become more common even in major currencies. This could increase the number of transactions that must be settled individually rather than being grouped together, which may place additional pressure on liquidity."

Another challenge comes from the diverse systems and processes used for payment splitting. Market participants often use proprietary or non-standardised methods to allocate and communicate splits, leading to inconsistencies and reconciliation errors. For example, there are essentially two methods for payment splitting – dividing the original transaction or dividing the payment process itself.

According to the GFMA, the latter approach could increase settlement risk if there is a lack of communication or proper notification. Effective communication, especially automated, is critical for successful reconciliation. The GFMA makes a number of recommendations. These include the adoption of automated payment splitting processes as well as automated processes for communications with counterparties. In addition, there should be greater use of industry-wide standards and protocols – for example, the use of updated ISO messages to include structured split information.

"Whilst it is unlikely that the whole market adopts a single automated approach, there is an opportunity to harmonise the format of the data being communicated," states the paper. "Consistency would enable market participants to automate processes, improving efficiency and reducing the risks of any funds not being recognised and returned. Such a standardised formatting approach could also be adopted by those using proprietary systems, again driving consistency across the industry."

The GFMA concludes that there are "opportunities to improve the FX payment splitting/shaping processes which will result in a reduction of FX Settlement Risk as well as improving liquidity flows and reducing overall costs", such as those incurred though the provision of intra-day credit or through increased manual interventions.

"Such opportunities are reliant on i) increased use of and standardisation of automated approaches and ii) improvements in communications between those involved in the settlement of FX transactions," states the paper.

EVER-INCREASING VOLUMES

Settlement risk represents a material risk today due to the ever-increasing traded volume in currencies which are not supported by existing solutions, says Keith Tippell, head of FX at OSTTRA.

"The 2025 BIS Triennial Survey results show the Chinese renminbi is now the fifth most traded currency, having nearly doubled its global market share since the 2019 survey. In addition, strong economic growth is driving increased trading in a range of other currencies including the Polish zloty and Thai baht." Tippell states that safe settlement remains a priority for market participants and OSTTRA is addressing these needs with a pragmatic service model which is specifically designed for the needs of these growing currency markets.

Electronic FX trading, along with other factors such as the availability of FX prime broking services, has led to a significant increase in currency trading. Inevitably, the total notional value of settlement risk has increased, and settlement risk limits have become strained, says Tippell.

"FX liquidity risk is the danger that an entity cannot meet short-term currency obligations. PvP services, such as OSTTRA PvP Settlement Orchestration, help mitigate the risk of a currency shortfall and provide transparency at times of market stress – this allows market participants to react and take appropriate funding actions," says Tippell.

Practical frameworks for closing the remaining gaps in settlement risk mitigation will be based on PvP services which are initially based on bilateral netting, have flexibility in terms of the timing of funding requirements, support splits for funding obligations and exhibit an overall currency funding footprint which doesn't create liquidity pinch points, says Tippell.

"In addition, close partnering with local market participants and a service model which has the flexibility to work optimally alongside the local market infrastructure will be key to closing the remaining mitigation gaps."

While PvP services have been a critical development in the mitigation of FX settlement risk, they have not yet reached all parts of the FX market. "Asian currencies such as the Chinese renminbi and the Thai baht, Eastern European currencies such as the Polish zloty and Czech koruna and Middle East currencies such as the United Arab Emirates dirham and Saudi riyal, are most typically cited by major market participants as the most underserved by existing PvP solutions," says Tippell. "All these currencies are part of the roadmap for OSTTRA PvP Settlement Orchestration." Local market dynamics are not directly limiting broader adoption of settlement risk mitigation tools, says Tippell.

"It's a case of one model doesn't fit all and the onus is on PvP service providers to support functional and operational models which respect local market dynamics and conventions - this will lead to optimal service provision for local and international market participants," says Tippell.

There is clear industry momentum for reducing settlement risk. For example, the updated FX Global Code is explicit. Under Principle 35's settlement mitigation hierarchy, it states: "Where practicable, market participants should eliminate settlement risk, for example by using settlement services that provide PvP settlement".

OSTTRA's mission is to ensure it's practicable to use its PvP settlement service for a wide range of currencies which do not currently benefit from PvP protection, says Tippell. "This focus on settlement-risk mitigation is strongly supported by global regulators given the increase in trading of currencies which currently fall out of scope for PvP protection. A major settlement event in the larger of these currencies could lead to a broader, market-wide, systemic event.

"A well-adopted PvP service for the six to ten largest deliverable currencies, which currently do not benefit from PvP protection, would mitigate the vast majority of the current market FX settlement risk. OSTTRA believes this is achievable in the next three to five years," says Tippell.