

# Developments in Business Simulation & Experiential Exercises, Volume 20, 1993

## THE FOREIGN EXCHANGE SPOT TRADING SIMULATION

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### ABSTRACT

This article describes a Foreign Exchange Trading Simulation Game, which is to assist participants to develop skills in trading. The major goal of this game is to illustrate the various factors in the market, that influence pricing. The Trading Simulation game was also designed to: relate a practical trading environment in which participants can experience the volatility as well as gain other skills necessary to successfully trade in today's market.

### BACKGROUND

The workshop covers all aspects of Foreign Exchange Trading to include Spot, Forward, Future and Options trading. However, due to the uniqueness of the skills necessary for trading Spot Foreign Exchange, this game was developed in order to re-enforce the training within the Workshop.

Since the introduction of floating Exchange rates in 1971, this market has continued to grow. The Federal Reserve Bank of New York has, since 1969 provided a survey illustrating the volume growth of this market. In 1969 the New York market had a daily turnover of 1 billion dollars and the most recent - as reported 1989 - was 140 billion dollars. Within the last five years, the global Foreign Exchange market has surpassed the United States Treasury market and become the largest daily turnover of trading.

The Foreign Exchange Simulation Game represents a twelve-year development period. It has been performed in such diverse locations as Sidney, Cairo, Moscow, Berlin, Mexico City, as well as others. The game itself is the outgrowth of a Foreign Exchange Trading Workshop. The focus of the Simulation Game is on Spot Foreign Exchange Trading. Spot Foreign Exchange Trading is the global daily Foreign Exchange turnover of approximately \$700,000,000,000, which represents in most financial centers more than 60 percent of the daily turnover. Financial institutes that are engaged in Foreign Exchange Trading are connected through various telecommunication networks. The players in the Foreign Exchange market include dealers and brokers as well as the Foreign Exchange departments of many nonbank business firms. The participants in the Foreign Exchange Workshop, which includes this Foreign Exchange Simulation Model, have all at one time or another participated in the game.

### METHOD

To perform the Foreign Exchange Simulation Game, the participants are divided into groups of three - two also is acceptable - and designated as a bank. Each bank is given a letter of the alphabet as its name. Each of the participants are assigned a specific function within the bank. Each bank will have one Desk Trader, one Floor Trader and one Position Person.

The functions of the Desk Trader have been set up to emulate banks Foreign Exchange Trader responsible of pricing customers. This is achieved within the simulation in the following ways: The Desk Trader must always provide a two-way price when quoting. In that each trader is provided with a certain amount of bank trading tickets. The Desk Trader by the amount of tickets is thus provided with a trading limits. The quoting of the price by the Desk Trader with remaining blank tickets is only suspended one minute before and one minute after the posted announcements. The Desk Trader is allowed to change the price prior to commitment by the customer. The dealer is responsible for writing each of their tickets upon the completion of the deal. The ticket is to be given to the Position Person in timely manner.

The functions of the Floor Trader emulate that of those nonbank business firms that are involved in Foreign Exchange Trading. This is achieved within the simulation role in the following ways: The Floor Trader visits the Desk Trader to obtain a two-way price. The Floor Trader is not obliged to declare before the quote whether they are buying or selling. The Floor Trader can either commit to buying or selling based on the rate by the Desk Trader or move on to another banks Desk Traders and receive another quote. The Floor Trader is also the intelligence gatherer for his or her bank. This is achieved by soliciting prices from various banks Desk Traders and giving them to his or her Desk Traders on timely manner. The Floor Trader is responsible for filling out a Floor Trade ticket each time a deal is committed to. This ticket is to be returned immediately to his or her banks Position Person.

The Floor Trader is limited to trading only by the amount of floor tickets issued to his or her bank. This thus represents - as in real life - a Foreign Exchange limits.

The functions of the Position Person emulate that of a bank or for that matter nonbank business firms involved in Foreign Exchange Trading. This is achieved within the simulation role in the following ways:

Position Person is responsible for posting all the completed desk and floor tickets onto the banks position sheet in a timely manner in order that both the Desk Trader and Floor Trader know at any given time the banks position as to whether it is long or sheer position (meaning either plus or minus) and at what rate.

The three members of the bank, based on their functions, work as a team as the sequence of the game illustrates. An opening rate will be

given by the Central Bank in the beginning of each session. This will be followed within 5 minutes by the first announcement. Following each announcement the Central Bank will give an indication rate. Desk Traders will have 1 minute to adjust and price up or down to reflect the announcement and then dealing will resume. Each Desk Trader with a blank ticket is obliged to quote a two-way price. This price is subject to change at dealer's discretion. Each price quoted is good for \$1,000,000 worth of the foreign currency.

Working as a team, it is critical that they agree on a strategy how to position themselves based on the announcements, which is provided before the trading begins as per sample.

### RESULTS

As stated earlier, this Foreign Exchange Trading Simulation game has been performed throughout the world in Financial Centers for twelve years. The Simulation game has been performed in conjunction with a Foreign Exchange Training Workshop in the classroom environment. The Simulation enables the instructor to provide the participants with an actual trading environment. This particular aspect brings out the variety of personalities and different skill levels of the participants. There have been occasions in which the skill levels of the attendees included senior Foreign Exchange Forward Traders, Bond Traders, Corporate as well as new hires participating in the same game. Participants with varying skill levels do not create difficulties. These varying skill levels do not impose a difficulty in performing the Simulation game. In fact, as in the actual market, the variety of skills is a contributing factor of successful trading. An example of this would be the varying approaches that participants take in completing their allotted tickets. Some with a prior trading experience might job the market, whereas others would develop a strategy based only on the announcements. Another example of how the Simulation benefits from the varied backgrounds is in the method of quoting. An individual with a corporate background tends to approach the market based on the amount of foreign currency. They have to buy or sell, whereas those individuals with prior trading experiences coming from Financial Institutions tend to quote everything in terms of dollars. In each case, the different methods benefit the participant in that they realize the need to accurately comprehend the dialogue.

In the game, the inclusion of the announcements assist in setting the trend of the pricing. This is especially true for those participants who do not job the market, but instead set up new positions and square up on the closing rate.