

Skipping the middle man

will you be joining the FX ECN party?

Nicholas Pratt explores why increasing numbers of both Retail and Institutional FX traders are being attracted to the transparency, speed, as well as trade execution and cost benefits of ECN trading platforms.

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Electronic communications networks (ECNs) have been a prominent part of the foreign exchange market ever since electronic trading started to make an impression back towards the end of the Millennium when new entrants such as Currenex, Hotspot FX and the short-lived Matchbook FX emerged to challenge the market dominance of EBS and Reuters which had in turn developed as an alternative to the closed shop that was the inter bank FX market.

The proposed benefits offered by ECNs have not changed in that time and were a combination of advancements in technology (particularly web-based tools) and the growing demand of buy-side firms to have greater access to the market. ECNs offered such access and the chance to be a price maker as well as a price taker along with less expensive execution and greater transparency. Since then the ECN model has continued to flourish in the FX world and the early forerunners such as Currenex and

Hotspot have been joined by a host of new ventures targeting both the retail and institutional markets.

Retail versus Institutional

Dukascopy Bank is a Swiss-based ECN that offers direct access to the Swiss foreign exchange marketplace and serves both institutional and retail clients. "The ECN model works almost identically in both retail and institutional trading environments, trades on the same datafeed but could benefit from different post trade services," says Dmitry Kukel, Chief Broker Officer of Dukascopy Bank. "Clients can execute their trading needs on a competitive price stream with just one means of access. The bank charges a commission for this service. The difference lies in the counterparty



risk and settlement of the executed trades: While institutions may face a prime brokerage bank, retail clients will settle with Dukascopy Bank directly.”

An increasing number of both retail and institutional FX traders are likely to be attracted to the ECN model because of the benefits of transparency and cost, says Kukel. “Pricing conditions have long been a major factor in choosing an executor, with the rise of electronic trading and processing speed has grown in importance for professional participants. Complying with the clients need for transparency is simply the next logical step to grow market share.”

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Dmitry Kukel

There are several factors, in addition to transparency and cost, which should influence a trader's choice of FX ECN marketplace to use, for both retail and institutional traders, says Kukel. “A stable and liquid trading environment, customer support and, especially in the institutional business, efficient post-trade handling are all important considerations. Added values such as charting, news, research and easy access come next.”

As the ECN market for both retail and institutional traders grows, these benefits will become important means of differentiation, says Kukel. “For retail clients the trading interface, the reporting tools and technical support are key areas. Software developments need to cater for a large field of requests and it can be tricky to increase functionality while preserving ease of use. Institutions require flexibility in post trade handling at the lowest possible costs. A lot of the new liquidity comes from funds and algo-traders that are trying to step in between brokers and banks. This works well in calm markets but it seems to have accentuated the risks during price spikes.”

The retail and institutional ECN offerings are currently separate but as providers look to the functions and features that will make up the next generation of platforms, is there a prospect that the two sectors will converge? Kukel thinks this is likely. “The retail and institution will converge as more and more solutions are available for post trades activities, such as Netlink. There are hardly any key functions that do not exist today. Minor additions for the user's comfort can always be added, as long as it does not complicate trading.”

More efficient marketplace

Gain GTX is a US-based independent ECN which is designed for hedge funds, high frequency traders and other buy-side financial institutions. According to Chief Operating Officer Vincent Sangiovanni, FX ECNs are helping to make the FX market more efficient by giving institutional traders more control over trade execution and position management as well as the ability to trade against prices made by ‘natural sellers’ or ‘natural buyers’, enabling buyers and sellers to meet at natural spreads. “The FX ECN model is maturing and gaining wide acceptance not only in the buy-side community, but the sell-side community as well. Banks are realizing the value of ‘client to client’ trading possible in the ECN model, leading to greater interest