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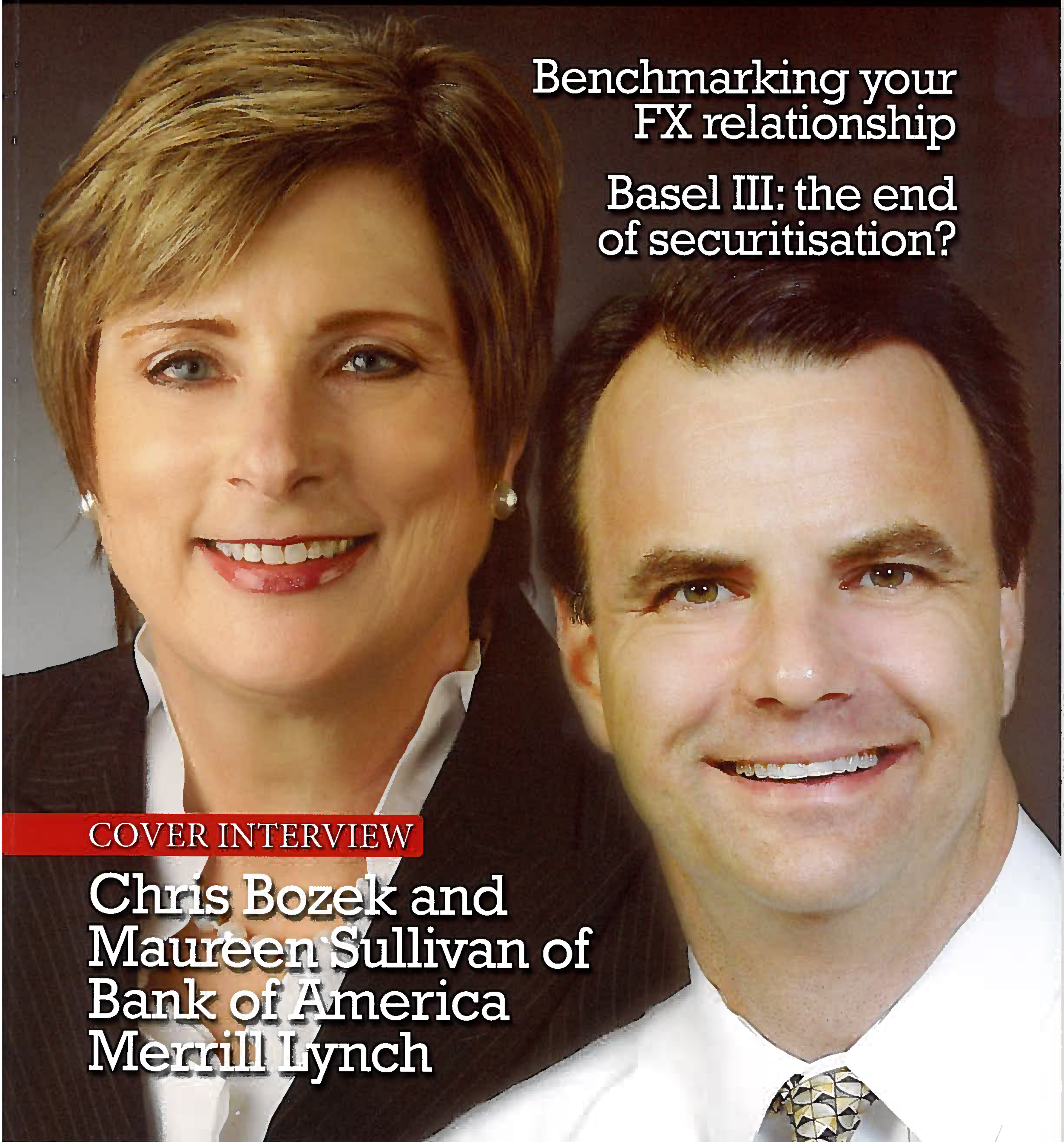

Benchmarking your FX relationship

Basel III: the end of securitisation?

COVER INTERVIEW

Chris Bozek and Maureen Sullivan of Bank of America Merrill Lynch

CHOOSING THE RIGHT WHITE LABEL TECHNOLOGY

There are several technology providers that offer white label solutions for the FX industry, such as MetaQuotes, Integral, Saxo Bank, Currenex and Dukascopy Bank, but which solution will be the market leader over the next 3-5 years? Will MT4 still be popular, what about MT5? Will Dukascopy Bank overtake it?

Developing an e-trading technology costs millions of dollars, pounds or euros and moreover, the development itself takes not months but years. As such, very few entities would – and do – decide to create their own trading system today.

Retail forex brokerage is an attractive business activity and one that can generate significant revenue for banks and brokers alike. Today, many more banks and institutions are moving into this area of the FX market, despite high barriers to entry such as regulation, technology, and minimum capital requirements. So what is driving this shift?

Firstly, regulation has pushed the FX brokerage business towards being a more 'onshore' activity since cross-border risks create an opportunity for local banks and brokers to develop their operations in a specific geographical market, through establishing a partnership with existing technology providers.

Furthermore, well established forex brokers are now adding new white label platforms to their existing suite, in order to diversify their offering. For example, FXCM, one of the biggest FX brokers in the US offers its own platforms as well as MetaTrader 4; FX Club, reportedly the fastest growing forex broker in the US, offers AcTrader alongside its own platform, while KakakuFX – one the Japan's biggest FX brokers – has added Dukascopy Bank's trading platforms.

Decision time

There seems to be a clear trend therefore for more and more regulated FX brokers to offer not only their proprietary platforms, but also various third party trading systems. But what additional income is being derived from this third party approach and how? Above all, which of the available technologies should be used?

Developing an e-trading technology costs millions of dollars, pounds or euros and moreover, the development itself takes not months but years. As such, very few entities would – and do – decide to create their own trading system today. The alternative is for the broker/bank to 'rent' an existing technology, whilst maintaining their own identity, via so-called 'white labelling'.

Since the merits of MT4 and its peers have been widely debated, in this article we focus on Dukascopy Bank, the only Swiss Bank that can provide its own technology. So why would Dukascopy Bank's white label technology (Jforex and web) represent a suitable solution for new or existing FX brokers to either expand into a new area of FX activity or to add an additional FX platform? What might be the potential income from the solution as well as the associated costs? In addition, what are the possible risks with such a collaboration?

Generally speaking, forex traders have become increasingly sophisticated over the last decade or so. As such, their needs have changed and their brokers have had to adapt accordingly. To be successful nowadays, a broker should be able to offer access to the market from anywhere via different technologies and channels (eg web, iPhone, iPad, Android). The access should support different trading systems (eg Java, Jforex, web, and API) and provide the flexibility to trade automatically. In this complex competitive landscape, Dukascopy Bank's white label solution represents a unique offering, covering all of the above needs.

Furthermore, there are neither technical implementation fees, nor maintenance fees. Dukascopy Bank is remunerated by charging only 3 USD for every million USD traded (hedged through its trading system). This solution allows brokers to save prime brokerage fees as there is no need to open multiple relationships with banks and prime brokers. The white label partner can set up its own commission policy and define different commissions for different groups of clients. According to Dukascopy Bank, the system seems to offer the most competitive pricing in the industry. Moreover, with 100 million USD of clients' assets invested in Forex, a broker or bank could expect 18 – 25 million USD gross income per year.

Benefits outweigh the risks

As with any such collaboration, there are risks. In fact, the two main risks that a white label bank or a broker would take are: the operational (IT) risk and the market risk. The operational risk is the most difficult one to quantify. There are no 100% guarantees and as such one should look further to determine what the state of play is with backup servers and redundancy lines or what the Business Continuity Plan is. Being a Swiss Bank (ie heavily regulated by the industry) Dukascopy Bank is obliged to ensure that this security is provided.

With regard to the market risk, it really depends on the white label partner and the particular white label solution in question. How does the hedging take place for instance? At what level does the white label partner want to provide liquidity? How does the trader's execution work (spread, average slippage, ping execution delay), on which price source is it based, with what price feed/liquidity is the broker/bank able to hedge? Will the hedging be done on the same data feed, manually or automatically? What is the quality of the data feed? Is the data feed provided to the clients an executable data feed?

These are all good questions since data feed inconsistencies, hedging inefficiencies and undesired market exposures could potentially put a broker in a difficult financial situation if not monitored properly.

All the functionalities in Dukascopy Bank's white label system were developed by taking into account each an every one of the aforementioned issues. For example, the white label partner can choose to add its own liquidity, bring an additional level of liquidity to its clients and de facto become one of the liquidity providers.

In addition, the white label partner can decide on the percentage of hedging that it wants to proceed with via Dukascopy Bank. The hedging is fully automatic and is done based on a single, unique data feed. Furthermore, the partner has access to one of the biggest liquidity aggregations in the world, bringing brokers both stability and quality in liquidity, spread and execution.

Last, but not least, is the fully customisable back office system, which has the potential to optimise white label internal resources. The back office represents the core of any company providing services or trades on financial markets. Without a flexible back office system, it is simply not possible to provide a quality report to regulators. With Dukascopy Bank, reports and platforms are customised to meet partners' requests and needs. The bank also provides technical support on all stages of implementation, as well as deepening the partnership through assisting with promotion: Dukascopy Bank proposes a franchising business model and redirects part of its internet traffic and clients to its white label partner.

According to the bank, the combination of this unique Swiss technology and the security of the Swiss Banking system offers both Dukascopy and its white label partners competitive advantage by combining the characteristics of a successful white label solution to be the perfect choice for a broker/bank, both satisfying their needs and bringing them success.

Dukascopy Bank's solution allows brokers to save prime brokerage fees as there is no need to open multiple relationships with banks and prime brokers. The white label partner can set up its own commission policy and define different commissions for different groups of clients.

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www.dukascopy.com