Technology and service:

Key ingredients for leading Retail FX providers

By Heather McLean

Forex as an asset class has been gaining widespread acceptance among retail investors over recent years. According to an estimate from the AITE Group, retail FX volume exceeded $60 billion a day at the end of 2006 and is expected to reach $100 billion a day in 2008. Drivers for the retail foreign exchange market include increased government regulation, which is providing greater transparency, massive growth in trading technology development and innovation coupled with the ability to send vast amounts of data over the internet.

However, K Duker, director of global FX for Deutsche Bank's retail FX business in Asia, states that these drivers are exactly the same for every industry. While figures bandied about state that the retail FX market is growing by around 30% year on year, the same figures are largely true of the institutional market. He comments: "Government regulation forcing transparency, technological advances, and the internet's growing ability to transfer large amounts of data in real time, have irreversibly changed the status quo. The point is the retail market is far larger than people realise. The traditional FX mindset simply does not have a concept of how big this market is."

Online Forex broker, FX Solutions, says there are several types of retail trader around at the moment. The first are experienced traders who are seeking the best execution and risk management tools. The second group are those who are new to trading FX; this group are shopping around and seeking platforms based on various cues, most often price which FX Solutions says could be a mistake. Then there are equity migrators, who are people moving from online stock trading to online forex trading, and techno and chart specialists who trade from charts and see FX as a new underlying security. The lack of panic over the recent market volatility illustrates how much the retail market has grown over the past two years.

Turbulence

Recent turbulence in the financial markets will contribute to a strong and sustainable growth rate in the retail FX trading market, expects Roland Meier, CEO of TeleTrader. He explains: "Financial markets on which you can go long and short always experience strong growth when traditional stock markets are in decline or experiencing volatility. Secondly, more volatility in the global financial markets means more trading opportunities for experienced traders and will therefore lead to more trades and higher trading volume. So we strongly believe that the still small percentage of retail investors trading FX will see a strong growth, and that many of the broker platforms currently not offering FX trading will add this in the near future."

While Daniel Darst, executive director for the institutional and partner business at FX Solutions, comments: "Retail FX traders are being born every moment. The turbulence in the markets accelerates their entry to currency trading and investing. It's a new and increasingly respected asset class, uncorrelated to stocks and fixed income. We see more and more retail investors looking carefully at FX and recognizing the opportunity. We find that the turbulence in other markets naturally ignites volatility in currencies and hence, more astute traders are able to identify areas for

Roland Meier

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trading. Technical charting and analysis is also buttressing this point of view," he continues.

All traders look for volatility in the market. Volatility is the reason for trading, particularly for clients who believe they can participate in markets by scalping or taking short term positions; day traders. Yet Jim Green, managing director at FXDD, comments: "Many of the dealers with whom I am familiar don't like the short term trading and scalping approach. It doesn't give them the chance to adjust their risk and it's like being nibbled to death by ducks. Depending on the business model a firm is following, these scalpers may not provide others with an opportunity to adjust their exposure or do anything else."

Increased competition

Interactive Brokers Group has noticed that the increased volatility has led to more active trading conditions. Andrew Wilkinson, director of media communications at Interactive Brokers Group, adds that competition in FX retail is unquestionably fierce. He comments: "Commissions on multi-million dollar deals makes for an attractive playground for brokers looking to maintain and justify wide spreads. Some are trying to add new bells and whistles in terms of charting capabilities. Others are simply making the look and feel of the platform appealing."

Wilkinson says that many investors, particularly those in the US, have woken up to the fact that the dollar has lost a great deal of value. He states those customers have sought out alternative assets to trade as well as searching for a way to protect the overall value of their portfolios. He adds: "But the landscape also demands that as investors' looks to overseas equity markets, they are able to efficiently make transactions not necessarily priced in the dollar. As such, currency conversion becomes the order of the day.

Andrew Wilkinson

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The currency option market will undoubtedly take off and show growth as has been seen in the equity market, and we're already seeing demand for it."

Alain Broyon, CEO at Dukascopy, agrees: "The increase of volatility gives investors more opportunities. It also increases their need to hedge their main portfolio. As a consequence, the bigger the volatility, the bigger the volume. This is one of the reasons why the Swiss FX Marketplace has increased its volume month after month."

He continues: "The traditional client landscape is developing fast in the retail sector, as FX is becoming a new asset class available for all investors, not only for professional. Nevertheless, clients are more informed about the structure of industry, and they have more complex needs such as charting software, news or API connection."

Automation and algos

Todd Crosland, CEO at Interbank FX, comments on the need for automation and APIs: "Automated trading does require a certain skill set of the client, but we have worked to provide the resources needed for those who are new to the concept. Our trading platform was one of the industry's first to offer the ability to program automated trading systems and this technology has been offered to our clients from the very beginning. APIs are also available for those that have special needs with their trading systems."

API demand is high, states Mr.Broyon. He comments: "Clients are more sophisticated and need access to API. Brokers have been obliged to develop their

Alain Broyon

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connectivity using the standard protocol. Nevertheless, many banks and brokers do not like to provide clients with access to FIX API, as it is another level of technology." There are already some simple solutions present in the market that reflect retail clients needs to trade a self developed algorithm. While these are simple and early designs, a lot needs to be done to really enable the FX retail trader to work in a fully automated, home grown environment.

TeleTrader is currently in the development stage of features that will enable its clients to trade their own algorithms with any integrated platform provider. "Our vision is to create a hybrid system of client side system development and testing and server side system and trade execution, where the user can upload his algorithms to the brokers system which then automatically executes it in a safe environment," explains Meier. "Such a setup will be significantly different from client side solutions which can be influenced negatively by network latency, internet problems, operating system troubles and other erratic behaviour," he adds.

FXDD has seen a growing interest in system trading, says Green, and in CTAs and third party independents. This is particularly true for clients who have come into the market and quickly learned that it is a difficult business for those who wish to succeed. "There's a final resolution and resignation that these new traders will let someone else who has the experience trade for them," states Green. "The third party trader is, I think, going to be a growing element of this business. The excitement and entertainment value of trading electronically, like video poker, can wear thin after a while, particularly if you see your equity continue to decline."

Glenn Stevens, CEO at GAIN Capital Group and Forex.com, says GAIN's proprietary technology is being extended through the delivery of alternatives for its clients to transact, from one of GAIN's three web-based trading platforms, its wireless platform, or using one of its two APIs for automated trading.

Currently, GAIN offers two APIs for automated trading; FIX and soap-based web services. Looking ahead, the company anticipates that a larger percentage of retail forex volume will come from algorithmic trading models, as firms make it easier to implement systems-based models and more retail traders embrace them.

Education for the masses

Regardless of the sophistication of the trader, it is the responsibility of the provider to supply the necessary education, says Crosland. Interbank FX has recently relaunched its IBFX University. This purely educational site includes free content from Interbank FX plus partners, to deliver as much information as possible to get traders started in this market.

Smart FX providers are adding value by providing educational seminars and knowledge transfer, better services plus additional features, like professional charting and technical analysis tools for traders. This will ultimately be the key to retaining clients and acquiring new ones, says Meier. "We do see a strong move towards online seminars as well as online

Jim Green

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chat services throughout the FX platform providers. This is due to the fact that more and more beginners are entering FX trading as well as the need for the FX providers to increase the trading volume by better educating their traders," he comments.

In terms of providing the right support to retail clients, it is important to employ the right support personnel says Green, and to give those support staff training so they are informed, the technology to be able to instantly access client information, and the authorisation and latitude to provide clients the service they demand and enjoy, to keep those clients from going somewhere else. Without those elements, clients will go elsewhere, Green states.

Trying to match the client's perspective, personality and emotional complexity with a particular approach to the market is important, states Green. He explains: "Almost anyone can learn to analyse the market and use indicators and to find patterns whereby they succeed. But often the most difficult parts of trading are the psychological and emotional aspects; pulling the trigger and making that trade..

"What we try to instill in our clients is a sense of discipline," Green continues. "The old adage in trading is plan your trade and trade your plan, and trade the market you have not the one you wish you had. Matching the structural analytic overlay on top of the emotional content means clients at least have the sense that they have a much better opportunity to make money."

Client acquisition and retention

On gaining new customers, Crosland states: "In the FX industry I have seen many hard sell [customer] acquisition approaches. I am proud to be part of a firm that is very upfront about the risks associated with the industry. We ask customers to stay on a demo for as long as it takes and we never pressure anyone to go from a demo to a live account."

Todd Crosland

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And on retaining clients, Crosland says: "In client retention strategies, we have implemented a debit card solution so that customers can quickly and easily access their funds. We also have a 'sky miles' rewards program. Our Platinum Rewards Card is essentially a credit card, however for every standard round turn lot our traders place we credit the card 50 rewards points. Interbank FX spends a significant amount of time and effort developing tools for our traders that are given to our account holders free of charge."

Customers appreciate education and honesty and tend to bond with a brand that provides that resource particularly well, says Wilkinson. He explains: "We have been in the business for 30 years and have always prided ourselves on providing services that professionals would need. We don't play games like marking up spreads or acquiring $200 accounts that will only churn and provide temporary profit. Our best customer is a long term customer and that relationship can only be built through trust."

Meier says: "Some FX providers include in their platform simple charting for clients, which is often too simple for more professional users and sometimes too difficult for beginners. An outsourced but integrated professional application for charting and technical analysis provides beginners as well as professional with all the features they need in order to enhance their FX trading."

Darst states: "We seek to make the trading experience fluid, intuitive and reaffirming. Some platforms are simply too complex and the user interface is a generic techno-display that doesn't recognize the needs of the trader, whether he or she is experienced or new to the business. It is probably fair to say that there is too much hype and unnecessary tooling on many of the platforms, but at the same time, we are catering to a self-directed trader whom we believe will be able to self-select and identify the most compatible trading system," he notes.

Daniel Darst

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Continuing, Darst says: "Client retention is typically a function of the efficiency of the trading platform, the ability to fill orders effectively when the markets are moving, to answer questions, to provide guidance and information, technical information and market news. These are the standard requirements for entry [to the market]."

New entrants

As the first major bank to go globally into the retail market 18 months ago, Deutsche Bank's Duker says market maker banks are uniquely positioned to meet the demands of retail. Banks such as Deutsche have the gravitas, balance sheet strength, pricing and top quality research that retail traders are inclined to trust.

Duker adds: "The entry of the major market maker banks into retail FX will inevitably increase price competition and accelerate the erosion of margins. Institutions who today rely on commissions or earning the spread will find it hard going. The future of retail FX will be determined by how institutions meet the triple challenges of high volume risk management, truly scalable platforms and high quality customer service."

Dukascopy has observed that it will be more and more difficult for retail brokers to compete with banks. The resources invested by banks are considerable, so the only way Dukascopy believes it will be possible for retail brokers to stay competitive will be to keep upgrading platforms, to increase service quality and to develop marketing strategies further.

K. Duker

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TeleTrader sees a trend amongst the FX providers to compete mainly via pricing and the spreads in the majors, says Meier. He claims that this will eventually be favourable for the banks, who will be able to make a thin margin due to cross selling opportunities. Yet fierce competition in the area of fees and tighter spreads can lead onlookers to believe that retail clients are looking only at fees to select their FX provider. Meier disagrees. "We strongly believe and experience that clients are looking for a well

balanced package of low fees, best execution combined with quality service and extra tools to improve their ability to trade successfully."

Yet banks and brokerage firms converging on the retail space are not a problem to existing providers, explains Darst: "For us, it is not a threat; quite the contrary, it's the best news, relative to the possibility of other entrants. Our point of view is that more discipline, more oversight and more substantial players in the retail FX space will bring great credibility and structured, compliant behaviour. That will benefit all of us.

"Our focus is to work with banks and brokerage firms who believe in e-business, who believe in online distribution and are willing to bring their powerful brand and client reach to bear," Darst continues. "Our business model is organized around partnerships. We believe that our technology is well served when it supports regulated, licensed firms including CTA's and Introducing Brokers who are able to deliver quality customized service to their clients. Our goal is to work with partners, rather than compete head-to-head with them in the retail marketplace."

Partnerships

Developing partnerships and offering different levels of outsourcing and partner programs to banks, and introducing brokers and other institutions which are in contact with potential retail clients, is a key growth factor for FX providers, states Meier. He comments that his company's customers, like FX Solutions and FX Bridge Technologies, are addressing this need already and offer complete FX platforms, including the backend, execution services, order entry frontends, plus a branded version of the TeleTrader charting and technical analysis package to their customers.

Over the past year, several banks have entered the retail FX market by white labelling the technology of retail brokers. It is clear that banks are now starting to realize the potential of this market. GAIN Capital expects to see more banks partnering with the leading retail firms in 2008.

Stevens comments: "We have an extensive introducing broker network and currently support over 40 white label relationships with broker/dealers, futures FCMs and other financial services firms in North America, Europe and Asia. These partnerships complement our direct marketing efforts and contribute up to 50% of GAIN's customer volume on a monthly basis." Yet one of the key issues involved with partnering with CTA's or Introducing Brokers is liability. This issue has been in the spotlight recently in the US and the NFA has indicated that it will begin requiring solicitors to become regulated at some stage in the future, says Crosland. The broker needs to be selective in its partnering decisions because those relationships can be beneficial, but they can also carry with them a substantial amount of liability, he warns.

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Conclusion

A revolution is clearly taking place in the retail FX market. More traders are joining the currency trading bandwagon than ever before and the industry seems set fair for even bigger and brighter things. Two important factors that are facilitating this rapid and exciting growth are the ability to supply clients with both state-of-the-art trading technology as well as superior service provision to help then deploy and utilise it. These two factors are becoming the key ingredients for all successful Retail FX providers.