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- leveraging trade replication technologies

Post Trade FX

- addressing risk, connectivity and regulatory complexity

Cloud Computing in FX

- offering wider market access

Algorithmic FX Trading

- increased precision with
order execution

FOCUS on Single Bank FX platforms

- moving to enrich the customer
experience

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Ed Pla

Tel. +1-203-719 2602
edward.pla@ubs.com

Marcus Butt

Tel. +44-20-7567 9873
marcus.butt@ubs.com

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Welcome to

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transforming global foreign exchange markets



AUTUMN 2011

Two of our main features in this edition are on FX aggregation and post trade FX services and both reflect themes that are highlighted in our focus article on single bank FX platforms. One is that relationship-based trading has once again become an important trend in the FX market which is demanding more transparency and a return to relationship-based pricing. The other is that many of the large FX banks have been ramping up their post-trade infrastructures to provide a more seamless and standardised post-trade environment for their customers. Despite continuous innovation and improvement across the industry, there is still significant residual cost and risk associated with FX post trade processing and much still remains to be done to improve the operational efficiency in the lifecycle of an FX trade.

Two other key articles we have put together explore a powerful new technology and fast growing trading service which we are convinced are going to significantly impact the whole FX market over the next few years.

Cloud computing technology is widening access to the FX market and some commentators believe that as we have reached a degree of maturity and commoditization in the provision of trading systems, it is now the delivery capability which is important and this is where the cloud will come into its own in e-FX. Predictions have even been made that the role of bank IT departments are likely to shift towards managing the network, where before they were more concerned about running the application.

Social Investment Networks are a fast growing trading service attracting increasing numbers of followers throughout the Retail FX market. We have examined how the leading social investing models work and what trade replication technologies are involved. Our conclusions support recent research which suggests that the potential global market for this type of trading and investment service is likely to be absolutely immense and we expect most FX brokers to respond to this trend by either partnering with existing providers or striking out with their own tailored solutions. Exactly what impact the social investing phenomena will have on the Institutional FX marketplace is hard to predict at the moment but players in that space would be wise to watch these developments very closely.

As usual we hope you enjoy this edition of the magazine.

Charles Jago
Editor

Susan Rennie

Susie@Aspmialtd.com
Managing Editor

Charles Jago

Charles@Aspmialtd.com
Editor (FX & Derivatives)

Charles Harris

Charles@Cjag.demon.co.uk
Advertising Manager

Helen Rochford

Helen@Aspmialtd.com
Production Manager

Michael Best

Michael@Aspmialtd.com
Subscriptions Manager

David Fielder

David.Fielder@e-forex.net
Features Manager

Larry Levy

Larry.Levy@e-forex.net
Digital events manager

Felix Shipkevich

Contributing writer
Regulatory Roundup

ASP Media Ltd

Suite 10, 3 Edgar Buildings
George Street, Bath, BA1 2FJ
United Kingdom
Tel: + 44 1208 821 802 (switchboard)
Tel: + 44 1208 821 801 (e-Forex sales & editorial)
Fax: + 44 1208 821 803

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Phill.design@btconnect.com
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Heather McLean
Regional e-FX Perspective
Canada



Richard Anthony
e-Forex Interview
Managing e-Risk



Frances Maguire
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Single Bank FX platforms



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Post Trade FX
Addressing risk & regulatory complexity



Algorithmic FX Trading
New toolsets for increased FX order precision



CEP Technology
Integration into FX architectures

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FOREX TECHNOLOGY

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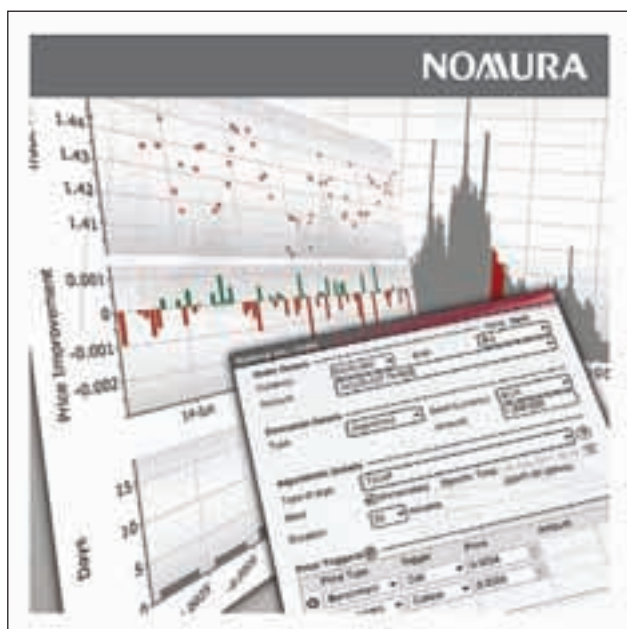
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Nomura releases first phase of FX Algo Toolkit

As part of a pre-trade algorithmic analysis suite, Nomura has released the first phase of the FX Algo Toolkit. This proprietary feature provides users with the ability to define their strategy and analyse historical performance and the cost of execution, which is clearly defined pre-trade. The FX Algo Toolkit compliments the existing algorithmic execution offering, which gives users access to a range of bespoke Nomura algorithms. The execution interface gives traders full control to interact with their order during the lifetime of the algorithm and supports multiple conditional controls. Further information can be found at www.nomuralive.com.

RBC Capital Markets introduces RBCDX

RBC Capital Markets has recently launched RBCDX, its proprietary trading platform which enables clients to trade FX, money markets, fixed income and deposits through a single portal, while providing access to RBC's global research. Commenting on the launch, Ed Monaghan, Managing Director and Global Head of Foreign Exchange, said "Our new trading solution offers a secure, fast and customizable gateway to a suite of FX products including spot, forward and option-dated forward trading in all major currencies, and allows clients to manage their fixed income and FX exposures on a 24-hour basis." RBCDX was built using Adobe

Lloyds Bank Corporate Markets launches Arena

Lloyds Bank Corporate Markets has launched Arena, its new e-trading application. Arena is a single, efficient one-stop execution platform which combines rich content such as market news, interactive charting, risk analytics tools and proprietary economic research with an easy-to-use and customisable interface.



Initially, Arena will offer execution for foreign exchange trading in over 50 currencies and access to money markets deposits in 19 currencies. Customers will be able to trade with speed and precision spot FX, forwards, swaps and time options. Commingling rich content and insights with control features such as the trade blotter and trading functions into one highly customisable interface will provide customers with all their needs in one view. Further asset classes such as vanilla interest rates derivatives and capabilities such as payments and collaboration tools are being developed.



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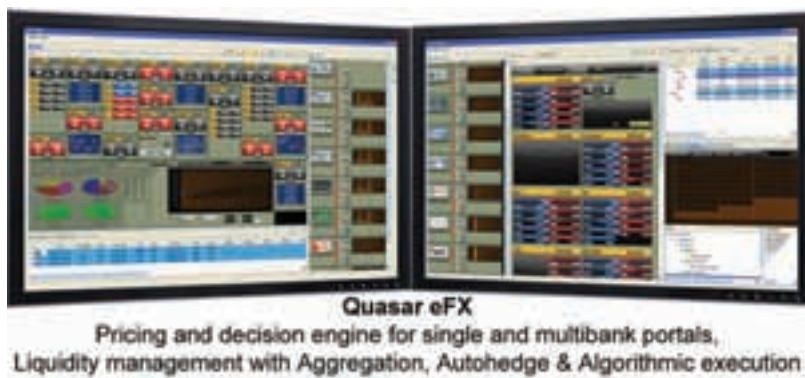
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DZ BANK choose Quasar eFX from Aphelion

Aphelion has announced that German DZ BANK has chosen Quasar eFX to create a new FX wholesale trading environment. The new solution will be hosted at Aphelion's hosting premises in London. "Our objective is to provide a high standard of customer service, for cooperative banks and corporate clients, as well as institutionals in the highly competitive foreign exchange environment. Aphelion exactly meets our requirements and offers our customers a tailor made FX solution with a wide range of functionality and speed" says Roland Weiß, Head of Corporate Sales FX at DZ BANK. "Aphelion is very pleased and proud to have been chosen

by DZ BANK to deliver on very ambitious goals and targets. - Says Peter Jörgne, CEO of Aphelion. "We are very much looking forward to working in Frankfurt and making Quasars presence felt here."



Swiss Finance Corporation selects Spectrum

Financial Software Systems, a leading provider of Risk and Portfolio Management Software has announced that Swiss Finance Corporation (SFC) has selected the Spectrum System. SFC, a London based FX broker, will utilize Spectrum to enhance its middle-to-back-office Foreign Exchange dealings in Spot, Forward, Swaps, Non-Deliverable Forward, and FX OTC Option contracts.



Spectrum provides SFC with a highly automated platform for conducting collateralized trading activities with its FX clients. SFC clients will be able to view all of their FX trade positions and margin capacity in real time over the internet via the Spectrum Reporting Portal. SFC selected Spectrum for three main reasons: the company's experience in the FX Broker space, Spectrum's ability to support a broad range of FX Option products and the web reporting portal. This is the fifth new name Broker / Dealer signed by Financial Software System's in 2011.

Nordea offers one-click trading

Nordea is now delivering one click trading via its own electronic trading platform, e Markets. While Request for Quote (RfQ) trading remains fully supported, Nordea believes many of its customers will find the quicker execution and ability to follow tradable prices at all times a clear winner.



The bank's multi-portal integration has also recently been re engineered to enable more functionality such as one click trading. "Our customers will benefit greatly from this timely delivery of quotes, especially in today's volatile markets," said Kenneth Steengaard, head of FX, MM and Commodities Trading at Nordea.



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GAIN Capital launches speciality execution desk



GAIN Capital has launched a speciality execution desk providing 24-hour access to experienced FX professionals who will assist clients in leveraging the extensive credit network and liquidity in the GTX marketplace to price and execute transactions. Backed by GAIN Capital, GAIN GTX is a highly innovative eFX technology solution for institutional

market participants, including banks, hedge funds and high frequency trading firms. GTX is first and foremost an independent FX ECN, but can also be leveraged for aggregation/liquidity management or white labeled for an institutions' internal or external use. GTX clients may also utilize GTX Direct, an FX prime brokerage service.

Leverate offers live Market News Feed

Forex broker solutions provider Leverate has announced the launch of a real-time Market News Feed and Economic Calendar, integrated to MT4, proprietary trading platforms and broker websites to aid Private Label brokers in gaining a competitive edge over other brokers in the market. The Market News Feed is a fundamental analysis of news and events in the international financial markets and are written by the industry's most respected analysts. Updates are

posted in real-time, automatically, with no need to refresh the page. Traders receive information on relevant movements of the most traded pairs, including the majors, small dollars and major crosses. The Market News Feed is available in 13 languages, and it can be integrated directly to all proprietary trading platforms, brokerage websites and MT4 clients. The Economic Calendar supplies a forecast of the financial markets, updated in real-time, directly in the WebTrader, MobileTrader and brokerage websites.

Cloud Trading Technologies offers risk solution on Microsoft Cloud

Cloud FX Risk is a centralised platform providing real-time risk management of client portfolios and control of the financial institutions exposure over multiple asset classes and complex risk scenarios. A proven solution, Cloud Trading Technologies have now extended their Cloud FX product suite to deliver real time risk management on the Azure cloud platform, ensuring a cost-effective, fast and scalable implementation.



Howard Tolman

"Real-time risk management will in future become mandatory rather than optional and must be instantly reactive to market events. Cloud FX Risk does this in real-time over multiple asset class portfolios, addressing the increased regulation that financial institutions face," says Howard Tolman, Cloud Trading Technology's Managing Director.

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EUROPE

Aphelion
Kungsgatan 2
SE-111 43 Stockholm
Sweden
Phone: +46 (0) 8 588 977 00

NORTH AMERICA

Aphelion
405 Lexington Avenue
Chrysler Building, 26th Floor
New York City, New York 10174
United States
Phone: +1 212 907-6489

ENQUIRIES

Peter Jörgne
Direct: +46 (0) 734 399 040
peter.jorgne@aphelion.se



PFSOFT releases new version of ProTrader

PFSoft has released a completely new version of ProTrader its multi-asset brokerage platform. Denis Borisovskiy, CEO of PFSOFT comments: "The result of year-long intense work involving analytics, developers and designers has resulted in a whole update of each part of the platform – Back-Office, ProTrader Desktop, ProTrader Web and ProTrader Mobile – so now our clients will get extended functionality and great usability for more efficient brokerage. The asset-class coverage has also been increased with delivered forwards and significantly enhanced. The server productivity and high availability were improved and now PFSOFT can offer superior scalability of the system with a new embedded cluster solution. Also we have worked on security with a third-party company so that ProTrader now meets the highest requirements of large financial institutions", he says.

TwoFour offers Margin Trading

TwoFour now offers Margin Trading, a real-time, cross asset solution for high volume margin trading organizations looking to mitigate risk while allowing their counterparties to trade on margin. TwoFour's margin processing tools are designed to improve risk management by using a robust set of rules and parameters that are flexible and configurable. Available margin can be checked at deal entry, in blotters, in reports and can be viewed in an intuitive search screen. Margin can be checked for FX spot, forward, and swaps, as well as for vanilla and exotic FX OTC options.




In addition, TwoFour has extended its solutions to include a web-based client-facing front-end using Microsoft's Silverlight technology. The new web portal allows clients to deliver white-labelled functionality to external customers. Functionality includes FX Request for Quote, the ability to manage positions, add settlement instructions, manage confirmations, search trades, manage margin accounts, view reports and more.

Hotspot FX launching Private Label offering

Hotspot FX is set to launch its latest innovation to the FX Market, Hotspot FX Private Label. This new white label offering leverages the technology from Hotspot's institutional FX ECN to enable financial firms and brokers to offer spot FX trading to their clients. "With Hotspot FX Private Label and our recently redesigned GUI, we are able to offer a complete end-to-end solution, enabling the user to operate and administer their own FX marketplace customized for their clients with liquidity providers of their choosing," said John Miesner, Managing Director & Global Head of Sales at Hotspot FX. "The platform's modular nature allows for easy integration with systems of all types," Miesner added.





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Gold-i Multi-MAM enhances MetaTrader 4

Trading systems integrator, Gold-i has upgraded its MAM (Multiple Allocation Manager) with the launch of the Gold-i Multi-MAM – a powerful addition to MetaTrader 4 which allocates trades from any number of master accounts to any number of sub-accounts, in real-time, automatically. The Gold-i Multi-MAM works entirely in the MetaTrader server and will work with any method of trade generation, including manual trading, EA trading, mobile trading and trading by the Gold-i Gate Bridge or other bridges. Whenever deposits or withdrawals are made into the client accounts, these are reflected in the relevant master account. The advanced functions of the Gold-i Multi-MAM allow the removal of accounts from the allocation group without closing any master trades or restarting the MetaTrader server. Tom Higgins, CEO of Gold-i comments, “The Gold-i Multi-MAM supports up to



Tom Higgins

512 allocation groups per Multi-MAM installation and addresses a gap in the market for a powerful post-trade allocation tool. This latest addition to the Gold-i suite of bolt-on products is already proving to be of great interest to a wide range of organisations, all recognising the role of the Gold-i Multi-MAM in increasing efficiencies and minimising risk.”

FX Fifty Five selects FlexTrade

FlexTrade Systems has announced that FX Fifty Five, the FX division of Market Securities Kyte Group, has deployed MaxxTrader, its full STP, white label trading system for sell-side institutions operating in the foreign exchange markets. Built by Adil Soyfoo and Nathan Halfon, FX Fifty Five is a specialist electronic FX markets execution venue delivering low latency access to tailored FX liquidity pools via GUI and API. “We are delighted with our partnership with FlexTrade,” said Halfon and Soyfoo. “MaxxTrader not only helps us



Nathan Halfon and Adil Soyfoo

provide a high standard of customer service, but it also manages and polices our liquidity in a highly efficient way, which is crucial to operating a pure FX agency.”

OANDA expands presence into Japanese FX market

OANDA, has established a new operation, OANDA Japan Incorporated. The Tokyo-based subsidiary will support OANDA’s rapidly growing institutional client base in Japan, and help fulfill the company’s aggressive business development efforts across the Asia Pacific region. “Institutional traders, particularly those in Japan, have long expressed a strong desire to access OANDA’s ultra-competitive spreads and deep forex liquidity,” said Michael Stumm, CEO of OANDA Corporation. “We launched OANDA Japan in response to a clear need in the Japanese forex market—the third most active forex trading market in the world—for low spreads and reliable liquidity sources.”

Saxo Bank launches FX Binary Touch Options

Saxo Bank has announced the launch of six Binary Touch Options on its trading platform. The Binary Touch options will initially be offered in six currency pairs; EURUSD, USDJPY, GBPUSD, EURJPY, EURGBP, and AUDUSD. They will be tradable from Saxo Bank’s FX Options Board, where clients are already able to trade regular FX Vanilla Options. Gustave Rieunier, Global Head of FX Options & Forward Trading at Saxo Bank, says, “Adding Binary Touch Options trading to our platform bridges the gap between FX Spot and FX Vanilla Options and meets the recent demand in the market for wanting to trade in the global currency market in a simple, straight forward manner.”

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QuoTrek offers new features for FX traders



time quotes, charts and news, not just snapshot market data.

QuoTrek now allows access to Forex, futures, stock and options data via the Android, in addition to BlackBerry and other Java-enabled devices. It can be purchased as a standalone product or an add-on to other eSignal products so that Forex traders can dynamically link their symbol lists between

QuoTrek and their desktop. Those who do not need real-time data can use the free delayed-data version on their iPhone. A glimpse at what is new with QuoTrek is available at: www.quotrek.com

The all-new QuoTrek offers an advantage over other mobile applications for traders on the go because it provides global, streaming, real-

Dukascopy Bank collaborates with FXDD and Alpari (US)



Alain Broyon

Dukascopy Bank SA has entered into collaboration with FXDD and Alpari (US), who are now offering Dukascopy Bank's trading technology, rapid execution and liquidity to U.S. residents.

Alain Broyon, CEO of Dukascopy Bank SA says: "Thanks to our white label solution we are able to offer our trading technology to partners and to continue our growth. All U.S. clients who are not eligible contract participants are welcome to continue trading on Dukascopy Bank's trading system through one of our U.S. Partners."

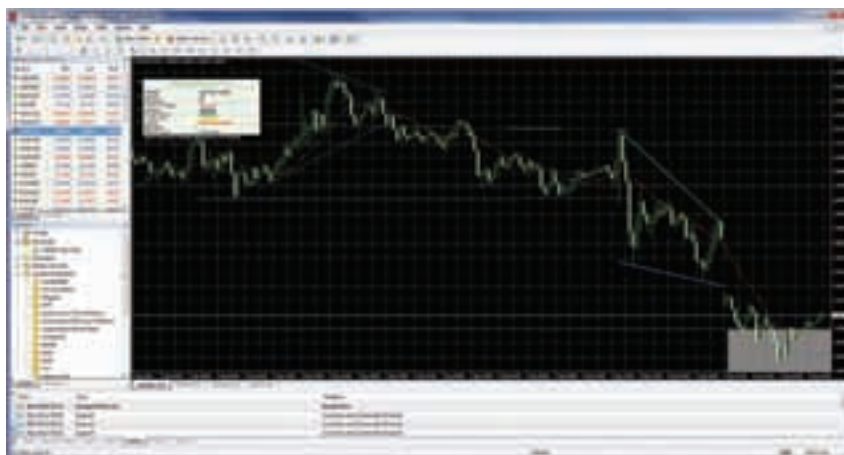
Vantage FX partners with Autochartist

VantageFX has announced the launch of the Autochartist market scanning software to their live account holders free of charge. This service will be of great value to both trend and swing traders.

charts via a custom plug-in which links seamlessly to the Autochartist application. With a simple drag and drop of a script the Autochartist web application will launch automatically in a new window. No need for users to sign on again.

Autochartist is one of the world's most advanced tools for the automatic identification of Chart and Fibonacci Patterns identified in real-time while markets are open. Their proprietary technology allows scanning of thousands of financial instruments 24 hours per day and automatically uncovers trading opportunities as they occur. Traders are alerted of pattern formations within minutes.

All features of Autochartist can now be delivered to the MetaTrader





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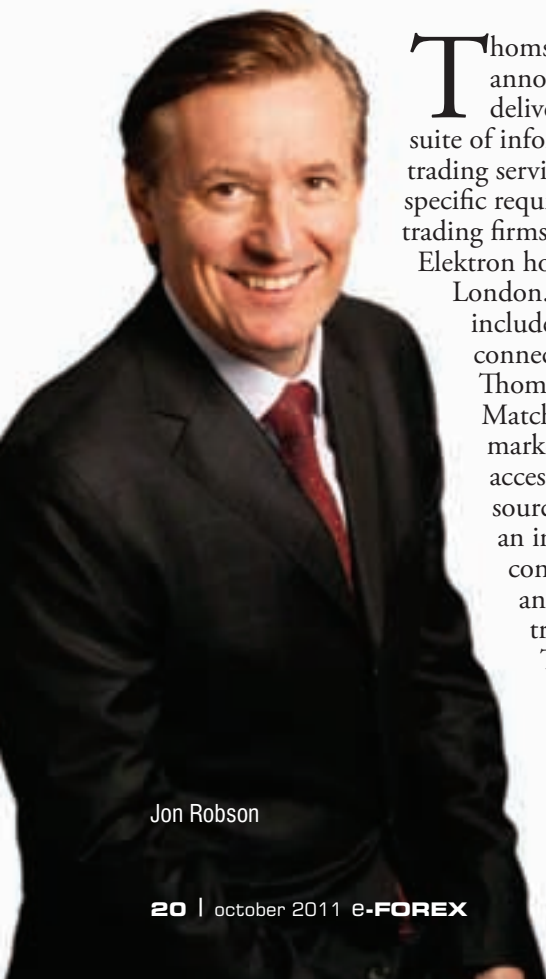
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For Vendors: We're continually seeking out complimentary vendors to expand on our growing service offerings. Our partners enjoy a mutually conducive relationship. For inquiries into our Panda Connect Program, please contact us at connect@pandats.com.

New innovations from eToro investment network

The eToro investment network has announced its latest set of product innovations, further enhancing its position as one of the market leaders in the provision of social trading in forex and CFD's. CopyTrader™ is a new feature which enables investors to automatically copy all the trades executed by the top financial traders on the eToro network. With CopyTrader™ investors can build their own people-based trading portfolio of best performing traders and assign a portion of their account balance to copying each of their trades. The soon to be announced eToro Guru Program offers registered traders (semi-pro and pro) a whole new source of regular earnings; monthly payments earned based on the number of eToro traders copying the guru trader's positions.

Thomson Reuters extends Elektron



Jon Robson

Thomson Reuters has announced that it will deliver an integrated suite of information and trading services to meet the specific requirements of FX trading firms leveraging the Elektron hosting sites in London. These services include low latency connectivity to the Thomson Reuters Matching FX Spot markets, together with access to all other key sources of FX liquidity, an integrated set of content services and pre and post trading applications. Through Elektron clients will have access to FX price discovery solutions, combining

FXDD releases Swordfish

FXDD has announced the release of their new proprietary trading platform, Swordfish, a powerful Forex trading tool designed for traders of every level.

With a highly customizable interface, including undocking and docking features, the company says FXDD Swordfish puts the user in control of where and how to view their information. Customizable color schemes and trading layouts make the trading experience unique for every user.



One click trading allows users to place buy or sell orders with a click of a button. With on-chart trading users can place market or pending orders without ever leaving their chart. Within Swordfish, "Algo Traders" (pre-programmed trading scripts) are used to automate the trading process and potentially predict future trends. Users can write their own Algo Trader script or import any of their existing favorites.

connectivity to the Thomson Reuters Matching liquidity pool, via a local data center cross-connect, with access to all other relevant sources of spot and derivatives FX liquidity providers as well as a broad range of single-dealer price feeds from banks.

Jon Robson, President, Enterprise Solutions, Thomson Reuters, said, "The Elektron high performance infrastructure has allowed us to strengthen our value proposition to deliver the most complete trading solution, supporting the most advanced trading strategies. Clients leveraging our Elektron Hosting facilities can now fuel their trading applications with the most complete set of connectivity, information and trading technology services on the market."



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Playing Sovereign Poker

The power of the free market and in particular its ability to speculate responsibly, has heightened the awareness of Western and Eastern politicians in both developed and lesser-developed countries causing them to ask, 'What is wrong with the entire system', 'Why were years of accumulated sovereign debts discovered so late? And 'Where were the rating agencies and accountable authorities during those years? On the other side of the spectrum but adding to the instability of the global financial market, were hoarded foreign exchange reserves. This instability has spread to the next asset class of commodities, causing, a never before seen, run on gold. It has also revealed that trust that has been placed in other financial safe-havens such as the Swiss currency is misleading.

A new order

The world's financial system needs a new order! While the USD and EUR are still dominating currency reserves, daily trading volumes and open market trading, it has become clear that currencies like the Swiss Franc, British Pound or Japanese Yen can no longer fill the gap or assist in an international transfer and stabilizing role for a number of reasons. It is now an established fact that the world's cash flows, reserves, and fund volumes to name but a few, have become far too big.

The following example recently occurred which illustrates the final limitation of currency power: At the beginning of September, the Swiss National Bank had to

Manfred Wiebogen
President ACI, The
Financial Markets
Association.

establish a EURCHF floor at 1.20 to protect its local economy and avoid a breakdown of its domestic industry and production.

At the same time world news papers and other media are reporting and speculating daily upon the possible break down of the Euro! (Which begs me to ask, Who are the real speculators?) The paradox being that now the Swiss National Bank itself has indirectly joined the EUR, (at least for the next few months) seeking ways to stabilize its strongly European linked economy.

After the end of the Second World War and in particular during the '70s and '80s the US currency played its world dominating role driven mainly by being simply the, 'Petro-Dollar'! Promising political stability and trust, it finally usurped the British Pounds dominance as the previous world-leading currency. In the past two decades the world's economy has become globalized due to which an enormous market, far bigger than that of the so-called 'developed countries', has emerged.

New legislative responsibilities

This calls for a new order and new legislative responsibilities taken on by politicians at international level. China is fast becoming the world's biggest manufacturer and is on its way to playing a dominant future role in innovation and sophisticated development, in line with other Asian states. Russia has to be considered, being by far the world's largest holder of natural reserves, with enormous growth potential in infrastructure and production! So, clamping down on the USD and EUR for covering over ninety percent of the financial business (in particular in FX) is frankly, grossly negligent.

Of course no one had foreseen the strong rise of China during the last decade. More to the point it is the right time, (remembering: i) sovereign debt crisis, ii) EUR discussion, iii) USD weakness, iv) hoarded currency reserves, v) protectionism of the RMB, vi) appreciation of the CHF, vii) explosion of the gold price etc.), for serious discussion and propositions at an international level and with the lead of the IMF, obliging other countries, such as China and Russia to take over increased international responsibility in the financial markets (payment systems, paper market, free float etc).

In the end, there is no way of excluding or freeing them. Of course, domestic and international systems, will need time to adjust. But all our markets need clear words and declarations to help fill the vacuum of leadership.

Call to politicians

It is vital, even though sometimes being an enormous burden, that we all continue to have on-going discussions on OTF/MTFs, Trade Reporting, FX Data Repositories, MiFID, Financial Transaction Tax, Basel III and so on, even though there are obviously some different standpoints between Europe and the US, and challenges to be met in gaining cooperation from China and Russia over many of these themes.

The call is out for politicians to look beyond blaming the industry concerning what is or what went wrong. The call is out for them to provide a political environment, in this closely linked world, where decisions and developments are based on sustainability and harmonization, under responsible leadership.



Fragmentation and liquidity in FX – is it worth upsetting the balance?

There is already significant fragmentation of liquidity in Wholesale FX which has facilitated the evolution of a competitive marketplace creating venues that have developed features appropriate to different user types. Justyn Trenner and David Poole, Co-Principals at ClientKnowledge examine the risks of creating stagnant pools of liquidity within FX if the current delicate balance of fragmentation is upset.

After much fluctuation, FX is in a period of reasonable stability of liquidity pools. While EBS and Reuters are still recognised as the leading inter-dealer brokers and some marketplaces have come and gone, there are still several growing and increasingly significant venues. So far, natural market dynamics have allowed venues offering sufficient liquidity and necessary services to flourish, while new venues who do not offer it, or whose model has not suited their target clients have failed.

When we consider how participants trade, important distinctions are to be made between three clearly different modes: voice-to-voice, manual-to-screen and a computer trades with another computer. Nonetheless, the fundamentals of the market are the same with each, even if the workflow is different. Using any of these methods to trade, in the overwhelming majority of cases banks acquire risk from clients; clients only limitedly trade risk between themselves; banks need to hold and lay off risk and clients will pay banks to take large risk positions and work those to the market.

With ongoing long-term increases in volume, there is more risk to manage and, responding to demand, the places that can receive and lay off risk have correspondingly multiplied, while the penalty

for pricing latency has grown and margins have contracted. As more methods of trading have emerged, the differences between voice, GUI-manual and e-trading are now much more nuanced than they were. One key effect of electronification is that it has dramatically improved transparency – prices can be seen at the click of a button and consequently it is far easier to know whether the price you are being offered is reasonable.

The penalty for latency can be felt across the spectrum of price delivery, as we have discovered through intelligent benchmarking work that compares KPIs against best practice. At the top end, a slow/bad price can be hit when it is less than a second (possibly substantially less than a second) old by an algorithm, before the price-maker has had a chance to remove it; bad pricing will always be punished. Over longer timeframes, the process is different, but the outcome the same: if a bank updates prices in its retail network every hour and it takes another hour or two to bring



the risk back into the trading book, then there is the risk of losing any profit gained from the original spread through lack of efficient risk processing.

The progression of platforms

The contrast between algorithmic trading using a selection of API feeds and calling up a salesperson who shouts across the floor to a trader for a price is huge and far bigger than the historic e-/manual divide. On the other hand, the different ways of trading are also converging: the difference in speed and margins to a buy-side between them requesting a quote through the web-based single dealer portal (SDP) of their bank and phoning a salesperson at the same bank who quotes them a price from a streaming rate at the salesperson's desktop drawn from the bank's proprietary pricing platform is minimal.

This convergence is in part due to the range of counterparties available. Venues such as FXall, Hotspot and Currenex offer both anonymous and visible trading areas on their venues and the combination of white-label ECNs and SDPs ensure that every organisation, from global banks to tiny corporations and private individuals, can execute FX trades electronically.

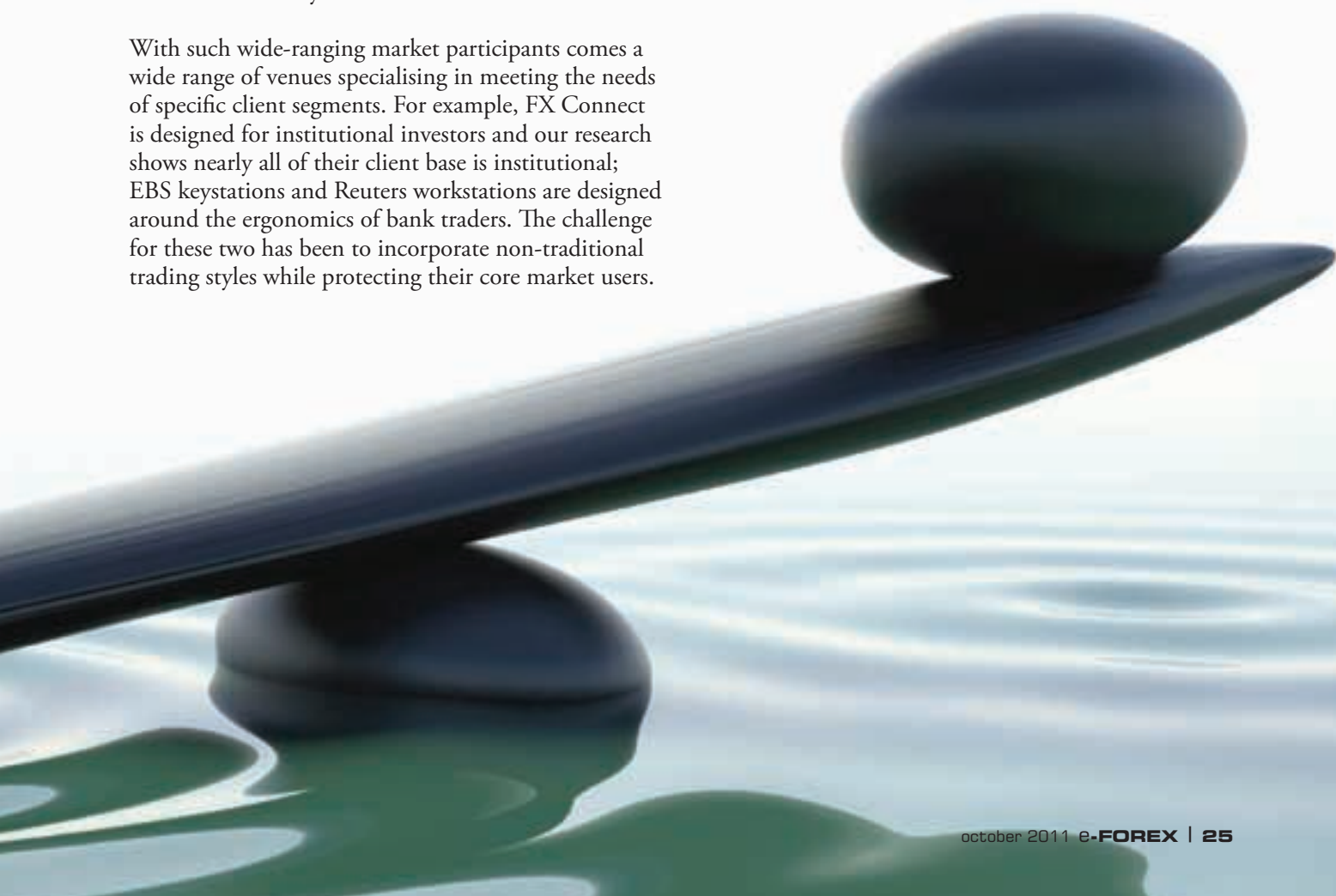
With such wide-ranging market participants comes a wide range of venues specialising in meeting the needs of specific client segments. For example, FX Connect is designed for institutional investors and our research shows nearly all of their client base is institutional; EBS keystations and Reuters workstations are designed around the ergonomics of bank traders. The challenge for these two has been to incorporate non-traditional trading styles while protecting their core market users.

One of the keys to the success of e-execution in FX has been the balance of fragmentation and sufficiency of liquidity in one place. The constant stream of adaptations and innovations introduced by both multi-lateral venues and bilateral platforms is due to the competition for clients and, as in any economic market, client demands are met by both new products and adaptations of existing ones.

The success of these is dependent upon the timing of their launch. The arrival of FX Connect and FXall filled a gap in the market not covered by existing products and both proved to be very successful. This is not always the case, as newcomers can struggle to achieve critical liquidity – others have sought to build block trade venues, with limited traction, and a major venue is responding by offering the capability, an example of innovation from within the industry.

Trying to please everyone

There are considerable differences in methods of execution across different market participants and products, driven by the transparency and liquidity of the market as well as the complexity of the product and requirements of the end user. Different venues





"One key effect of electronification is that it has dramatically improved transparency – prices can be seen at the click of a button and consequently it is far easier to know whether the price you are being offered is reasonable."

have successfully marketed themselves to become specialist providers to different users. For example, EBS attracts banks and high frequency hedge funds (although HFTs can only access the EBS market through an approved EBS Prime bank), FX Connect is successful with institutions and FXall is popular with both corporations and institutions.

Of the buy-sides that ClientKnowledge interviewed that use multi-dealer portals:

- >95% of FX Connect and >60% of FXall users are buy-side institutions
- >60% of Currenex users are corporations
- >35% of 360T's and Bloomberg (FXGo)'s users are banks

A fragmented market with separate providers emphasises and enhances the differences in behaviours between types of consumer. There is an enormous depth and range of methods of trading, from the person in a corporation who phones their bank to the algorithm at a hedge fund which makes the decision

of which price to execute from a range of API feeds, where the price change is measured in milliseconds.

The same differences apply to the sell-side – there is a wide gap between the bank algorithm that makes prices and pushes them out to clients in the blink of an eye and the salesperson who has to shout to a trader who makes a price manually. The time taken and margins paid and made are vastly different in both cases but the underlying processes are the same. These different methods lend themselves to being treated separately, by different providers or by different services from a single provider – hence the fragmentation of services we find in FX. The tipping point comes when the liquidity is spread too thinly and execution ability is affected.

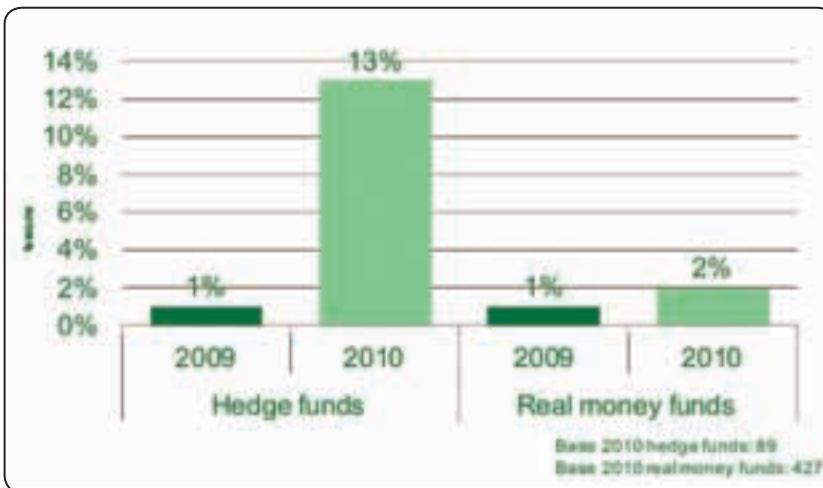
The proportion of fully automated algorithmic trading (where a computer rule both determines the signal and executes the trade) is still small, as is execution of risk (where the signal is determined separately, often manually) by smart algorithms for order routing, but the algorithmic market is growing, and is already influential, even in its infancy. The systematic trader (man or machine) is able to identify and punish bad pricing faster and more often than an unaided human trader, leaving less alpha on the table.

Irrespective of actual activity levels, algorithmic trading has a significant impact on the wider market, forcing other market participants to fight back – to adopt appropriate systems so they can price better, win the race to find alpha themselves and to implement the necessary risk techniques; similarly, venues and vendors need to develop processes to allow manual traders to compete on a more even basis, with rules and processes that compensate for human interaction.

Liquidity, liquidity, liquidity

There are some attributes that everyone in the market needs from a liquidity source, starting with deep liquidity and including reliability and accessibility. These terms have different implications for different types of trader. For example, liquidity for a corporation using FXall entails being confident that your banks are on the system but with EBS, it implies having a high degree of confidence that another party will cover you if you place a passive order. In other words, while, in simple terms, liquidity translates to certainty of fill when you want it, the wider considerations and conditions (the willingness to trade off certainty of fill for the possibility of a slightly improved price, or knowledge of counterparty so you can reward them

Growth of algorithmic execution (source: ClientKnowledge)



Estimated proportion of volume executed using algorithms

for best execution and so forth) have differentiated importance and balance for different market-users.

Beyond these, different trading parties have many other demands, from API feeds to knowledge of who else uses a platform so that one can interpret the pricing better or calibrate a strategy according to the ability to transact odd sized trades. Satisfying the need for tailored services while maintaining sufficient liquidity on each platform is the challenge the market has largely met. The consequences on liquidity from



David Poole

"The contrast between algorithmic trading using a selection of API feeds and calling up a salesperson who shouts across the floor to a trader for a price is huge and far bigger than the historic e-/manual divide."

forcing the market to introduce new sources of liquidity will not necessarily be beneficial and may, in fact, bring about more fragmentation and lead to the opposite effect to the aims of the regulators.

Piecing together the picture

The FX market is a large and fragmented market, with many participants for whom to cater. The regulatory changes and advances in technology further complicate the market. Each significant type of participant has a particular set of needs, some which need thought and possibly evolution in order to move forward successfully in an evolving environment.

Sell-sides

Sell-sides need the ability to be able to make prices across a range of channels in order to access their clients, who have different requirements and preferences when it comes to executing their foreign exchange business. In order to manage this, banks need to focus on understanding the different venues' and clients' flows' characteristics and price them accordingly. Consequently, they also require the facility to manage the risk acquired through these multiple venues back to their trading book. In turn, the risk can be laid off (or off-setting flow sought) through numerous channels.

In order to provide a service that both satisfies clients' needs and is profitable, it is time for a review of cross-asset margining. In order to be most effective, detailed analysis of what works best for a particular style of trading is crucial – balancing your need for reliability of fill against price is only possible once you have looked at costs, fill probabilities, activity, ticker on different venues and bi-lateral platforms and use them to make choices on where and how to approach trading.

Buy-sides

The issue for buy-sides in accessing market liquidity surrounds the trade-off between liquidity and service-led pricing. They need to consider the benefits accrued from aggregation processes and a highly liquid market, but additional responsibility for handling complex trades and processing, compared to outsourcing the risk and more complicated processing to a sell-side and be willing to pay for it. In short, buy-sides must

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establish which are the most efficient routes to market for their trading activity and which aspects of their business it would be more effective to outsource.

Market intermediaries

Market intermediaries are under pressure to capture flow, and the best way to do this is to make their market place responsive to the needs of their particular user-types. Broking, clearing and settlement intermediaries need to demonstrate value-add by improving likelihood of fills (liquidity on venues) allied to facilitating tools, both at point of trade and for ancillary functions (reporting, credit, clearing and risk management, confirmation and settlement) in order to remain valuable to clients. Keeping everybody happy is a balancing act, sometimes involving the protection of the more vulnerable by the careful management of the most aggressive high frequency algorithmic traders; an example of this would be to set a minimum time for quotes to be offered. A further consideration for them is to ensure their venue is protected from unexpected and non-transparent liquidity management practices.

The smart market-place operators will make it their business to maintain a constant dialogue, arbitrating and arbitrating between the needs of their different users. The penalty for not doing so will be that liquidity will shift from one venue to another. The existence of the present array of venues forces operators to respond to these needs while ensuring that liquidity is not so fragmented that venues do not have adequate flow and time to respond constructively to the needs of their customers.

Conclusion

The most important aspects of a venue for any user are liquidity (and that the action is real – not spoofed) and the probability that they will be able to be filled when, and at the price they expect. Orderly markets require the presence of that liquidity, the ancillary services that facilitate market access and proper management of the marketplace. They also require that market users themselves adapt to the liquidity in those venues and the facilities offered by those venues to facilitate equitable access. There is a significant responsibility on operators and traders both in this respect. Provided they accept and act on those responsibilities, we see no reason to upset the current balance of fragmentation in FX. Users are best served by accessing their liquidity where most liquidity is; that is, in existing marketplaces properly managed.



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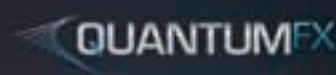
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Nicholas Pratt

A return to the traditional values of the FX market is seeing a greater demand for transparency. Nicholas Pratt examines how these demands are influencing the development of next generation aggregation services.

The FX market has always had a wide variety of liquidity sources, hence the popularity of aggregation services. However over the last few years, these services have now moved on from the initial objective of gathering up multiple liquidity sources into one easily viewable and executable location. As the platform providers look to develop next generation products that take the aggregation model to the next level, there are now far more things to consider.

The first of these is customising, tailoring and optimising the services to match the evolving demands

of the different FX trading participants – whether they are market makers, buy-side desks or high frequency trading firms. What has become clear is that the FX market now houses a wider variety of trading strategies than ever before. Many of these strategies have developed thanks to the advancement of technology and algorithms, allowing for greater sophistication, faster executions and increased trading volumes.

FX trading strategies have also been influenced by the developments in other asset classes, especially the equities market where the dominant trend of the last few years has been the emergence of so-called dark trading, where participants trade anonymously in off-exchange locations such as crossing networks and the systematically internalised order books of large sell-side brokers. Sure enough dark trading has become a feature of the FX market, despite the fact that it is an over-the-counter market without the central counterparties in the equities market. In fact, for a while it appeared that the imported trading model of anonymity, dark liquidity and agency brokers would become more prevalent than the traditional, relationship-based trading model that had always prevailed. Now though it appears that the thirst for tradition has returned.

Meeting demand for transparency

TraderTools, a leading FX trading platform vendor that includes liquidity aggregation as part of its overall offering, has responded to this demand for transparency by launching its LightFX service, a fully-disclosed, relationship-based FX pricing and aggregation service, which has been developed in partnership with Citi's Prime Finance.

“Over time we have built a database with our liquidity providers based on who is better in certain currency



pairs, with certain counterparties and at certain times of the day,” says Yaacov Heidingsfeld, TraderTools chief executive. “Increasingly we are finding it is all about transparency. Liquidity providers want to know who they are providing prices to. They want to know the predictability and reliability of their flow and how aggressive that flow is. We have always had this data but with the improvements in technology we are now able to do more analysis in a much quicker timeframe. Through our partnership with Sybase and its Aleri division we are able to employ CEP technology and then feed this into our SOR technology.”

The service is really aimed at the mid-tier and below, where banks are redistributing prices and for those banks that are outside of the top 15 banks that make

up the FX interbank market, says Heidingsfeld. “These banks are more regionally focused and will be strong on particular currency pairs and not so strong on others, which is why it is important that there is more transparency around the liquidity. There are also more sophisticated liquidity takers in the corporate space that are trading FX for alpha or hedging purposes that require more transparency around liquidity and execution. And by giving the liquidity-providing banks comprehensive data on how their liquidity is being redistributed and executed against, the top-tier banks are able to provide better prices.”

Differentiation from ECN services

The reason for the LightFX offering is to differentiate from the ECN-based services which provide



Yaacov Heidingsfeld

"Liquidity providers want to know who they are providing prices to. They want to know the predictability and reliability of their flow and how aggressive that flow is."

the bulk of the liquidity in the FX market, says Heidingsfeld. He believes the market's demand for more transparency and a return to relationship-based pricing will appeal to both liquidity takers (who will receive better, relationship-based pricing) and liquidity providers (who will be able to offer a more transparent service to their clients). "The biggest chunk of liquidity in the market is still provided via the ECNs which are based on an anonymous trading model. We asked if that anonymity was something our clients wanted. And while there are those that do, such as high-frequency traders and hedge funds, there is a large part of the market that wants more transparency. So we are filling a void."

The lack of transparency is a big issue in the FX market. For example, in February an Arkansas pension fund sued a custody bank because it believed that it

was being overcharged for its currency transactions. The lawsuit suggests that buy-side firms operating in the FX market are now paying greater attention to the pursuit of best execution and this is something that liquidity aggregation services will have to cater to, says Heidingsfeld. "The information we are providing is post-trade data and transaction cost analysis and best execution – things that have been prevalent in other asset classes, namely equities, but have largely been absent from the FX world. We are not just providing data for single executions but for multiple executions over time so that firms can use that data to formulate their strategy."

It is important to make the distinction between what Heidingsfeld calls "curve-fitting" (where traders will devise their strategy first and then fit the data into this pre-meditated plan) and developing the strategy around the data. And by making post-trade data more available and accessible firms, they can more easily adopt the latter approach.

When money was more available across the board, many financial institutions were willing to take what was being offered by prime brokers. But now that things are a bit tighter and liquidity is less available, we've been witnessing a return to relationship pricing. Banks are being more selective about who they supply to, and customers are going back to the banks that used to serve them. In addition, although liquidity is less free-flowing and markets are far flatter, a number of things have improved, especially the availability of hosting services. Banks have devoted more resources to the hosting services they offer and the attitude of their customers has changed. Whereas previously hosting services were seen as a low-rent option, they are now being seen as the model of choice – and not just because of the money that is saved on IT implementation and maintenance costs.

Dark pools

There is no one size fits all approach in the FX market but it is clear that some approaches have been more fashionable than others, says Heidingsfeld. For example, the last three years has seen the rise of so-called dark pools. "Dark pools were the flavour of the month. Everybody wanted them. The trading firms thought that the big FX banks were not giving them good prices because they knew who they were and this led to a desire for anonymity and the spread of the dark pools. But now those trading firms have found that it was not as great on the dark side as it promised

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to be and we are seeing them coming back into the light. I still think there is a place for dark pools and I think they are here to stay. But we are definitely seeing a greater appetite for transparent liquidity. We are able to tell our clients that we are aggregating single banks at a price they can execute on. We are not aggregating the aggregators, where the liquidity on display may be part of mirage. I don't think anyone would deny that banks give different prices to different people, but in the whole debate over the need to be anonymous to avoid unfavourable pricing, the baby was thrown out with the bathwater. Now we are seeing that there are still some firms that favour anonymity because it is fundamental to their trading and business strategies. Essentially, they are trading firms rather than firms that also trade. But there are many others that have no demand at all for anonymity."

Now, an educated market participant will be able to choose the solution that best suits them because all types of solutions are available. And by adding an expansive data service to the aggregation solution, Heidingsfeld believes that aggregation services can truly remain a trader's best friend. "Information is the key to any industry and, in this context, the information is beneficial to both parties involved in the trade and is not harmful to either."

Relationship-based trading

There are two broad trends in the aggregation game according to Richard Tibbetts, chief technology officer at StreamBase Systems, a complex event processing technology provider. The first is a renewed focus on the importance of relationships, especially among the sell-side firms building aggregation platforms who are looking to develop customized connections to their distributing banks. "They want to aggregate a number of banks they connect to and how they connect to them. Price is still the major component but the relationship is also important."

The relationship aspect is that the routing decision may not be based on price. It may be based on who is providing the most flow, says Tibbetts. "We are automating that intelligence and building it into the cycle. It is something you have to be dedicated to constantly improving. There is a constant stream of changes. We will roll out a new system but have to check daily that the rules are right – the exposure to that firm; the daily volume supplied to that firm; TCA; specific currency pairs; percentage of order fills. The question is whether, over the course of the



Richard Tibbetts

"Those firms that are not aware of aggregation will probably see the quality of their execution erode."

day, the counterparty is doing right by me so we have to look at the long-term and the short-term metrics simultaneously."

Dealers used to have a simplistic model for assessing their clients based on gold, silver and bronze, but now it is increasingly complex and more attuned to individual firms, says Tibbetts. "Market makers will give more competitive prices to those firms that are keeping them honest by using aggregation technology."

The other broad trend is that there are trading firms using multiple ECNs, says Tibbetts. "The question for them is how to ensure best execution from these ECNs. Can I predict liquidity? How do I ensure that the prices I'm seeing are real? How do I distribute my liquidity across multiple ECNs? This involves accumulating large amounts of pricing data and subjecting it to quantitative analysis."



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Traditional versus equity import model

These two broad trends reflect the fact that there are two models in the FX world. The traditional model that is relationship-oriented and interbank-based and the equities import model. “Five years ago the thought was that the equities import model was going to take over the FX world but the price of credit has affected this. So the traditional model has been reinvigorated by structural change and this has led to a higher demand for aggregation services focused on interbank liquidity.”

“As a CEP provider we can provide platforms for both styles. The quants provide the aggregation rules, and we provide the CEP platform with a wide range of connectivity options. Customers incorporate their quantitative rules into their systems to gain competitive edge. We give them full flexibility to construct their aggregation anyway they want to. We also make it flexible enough to allow firms to change their style - from ECN to interbank – without having to change the platform. People are looking for a system that is flexible rather than a system they will have to throw away after a few years and build another one.”

“We are also truly at the next generation stage where we are starting to see people replace their first generation systems which were either internally built or bought from a third party provider but are no longer meeting their needs. Now, by using a platform based on continuous development, maybe that replacement cycle can be broken. There will always be situations such as M&As that necessitate system replacements but platforms based on continuous

development should allow firms to stay ahead of the technology or at least keep up with their competitors.”

Such is the prominence of FX aggregation services, without which Tibbetts cannot imagine anyone electronically trading FX. “Those firms that are not aware of aggregation will probably see the quality of their execution erode. On the dealing side, they are more aware of customer behavior and can tune their prices to the trends that they see. So it is a bit of an arms race, even on the relationship-based side of the business, and will be increasingly so.”

Integration and re-engineering issues

For Harry Gozlan, chief executive and founder of smartTrade, many of the first generation aggregation services require re-engineering to address both functioning and non-functioning concerns. “In terms of non-functioning concerns, the challenge has been to address how the aggregation platform is integrated into the firms’ other systems, namely its overall FX liquidity management system.”

The big change here has been the increasing use of hosting services for not just aggregation platforms but a whole host of services contained within an FX liquidity management system. “Because it has to integrate with so many other systems, it is important that it is open and flexible.”

Low latency and increased throughput have also become more important, especially with the popularity of the hosted service model where both pre and post-trade data has to be sent to systems managed outside of the clients’ own infrastructure. “The data has to be cleaned and sent to the client as efficiently as possible. Not all aggregation systems are capable of this.”





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On the functioning side, aggregation platforms have had to cater for clients' increasing demand for customisation. "The aggregation system has to allow them to put their own native code into it and to work with their own business logic. For example, firms will have their own rules to ensure around venue protection to avoid hitting the same venue twice. There is also a greater use of post-trade data for troubleshooting unfilled orders and also monitoring best execution."

In terms of managing the post-trade data challenges, the task is not so much the collection of the data (something which had proved difficult in the past in the over-the-counter FX market) but in ensuring that the data is sent to the right risk management system. "The aggregator must therefore have the ability to push the right trade confirmation to the right client system," says Gozlan.

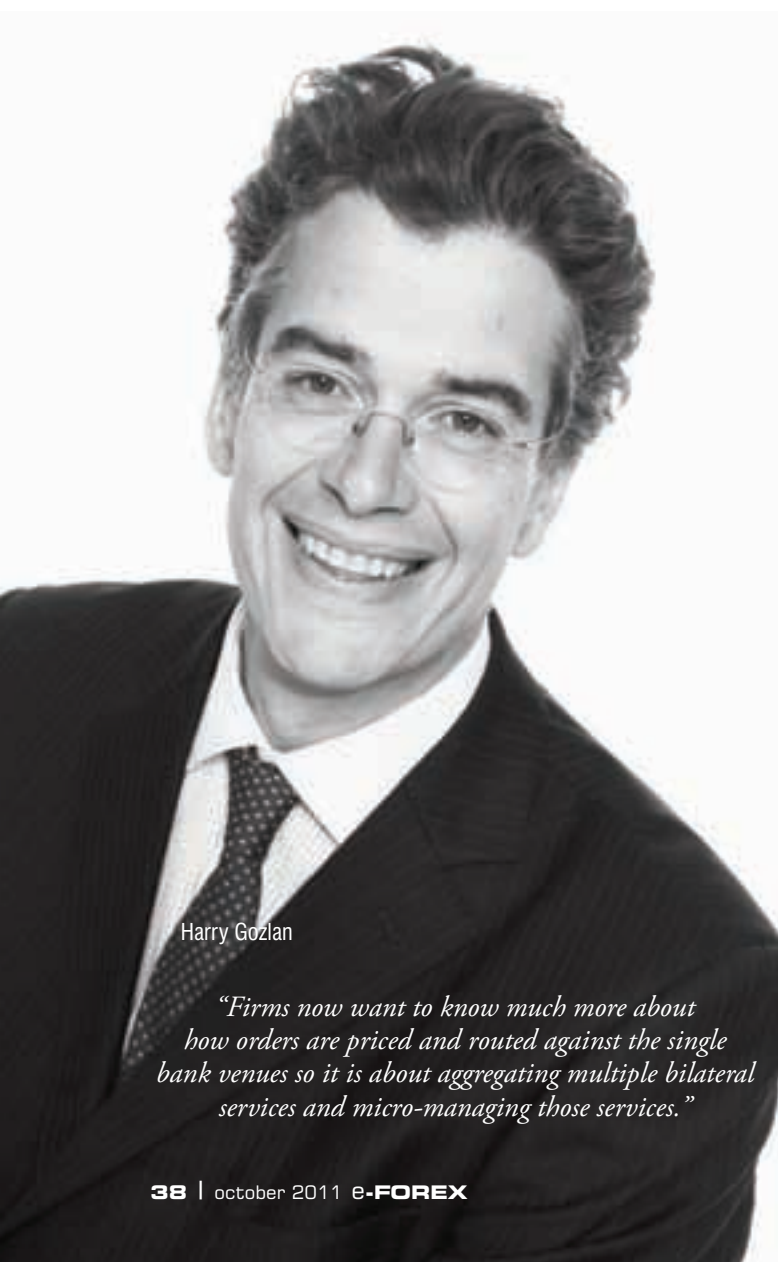


Customisation

Gozlan agrees that the use of dark, lit or grey liquidity sources is a subject of increasing debate within the FX industry. For the aggregation service providers it merely means more of a focus on catering for more customisation. "We manage the fact that the liquidity venues will publicise only sections of their book depending on certain conditions and factors. And they will vary the rate at which this information is made available. As an aggregator it is all about how you package the service."

For example, if a firm trades through an ECN, you have to know how that flow is organised, says Gozlan. "What has become clear is that the rules of the game are not the same for everyone. This realisation is why firms now want their own aggregation platform rather than an off-the-shelf product or a platform that is part of an all-in-one liquidity management system. It is important for the aggregation platform providers therefore to know how the clients want their systems to work and to be able to fine-tune their offerings to these demands."

For the likes of smartTrade it is really a question of internal design, says Gozlan. "The first generation of aggregation platforms struggled to implement this engineering but now it is crucial that the platform providers can integrate with the clients' own systems in a matter of weeks. There are still some clients that require a straight-forward, rigid platform but generally it is the role of the provider to offer a platform that is open and flexible. It should then be up to the clients to set the rules and for the provider to offer the services to do that."



Harry Gozlan

"Firms now want to know much more about how orders are priced and routed against the single bank venues so it is about aggregating multiple bilateral services and micro-managing those services."



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Court cases such as the one involving the custody bank that is mentioned above have been due to the lack of transparency over FX prices and best execution, says Gozlan. "Firms now want to know much more about how orders are priced and routed against the single bank venues so it is about aggregating multiple bilateral services and micro-managing those services."

There may be no regulatory mandate for seeking best execution in the FX market but Gozlan believes that it will become more important for trading firms, especially for those firms engaged in indirect FX trades, where an FX transaction may be part of multi-asset trading strategy or part of an auto-hedging transaction. "We are seeing more concern from clients around their execution. They are asking about their hit-rates and asking why the smart order routing engine went to one location and not another. They are also enquiring as to how they can test the different ways to access the market and use post-trade data to conduct some back-testing for their algorithms. So the audit capability provided by post-trade data services is very important and a strong selling point for liquidity providers and vendors."

Fine-tuning

Gozlan feels that the adoption of aggregation services has reached a point where the vast majority of participants are now using a platform of some kind. The job for the platform providers therefore is less about selling the benefits of aggregation itself and more about fine-tuning their offerings to suit the specific trading preferences of their clients. "It is like mobile phones. Nowadays almost everybody has a phone but there are the extra features and functions that people want. This is what we now have to provide as part of an aggregation platform. For example, we may have to include some crossing aspects or dark liquidity pools or more transparent liquidity sources. I don't think one approach is the answer to everything. And you have to remember that the aggregation platform is only part of the liquidity management system. All of these different systems have to co-exist as efficiently as possible so it is about aggregation and integration."

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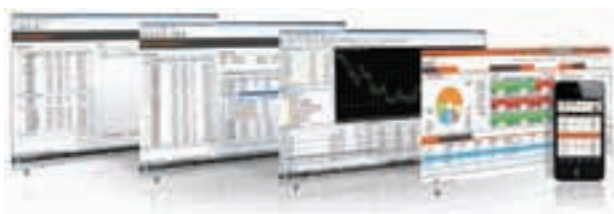
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Leverate also provides a comprehensive back-office Reporting Interface. Developed in-house and is easily customized to match the needs of institutional clients, the Reporting Interface allows institutional clients to monitor and manage their traders' activities. A wide array of reporting



Central Risk Management Server - v1.3.0.26

File View Connections Tools Administration

Trade Log

Trader	Instrument	Type	Amount	Status	Request Time	Fill Price	Request Res...	Desired Price	Total Exec...	Trade Type	Trigger Type	Pips Difference
75500664	EURUSD	Sell	1,000,000.00	Confirmed	07/07/2011 17:01:21...	1.43185	None	1.43182	0.139	Market...	Manual	0.0000
75500664	EURUSD	Sell	1,000,000.00	Confirmed	07/07/2011 17:01:08...	1.43181	None	1.43166	0.227	Market...	Manual	0.0002
833206	EURUSD	Sell	4,000.00	Confirmed	07/07/2011 17:00:52...	1.43161	None	1.43142	0.220	FXOnB	Manual	0.0002
7020	GBPUSD	Sell	13,000.00	Confirmed	07/07/2011 17:00:32.89	1.59754	None	1.5974	0.230	Market	StopLoss	0.0001
833241	EURJPY	Sell	2,000.00	Confirmed	07/07/2011 17:00:09.61	116.341	None	116.338	0.345	FXOnB	TakeProfit	0.00
833241	EURJPY	Sell	1,000.00	Confirmed	07/07/2011 17:00:09...	116.341	None	116.338	0.321	FXOnB	TakeProfit	0.00

300

Tab View

Broker Open Positions Liquidity Provider Open Positions Liquidity Provider Transactions

Balance	Equity	Margin	Free Margin	Margin Level	Profit	Broker Commission	Rollover diff	Rollover	Total
\$579,666.28	\$462,821.77	\$880,655.34	\$-287,723.57	54 %	\$-289,614.75	\$748.23	\$1,258.47	\$-5,982.11	
\$190,184.13	\$192,726.26	\$123,246.61	\$69,479.66	156 %	\$3,288.42	\$197.17	\$212.02	\$-316.92	
\$46,320.12	\$41,578.66	\$12,324.06	\$29,054.92	332 %	\$-9,844.15	\$18.79	\$22.25	\$1,950.31	
\$38,234.88	\$40,633.83	\$8,968.22	\$31,665.61	453 %	\$2,359.29	\$15.45	\$19.42	\$94.96	
\$44,234.73	\$46,268.90	\$4,341.87	\$41,927.03	1,066 %	\$2,065.88	\$6.51	\$6.63	\$-14.88	
\$371,612.57	\$376,035.10	\$31,107.17	\$346,927.93	1,715 %	\$6,891.06	\$46.87	\$5.00	\$-7.04	
						\$1,083.32	\$1,534.62	\$-4,442.09	

Log

functions are available, such as Trades Log, Monthly Summary, Group Daily Summary and Instrument Summary, and customized reports are also available per each client's requirements. The Reporting Interface is entirely web-based, permitting the access of reports 24 hours per day, 7 days a week.

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automated messaging functionality, facilitating the increase of conversions and trading volume.

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For more information regarding Leverage's Institutional Offering, please contact sales@leverage.com or visit www.leverage.com.

Addressing risk, connectivity and regulatory complexity in Post Trade FX



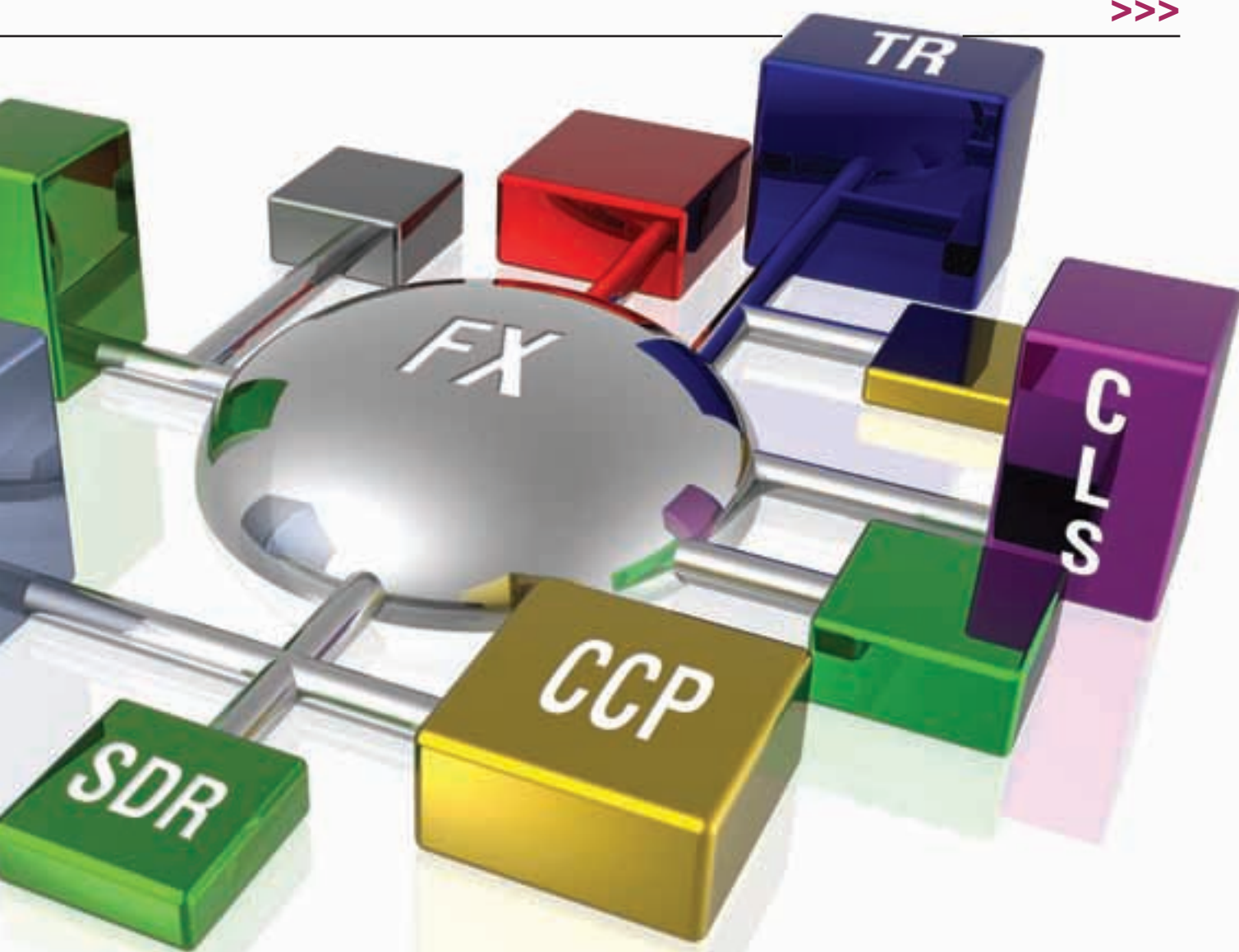
By Frances Maguire

While the FX industry is well versed in addressing the challenges of connectivity and the operational and credit risk in the back office arising from spiralling volumes, Frances Maguire asks how it will deal with more complex regulatory demands in the post-trade arena.

In one sense the new regulatory requirements being drafted could actually do the FX back office a favour. Banks are already grappling with the fact that the need to process and risk manage spiralling volumes and smaller ticket sizes means that, in many cases, the back office is holding the front office back from going after new business. As banks need to bring the back office up to speed anyway, now having to respond to more onerous and complex regulatory requirements will mean that bigger budgets will have to be allocated to the back office. The back office has been playing catch-up for a few years now in a bid to fully automate the trade lifecycle across different systems and fully utilise netting to be able to process more tickets, faster.

Volumes

Sang Lee, co-founder and managing partner of Aite Group, believes the biggest issue driving change in the FX back office is the need to process greater volumes. He says: "The assumption is that trading volumes in the bilaterally over the counter market should not be as high as the exchange traded market but the FX market is more like an exchange-traded market and volumes have been soaring over the past few years. It trades more than \$4 trillion daily and processing with the spiralling number of tickets is a huge challenge for the back office." Furthermore the advance of automated trading and the declining average trade



size, due to decimalisation, has simply exacerbated the problem, he says.

To date, most of the regulatory focus following the credit crisis has been on the credit products, and FX has avoided some of the spotlight, but Lee says this could change as it is a very important marketplace and because it is an OTC market. However, he adds, the FX is different from other asset classes and he believes the huge take-up of FX prime brokerage has helped it to function more like an exchange-traded market.

He says: “Through FX prime brokers, non-banks can participate in the market in a somewhat safer manner because they are being given a credit line by the large banks. Similar to an exchange, the prime broker acts like a central counterparty by vouching for the players in the marketplace and help lower risk surrounding counterparties.

Additionally, the formation of CLS makes the FX market unique, and helps negate settlement risk in the FX market, by far the biggest risk concern.

Combining FX prime brokerage and CLS gives the FX the appearance of a CCP, and having these infrastructures may explain why the FX market has escaped from some of the regulatory concerns up until now.”

While the large FX banks have been ramping up their post-trade infrastructures, Lee says the client-to-dealer market has lagged behind over the years and the buy-side firms are now becoming the weak link in the process, still dealing with market fragmentation, and automating and processing growing ticket volumes. As these firms become more active, they need to automate more, and according to Lee client-side firms are struggling to bring the middle office – risk, position management, processing and netting of tickets – up to speed and this is going to become more evident as their participation in the market increases.

Improving lifecycle operational efficiency

Jim Dennelly, senior vice president of SunGard’s Sierra business unit, says although the final outcome of regulatory changes is still uncertain, what is very clear



Sang Lee

"The assumption is that trading volumes in the bilaterally over the counter market should not be as high as the exchange traded market but the FX market is more like an exchange-traded market and volumes have been soaring over the past few years."

is that the operational efficiency in the lifecycle of an FX trade had got to be improved. The investment over the past 10 years has focused on the front office, on trade execution, connecting to multiple platforms and increasing market share of trades. The back office, which is typically more complex because it involves clearing and settlement, has lagged in terms of investment, he says. "No matter what happens in the regulatory framework we know that most likely reporting will be required, which means there needs to be better access to data, and there will be challenges ahead with regard to central clearing. This is going to be a challenge for big and small banks, in terms of volume, and getting trades to CCPs in the time cycle, efficiently."


According to Dennelly, most of the high volume traders of FX are outlook traders that shop their prices very accurately to get the best execution. "If you want to compete in this space you have to be very operationally efficient in the back office and in reporting. A high level of automated is needed to lower the cost per transaction," he adds.

Says Dennelly: "Where we have made our biggest investment in the past year has been in automating and building exception processing capabilities in the back office workflow to provide a real-time dashboard that will interact with these different connection points, in real-time, and allow users to be able to put through tremendous amounts of volume. Some of the bigger clients we are talking to want to process more than a million transactions per day. One of the benefits of SierraLink is the consolidation into a single framework because this makes reporting much easier. Some users are consolidating between 5-15 execution engines and the quicker these can be brought together into a central repository; the easier reporting will be, no matter what the regulatory requirements are. A large focus of the redesign that will include the new dashboard will be the back office, and this is currently in test for release in the first quarter of 2012."

He adds: "Netting, too, is going to become very important. Once you bring in central clearing agents, or even aggregation tools, charges are based on per transaction and the more that can be netted, the lower the fees, thus reducing the average cost per transaction. This is where a centralised back office, with real time capabilities to net, is going to lower cost. This will translate into the front office in helping to increase market share because margins are so thin."

With the spiralling volumes in algorithmic trading and greater volatility in the market, Dennelly says that the back office was becoming a hindrance to the front office, even before the new regulatory requirements. "The size and scale of trading volumes has made the FX back office a very serious challenge and firms are looking at how to make it more efficient as it is holding the front office back from chasing new business, because it is too expensive and the front office is actually being told the back office cannot cope with higher volume," he says.

Today, the back office is, in some cases, exceeding some front office capabilities and Dennelly believes the need to process FX in real-time is going to drive the future evolution of the back office, along with regulatory changes. "If you can solve the first problem, and have the data available in a normalised fashion, dealing with the regulatory requirements is achievable. It is all about how quickly FX transactions can be processed, without limiting the front office. Rules-based processing to reduce the number of exceptions will not only drive the back office but the next round of growth in the FX industry."



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Whereas before increased volume increased the operational risk and cost in the back office, now the front office and the regulatory requirements will drive the back office workflow automation.”

Regulatory challenges

For Steven Zieselman, head of trade workflow solutions at FXall, a core issue has always been risk reduction in handling transactions and the need for clients to get trades confirmed bilaterally with counterparties and delivered to downstream systems, in a timely and efficient manner. However, the introduction of mandatory clearing and trade reporting has the potential to add a significant number of end points and processes to this flow, regardless of what products will be cleared. This is an extra layer that has to be integrated, even for those firms that already have a fairly high level of STP. He says: “We are analyzing the regulatory changes to understand how our clients could continue to use their preferred methods of execution, whether or not the trades are done through a Swap Execution Facility, reported to a trade repository or cleared.”



Jim Denny

“The size and scale of trading volumes has made the FX back office a very serious challenge and firms are looking at how to make it more efficient as it is holding the front office back from chasing new business, ..”

Zieselman says: “SEF” may have additional reporting responsibilities and connectivity to different endpoints, we expect these to be leveraged by end users and major swap participants.”

Proposals for the new regulations have indicated that SEFs will be required to have RFQs sent to at least five market participants “If this is the case, we would need to add capacity and business logic to define the conditions and terms of the trade so that we can make it part of client processes.” he adds.

But Zieselman says moves to manage risk more efficiently in the back office began some time ago. He says: “Even before 2008, smaller ticket sizes and higher volumes have prompted market participants to scale up their back office processes. The changes needed to accommodate new regulatory requirements are likely to make it necessary to increase capacity and scale even further.”

For Zieselman, trends towards smaller ticket sizes and the trading of smaller lots to manage risk are here to stay. The profile of those trading larger and smaller ticket sizes is different with more opportunity for market exposure with smaller tickets and higher volumes. He says: “We have a lot of clients with exposure on much larger ticket sizes trading on our relationship based platform. Their risk profile is less about handling large numbers of tickets in a repetitive way, and more about having options available to them for how and when trades are routed downstream. The goals are the same but their methodology and the way we support them can vary widely.”

Netting is often cited as an important tool in increasing post-trade efficiency and FXall offers customers the ability to average-price and net down transactions as part of its active trading segment. Zieselman says: “When clients accumulate or clear out a position with smaller trades, we have a tool in the application that allows them to see their positions and credit utilisation. They can see where they are during the day and what their consumption pattern looks like, and we give them opportunity to reduce the number of trades that have to get processed.”

In some cases, this means that FXall’s customers, depending on their prime broker relationships, can actually net before their trades even hit their back office, as they have full visibility and can choose the frequency of what they want to send downstream. He adds: “The post trade process is focused on security



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Running of the Bulls, Pamplona, Spain



Steven Zieselmann

“Even before 2008, smaller ticket sizes and higher volumes have prompted market participants to scale up their back office processes. The changes needed to accommodate new regulatory requirements are likely to make it necessary to increase capacity and scale even further.”

and certainty of delivery. There is a lot more ground to cover in terms of the number of participants who use post-trade, real-time services.”

Addressing risk

Gil Mandelzis, co-founder and chief executive officer of Traiana, believes the FX industry has been very proactive in terms of looking at the risks in the industry and addressing them. The establishment of CLS is a great example of many of the initiatives as well as the work Traiana has been doing with the FX prime brokers for some years to develop the next generation back office tools. “Other asset classes do not have an infrastructure like CLS, and the FX industry has certainly fared the recent financial crisis exceptionally well both objectively and relatively speaking”.

“We and our customers continuously work to identify risks in the FX market and proactively address them as opposed to waiting for someone else to intervene,” he says.

To this end Traiana has recently partnered with leading FX prime brokers, Citi, Deutsche Bank, JP Morgan

and Morgan Stanley, together with the six biggest FX platforms, Bloomberg Tradebook, Currenex, EBS, FXCM, Hotspot FX and Thomson Reuters, to launch an industry-wide initiative to centrally monitor and manage FX ECN trading activity and trading limits globally.

Mandelzis says that the FX industry now has a consolidated, real-time, limit monitor dashboard solution for high-frequency trading that can show prime brokers their client activity across electronic. The monitoring solution looks for counterparty risk, either from approaching or breaching limits, as well as any technology problems that need to be addressed in real-time, and give brokers the ability to kill client activity, across all their platforms, instantly if there is any indication of significant risk.

He says: “This is a very big industry initiative, that is generating a lot of excitement, and we believe is very necessary and will change the landscape. It is another example of the FX industry being very proactive, rather than reactive, in addressing risk. We believe the FX market is already way ahead of the rest of the asset classes and here it has taken a significant leap further.

“This comes on the back of these banks already using our real-time risk monitoring solutions for prime brokerage trades. Managing real-time risks that are associated with prime brokerage and high frequency trading is very high on our agenda.”

By connecting prime brokers and ECNs in real-time, the service will provide the FX industry with the control and real-time risk management capabilities to manage risks from algorithmic and high frequency trading. The launch of the new version of Harmony CreditLink culminates a comprehensive effort by all partners over many months, and is now live and available to all Harmony members.

High frequency and algorithmic FX trading

The increase in high frequency and algorithmic FX trading has made the provision of adequate controls and real-time risk capability critically important to prime brokers managing risk across clients trading on ECNs. Using Harmony CreditLink, prime brokers now have the ability to monitor their clients’ credit risk across multiple ECNs on a real-time basis, act on exceptions in a single integrated dashboard, and open, change, or close credit lines to manage risk while maximising clients’ trading ability.

With real-time integration to ECN credit and post-trade APIs, Harmony will proactively notify the prime broker of limit breaches and allow the prime broker to modify credit lines or terminate trading activity with an integrated Kill-Switch capability. By providing centralised, automated and secure ECN limit management, credit risk for all counterparties will be significantly reduced.

Mandelzis says: “The ability to monitor trading in real-time is absolutely essential for this segment of the market. This is not something that the regulators have asked for, or mandated, but the banks and ECNs, and we believe this solution is very important for the market to exist as it adds another layer of protection to risk management and real-time monitoring in the market.”

Many decisions have yet to be made, and the regulatory picture is not yet final. There is a call for a global trade repository, something the FX market does not have today and an infrastructure that Mandelzis believes will add to the market. Further clarity on the implementation of clearing for OTC instruments



Gil Mandelzis

“Banks need to be ready to connect to more counterparties, venues and services, be it CCPs, SEFs or Trade Repositories. This adds significant complexity and challenges in the terms of the variety of protocols and workflows that exist and that are going to continue to change, ...”



and the operation of Swap Execution Facilities is still needed and Traiana is providing the option to automate these flows if and when it is needed.

Mandelzis says: “Banks need to be ready to connect to more counterparties, venues and services, be it CCPs, SEFs or Trade Repositories. This adds significant complexity and challenges in the terms of the variety of protocols and workflows that exist and that are going to continue to change, because we know that whatever exists today, the next few years will be characterised by a realisation of what does and does not work. Not only do banks need to accommodate this significant complexity and lack of standardisation, it is clear the need to change and re-engineer processes is going to be the state of affairs in the years to come. This makes a good case for using a specialised vendor and this is our value proposition.”

Compliance issues

Peter Kriskinans, Managing Director of DealHub, believes that compliance with the regulations presents a number of urgent critical issues and decisions that need to be tackled, which include the implementation of smart routing for FX options and NDFs to Swap Execution Facilities, whilst continuing to execute exempt products through existing venues and trading models; putting in place both the business model, connectivity and workflow changes required to support the clearing of regulated instruments with Central Counterparties (CCPs); and establishing connectivity to the new Swap Data Repositories (SDRs).

“Each of these challenges fundamentally requires changes to a firm’s workflow, technology and connectivity, the services a firm delivers to its clients and potentially its client real estate,” he says.

While firms will seek to manage these changes quickly and in a cost effective way, it is also essential that they future-proof their infrastructures by implementing



Peter Kriskinans

“Those forward-thinking firms that build flexibility and extensibility into the core of their infrastructures will be best placed to address the evolving regulatory and client requirements, as well as the additional stresses of increasing volumes and the accelerating pace of high frequency trading.”

an extensible framework that will enable the bank to rapidly customise the workflow. Kriskinans says that whichever models emerge from this uncertain period of regulatory, economic and technology change, it is unlikely they will be the last word; hence the need for flexibility is critical.

Frameworks such as DealHub offers the extensibility and flexibility required, by combining powerful event processing and routing capabilities with an ultra low latency connectivity layer, to manage the workflow and routing of all FX instruments to both banks internal systems and external venues, SEFs, CCPs and SDRs. Kriskinans says: “Those forward-thinking firms that build flexibility and extensibility into the core of their infrastructures will be best placed to address the evolving regulatory and client requirements, as well as the additional stresses of increasing volumes and the accelerating pace of high frequency trading.”

DealHub invests heavily in research and development each year to innovate across pre and post trade workflow, both extending the breadth and depth

of functionality provided and engineering higher performance across the entire DealHub framework. Innovation to date, such as latency optimisation, limit management, margining and collateral management solutions, has resulted both from projects sponsored by clients that address immediate challenges they have as well as more strategic research, originated by the company itself.

Real-time solutions

Despite continuous innovation and improvement in post trade processes across the industry there is still significant residual cost and risk associated with FX post trade processes, and DealHub is currently developing a number of new services and business models, in response to customer demands, aimed directly at addressing these residual risks and costs, to be announced later this year.

According to Kriskinans, the growth of high frequency ECN-based trading (HFT) is one of the key factors driving the need for real-time post-trade processes, but equally relevant are the continued expansion of prime brokerage models and the ever increasing sophistication of trading models and technology, on both the buy- and sell-side. “All of these are driving the need and emphasis on real-time risk management solutions through the pre- and post-trade process,” he adds.

The requirement to manage collateral for cleared products also presents some new challenges for firms. While, collateral requirements can be changed on a daily or even intra-day basis, Kriskinans says that existing PB workflows and agreements will need to evolve. He says: “While firms can leverage the clearing infrastructure they have in place for other cleared asset classes, many firms are considering FX specific solutions that integrate more deeply with their existing FX technology architectures and meet the specific needs of the FX workflows. There is always a trade-off to be managed between the benefits of a unified, standardised post trade landscape and the risk that introduces - the reduction of cost competition, the concentration of risk and potentially a slowing in the overall rate of innovation.”

Clearly therefore, while regulatory compliance is one of the key drivers for investment in post-trade infrastructures, the most forward thinking firms will also focus on how they can leverage their investment to further differentiate what they provide to their clients and find ways to increase revenue growth and profitability.

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Is Your FX Brokerage Functioning Optimally?

5 Tips on How Existing Brokers Can Easily Boost Their Performance

Panda Trading Systems is a leading FX trading technology provider specializing in system integration, MetaTrader server-side technology and fully customizable developments, available on-demand. New and veteran brokers turn to the Panda TS' advisory services to learn how to best accelerate reaction to market trends and adopt new technologies while minimizing operational risks and costs.

As a premium technology provider, our goal at Panda TS is to stay ahead of the game and solve problems before they crop up. Top brokers consult with our advisory team to learn how to best streamline new technologies into their existing architecture.

We see time and time again how even small changes can help significantly boost performance. This step-by-step guide just touches upon the tip of the iceberg, but these tips will help new and existing brokers examine certain key elements of their business performance.

1 Perform Routine System Checks

The first thing to examine when looking to enhance an existing brokerage is whether or not the current infrastructure is functioning properly. Before looking to expand, it's imperative to run a complete system check and make sure that all existing frameworks are stable and able to support the necessary upgrades and add-ons. A "clean engine" will ensure the success of any new technology implementation and will set the stage for a fast and seamless integration period.

How To Do It:

All systems within the broker's organization should be monitored regularly. Proper server monitoring, networking monitoring and ensuring proper system functionality is part of the regular upkeep that is necessary for an optimally functioning brokerage and allows the broker to prevent potential system failures.

2 Build for Scale

A FX brokerage is a fast-growing business and successful brokers have thousands upon thousands of live clients (and exponentially more active demo accounts). Process automation is a key factor to the success of any FX brokerage. During the entire sales process, implementation of proper technology that allows for easy automation and tracking saves on manpower and allows for fast response time. Different technology solutions synchronizes activities between the various platforms within an organization, contributing to a more consistent

How To Do It:

Brokers should consider investing in technology that allows for implementing easy automation, facilitating any existing sales process. It's important to consult with industry professionals as no single solution is the right fit for all.

experience for the trader. This technological infrastructure also provides the "hub" from which crucial BI analyses reports can be extracted.

3 Always Optimize

The FX online trading market is demanding and ever-evolving. To stay ahead, broker should instills dynamic business processes that allow for fast and ongoing optimizations. Small changes to any current infrastructure can make a world of difference when it comes to faster and smoother implementation of new technologies; minimizing operational risks and costs.

How To Do It:

There are multiple ways in which brokers can use new technologies to enhance business processes. It's important to consult with a technology specialist who can help explain the different ways to achieve specific goals. Even the most inflexible WL platform can be enhanced!

4 Build and Maintain A Client Base

Increasing brand awareness is a critical process that requires a substantial investment. Many brokers make the mistake of sending a lot of traffic to a system that isn't optimally built to properly handle such an influx. Various technology solutions can help convert new clients, convert demo account users to real account users and to automate engagement procedures for smart retention practices.

How To Do It:

Increase the productivity of any engagement processes through automatic segmentation. Implement technologies that allow for the most control over the data stored on the MT4 servers. Automation significantly increases trading volume and lifetime customer value. Today, there are powerful tools that allow for easy integration between existing CRM systems and back offices and the MT4.

5 Seek Out White Labels and IBs

In order to scale an FX business, focus on attracting white labels and IBs. Top brokers generate a substantial amount of their trading volume from partners. Fearing that the market is already too saturated, many brokers give up on finding good partners before they even get started.

How To Do It:

There is a lot of potential to develop good partnerships. It is worth investing in white labels and IBs by offering them valuable tools and advisory services. Today, we see a lot of brokers who are losing potential white label business to their technology providers. Brokers should choose only objective technology providers that empower them to offer unique solutions to their white labels and IBs.

Interested in learning more? Contact us today to speak to one of our expert technology consultants or to request more information via email.

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Regional e-FX perspective on Canada



Heather McLean

Canada consists of ten provinces and three territories and is one of the world's wealthiest nations. It has a very diversified economy much reliant on natural resources and trading relationships with overseas countries, particularly the United States. Heather McLean explores the current FX trading environment within this huge country and how leading Institutional and Retail FX providers are meeting increasing demand for electronic FX execution solutions amongst their clients.

Canada earned high regard for the strength and stability of its financial system throughout the recent financial crisis. As a result, more foreign financial service firms have begun to see the need for establishing a strategic foothold in the region and investor interest in the country has never been higher. The inflow of such foreign interest could not have stepped on more fertile grounds. The capital market landscape in Canada has recently been marked by the development of multiple Alternative Trading Systems (ATS) such as Alpha, Chi-X, Pure and Omega, to name a few. Although these marketplaces have experienced difficulties in attracting significant trading volumes, the growing reputation of Canada as a provider of some of the safest, reliable and potentially lucrative financial marketplaces in the world is bound to improve the situation.

Dmitry Evseev, senior foreign exchange trader at Penson Financial Services Canada, a provider of securities clearing and related services, says the country has been at the epicentre of investor and

market interest from abroad. “Penson is experiencing larger than normal demand from foreign prospects for a variety of products, including those related to hedging client currency exposures from trading equities on the Canadian exchanges, FX margin trading and over the counter currency options,” he notes.

Increasing e-trading volumes

For well over five years official statistics have shown a material growth rate in global electronic FX volumes. Canada is no exception, notes Lorne Gavsie, Managing Director of electronic FX at BMO Capital Markets, based in Toronto, though he says the trajectory has been slower than has been seen in some other countries. “However, the transition to e-FX is now in full swing in Canada, and banks are busy upgrading their technology to ensure domestic clients are not leaving for foreign liquidity providers,” Gavsie remarks.

“To that extent, BMO has been actively expanding its e-FX capabilities. We have increased the number of e-FX access points with our clients over the past several years, both through commonly used electronic communications networks (ECNs) and single-point access. BMO’s FX core strategy is to meet, and serve our clients in the venue of their choice, and to this end our e-FX expansion is a key priority for the firm. Additionally, as a result of our strong position in the Canadian dollar, and as a stable, highly rated counterparty, we have been rewarded with exponential growth outside of our traditional footprint over the past several years,” continues Gavsie. “While many large scale institutional clients continue to execute through

more traditional methods, their focus on post-trade automation often takes precedence over price. To this effect we are investing heavily in our middle and back office technology to provide our customers with all available tools deemed necessary to satisfy their business needs.”

Use of electronic channels

Philippe Savoy, Managing Director and Global Head of FX Electronic Distribution at RBC Capital Markets, says that looking at the market as a whole, Canada will see continued high growth percentage increases, across all electronic channels, be it proprietary or multi-bank. He adds: “More specifically, if we look at individual segments, RBC Capital Markets believe the Canadian corporate sector is likely to show the greatest increase in demand for electronic services. This is because compared to institutional and middle market clients, corporate clients have traditionally been less exposed to electronic trading.

However, the current competitiveness and the changing landscape across best execution is driving a definite shift in the corporate space, which will ultimately increase corporate clients’ appetite for electronic services,” he notes.

Continuing, Savoy says: “One of the key drivers for this increase has been the sell-side making necessary improvements in order to ensure the client is able to obtain consistent and competitive



Source: The Canadian FX Committee

Classification	Execution Methods Primarily for Dealers			Execution Methods Primarily for Customers			TOTAL
	Dealer Direct	Electronic Booking	Voice Booking	Customer Direct	Single-bank Proprietary Platforms	Multi-bank Dealing Systems	
By Currency Pair:							
Canadian Dollar against							
USD	38	25	15	11	1	8	100
Other	27	10	1	48	2	12	100
U.S. Dollar against							
EUR	28	34	18	11	2	11	100
JPY	32	38	9	12	1	8	100
GBP	40	31	12	10	1	8	100
Total Currency Pairs	34	28	18	18	1	9	100
By Instrument:							
Spot	48	27	8	14	2	3	100
Outright forwards	24	8	8	37	2	22	100
Foreign exchange swaps	30	28	23	13	1	6	100
Cross currency swaps	81	7	18	11	1	2	100
Options	24	42	2	25	1	4	100
Total Instruments	34	28	18	18	1	9	100
By Counterparty:							
With reporting dealers	60	28	18	8	3	3	100
With other dealers	38	38	22	8	1	3	100
With other financial institutions	0	0	1	62	4	33	100
With non-financial customers	0	2	1	88	5	8	100
Total Counterparties	34	28	18	18	1	9	100

Execution methods. Percent shares - April 2011

pricing from their chosen providers' electronic service. For instance, at RBC we have re-engineered our pricing engines, our fast pricing deal capture systems and our auto-pricing to multi-bank channels. We have also selected several multi-bank channels to service the different client segments in Canada. The redevelopment of our services will also include the launch of our new proprietary platform called RBC DX."

"Through our existing proprietary platform, FX Direct, as well as strategic partnerships with several multibank channels, RBC has developed a sophisticated e-commerce offering to satisfy all client segments in Canada and abroad," he states.

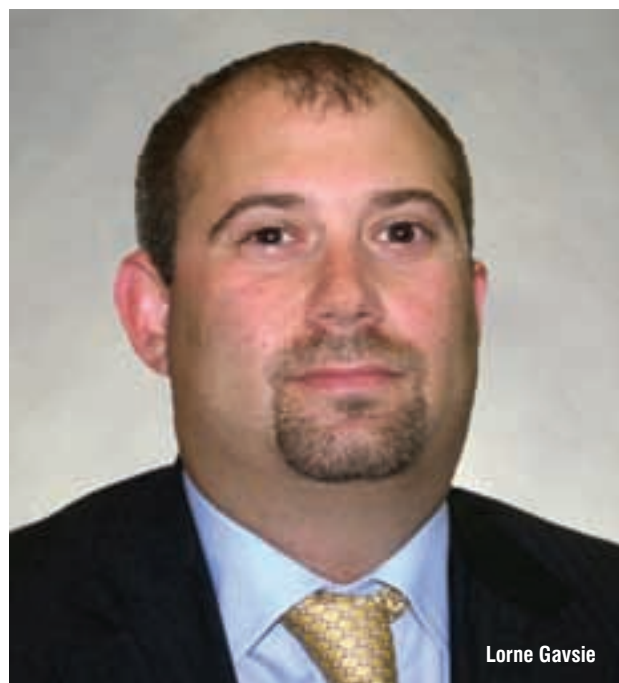
Canadian FX buy side demands

From an institutional stand point, the traditional methods of FX delivery in Canada have been voice-based, with some adoption of electronic channels. Savoy remarks that over the last five or six years, many commercial FX requirements have been catered for by the use of single dealer platforms and e-channel solutions. "As corporate clients have started changing their methods of execution, often asking for multiple banks over the phone, e-commerce can only facilitate that trade execution process," Savoy comments. "In addition, internal regulation and controls within companies are increasingly requiring an audit trail with trade execution as proof that the buy side clients are receiving fair and accurate pricing. As a result, the way that corporate clients request execution from their providers has to change and 'electronic means' are the logical way to fulfil those requirements. Electronic solutions are evolving as customers are requesting straight through processing into their down stream

accounting and payment systems. This is how the sell side is meeting that challenge. From RBC's perspective, our use of multi-bank portals guarantees best execution in a competitive environment. This, coupled with RBC DX, our soon to be launched proprietary online trading platform, will allow clients to work market orders to meet best execution requirements 24/7," states Savoy.

The personal touch

Takis Spiropoulos, Managing Director, head of e-solutions group, Capital Markets Trading at CIBC World Markets, remarks: "Traditionally large corporate clients have had dedicated FX sales coverage. Usually one relationship coverage person (with a backup) would call, depending on the client and their needs, at various frequencies throughout the day. They would be provided with breaking news, technical and general market colour via the phone. Orders would be solicited and clients might also call the sales person directly."



Lorne Gavsie

"...the transition to e-FX is now in full swing in Canada, and banks are busy upgrading their technology to ensure domestic clients are not leaving for foreign liquidity providers..."



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ASIA

David Wilkins
+852.2.842.5303
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Spiropoulos says: “As the penetration of e-commerce systems is increasing in Canada, many users that first tended toward simpler RFQ-based technology solutions have started looking for systems with streaming prices and straight through processing capabilities. A small number of companies are using multi-dealer platforms, but most use a single-dealer platform for smaller transactions.”

“Large real money managers are ahead of the curve and large corporates are also jumping on the bandwagon. However, with the exception of these large clients, Canadian buy side clients are fairly traditional in the way they transact FX and still like to have a live contact,” continues Spiropoulos. “This started changing a few years ago and client demands for electronic trading are now rapidly evolving, mostly along the execution lines. Requests for e-commerce solutions are being received from top and mid market clients for smaller orders as well as crosses.”

Spiropoulos adds: “Clients are also requiring faster quote times which can only be delivered via electronic routing. Not only has price discovery become more important, but in fact many clients are now mandated to receive multiple quotes (at least two) on trades. Because of this dynamic alone, business transacted via electronic systems will continue to grow.”

Brokerage landscape

On how some Canadian brokerage clients have traditionally had their FX requirements catered for, and in what ways their demands for electronic execution solutions are evolving and are now being met, Evseev says that, “with new types of customers come new ways of doing business. In the past, the need for real time hedging of currency exposures related to stock trading was the domain of high frequency arbitrage firms. They possessed sufficient programming experience to connect executing algorithms to separate FX and equities electronic venues. Today, all these capabilities are now features sought by cutting edge retail brokers. Raising the customer service bar to provide seamless execution of equities trades on Canadian marketplaces is now the norm. Needless to say, this type of sell side service requires deep integration between FX and equities execution channels which must be supplied from a single location.”

Regulatory reform

As a G20 country, Canada is participating in the international initiative to improve market infrastructure and stability. Within the context of



“Retail forex has been noticeably absent from the Canadian broker dealer landscape over the past several years, even though it has been increasing in other comparable jurisdictions across the globe.”

OTC derivatives, proposals are under consideration in both Canada and in other jurisdictions to improve standardisation and transparency and to encourage the use of central counter party clearing and electronic trading venues by the end of 2012.

The expectation is that these reforms will ultimately lead to a significant transformation of these markets, as clearing and trading transitions from largely bilateral relationships to more centralised models.

Savoy comments: “The foreign exchange market is already mature, efficient and transparent, and has been proven to function well, even in times of significant stress across the wider financial system. Frameworks have long been in place for centralised settlement, extensive electronic trading already occurs, and foreign exchange is, by its very nature, a global market. Having said that, Canadian public authorities have not released detailed proposals on proposed reforms to OTC derivatives, including the extent to which these proposals could have implications for foreign exchange markets.”

“The Canadian Market Infrastructure Committee (comprised of RBC and other major Canadian banks and buy-side firms) is working closely with public authorities on these regulatory reforms. Consultations

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regarding the scope of the possible changes, including exemptions, are ongoing and are expected to be completed later this fall,” Savoy continues.

Impact on Retail FX

The Canadian regulatory environment has been a catalyst for the conservative approach of many Canadian institutions, and the underlying reason for Canadian banks and non-financial institutions being in such strong standing globally today, claims Gavsie. However, he adds: “As a result of the conservative regulatory environment, retail electronic FX is not widely available in Canada. The perception of foreign exchange trading being of high risk has limited the take up of FX as an asset class domestically, and it seems Canadian regulators do not have appetite to make this product available on a broader scale for retail investors at this time.”

“Over the coming years, as regulatory constraints in other jurisdictions force a reduction in available leverage to retail FX investors, and lead to stricter rules for platform operators, we will likely see increased competition in this space within Canada,” states Gavsie. Canada’s FX regulatory framework is becoming clearer and more consistent across all provinces, states Evseev. He says this will provide the landscape for growth opportunities in the area of retail forex, a product that has been noticeably absent from the Canadian broker dealer landscape over the past several years, even though it has been increasing in other comparable jurisdictions across the globe.

“Growth potential stems from regulated broker dealers eager to offer end users products that are second to none when it comes to the quality of executions and

liquidity,” he states. “Furthermore, with standardised rules in place, the industry will not only have a level playing field to mount offerings, but it will also help improve the reputation of the retail forex business, which suffered from the activities of a few unscrupulous players.”

Commodities

On the role that commodities play in creating specific demand for niche online dealing and cross asset class solutions amongst Canadian institutions, Savoy states: “Commodities are not necessarily the driver per se. Banks are focusing more on cross asset class solutions. We will soon be releasing our new multi-asset proprietary application RBC DX which will enable customers to transact foreign exchange, fixed income, money market and deposits. From our stand point, combining these asset classes onto one user interface will help customers streamline the execution of their fixed income and FX exposures.”

While Spiropoulos comments: “Currently a large percentage of commodities are traded through the exchanges and given the liquidity and transparency plus the ease of doing business this trend should continue. Only very large sophisticated investors look for ‘over the counter’ type pricing on commodities, but this is a mere fraction of the overall volumes.”

“Corporate demand for online trading of commodities is at an early stage, and growth in this space will probably come from the retail sector,” continues Spiropoulos. “Cross asset solutions have room to grow, but at a slower pace, as many corporate commodity players are focused on more vanilla offerings, and will embrace new products when these become more widely accepted.”

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666 Burrard Street
Suite 500
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Source: The Canadian FX Committee

	Foreign exchange derivatives			Number of business days	Average total daily turnover	Per cent change
	Currency swaps	Options	Total			
Oct. 2005	34.8	55.2	79.8	20	4.0	
Apr. 2006	27.8	28.8	55.8	19	2.9	-27.5
Oct. 2006	18.5	25.5	44.0	21	2.1	-27.6
Apr. 2007	22.8	36.4	58.1	20	3.0	42.9
Oct. 2007	34.0	44.2	86.1	22	3.1	3.3
Apr. 2008	23.3	35.8	58.9	22	2.7	-12.9
Oct. 2008	21.1	39.9	60.1	22	2.7	0.0
Apr. 2009	21.8	26.3	47.1	21	2.2	-18.6
Oct. 2009	17.8	28.0	45.8	21	2.2	0.0
Apr. 2010	24.3	41.7	66.0	21	3.1	40.9
Oct. 2010	23.8	43.2	67.1	20	3.4	9.7
Apr. 2011	33.0	44.1	77.1	20	3.6	14.7

Over-the-counter (OTC) derivatives market turnover in Canada.
Summary of surveys - Billions of U.S. dollars

Fund and investor perspectives

In comparison with Europe and the US, the domestic hedge fund industry in Canada remains quite small. However institutional fund managers in Canada have been quick to adopt e-FX and as in other countries, a major driver for this has been the need to make splits and allocations across multiple investment accounts when making a bulk FX trade. The costs and risks involved in doing this manually are unacceptable. As elsewhere, an important factor behind the increasing volume of e-FX activity among Canadian investment managers and investors has been continued interest in foreign exchange as a tradable in its own right. Broadly speaking, as traditional asset classes become more and more challenged from a 'rate of return' perspective, FX is looking increasingly attractive as a separate, tradable asset class in Canada, notes Savoy. "Retail FX is growing and will continue to grow," he continues. "Just in the same way that people buy stocks for a return, more and more individuals are buying currencies as a way of augmenting and creating alpha within a portfolio."

"With the recent strength of the Canadian dollar, investors are looking for different asset classes to transact unrelated to their core positions and are treating FX as a separate asset class. In doing so, they are taking a more proactive approach in augmenting returns on their portfolios and generating alpha from currency trading," says Savoy.

The Canadian market is currently focused on the leveraged community, which has a high level of sophisticated leveraged funds, says Savoy. "As the client base becomes more sophisticated in Canada, there will be a stronger demand for greater price transparency, more creative solutions, and I would also expect to see an increase in algorithmic and advanced trading execution."

"Proximity to primary markets has traditionally kept high frequency trading firms out of Canada, but with collocated facilities now available in all of the major ECNs and low corporate taxes in Canada, there are fewer barriers to entry," remarks Savoy. "Algorithmic trading means more than just black boxes and fast order entry. Scheduling plays an important part and RBC continues to find new ways to access liquidity and provide best execution for clients, either directly or as an agency service."

Specialised products and services

Evseev comments: "Expanding interest from hedge funds and other professional traders for the one stop shop trading experience is a future prospect for specialised services in this region. This includes a suite of custody, cross margining, financing, securities lending, repo and other services which can be collectively thought of as Prime Brokerage. Penson sees large growth potential in this area and is taking active steps towards meeting client needs."

Savoy adds: "The FX market is saturated with product offerings outside of research and execution, but ultimately clients are likely to remain faithful to those liquidity providers that remain consistent and reliable in fragmented markets. We have RBC DX which



Philippe Savoy

"Electronic solutions are evolving as customers are requesting straight through processing into their downstream accounting and payment systems."

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will offer multi-asset execution; however, our focus remains on producing quality research to assist clients in determining timing for best execution.”

While Spiropoulos notes that bank lending syndicates have been ‘re-priced’ and in many cases expanded since 2008, He comments: “This has led to increased competition for ancillary business, especially FX, which typically all banks offer. Changes in accounting rules have made it cumbersome to get hedge accounting treatment for derivatives. Companies in the energy industry are primarily using mark-to-market accounting due to the volume and types of hedging instruments. We see increased interest in structured products as companies want more flexibility and tailored solutions.”

“The traditional role of information provider by the sales desk will still be utilised in the future, and it is becoming even more important to deploy tools that free up their time to concentrate on servicing the client needs. At CIBC, internal deployment of e-commerce systems provide sales desks in various geographical locations with access to streaming executable prices for spot, forwards and swaps. These systems enable marketers to respond quickly to client price requests, trade and book deals electronically and route the risk to the appropriate trading book for risk management. Straight through processing and further automation of post-trade services, such as give-ups, result in increased efficiency and capacity to deal with large volumes,” states Spiropoulos.

Playing catch-up

With regard to electronic FX business, Canadian banks were largely well behind the curve when compared to the larger tier one global players. Major technological advancement has been experienced in the

FX marketplace over the past five to eight years and Canadian banks have simply been late to the game. This has undoubtedly been driven in part by the buy side which had not been demanding better electronic FX solutions, though this has definitely changed recently.

“All the Canadian banks appear to be playing catch up with the global competition with varying levels of commitment, focus and success,” comments Gavsie. “BMO has committed considerable resources to ensure we are able to provide clients with automated dealing capabilities that meet their needs. We are delivering solutions that address client needs, this includes differing platforms by client segment and post-trade functionality that is not widely available from other banks.”

“At BMO our cash management and FX businesses are closely aligned. Client feedback is regularly shared across both product groups and this helps us to continuously develop new solutions. We have provided clients with access to both electronic FX and cash management services online for many years, well before many of our local competitors, and we are always looking to improve them. In fact, our services have recently been revamped through our new Online Banking for Business platform, which integrates our FX and cash management operations, making it easier for our clients to do their transactions in one place, with developments in line to pull in more capabilities in the future. These and future innovations are 100% driven by our clients’ business needs. Ease of use for the client is really where we should all be headed,” contends Gavsie.

Generally speaking, claims Savoy, most of the major Canadian banks, including RBC, continue to increase their electronic FX distribution through better and faster pricing, low latency execution systems, STP tools and auto pricing. “These are all key components which have made RBC much more competitive in the global marketplace, and specifically within Canada,” he says.

While Spiropoulos states: “The customised workflows we have implemented in our FXOnline

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payments platform around trade entry, authorisation and settlement instructions, have been complimented with streaming spot prices, so that more active clients can better time the transfer of funds between cross currency accounts, send wires and drafts and split payments accordingly. CIBC has invested in infrastructure to source global liquidity in an optimal way and make it available via proprietary front ends, APIs and multi-dealer platforms.”

“We provide our clients with choices,” claims Spiropoulos. He explains: “They can double click on streaming executable prices to trade immediately, or enter orders, or use algorithms to execute. They can connect to our FIX API and use our feed in their own order management and liquidity aggregation systems, or access our streaming prices via multi-dealer platforms. When they ask for prices over the phone, the sales desks can use the internal e-commerce systems for pricing and execution. When our clients place orders over the phone, our traders can use the liquidity aggregation tool to access multiple pools of liquidity to handle the risk.”

“More sophisticated clients now have the flexibility to use CIBC’s real time order management system to enter orders that go beyond simple take profits and stop losses,” says Spiropoulos. “In addition to traditional ‘if done’, ‘one cancels other’, and ‘good until’ orders, clients can utilise CIBC’s smart order routing engine for auto-execution and for minimisation of market impact using time-slicing and iceberg functionality.”

Spiropoulos continues to state that CIBC’s strategy is very much client focused, and the company attempts to provide consistent and competitive pricing to meet their needs. “Additionally, accessing and aggregating interbank liquidity to feed our streaming systems, and having the ability to auto-execute client flows using smart order routing algorithms, positions CIBC favourably with respect to regulatory developments around Swap Execution Facilities,” he claims.

The way ahead

Canadian innovation in electronic FX trading looks set to continue. Demand for e-FX amongst all client sectors is growing and this is likely to be fuelled by the need for improved STP and post trade processing linked to regulatory compliance, a desire for more effective risk management applications as well as Best execution requirements and increasing investor interest in FX as a tradeable asset class. It’s also worth pointing out that unlike some other regions of the world Canadian



Takis Spiropoulos

“Not only has price discovery become more important, but in fact many clients are now mandated to receive multiple quotes (at least two) on trades. Because of this dynamic alone, business transacted via electronic systems will continue to grow.”

corporates don’t appear to have any conceptual reservations about electronic FX which might otherwise hinder continued uptake of the e-channel amongst this client segment. FX volumes generated by the more active alpha-seeking trading community are also set to increase. Multi-asset class technology has become a general trend in the professional trading world, states Evseev, who comments: “Customers are constantly in search of ways to be more net revenue efficient, while obtaining better and lower latency access to more markets from one location. Leading FX providers have the incentives to embrace this trend by feeding their prices into popular multi-asset and algorithmically capable platforms, making the FX market an easily available choice to traders who do not have access to or do not wish to use single bank platforms, high frequency algos or algos designed to auto-hedge equities-related currency exposure.”

Finally among all asset classes, OTC currency options have recently been standing out in generating buy side interest, claims Evseev. “With increasingly wide and unpredictable fluctuations in currency spot exchange rates, clients have become more aware of the benefits that non-standardised options contracts can bring in hedging the associated risks, at relatively low costs. It can be expected that more electronic platforms on the sell side will include option pricing modules and increase the sophistication of the ones that are already live.”

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Meeting a man with his eye on the ball

e-Forex talks with Richard Anthony, head of e-risk - FX & Metals at HSBC

Richard, what are your main day to day responsibilities at HSBC?

I am responsible for the pricing and risk management of electronic foreign exchange transactions. Over the last 20 months HSBC has been investing heavily in its eFX infrastructure. Thus, as well as my day-to-day risk management responsibilities I am heavily involved in the management of the ongoing strategic improvements we are making to our offering; ensuring we build an eFX offering commensurate with HSBC's wider FX business.

Over the last year HSBC has been undertaking ambitious plans for strengthening what is already a powerful global FX franchise. In what ways has your team also been working at the same time to enhance the banks' FX e-commerce offering?

Within the eFX group we have dedicated teams ensuring that our offering meets the needs of our client base; from identifying and implementing changes in our product suite through to enhancing the user experience. As my team is responsible for the pricing and risk management of electronic transactions, our goal is to ensure that we provide the most competitive and consistent pricing for our clients at all times. To achieve this we have been investing heavily in the trading side of the eFX business; both in terms of quantitative development to improve our pricing and risk management algorithms and, in terms of our underlying technology that supports those algorithms.

HSBC is one of the few banks with a truly global footprint which provides you with unrivalled market insight across multiple regions and client sectors. How has that helped in the development of your e-FX services?

HSBC's global footprint means we have FX personnel in a large number of centres, a reach not rivalled by the majority of our competitors. This presence provides valuable local expertise which enhances the pricing process for less frequently traded currencies and outside of local hours. By leveraging this local presence and local liquidity we are able to offer competitive and consistent pricing at all times.

Do you agree with some analysts who contend that the market always gets faster and that success in FX is directly related to the level of IT and technology spend?

The industry continues to focus on reducing latency as there is a clear advantage in being the first to react to any input into the pricing and risk management process. This has led to a technological "arms-race" which has been the subject of much discussion and debate amongst market participants. The market has therefore got faster and this has indeed fuelled technological spend by those who wish to remain competitive; a market-maker may have



??



the best pricing and risk management algorithms but if they were to the last to deliver a price, or react to a risk management signal then those algorithms will struggle. The more pertinent question is whether success in FX should be directly related to the level of IT and technology spend?

There continues to be increased demand for FX Prime Brokerage from many regions around the world. What steps has HSBC been taking to ramp up your FXPB services to meet this?

Early in 2010, we launched our FX Prime Services business globally. We have desks in Asia, EMEA and the US to cover our growing client base. We have invested in technology and client services in to address client demand across client segments and regions. As our clients grow their business, we are committed to understand their challenges and offer solutions by leveraging our global presence, strong balance sheet and diverse franchise. Many clients come to HSBC as they recognise our expertise in emerging markets and look to us to provide guidance in these markets as they grow their businesses and because of our strength in balance sheet. Our systems and processes are scalable, so as the FXPB service grows, we focus on working closely with our clients to mitigate credit and operational risk as much as possible and add value by helping them to better manage through volatile FX markets.

Why do you think offshore renminbi trading is proving so popular and how has HSBC been extending it's capabilities in the electronic execution of CNH?

We have seen a great deal of interest in the offshore renminbi market. HSBC did the first CNH spot transaction, dealt the first CNH options and were first to create a tradeable CNH index. More people can now access the renminbi market than ever before and as the first bank to offer CNH electronically, we continue to support the development of the market. The freely floating nature of the currency means that one can buy it, sell it, borrow it, lend it and not having to use NDFs removes the fixing risk. Add the fact that one does not have to pay a premium to hold it (as with the

NDF) and it's easy to understand why CNH volumes are already greater than CNY NDFs.

Many leading FX banks are trying to find the right balance with their tactical and strategic response to regulatory and market changes. How is HSBC addressing the likely impact of new OTC regulatory requirements on your electronic FX trading business?

There are still many unknowns in the regulatory environment around what products are in scope in the FX asset class for Clearing, Reporting and execution on a SEF. Designing strategic solutions whilst many requirements remain uncertain is harder. Many requirements will crystallise when final determination regarding the US Treasury exemption of FX Forwards and FX Swaps from the Swaps definition in the Dodd Frank Act is made. HSBC are involved in all relevant industry groups and are working with AFME to keep up to date with the



changing regulatory environment. FX Spot is out of scope for clearing, trade reporting and can still be transacted by voice or on a SDP so work is continuing on developing our internal and external capabilities. On FX Options we are working with several potential SEF providers to ensure we have connectivity to both stream liquidity and transact on these platforms as they are launched.

Post trade services is one specific area where many FX market participants are currently focusing their efforts to improve STP and reduce risk. What are the most urgent and critical post trade FX issues facing leading FX providers like HSBC as you take steps to overcome the various work-flow and technology hurdles associated with connectivity to clearing houses and trade repositories?

Connectivity is the first hurdle banks need to overcome, there is no consistent common format message being used between different CCPs and trade repositories, so internal code needs to be transformed in to various formats, complicating the connectivity challenge. FX is a global business but different jurisdictions are implementing aregional trade repositories. The work flow to ensure trades are reported in the correct format in the correct location will be a challenge. HSBC is supportive of the Global FX Trade Repository run by DTCC and would hope in time this will be used to populate other regional repositories. There will be an increase in collateral requirements as firms will lose the offset between their cash and derivatives trades, with collateral on cash still being bilateral and on derivatives being with CCPs, this increase will be compounded by the need to post Initial Margin and post capital into default funds at CCPs. Clients will also need assistance in having a consolidated view of their entire portfolio, reporting to repositories and managing collateral between cleared and uncleared transactions and will need to partner with banks to facilitate this. As we build out our OTC Client Clearing offering, we are taking these client challenges into consideration to ensure we create solutions for them.

Do you believe that regulatory pressures will see FX evolving into a hybrid model with clients clearing some products like FX Options on a CCP and other products being cleared OTC?

There are currently hurdles to overcome mainly around liquidity in order



"..we have been investing heavily in the trading side of the eFX business; both in terms of quantitative development to improve our pricing and risk management algorithms and, in terms of our underlying technology that supports those algorithms."

to facilitate the clearing of physically settled FX, these will need to be resolved before FX Options can be cleared. Initially the industry will work towards ensuring the regulation can be adhered to. This will result in FX Options and NDFs being cleared and FX Spot, FX Forwards and FX Swaps being traded OTC (if the US Treasury exemption is granted). As explained earlier this will increase both buy-side and sell-side collateral requirements, there will inevitably be a push from the CCPs to clear unmandated products to increase revenues and this is likely to be supported especially by the buy-side as this will reduce collateral requirements and simplify work flow. Clients will also be looking at this as a cost - benefit analysis. Regulations will be very costly and clients will need to determine the added benefit of these regulations and determine if it is worth the added cost to voluntarily incorporate their OTC products.

Do you think the role of e-FX is changing and moving beyond the basic transactional process, perhaps

towards a customer relationship model based around empowering clients and helping them to extract more value from research, risk and advisory services?

Yes. Clients demand more from their FX providers and as such the role is moving away from just the “basic transactional process” towards offering more sophisticated value added services in a number of ways; for example the need to provide more specific eFX solutions that are more effective in managing clients execution needs beyond what is available in the standard single- and multi-bank platforms. Electronic platforms are growing in sophistication and are an effective way of delivering trade ideas, research and pre-trade analytics. They are however just part of the client offering and most effective when provided in conjunction with traditional channels where clients still embrace the model of talking to key Sales, Research and Traders.

Over the coming months e-Forex is going to be focusing on how alternative new digital media channels, including mobile applications and Social Media Investment Networks are being applied across both the Institutional and Retail FX markets to enhance and enrich client relationships. How do you view Social Media in the context of helping to deliver e-FX solutions and potentially adding value for clients?

Demand for richer multimedia experiences in trading environments is now crossing over more consistently from the consumer space. Clients still value fast, reliable pricing most of all, but the decision-support space can be significantly enhanced with value-added information delivered in context. Customers expect a consistent experience whether they are trading on their desktop or using their mobile device. It remains vitally important to support all relevant mobile platforms and not to try to force customers to choose technology brand. Developments in social media



investment networks are being driven largely by the retail side at present. They are likely to continue to build momentum overall but it is very unclear which model and platform(s) will become most significant. We continue to keep a keen eye on all developments in the social media investment network including Twitter-style platforms in general.

Traditionally HSBC has maintained a competitive edge in FX by leveraging your strong brand, balance sheet and emerging markets expertise. Looking ahead, how will you look to differentiate your services in the electronic FX space?

Differentiating for HSBC is first about ensuring that our core set of services are competitive and then making sure that the information and ideas from our global network are effectively distributed and giving our clients access to the liquidity in these local markets. This is especially true of the emerging markets space and its associated products. We must ensure our platform is simple and easy to use for every location and, through our product offering, deliver our local expertise globally.

One final question on metals. Gold – is it a buy or sell in your opinion?

That depends on your investment horizon. On a longer term view I would say that you want to hold gold in your portfolio.

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Single Bank FX platforms - moving to enrich the customer experience

Frances Maguire talks to a selection of leading banks about how they are differentiating themselves and adding value to their e-FX platforms in a maturing, but still increasingly competitive, market place.

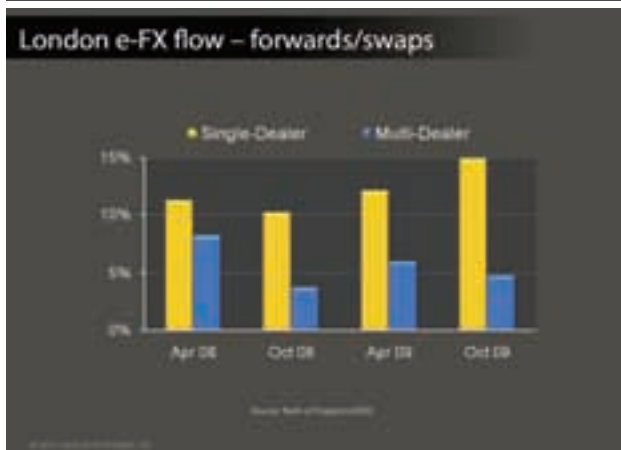
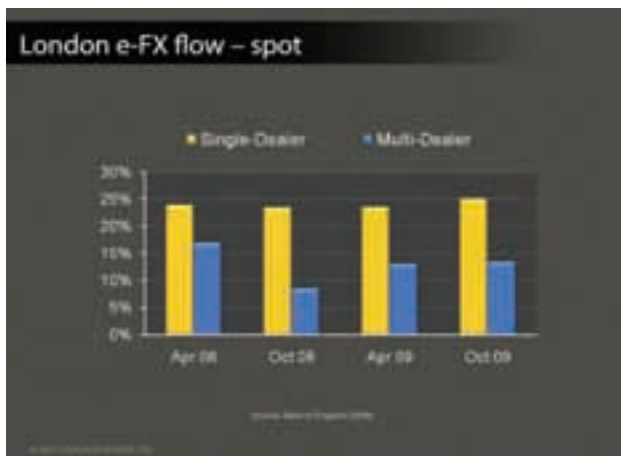
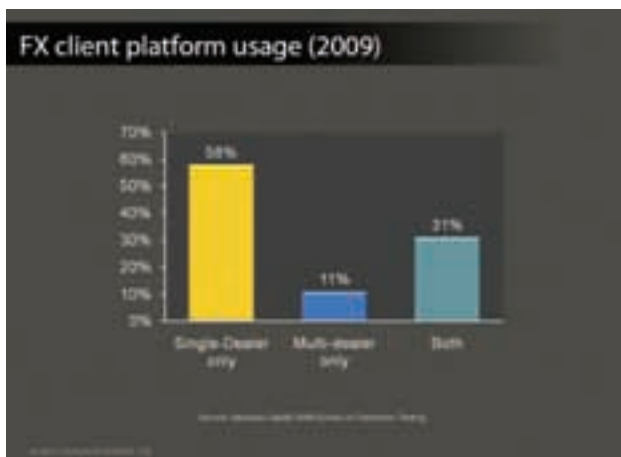
Single bank FX platforms are winning out over multi-bank platforms. Not surprisingly, the main reason for this is simply that banks are investing more heavily in them, and in doing so, focusing on extending the service offerings and innovating to further enrich the usability of their platforms. No longer able to compete on pricing or even execution services, banks are concentrating on the value-add of their e-FX offerings. Whether it is research or smarter web technology, the buzzword is “customisation” and the focus is on delivering to clients the kind of services they want, when they want them.

For Paul Caplin, CEO of Caplin Systems, single bank platforms have become a central part of the trading landscape in FX. He says: “So much flow now goes through single dealer platforms that every bank has to take them seriously, as a strategic weapon. There is a lot of pressure on banks to build more competitive FX single dealer platforms. How banks make their FX SDP more competitive depends very much on what the

unique selling points of the bank are, and who its end users are.”

Caplin says that capacity should not be an issue for banks going forward because scalability is a problem that’s already been solved. Despite the increase in regulatory requirements, banks continue to invest heavily in e-commerce platforms. Caplin believes that the regulatory pressure from 2008 is beginning to slow down as politicians, with greater concerns about the economy as a whole, are beginning to see that the over regulation of the banking industry could actually do more harm than good.

Five years ago, it was thought that multi-bank platforms would take a large share of the business from corporates wanting multi-quotes. This is entirely changed now, as, while supplying quotes to the multi-bank platforms, the same banks invested more heavily in their single dealer platforms. Single bank platforms have gained market share year-on-year and now carry about 50 per cent more flow in the spot market than the multi



bank platforms, and in the swaps market, the flow is twice as much.

Caplin says the reason the single bank platforms won out is simply because banks were able to offer better service than the multi-bank portals in the major currency pairs, with spreads being very compressed. The focus of competition has shifted away from price and towards softer benefits, such as speed of execution, certainty of execution, integration of electronic trade content and straight through processing, and ease of



Paul Caplin

“Banks increasingly are providing the integration between FX trading and research, technical analysis and trade ideas, and in the corporate market, they are integrating FX increasingly tightly with transaction services.”

use. With the exception of STP, he says, all of these factors tend to be better catered for on the single bank platforms.

“With spreads so tight, and with greater transparency offered through the multi-dealer platforms, there is less reason to get multiple quotes, when they can get a much better service from their single bank portal. Multi-bank platforms, by definition, provide the lowest common denominator service offered across all the banks they are connected to, and they don’t provide the same integration with other services. Banks increasingly are providing the integration between FX trading and research, technical analysis and trade ideas, and in the corporate market, they are integrating FX increasingly tightly with transaction services,” he adds.

Caplin Systems works with banks, such as Citi, both for Citi Velocity and Pulse, and Royal Bank of Scotland, across the online platforms and mobile devices. “I don’t think any one in this market has any doubt that their clients want mobile facilities, the question is how fast is it going to evolve, but there is no question it will become a vital part of the mix in terms of delivering content. It depends on understanding what it is the end user needs on a daily basis that can be incorporated into mobile solutions,” Caplin adds.

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Cross-product integration

Deutsche Bank, one of the first to build an FX portal, FX on Autobahn, is still building and developing new customer services. Dirk Ward, managing director, product manager for FX on autobahn at Deutsche Bank says in the past year, the bank has focused on adding cross-product integration to the application, in response to client demand.

He says: “We have offered API connectivity, Excel uploads and FIX formats for some time, and, across the market, there is an increased usage of these different ways of accessing platforms and liquidity, whether it is through a single bank, multi-bank portal or other aggregated offerings.” Deutsche Bank also offers fixing services, as Ward says that corporate clients, and some real money managers, are interested in the convenience and transparency of a benchmarking product.

The maturation of the e-FX market is placing more pressure on providers to offer a much higher level of customer service. “There’s an increasingly competitive marketplace as more providers of electronic capabilities come into the market. Excellent liquidity provision is still a critical requirement, but it’s not necessarily sufficient to get a client’s business today, so we have continually focused on providing value-added services, both pre-trade, and particularly, post-trade,” he says.

Apart from providing full STP from the bank’s platform, Deutsche Bank integrates with a number of third party providers. As Ward says, the reason for this is that an important market dynamic is customers wanting to combine their post-trade solutions from various providers, while the bank is always looking to fill gaps where it sees customer demand for third party platforms.

Ward says: “The big challenge here is to provide a seamless and standardised post-trade environment for our customers so this year we are adding functionality to our post-trade processes to facilitate better trade modification and availability of trade information.”

He adds that for a lot of users STP starts at the pre-trade level and a good deal of their post-trade behaviour, in terms of the types of allocations used, is predetermined. “We are increasingly finding that customers want systematic solutions for their orders, and we are seeing activity in the combination of single bank liquidity with algorithmic trades on multiple platforms. While this is happening pre-trade, all of this has to be integrated consistently on a post-trade



basis. Customers that trade our DMA [Direct Market Access] algos on other platforms want to be able to mix-and-match with our liquidity as well,” he adds.

Creating new workflows

Ward stresses that a lot of the work Deutsche Bank is doing happens below the waterline. In order to be able to provide something other than a one-size-fits-all solution, the back end of the bank’s system needs to be flexible enough to re-combine it for various workflows. As well, an extensive re-engineering process has taken place over the past year at Deutsche Bank to gain strong flexibility to be able to create new workflows for new clients, as quickly as possible. “Autobahn has always set the standard for single dealer platforms and throughout the years has achieved important industry firsts,” Ward continues. The aim to always deliver best-in-class eServices led to this month’s launch of Deutsche Bank’s Autobahn App Market & Toolbar. The Autobahn App Market provides clients with a single access point to the Bank’s electronic capital markets distribution services, spanning the full trade lifecycle.

With more complex order types and the growing use of algorithmic and fixing orders, Ward says Deutsche Bank has tried to create alternatives so that customers have the ability to control and automate the way they

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execute with the bank, as much as possible. “One of the advantages of having a certain market share is the ability to internalise trade flow and reduce the market impact clients have when they execute.”

The use of mobile and tablet applications, for Ward, has not developed to quite the extent that was initially expected outside the retail market. While Deutsche Bank provides research on tablets and mobile, replacing a good deal of the paper process, electronically, there has been very little use of in-execution functionality and the new technology has not displaced its standard desktop/web-based research access. “We are definitely picking and choosing the ways in which we are applying mobile technology, and clients seem to be doing the same,” he says.

The trend is away from product-based development and towards client-driven solutions, and today, it is critical to the success of e-FX. An important part of Deutsche Bank’s strategy is making its technology work with their customers’ particular workflow. A lot of users will combine execution across various platforms, and, in some cases, have execution algorithms or very specific order workflows, and then, post-trade, have more than one STP processes - and they want to be able to use this in a way that is efficient and error-free. Ward says: “A big part of what we do is making an increasingly heavy amount of data,

and a variety of transactions, easier and easier to use the way that clients intend.”

Getting customer feedback

Last month, Lloyds Bank Corporate Markets launched its redesigned, functionally-rich e-commerce platform, Arena. Rob Garwood, head of FX Sales at Lloyds Bank Corporate Markets, says the increasing competition in FX means that customers are rightly becoming more demanding and more aware of the products and services available to them. For this reason, Lloyds Bank Corporate Markets set-up a customer advisory board from day one when designing Arena. He says: “The idea was to get customers, the real users of FX platforms, to help us design our new e-platform, Arena. Having the ability of demonstrating new features, design ideas and interface to trusted customers and getting their objective feedback has played an essential role in our development process.”

While Arena delivers on execution Garwood says that the bank’s focus was also to include all the economics and market strategy research produced by its chief economist, Trevor Williams, and his team, into a single platform. “This includes written and video content. In addition, we included extensive charting capabilities and news into this ‘one view’ of the market so that Arena can address our clients’ pre-trade needs in one platform. We are also including sophisticated risk analytical tools which will help customers with their hedging decisions. Clients can also see all their trades with Lloyds in one single view - the blotter, which includes both online and voice-driven trades. We are also developing our transaction banking capabilities so that soon, customers will be able to view their account balances and eventually be able to execute payments, conduct cash flow analysis via Arena.”

The Arena platform is designed to address the needs of many types of customers - from small and medium size enterprises to large multinationals and financial institutions. Therefore, customisation was always a significant focus for Lloyds. The bank delivers customisation by enabling them to personalise the Arena interface and through tailored, modular workspaces specific to client segments. In this way, Garwood says, clients’ workspaces on their desktops will contain only the information that they place a premium on.

In building Arena, emerging web based technologies that help optimise desktop trading space and enhance the user experience, have been a big focus for Lloyds Bank Corporate Markets. Says Garwood: “The fact that



Rob Garwood

“Having the ability of demonstrating new features, design ideas and interface to trusted customers and getting their objective feedback has played an essential role in our development process.”

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we are relatively late has some advantages – the fact that technology has moved on to a point where it is easier, faster, more reliable to deliver enhanced functionalities at a lower cost to our clients, and the fact that the requirements are better understood means that our time to market with a product suite that delivers in a high impact way, is shorter.” But with regard to mobile technology, Garwood says that at present the bank’s customers are more concerned about accessing research content ‘on the move’ than trading functionality, something that may change over time and so the bank is already looking at future developments in this area in line with client requirements.

Flexible pricing frameworks

Core to its e-FX program is the pricing engine powering Arena as a bilateral execution pricing platform and allowing the bank to extend the Arena service to multilateral trading venues. Garwood says that in order to truly service clients across the different segments, there is a need to be able to engage with them in the venue of their choice. “This means deploying a core pricing engine that is not only fast, but that the bank can quickly adapt to changing market conditions and changing client requirements. We went with a pricing framework build that offered us (and our clients) that flexibility,” he adds.

Arena is regarded by the bank as a tool to strengthen its customer relationships. Garwood says the service offering is about combining online and offline services. He says: “Some customers need a reliable platform to execute transactions and Arena will deliver that. But we have also included proprietary risk analytical tools, cash flow analysis and cross products tools, which we feel will improve our customers ability to understand and manage their financial exposures. Additionally, we are fully resourced to enhance our platforms to provide further bespoke analysis tools developed by our Risk Solutions team.”

Arena is launching as an FX and money markets platform and the bank is planning to add liquidity, rates and further transactional banking products over the next couple of years. “This is clearly an exciting project for Lloyds and a key development for our clients and the services we deliver to them,” Garwood says.

He adds that the bank keeps a close eye on the changing regulatory landscape and the impact it may have on how and why customers use FX, to help customers understand and navigate the new environment. Garwood says regulations such as Derivatives on Exchange, MiFID, Basel III and Solvency II will impact the bank’s client segments in different ways and it has been updating them, in these key areas, on a continuous basis.

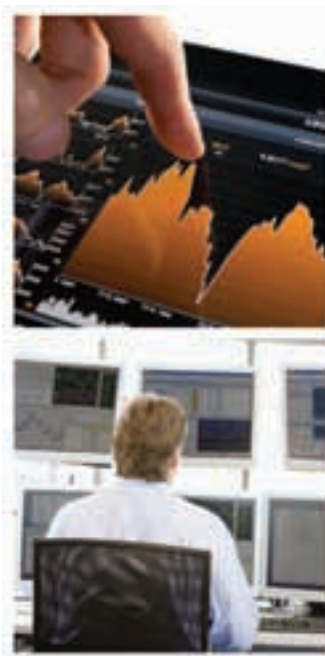
Client fragmentation

Thomas Soede, global head of electronic commerce at BNP Paribas in London, says the bank has identified four different client segments using its FX single bank platform: institutional clients, including real money managers and hedge fund clients; large corporate and multi-national companies; small and medium-sized companies; and the private bank market. All of which have different reasons for accessing the FX market through BNP Paribas and, Soede says, different pre-trade, trade and post-trade services and level of service needed. Soede said: “Client fragmentation offers banks like BNP Paribas an opportunity. The only shared item is that they want to do everything/everywhere electronically.”

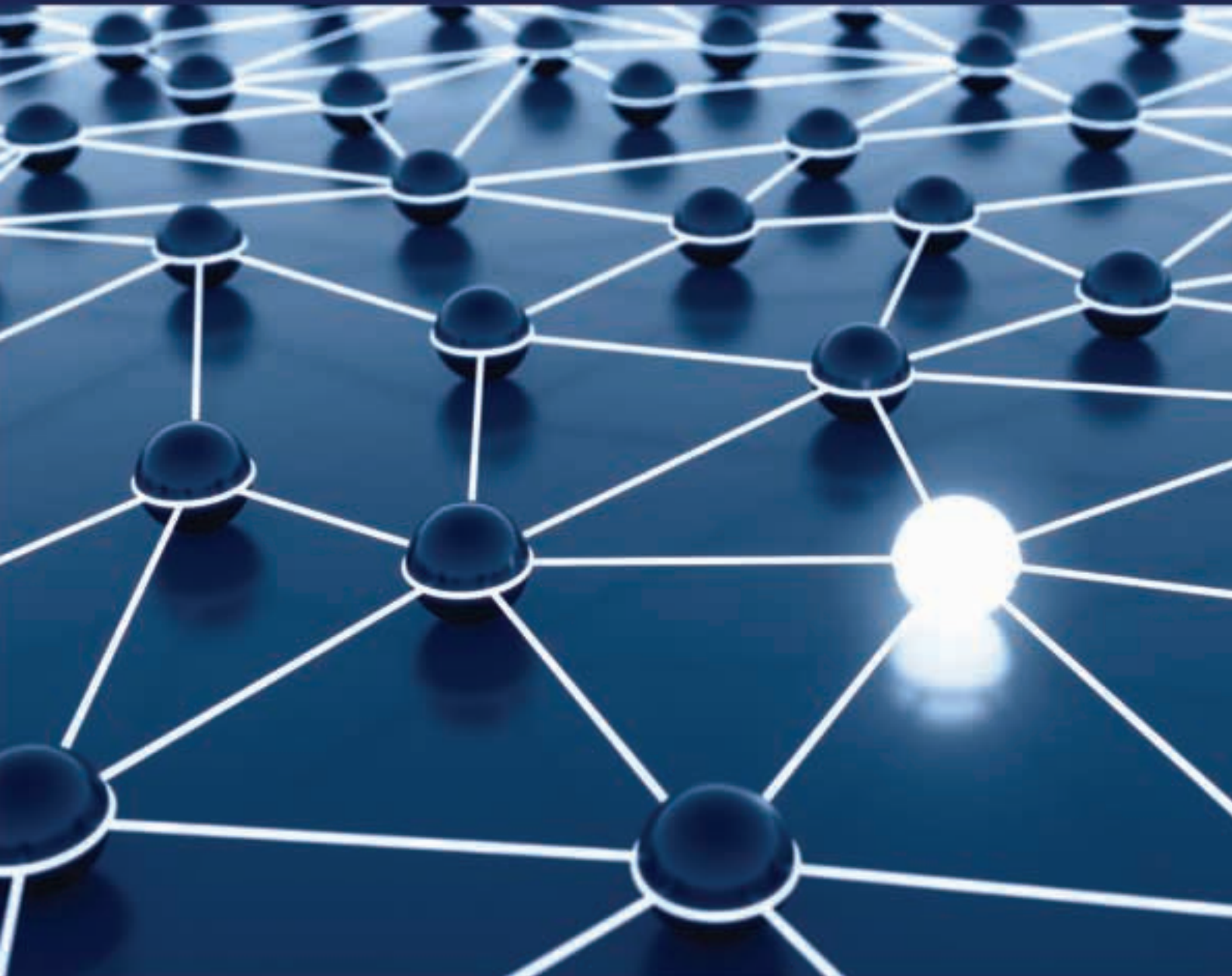
He says: “We also believe that those clients that see FX as an asset class or FX as a utility have to be incorporated into product bundles, for example, for the SMEs, FX has to be included as part of a wider package that caters for their requirements on lending, cash management, trade finance and letters of credit, as for this client segment FX is

not a standalone product. It is for a large hedge fund or large corporate looking to hedge exposures to emerging market currencies, but not for the wider client base.”

The client profile differs again for private banks, which tend to be heavy users of structured products. Soede says that in a typical private bank product portfolio, 70 per cent will be equity-linked, 30 per cent will be fixed income-linked, and FX will play a role in 20-30 per cent of the fixed income part of a typical private bank investor, or high net-worth individual. He says: “The next challenge for global players in the electronic market, trading FX, will be to identify the right bank to partner with, with the best fit, and the right expertise, manpower, research and development for the specific client segment needed.”



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Thomas Soede

"The next challenge for global players in the electronic market, trading FX, will be to identify the right bank to partner with, with the best fit, and the right expertise, manpower, research and development for the specific client segment needed."

BNP Paribas offers all the cash products, such as spot, outright and swaps, access to NDFs, and by the end of this year onshore booking in more than 35 jurisdictions on its e-Commerce platform. Soede says: "One of the key drivers in client service, in servicing the needs of multinational customers, is the local booking services available. A lot of the current players in FX are falling behind. They offer NDFs but the ability to offer onshore booking of currencies is only available from a few banks. The ability to trade options, both multi-leg and single leg options including all of the exotic options, will be added to BNP Paribas' single bank platform, with a beta launch in October, before being rolled out globally."

Post trade services

For Soede, pre-trade services, such as research and analytics, were the main focus in the 1990's, and banks zoned in on developing electronic execution in 2000-2010. "These services are now very commoditised and the big focus for banks, especially on the institutional side, will be on post-trade services, and the race is on to see which banks will be able to offer an integrated package, from pre- to post-trade, where a client can trade an NDF or an option from execution all the way down to clearing. BNP Paribas intends to be one of them."

From March 2011, BNP Paribas enabled iPhone users to access the bank's GlobalMarkets electronic commerce platform with the launch of its MobileMarkets iPhone application just months after the launch of a similar application for the Apple iPad, giving users access to 33 separate tools, including FX forecasts and trade ideas. A Blackberry application will shortly be added.

Soede says: "This enables our clients to take their user journey with them, whether they are in office with pre-trade, post-trade and trade functionality or taking home an iPhone, iPad or Blackberry service, where they can see all pre-trade functionality, including research, trade ideas and commentary. Stages two and three will be order management and post-trade services. It is not anymore a question of every time, but everywhere. Clients want relevant information all the time."

He adds that the desktop, PC tablet and mobile are fully synchronised so that the user's workflow continues across all channels, without interruption. "Our philosophy is not to give our clients a pre-set screen, but to give them a menu where they can subscribe to any parts, and add their services into a 'container' that they can design, customise and consume. It is relevant events they want, not everything."

Further customisation is being worked on for the different job roles of the user base within the company or financial institution, so that the bank's portal will be personalised to suit the trader, risk manager, and operations staff, depending on what information they need to see. "By creating a communications engine, we can provide social environments between BNP Paribas and our clients at multi-service level access, i.e. our operations staff being able to talk to the operations staff at client level using our proprietary technology. We can take this one step further by creating 'events' in the trade lifecycle that clients can subscribe to. This is creating a much wider use of our single proprietary platform. The execution almost becomes secondary," he adds.

Tailored services

Thomas Vinding, director, head of e-Markets at Nordea Markets says that in the early days of e-commerce platforms many banks, including Nordea, began by building one-size-fits-all platforms for all customer types and while it was a good strategy back then, customers are now much more experienced in using the web and they now put pressure on banks to provide them with much more tailored services. While execution services, including pre- and post trade services, are a must-have, customers expect a range of added-value services from single dealer platforms.

To this end, Vinding says: “Firstly, we offer our clients a huge package of analytical tools, called Nordea Analytics, which enable our customers to get a better overview of their risk exposures and helps them to make what-if simulations on a product or portfolio level as well as delivering deep market insight via historical and real-time analysis tools. Nordea Analytics is especially popular among our more sophisticated customers. Secondly, we offer our customers access to our intellectual property such as research publications and general financial market information such as news feeds, live prices and economic calendars.”

In order to offer tailored solutions, Nordea has developed a proprietary front-end as the only way to achieve high flexibility and be a differentiator. Then based on the customer type, Nordea can then select the most relevant components. Says Vinding: “Modern web technology and new applications come with a lot of new standard build-in features such as hovering, docking and enriched notifications and as these seem to apply fairly broadly these technical improvements can be used to optimise desktop space and at the same time these features improve navigation and usability so that our customers can easily navigate around. All this must be supplemented with a powerful and intelligent free-text search engine as Google which proved many years ago that this is the preferred way of finding information and/or a specific feature.”



Thomas Vinding

“Over time I expect that customers will expect that they can be served electronically in several ways and thus request more than ‘just’ execution services.”

While Vinding believes that the growing use of further services on mobile or tablet applications as a convenient supplement to banks’ e-offerings should be carefully selected, he also believes that they allow banks to present their intellectual property in new and smarter ways that bring the customer closer to the bank. Although not all services are suited to mobile devices, Vinding says that new services, such as podcasts and webcasts are growing in use as an extension of Nordea’s overall e-FX offering.

Smarter FX e-commerce engines

The development of faster and smarter FX e-commerce engines are further empowering clients in their search for best execution and more flexible risk and FX order management, to the extent it has become an arms race these days as banks seek liquidity and build up dark pools in order to be competitive and profitable. He says: “This obviously requires more flow which in turn leads to continued spread compression. For the client this is indeed a positive thing as spreads are narrow and there are plenty of makers to choose from. In today’s FX markets clients are having a good time.”

“When that said since the FX market behaviour and dynamics change as we speak clients may have to enrich their execution tools and capabilities further in order to cope with much more frequent price and spread changes as a result of the algo engines.”

Vinding also believes that the role e-FX plays in facilitating customer relationship models, based around helping clients extract more value from advisory services, is increasing but it is a slow moving trend. He adds: “The most obvious reason for this is that the income effect of these investments compared to investments in e-trading is very blurred, but also that banks’ willingness and short term incentive to follow up on customers of these services is limited. Over time I expect that customers will expect that they can be served electronically in several ways and thus request more than ‘just’ execution services.”

As e-FX platforms continue to develop he believes that there will be a greater tendency towards client specific solutions, however, he suspects many banks will continue to provide product specific services as they will be reluctant to change what they have too much already.

Increasing levels of customisation

Steve Godfrey, executive vice president and head of the Foreign Exchange e-Commerce division at Wells Fargo, says that clients expect the bank to continue

to improve the bank's foreign exchange platform. The bank has had a long standing investment in foreign exchange services, focused on its Foreign Exchange Online (FXOL) service, which was newly-launched earlier this year. The rewrite of the platform has added many features and enhancements, many of which were suggested by clients. This has significantly increased the level of customisation that can be achieved beyond simply providing an FX execution platform.

Godfrey says the new version of FXOL is more deeply integrated into the bank's Commercial Electronic Office (CEO) portal for delivering banking services to the medium to large corporates and financial institutions customers. He says: "This client segment was looking for a foreign exchange application that was integrated and worked in the same manner as other applications that they were using. This means that foreign exchange transactions are now reported in the same way, and delivered in the same mechanisms, as non-FX transactions and regular banking statements."

FXOL allows users to pick from a number of different workflows to execute a transaction. The two primary methods are for those clients that want to get a rate first, and settle using the traditional FX workflow; or for those who prefer to enter settlement instructions first and then get a rate; this will match their internal business process. Godfrey says: "This flexibility of workflow is a key component of the upgrade to the FX platform. It gives our clients greater choice depending upon the security and entitlements that customers might put around the process. Some customers have multiple levels of approval required to execute transactions; others may choose not to do that."

"We have designed the e-FX platform very specifically to meet the needs of this client segment. We have traditionally focused on differentiating ourselves in this segment by providing a single bank application addressing specific corporate FX needs, designed to be integrated into our CEO's suite of applications for treasury, credit and other banking services. Some are executing FX transactions as part of their cash management for global payments, other are using it as a risk management tool in the traditional trading FX activity and need a different workflow."

Adding value

Godfrey says the strategy at Wells Fargo is to differentiate its e-Commerce platforms from its competitors and the bank invests in areas where it can add value. For this reason, the analytical tools provided on the platform are in relation to the



Stephen Godfrey

"Our best ideas always come from listening to our customers"

banking services of user and banking research for making hedging decisions, rather than trying to compete with the news organisations. "We recognise that our customers have already got news feeds so we look to provide functionality to help them make trading decisions, through a combination of analytics and chat functionality, for example when working with our currency strategy team. Our e-products take in consideration the overall relationship and everything we are providing to the client."

Godfrey believes that clients will use electronic products where they are deeply integrated with the traditional phone relationship they have with their banking provider. Wells Fargo continues to adapt mobile capabilities to meet client workflows and the primary demand at this point is to provide notifications and alerts through its mobile channels. One of the areas Wells Fargo will focus on in the future is expanding its global capabilities to serve clients doing business outside of the US and providing e-FX services to wider client segments within the bank. While there is a lot of commonality in what clients are looking for from FX platforms, whether they are a small business, middle market, large corporate or active trading financial institutions, there are differences as well.

He says: "Our client-centred strategy is to build those applications that meet the needs of the particular segments – just as we have FX specialist teams dedicated



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to each group. We are looking to expand beyond the commercial and corporate marketplace to also serve the larger financial institutions that are actively trading FX. We see opportunities in this segment to provide services around execution that will make it a very valuable tool for the client, in addition to very solid and fair pricing. We will look to provide rich features in addition to the ability to just pull the trigger on a trade.”

Godfrey believes that one-size does not fit all across clients with different reasons for executing an FX contract and will be designing the platform to suit the specific client segment, with further customisation available. “Our best ideas always come from listening to our customers”, says Godfrey.

Customer service

Stamos Fokianos, global head, e-FX Trading, at RBC Capital Markets agrees that price discovery and instant execution are no longer differentiators, they are prerequisites, and as the industry waits to see how the future regulations will affect the transaction execution and settlement, one of the primary differentiators is customer service. “Clients are not happy with problems just being resolved quickly, they expect not to have problems in the first place. Banks are therefore investing in system monitoring dashboards which warn about a problem being gradually developed (for example, the CPU usage in a particular server), as well as well trained technical staff that appreciate not just the complex IT issues involved in resolving a production problem, but also the financial impact for a modern FX business and its clients being temporarily offline,” he says.

Furthermore, he says these client expectations multiply in the API product offering (an extension of the GUI single bank platform using direct connectivity), where speed and volume are of the essence for accurate trading and order execution. APIs linked to price aggregated OMSs (Order Management Systems) cannot afford to fail in their decision making and subsequent order allocation and there are multiple points of failure that need to be managed in order for this business to be reliably delivered.

The standard of e-FX platforms in the market today, whether single bank or multi bank, is so high that offering good pricing and execution is not enough to compete with the plethora of client options.

Fokianos says RBC aims to offer a comprehensive service that involves multi-asset trading, research and other value-add tools such as: an online FX Forward ‘Maturity Diary’, a real-time Trading Blotter and cash management systems integration enabling clients subscribing to RBC’s Cash Management System, RBC Express Clients to link their trades on RBCDX with an outgoing wire payment.

Fokianos adds: “We are also providing the ability for clients to customise the web-based application so that it fits in to the way they operate. We need to keep in mind that our product is not a means to itself but one of the many tools that our clients need to use daily to manage their daily business. Customisation should not be limited to layout rather there should also be emphasis on usability.”

RBC’s FX orders module offers the ability to view orders in a ‘client perspective’ or ‘bank perspective’. Again the goal is not to create a ‘one size fits all’ rather to create a system that is completely flexible to match all trading styles.



Fokianos adds that the customisation of a webpage is now an expectation by every internet user, and from an operational perspective, it is also essential to process orders in a more customised way; clients provide significant business opportunities through linked and other types of orders that go beyond the simple stop loss or take profit arrangement. RBC is actively involved in discussions with regulators and market infrastructures about the

different ways that FX might evolve, and all its FX product development is done in such a way that can be quickly and easily adapted to any new regulatory requirements. The bank’s electronic pricing and execution processes, whether through multibank or single bank platforms, are already offering competitive and accurate market pricing and can be routed for settlement to central repositories or any other mechanism that will be defined in the future.

New GUI technology

For Fokianos, the most important element of the new GUI technology is the ability to size windows in exactly the way you need them, without compromising the presentation of the information within that window. Resizing windows and being able to detach them from the central applications, allows clients to create their own desktop and optimise their

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Stamos Fokianos

“Electronic platforms provide a significant amount of research, data and charts but the human interaction helps to apply this general information to the individual client plans.”

trading space. This resizing and window detachment is extended to charting; charts are adapted easily to the period the client is observing and overlaid by additional curves, such as different period moving averages. Research is also customisable to provide the amount of information that each client requires; this can vary from single line headlines that can be expanded to the full article, to a much bigger space continuously occupied by in-depth analysis.

“We are continuously enhancing our products based on a number of factors, primarily taking into account client feedback. In doing so, we have to balance functionality with security. There are several considerations around institutional business being transacted using mobile applications and, as a consequence, potentially off premises, and to that extend we are always sensitive to conducting our business in a properly regulated way in order to protect the integrity of the submitted transactions,” he adds.

Fokianos believes acquiring e-FX market-share is significantly more complicated today. As mentioned before, the client experience is not limited to just pricing, but it also extends to many other elements including customer support. The bid/offer spread, although very narrow, is not a key point of competition since it is the same by all the main players.

He says: “e-FX engines have been developed to provide “biased” pricing using their internal inventory and therefore price discovery is more around matching a suitable interest. In addition, the prime brokerage businesses of banks allow clients to post their own interest as market makers and in doing so the bank can act as a direct agent matching two opposing client interests or even matching a counterparty bank with a client of theirs.” The combination of axed pricing, precision pricing and being able to act as a direct agent, rather than a risk manager, has therefore added significant variety in price discovery and some might argue has fragmented the market and created the ability for brief arbitrage opportunities that last microseconds.

More time for human interaction

Fokianos also adds that e-FX is primarily designed to facilitate the transactional process so that more time can be invested in advisory services. The bank sales person has significantly more quality time to help clients achieve their business goals by digesting and interpreting through expert analysis a number of different market events in a global interconnected marketplace. “Electronic platforms provide a significant amount of research, data and charts but the human interaction helps to apply this general information to the individual client plans,” says Fokianos.

He believes that customisation is and will always be a key differentiator in the provision of e-FX platforms, although he adds there is a need to balance customisation and economies of scale. He says: “The life-cycle of a product is significantly shorter than what it used to be and it is not enough to spend money to overcome the initial barriers to entry. Once entrenched in the e-FX business, which is essential to support the overall modern global FX business, there is a need to continuously improve the infrastructure, the applications, the look-and-feel and the risk management of the executed transactions.”

This means needing to innovate in order to create temporary monopolies that attract a premium price, before they get copied and commoditised. According to Fokianos, the costs to build and then run this business are significant and may help explain why lower volume products have not yet found their way on the web the same way that cash FX has. He believes that, like every business that requires scale in order to be successful, e-FX needs to keep up with new client demands but deliver those at a cost that makes the transaction a win-win for both parties, something that sounds fairly straight-forward but that is certain to drive the next round of innovation in single bank platforms.



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Regulatory changes, discussions around a Tobin Tax.

Isn't the biggest global financial market actually in a good shape?



By Alfred Schorno,
Managing Partner, 360 Trading Networks

So far the Foreign Exchange market has survived everything. It got through the Lehman crisis and has survived all impacts post Lehman from the Greek financial crises, the European debt crisis and also doubts about the survival of the Euro and despite all this claims for additional regulatory controls and tighter currency regulations are not running dry.

It remains a reality that politics could finish off what nothing else could. The majority of FX professionals express concerns about the impact of further market regulation on their businesses. Speaking to a wide range of market participants, we

understand that most of them are not in favor of structural market reforms. As a matter of fact most of the market participants are of the strong opinion that FX markets are well controlled – a reason supported by the fact that the markets performed with just the smallest of interruptions during all the recent turmoil.

Also the revitalized idea by some political leaders about a financial transaction or Tobin tax adds only uncertainty and raises questions over which model would be best for the market participants and the future of the industry. No one welcomes an additional tax. Recent studies have shown that only a small minority feel that the FX markets would benefit from both clearing house and exchange-traded requirements.

Hitting the good players

A minimal understanding of the globalized market structure shows that a transaction tax on FX would only hit the ones which cannot move their business or avoid it, in other words the “good” players like corporates. For corporate customers an additional tax will have a direct impact and lead to an additional cost which will be carried forward to the real economy and potentially harm a delicate economic recovery; it will have no impact on those it is supposed to target, namely institutional users or hedge funds, as these market participants can easily move their trading locations to countries or market places which are not implementing such tax changes.

Despite all these political, sometimes tactical, initiatives and discussion, the future remains unknown. The only thing which is clear is that the US is looking to drive for more transparency and



accountability in the derivatives market – and this will, in turn, have an impact on the overall FX market. This will not be, as was feared, through tighter rules and costly changes to FX swaps and forwards. Instead, the target products are just FX options and non-deliverable forwards (NDFs) – at least for now.

It is these two products which have been targeted under the Dodd-Frank Act. The biggest changes coming from the Dodd-Frank Act will be on bank's sales and trading business as all clearable and standardized FX options bought and sold as well as dealing in NDFs will have to be posted on a electronic market place, more specifically defined in the US as a swap execution facility (SEF) or in Europe as a multilateral trading facility (MTF).

Changes for some Market Maker banks are quite significant as some of the key players have concentrated their single bank portal offering around the exclusive structuring, calculation and dealing features for options. The final regulations of the FX options and NDF markets are yet to be published as the clearing and execution rules are being re-drafted after many buy-side participants claimed that the first draft was overly restrictive. Should the rules remain as they now are, then single dealer portals will not be allowed to offer FX option and NDF dealing functions. All executions will then have to be dealt on a multi-dealer execution portal like 360T, which has both the features and functionality for dealing in NDF and option structures. Something of a shift

may well already be taking place, as we see daily volumes in these products increasing in recent months. Nonetheless, additional requirements will burden everyone in the industry with costs and the outcome and/or additional security or what better transparency means is still questionable.

Execution portals

And let me add a thought to all of those who express excitement about a more levelled playing field in the market of execution portals. It is still quite a way until MTFs or SEFs will be able to offer their service as a link in the chain to central clearing, especially as the central clearing and trade repositories need to organize their market structure and requirements, which are also still unclear.

A short cut could be to allow SEFs and MTFs to operate as electronic multi-bank execution market places as they do today and to let them report all FX option and NDF trades to a central repository - as stipulated by the market surveillance authority. This would provide the regulators the required tools for monitoring risk.

And maybe one last thought to all these efforts: as long as there are market regions like Singapore, Dubai, Abu Dhabi or any off-shore islands which are not partnering in to the resolutions driven by the EU and the United states, the global FX players responsible for this course of action will simply move to these trading locations and undermine any well-intended action.

Offering wider market access – Cloud Computing proves well suited to FX

Cloud computing services are widening access to the FX market and helping firms to better integrate front, middle and back-office functions. Joe Morgan examines in what ways use of cloud computing can improve the operational capabilities of trading desks and allow FX firms to fine tune their offering.

Proponents of cloud computing liken it to the evolved model of electricity distribution we have today. It is pointed out that when industry first started using electricity, each business built its own power generating plant. The replacement of this model with a centralised national grid – where electricity is delivered to customers who pay for their usage without having to make an upfront investment or shoulder maintenance costs – is said to be analogous with the cloud. Adherents of the cloud say it is a natural development for consumers and businesses alike to outsource computational services, rather than rely on servers and IT architecture stored in-house.

Cloud Services

Kevin Houston, chairman of Rapid Addition, a specialist software solutions provider to financial institutions, says a “morphing process” is underway, from banks and trading firms managing IT infrastructure in-house to “sharing everything as a utility”. His view is underlined by research published by Gartner, a technology research firm, which predicts that by 2012, a fifth of businesses will own no IT assets. Research by Gartner has predicted that worldwide cloud services revenue will increase from just \$46.4 billion in 2008 to \$150.1 billion by 2013.

Houston even includes proximity hosting services – whereby a server is installed next to the matching engine of an exchange or trading platform – as part of an IT outsourcing trend sweeping across the financial markets. “There is a continuum in levels of shared IT infrastructure which raises the question of how you define the cloud. Thomson Reuters Elektron, for example, offers shared server space with software installed. But it also offers direct market access (DMA) gateways and high performance networking,” says Houston. “The Elektron offering is much closer to a private cloud.

But a private cloud with special characteristics of low latency. Customers may just need server rack space or a low latency trading solution.”

Dr Michael Newberry, UK product manager for the Windows Azure platform at Microsoft, says the cloud can be “narrowly defined” as “just-in-time provisioning and scaling of services on shared hardware.” Newberry favours this definition because it “captures the scalability of the cloud” without “making assumptions” about where the cloud is actually based. “There is the private cloud, based inside a financial institution, a hosted system or a public cloud which all fall inside the boundaries of this definition,” he says.

In summarizing the paradigm shift which, he feels, cloud computing brings to the industries like FX, Newberry uses a question he asks to his customers. “I often say to organisations, what would you do if there were no limitations or boundaries on the computing power that you have at your finger-tips. If you had unlimited power, what would you do differently? What could you do that you can’t do today?” he says.

Key benefits of the cloud

Howard Tolman, Managing Director of Cloud Trading Technologies in London, which specialises in complex pricing of financial instruments and online Forex trading software, summarizes the three key benefits of the cloud as being the removal of costly capital expenditure investment, low deployment costs and rapid scalability. Investment in technology migrates from capital expenditure – in which IT systems and architecture are purchased in a costly upfront purchase – to operational expenditure, where computational power is used in a way akin to a pay-as-you-go model.

Tolman points out that when a bank enlists the services of a cloud computing specialist, it immediately obtains the economies of scale benefits that the provider has already invested in its data center and IT architecture. He says this makes sense as it allows

banks and Forex trading firms to focus upon the core competencies of their business.

“Banks have made themselves IT companies. But their core business is banking. The whole idea that the top twenty banks are all going to come up with something completely different in their processing in the trading space is a fallacy,” says Tolman. “We are reaching some stage of maturity and commoditization of trading systems. It is the delivery capability which is important.”





Furthermore, Tolman points out the increasing operational risks banks and trading firms face when having to continually upgrade IT systems in response to market conditions or regulatory requirements. The cloud enables banks to 'future proof' new technology and systems. "Users of the cloud can take advantage of the investment that firms like Microsoft have made. This means they can have computing power straight away, rather than investing in infrastructure to make it work. You can try innovative stuff and if it doesn't work you can just switch it off and pay for what you use," says Newberry of Microsoft.

Upgrades can be done in a seamless manner, removing the potential high costs of having to install new systems or technology architecture. Tolman contrasts this with the traditional banking technology model, where time delays are common place if additional server space has to be deployed for a new project.

Homogenous environment

Robin Manicom, director financial services, Europe Middle East and Africa (EMEA) at Equinix, a global data center specialist with networking and service partners that build cloud offerings, contrasts the heterogeneous enterprise environment – where equipment from different technology vendors is bolted together – to the homogenous environment of the cloud, where a single server architecture is used resulting in a far lower ratio of administrators to servers in cloud operations.

He also says the cloud turns the traditional conservative banking technology model – where new projects often have to wait approval by committees – "on its head", creating a new more fluid and innovative environment. "In the traditional Capex

heavy model, organisations have to obtain funding for a project and then buy a large amount of equipment from a technology provider. When this equipment arrives, one is forced to basically write it off over a number of years but still pay a maintenance charge to support that initial purchase over the term," says Manicom. "The cloud turns this traditional model on its head – switching a Capex spend into Opex spend over most likely a two, three or five-year contract. But from day one your initial payment is substantially



Howard Tolman

"We are reaching some stage of maturity and commoditization of trading systems. It is the delivery capability which is important."



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Needs of FX

Tolman argues that the capacity of the cloud to provide high-speed calculations using large volumes of data is becoming more important to FX firms, particularly in the current regulatory environment. "Central banks and regulators will want answers very quickly. If you are a sterling-based bank, for example, issuing a credit default swap in dollars and an event triggers the stress testing of a portfolio against not just the credit risk but the foreign exchange risk, cloud lends itself to this type of calculation," says Tolman.

Harpal Sandhu, CEO at Integral in Silicon Valley, a technology provider that offers the entire life cycle of FX as a service through FX Cloud, an open FX platform, says the fragmented nature of FX markets – characterised by competing hubs vying for liquidity – also particularly lends itself to Cloud-based solutions. Integral tailors its trading and aggregation solutions to match the profile of its customers which include buy side banks, brokers, prime brokers, hedge funds and sell side banks.

Integral has a data center in London, server space within Equinix's Secaucus NY4 in New Jersey along with back-up data centers in different locations across the globe. Clients can connect to more than 200 financial institutions, along with major Forex trading hubs such as Bloomberg, Currenex, Electronic Broking Services (EBS) and Reuters.

"Forex markets are opaque and heterogeneous. We allow customers to customise how they trade, who they see and who they are visible to. We take what you have and you trade on one screen," says Sandhu.

George Popescu, CEO of Boston Technologies, a provider of software solutions and trading platforms to institutional and retail brokerage firms in the FX market, points to the unsteady nature of the Forex markets, which he says makes the scalability which the cloud offers very important. "There are times when people have to trade a lot and others when things are quiet. So because of this, one has to scale the resources on a whim but also because the market is very competitive. It also means scaling for new customers," says Popescu.

Lowered entry barriers

Sandhu points out that cloud computing technology



Robin Manicom

"The cloud turns this traditional model on its head – switching a Capex spend into Opex over most likely a two, three or five-year contract."

has lowered barriers to entry in the Forex market. While Integral's clients now include many major banks, initially its customer base consisted of many second-tier or regional banks in the US, without the resources to build their own Forex trading infrastructure. "We remove potential conflicts of interest that can arise if a second-tier bank enlists the FX services of a prime broker who will of course be able to see all their trading positions," explains Sandhu. "Our customers have much more flexibility. They can switch prime brokers and liquidity providers at will."

Sam Johnston, director of cloud and IT services at Equinix, believes that cloud-based services will initially be used for the offline components of Forex trading. This will include the development and back-testing of algorithms with historic market data, along with risk calculations which can require large amounts of server space. These include Monte Carlo simulations – which are deployed to reduce uncertainty in anticipating future events – a tool widely used in risk management, portfolio management and the pricing of derivatives. "The big computing farms designed specifically for these purposes are typically under-utilised" says Johnston.



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Newberry of Microsoft says cloud technology is helping to facilitate linkages between different silos within banks, which is particularly valuable, given the current regulatory push for banks to aggregate data between different asset classes and instigate a more holistic market view, rather than the traditional silos-based approach. For example, disparate execution channels and organizational silos represent a hurdle to US banks' compliance with the Securities and Exchange Commission's Market-Access Rule (MAR) 15c3-5, which has requirements for banks to look at total trading positions across different divisions in real-time with pre-trade checks.

Manicom of Equinix also emphasizes the scalability of the cloud and its capacity to facilitate real-time risk calculations which he anticipates to be required much more stringently, given pressure from regulators on both sides of the Atlantic. "During the day the market can move so much that a bank's credit risk position could be compromised and it may not find out until the overnight batch of data has been processed. So bank's will be looking at cloud solutions which provide cost-effective ways to perform this work in real-

time, in an effort to control mitigate some risk and speed processing time, when in the past this approach was cost [prohibitive]" says Manicom.

SaaS and PaaS

Johnston expects the initial interest in the cloud among Forex market participants to focus upon Infrastructure as a Service (IaaS) with Platform-as-a-Service (PaaS) becoming more prevalent in the future.

However, Ralf Behnstedt, a managing partner at FX Architects, a team of Forex specialists advising on how to strengthen business and operations in the industry, who argues that IaaS is already used in many financial institutions, which means a migration to the cloud will not add significant benefits. "The real advantage will come from Software-as-a-Service (SaaS). If the bank does not need to host their Forex business applications anymore but can get them almost for free using the cloud – that will be the big winner for the industry," he says.

Richard Man, head of business development at BT Radianz, which has established a Financial Community Cloud of institutions and vendors, says the cloud's delivery of the SaaS model marks a significant development for the financial services industry. "Taking a pay-as-you-go model and being able to bill monthly for software that required annual licencing in the past means that software and applications can be bundled into monthly network charges. This opens up the doors for a whole new world for discussions with application vendors," he says.

Meanwhile, Johnston of Equinix expects financial community clouds to flourish – where a variety of financial institutions and trading firms share server storage space in a data center. Equinix's financial customers can already obtain access to a variety of cloud services via a direct connection between their dedicated infrastructure and a variety of specialist cloud providers based either in the same facility or



Harpal Sandhu

"The beauty of having a broader interconnected network (in the cloud) is that elements of that network can fail but it is immediately supplemented by liquidity in other parts of the network."

another data center
which forms part of
Equinix's global network.

Johnston also expects a flourishing of the hybrid cloud model, in which institutions choose to have some services in-house and others on the cloud. "You could have a very high performance system pushing orders into the market, while a public cloud is used to do daily batch risk analysis," says Johnston.

Latency issues

In financial markets becoming increasingly dominated by ultra-low latency trading, in which leading banks and trading firms battle each other in a race to achieve ever faster trading speeds, Manicom believes the cloud may not be the best solution for front office trading systems. "If you want to fire an algorithmic generated FX order at a time when you are ahead of the market by 100 microseconds, you do not want to run the risk of your cloud server being busy at that point," he says.

Popescu of Boston Technologies takes a similar view on the potential latency pitfalls in implementing cloud-based solutions for ultra-low latency trading. "For the masses, for the majority of traders I think the cloud is the best. But for some of the institutional market and for the highly competitive, sophisticated market, I do not think it is," he says.

Manicom offers that the multi-tenant environment of shared server racks within the data center of a cloud computing provider can create potential latency problems for ultra-fast FX trading. He says a so-called "noisy neighbour" problem can emerge, should a resident in the data center perform an extraordinary task which involves a large amount of compute capacity. "If number crunching for risk checking a batch of data takes one hour and ten minutes instead of an hour, that's not the end of the world. But if a trade takes 500 microseconds instead of 50 microseconds, that translates to real costs," says Manicom.



Sam Johnston

"You could have a very high performance system pushing orders into the market, while a public cloud is used to do daily batch risk analysis,"

However, Sandhu of Integral does not agree that the cloud creates problems for latency, arguing that in fact the cloud can be even more robust than internal systems used by major sell side firms in withstanding spikes of market stress. He points out that Integral's systems are continuously monitored for potential latency issues. "On the week after the Japanese earthquake, we experienced a six-fold spike in volume in Japanese Yen trading in one hour. Yet there was no perceptible latency issues whereas two of the top five banks in the world shut systems down because they could not handle the load," he says.

Sandhu says Integral's customers benefit from its "distributive network" of participants which can be robust in rare incidents of market stress, in contrast to systems reliant upon a single order book to provide liquidity. "In times of volume or liquidity stress – both of which took place in the flash crash of May 2010 – you will have participants that fail," explains Sandhu. "The beauty of having a broader interconnected network is that elements of that network can fail but it is immediately supplemented by liquidity in other parts of the network."



Richard Man

"Taking a pay-as-you-go model and being able to bill monthly for software that required annual licencing in the past means that software and applications can be bundled into monthly network charges."

Data security

Critics of the cloud also raise concerns over data security, an area of particular concern to the financial services industry where protecting proprietary data is of critical importance. The concept of shifting data outside to a third party is somewhat inimical to the ethos of the banking community, in which a financial institution's data is closely guarded with stringent checks. Indeed, in the current climate where hackers – often employed by organized criminal groups – are targeting the systems of banks and exchanges, there is undoubtedly a reluctance in finance to put data security into the hands of a third party.

Behnstedt of FX Architects concedes that outsourcing data to the cloud does not come without security risks. "There is the risk that someone steals from the cloud in a hacking attack which would result in an unreparable cost of reputation to the bank," he says. Behnstedt posits possible solutions to this problem such as the encryption of all data, rendering the information unintelligible, in the event of a hacking attack. "Another solution could be that the data gets

spread across many databases so that stealing one piece of data does not provide any insight," he says.

However, Houstoun of Rapid Addition points out that large volumes of data held within the walls of financial institutions and specialist Forex firms do not contain information which could put them at risk, should the data fall into the wrong hands. "FX prices are public record. If you want to analyse a big data set of tick-by-tick FX prices for a particular pattern, storing that data in the cloud is fine," he says. "The use of the data may be very secretive but quite often the data in itself isn't."

Newberry says Microsoft emphasises the important of data governance to its clients in the UK, which stipulate what type of information is and is not allowed to be moved to a cloud platform. "There are particular pieces of data, particular pieces of identifiable information that have to stay within an organisation. And there is other stuff - transient data, information that is transient that has value for the next few minutes but beyond that has no value - which does suit moving on to the cloud," says Newberry.



Kevin Houstoun

"FX prices are public record. If you want to analyse a big data set of tick-by-tick FX prices for a particular pattern, storing that data in the cloud is fine,"

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Regulatory restrictions

Aside from the concerns over data security that the cloud may bring FX firms also have to consider the regulatory data restrictions which can apply when data is transferred between different jurisdictions. Equinix, for example, has 98 data centers across 38 markets, throughout the top 16 financial centres of the world. A cloud service transferring portions of data between these different locations would need to navigate myriad data protection laws and protocols.



George Popescu

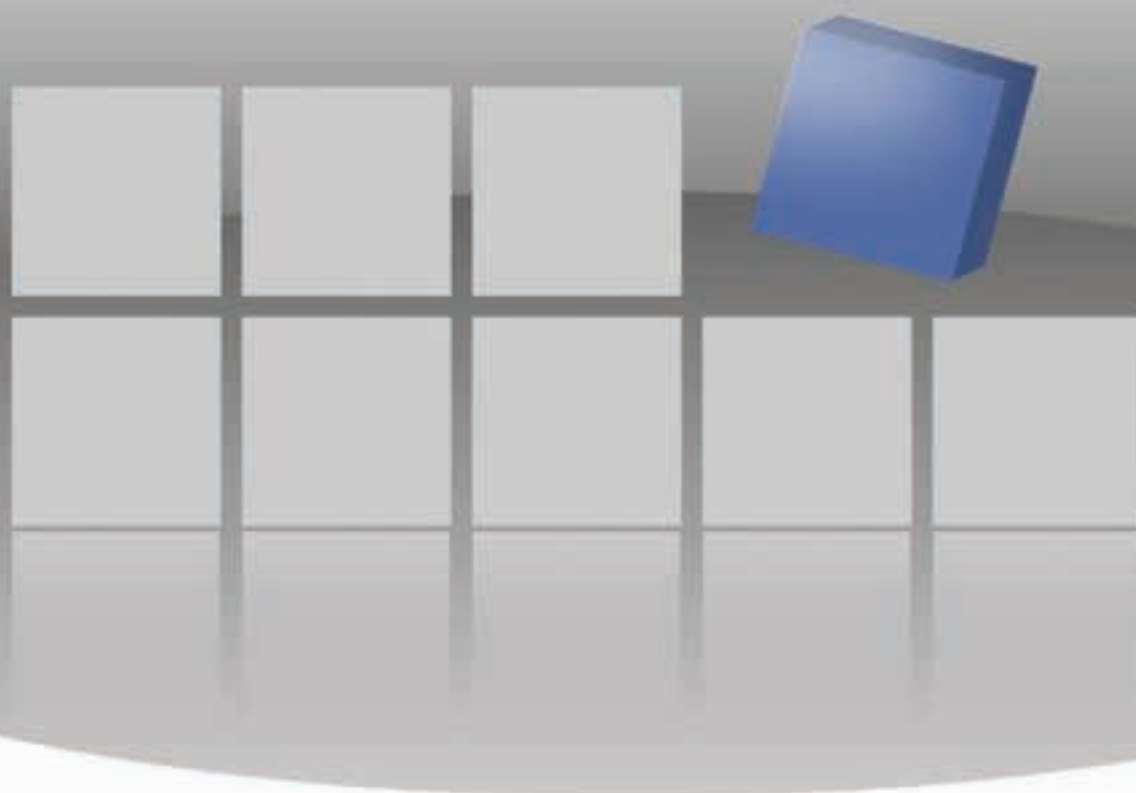
"For the masses, for the majority of traders I think the cloud is the best."

Popescu of Boston Technologies says data protection regulations in different countries need to be scrutinised when providing a cloud service. "Some of our customers are regulated Swiss banks and Polish banks. By regulation, they have to host systems in their data center," he says.

While banks and trading firms navigating such restrictions should consult with specialist cloud computing providers and data protection experts, Behnstedt is convinced that such data legal issues will be resolved within a few years. "On the other hand this [data laws] also opens the door for new services. A 'security broker' – someone in between the financial service provider and the cloud computing provider – could ensure data security integrity," he says.

Alternatively, banks and trading firms can opt for a 'private cloud' model or hybrid cloud – where a portion of computational processing is done on site while other services are outsourced to an external cloud provider – as an effective way of circumventing any legal restrictions on the transfer of data while also ensuring that business critical and proprietary data stays in-house.

"Given the growing complexities and caution banks and trading firms must now operate within when considering operations that involve data security, they are probably not going to put finance systems into the public cloud – in a cloud where the physical hardware and memory of computers and servers are in a shared environment," says Manicom of Equinix. "So it may be better to take the benefits of cloud architecture – such as low moving from a capex to an opex spend and attractive commercial terms – without sharing the



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Ralf Behnstedt

"The role of a bank IT department can shift towards 'managing the network', where as before it was about 'running the application'"

infrastructure with anyone else. cloud services might be best located in a data center for a bank's sole use."

Hybrid clouds

Man of BT Radianz says there will be a rise in use of hybrid clouds in the financial services industry. "We know that our customers have moved to the public cloud for specific functions such as HR and CRM. The caveat here is that while the applications may run in the cloud, the proprietary data may still physically sit on the firm's premises and that seems to be an acceptable compromise," he says.

Once the "prickly issues" of data security and regulatory compliance can be overcome in the financial services industry, Man of BT Radianz believes there will be an "exponential growth" in cloud technologies. "Key to this is that the regulators which are currently lagging on technology innovation can catch-up with what is coming out of Silicon Valley which measures history on what was happening six months ago," he says.

The cloud's capacity to enable banks and trading firms to deploy new technology without large upfront investment costs, with spending on infrastructure spread into flexible payments should make it an increasingly popular IT solution. This is likely to bolster innovation in the FX industry, as it will facilitate more opportunities for banks and trading firms to experiment with new projects.

Houstoun of Rapid Addition says participants in the Forex industry should decide exactly what computational problems they want to solve before taking the plunge and opting for a cloud-based solution. "Then it is a case of aligning the model the cloud provider offers with what you are trying to do," says Houstoun.

While Tolman of Cloud Trading Technologies argues that vested interests within banks and trading firms are resisting take up of cloud solutions, he expects these to subside as the benefits of the cloud become more apparent and firms which do not enjoy the potential cost savings offered by the cloud come under "existential threat".

Paradigm shift in Financial IT

Behnstedt of FX Architects says the advent of the cloud is such a paradigm shift in financial technology that it could make the existing structure of IT departments "obsolete" if there is a failure to adapt. But he argues that if bank IT departments view the cloud as an opportunity – rather than a threat – a brighter future will be possible.

"The role of a bank IT department can shift towards 'managing the network', where as before it was about 'running the application'. Bank IT guys need to see the cloud as a challenge and not as a threat. This is a fundamental pre-requisite to being part of the change. The change will happen anyway as business always looks for opportunities to decrease the cost base," says Behnstedt.

In fact, Behnstedt expects cloud computing to be embraced to such an extent that in the next five years the term is likely to become implicit in the same way that "client-server" became implicit after the first major paradigm shift that started with the introduction of the PC some 30 years ago. "It could just become the natural way of hosting applications in future. I'm not saying it will. But it clearly has the potential to do so," he says.

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Integrating CEP technology as a core component of real-time FX trading architectures.



Roger Aitken

Complex Event Processing (CEP) technology continues to fan out further and faster across the FX market moving beyond the algorithmic trading arena into new areas. Roger Aitken examines the landscape and canvasses some leading vendors.

The adoption of Complex Event Processing (CEP) technology by capital market firms in the FX space and elsewhere across the asset class spectrum continues to display little sign of waning and is being viewed increasingly as a key component of FX trading and associated architectures. The application of the technology is also going beyond what was initially intended creating what might be described as the second generation phase of CEP.



While first generation CEP tools concentrated on specific high correlation functions like algorithmic trading, second CEP generation is much more about meeting an umbrella of requirements across firms - spanning front, middle and back-office activities.

It is an emerging network technology that creates actionable, situational knowledge from distributed message-based systems, databases and applications in real time or as near real time. It consists of processing many events that occur across all the layers of an organisation - financial or otherwise. This processing capability enables firms to manage multiple events within complex heterogeneous networks, hence its increasing uptake within high frequency and algorithmic trading platforms.



New applications

The technology gives market participants the infrastructure to solve the challenges of significantly higher data rates in the financial markets and the explosive growth of algorithmic trading. Now however, the use of CEP is extending beyond proprietary and algo trading into areas such as data monitoring and mining, order routing, surveillance, compliance, data derivations and trading oversight.

A report published a few years ago by Boston-based research firm Aite Group showed CEP spending in financial markets growing exponentially at over 100% per annum - with CEP financial industry expenditures hitting an estimated \$1bn by 2010. "This growth will be driven by expanding usage and sophistication of

algorithmic trading strategies across asset classes and increasing market complexity in market surveillance for regulation, execution, and compliance," Aite's analysts stated at the time. Since Aite's report was first initiated and published we have had a severe financial crisis so the exact percentages for CEP use cases will probably have altered, whilst annual expenditures on the technology by financial institutions in aggregate - post the financial crash - could also have moderated. A new Aite report on the area is expected before the year end which should shed more light on this.

In recognition of these market trends, CEP solutions now span a number of distinct categories including CEP platforms, event-based middleware, CEP-enabled business intelligence (BI) / business activity

monitoring (BAM), Database solutions, and CEP trading solutions.

Niche to mainstream

According to Stuart Grant, business development manager, Financial Services (EMEA), at system vendor Sybase, CEP is going from the niche to the mainstream. “Technology always has a way of settling into its most obvious uses. Areas such as market data analytics and algorithms were ones that CEP naturally fell into but now it is naturally expanding into other areas of the business such as real-time or near-time risk management and position keeping. Organisations have also got their heads around what this capability can offer and witnessed the benefits of being able to use a ‘standards-based’ piece of software across multiple areas of the firm.”

Grant notes that the FX and the equity environments are the two areas where the vendor is seeing the “most pick-up” for CEP - across trading and risk management areas. “The CEP engine is not only good at aggregating market data, it’s also good at aggregating position information. As such, new areas where this technology is being utilised span real-time positioning keeping as well as real-time risk analytics aggregation from front office trading systems.”

While use cases by the institutional and retail side do differ and there is “no single standout reason” for adoption, the Sybase executive notes that with such drivers at play they are starting to see “pull through” into the retail space. This is as many organisations try to “blend their retail and institutional flow on the FX side” in order to try and gain market share.

He adds: “There are also a number of organisations trying to gain sort of ‘flow monster’ status in the FX market and they’re aggregating as much as possible. On the other side we’re starting to see institutions in the retail space provide more sophisticated tools to their end customer (e.g. day traders, etc.). As these latter participants are becoming more sophisticated Grant says they are starting to see some of the institutional tools like such as algos being “migrated into that retail environment.”

Furthermore, by using CEP across multiple areas, banks feel they are able to recoup many of their costs due to the increase in operational support that the technology provides. Australia & New Zealand Bank (ANZ) is



Stuart Grant

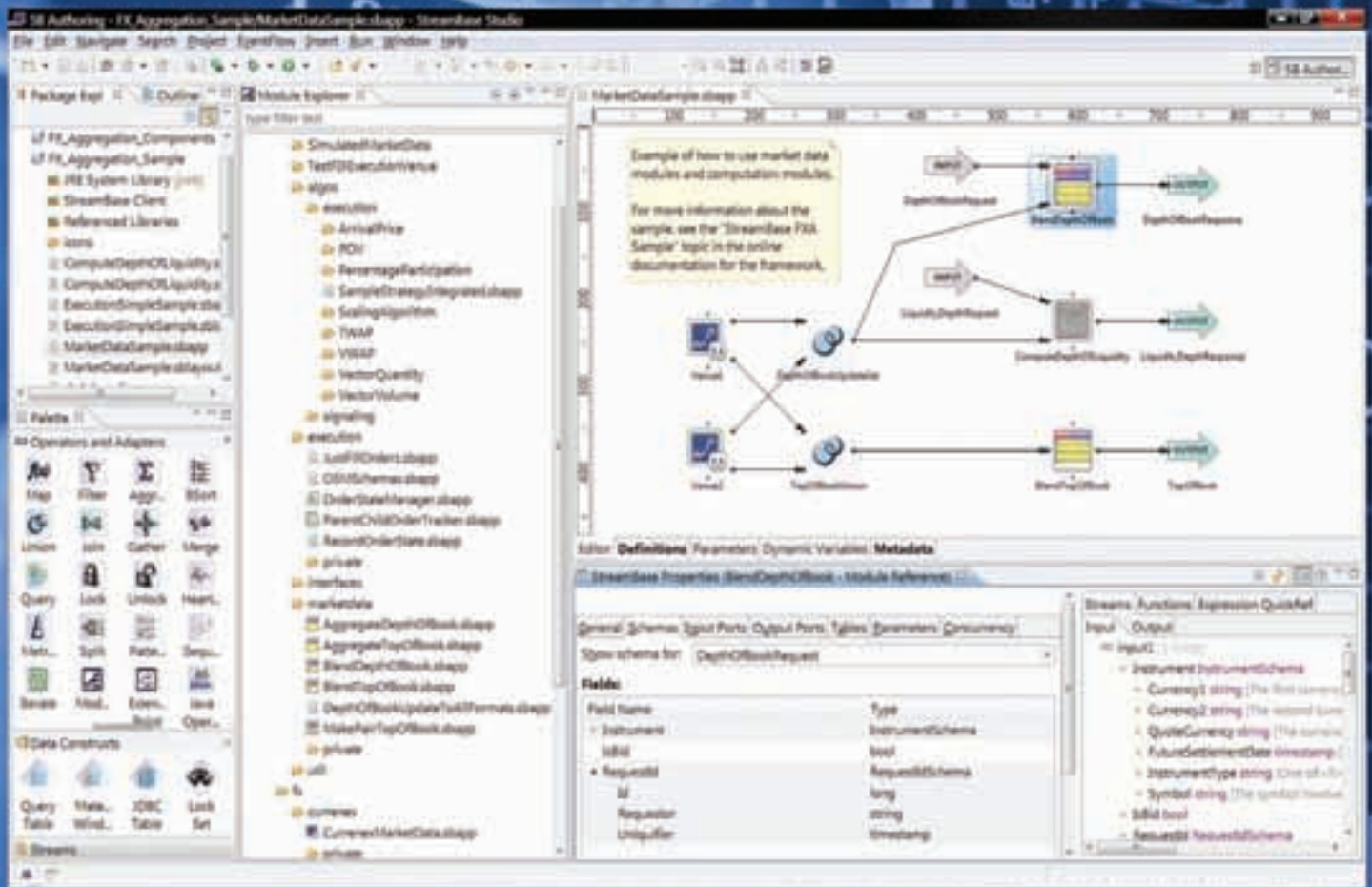
“...market data analytics and algorithms were ones that CEP naturally fell into but now it is naturally expanding into other areas of the business such as real-time or near-time risk management and position keeping.”

using a customised and enhanced version of the Progress Apama FX Aggregation Accelerator for its foreign exchange operations to create and deploy advanced FX algorithms, across multiple sources of liquidity, offer innovative services to clients and dramatically improve the ability to handle increased trade volume.

The bank stated in October 2010 that it expects that the “improved visibility of liquidity and the ability to support a significant increase in trade volume” will lead to a full return on its investment in just one year, while giving ANZ the FX eCommerce infrastructure necessary to scale globally and maintain a high levels of competitiveness in the FX marketplace.

Core premise of CEP

Louis Lovas, Director of Solutions at OneMarketData, a provider of tick data management and analytics, says: “Increased use of CEP technology is and will be stimulated by the core premise of CEP. This is namely that it has the ability to deliver higher performing,



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scalable capabilities to both the sell-side and the buy-side faster than traditional methodologies for application development.”

From a pure technology perspective, CEP engines and their strategy modelling tools transparently handle many of the mundane yet vitally important tasks to achieve low latency, fault tolerance, broad connectivity and tick capture by leveraging scalable multi-core processors often at times reaching up to 24 and 32 cores. Taking a common example, Lovas explains: “Aggregation is a mainstay in electronic FX trading, much of it powered by CEP technology, which easily lends itself to liquidity management across the global/fragmented FX market.”

It is not uncommon he says for buy-side clients to connect to multiple ECNs and single-bank liquidity providers and manage a vast liquidity pool - not just across a few but often six to ten sources - for alpha-seeking, market making and smart order routing. “The use of CEP technology scales well to meet this demand, especially in FX where the spot market is the most liquid and highly traded market in the

world. Furthermore, aggregation implies market data and substantial amounts of it. Therefore, a strong complement to a CEP engine is the ability to capture and store market data for back-testing and quant research for those CEP-based strategies - watching trades, profit potential and draw-downs all in real-time.”

Firms looking to leverage CEP should realise, however, that it is an investment in technology they are making. Such technology still requires care as there is a learning curve for IT staff, development and maintenance cycles and releases to manage. “CEP is not a panacea to trading infrastructure,” says Lovas. “It’s just a tool that in skilled hands can be wielded effectively.”

New areas for CEP tools

New areas are opening up in the FX space for the deployment of CEP tools by trading firms. It can be used for automated pricing, market insights for traders and market liquidity analysis, on top of looking into order books to analyse market depth. It has also expanded more recently to cover for real-time position valuation for risk management aspects and limit/exposure monitoring. From FX pricing, market participants often then proceed onto hedging schemes, where intra-day exposure is not that high and risk can be hedged off.

“What is new for us in the FX arena essentially breaks out into three broad categories,” says Dan Hubscher, Industry Marketing Manager (Capital Markets), at Progress Software. “Sell-side facing trading functions of market making, sales and e-commerce; buy-side trading functions of algorithmic trading and alpha seeking; and real-time risk management.”

Real-time risk management is critical for auto-hedging, something which has become a key focus for Progress, says Hubscher. “So, as client orders are received at firms they can automatically be dealt with by CEP - without the need for manual intervention - prior to trades being forwarded to the market. Should the risk profile build up and reach unacceptable levels then the auto hedging feature is initiated and starts to mitigate or even flatten out the position.”

This has historically been handled by firms on an end-of-day or intra-day basis. Now it is becoming more near to real time, says Hubscher. “By using CEP technology, limit management and enforcement of trader positions can be facilitated. Applied properly the technology not only enables institutions to ensure greater safety and security (e.g. limit breaches, fat



“Applied properly, CEP technology not only enables institutions to ensure greater safety and security but also to trade greater FX volumes and potentially reap higher profitability.”

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finger checks), but help a firm with capital allocation to trade greater FX volumes and potentially reap higher profitability.

Measuring effectiveness

As to how FX market participants can measure the usability, reliability and scalability of CEP platforms, Hubscher observes, “the market today pretty much understands that it is proven technology and highly scalable. Rather it is more about CEP measuring the performance and monitoring of trading (e.g. algo/ automated trading strategies) to check that they are optimal or need tweaking.”

OneTick’s Lovas says: “CEP technology has ‘cut its teeth’ in the latency charged world of equities. So, buy-side firms looking to FX for alpha as a means to hedge or trade cross-border can leverage that same technology base with the assurance of precedence. CEP has reached a maturity that usability, reliability, scalability, maintainability are the ante to the game.”

However, he contends that the “latency war” will be fought more in the CEP-based trading and risk infrastructures themselves, not as in the classic equities areas like co-location, which he contends does not yet exist in FX. “I don’t think we’ll see this need in FX for a while since the risk latency demands of 1 to 3 microseconds are just not there yet,” he suggests. “However, FX is the most liquid market in the world, implying it’s the most data intensive. So, the demands for management of data are higher due to the diversity.”

In connection with ways of aligning CEP technology with market data infrastructures to help improve trading and risk management operations, Lovas notes that in the equities space pre-trade risk it is moving

to hardware assist via FPGA. This can be leveraged from within CEP.

This new latency war is predicated on the new U.S. SEC regulation (market access rule requirement, 15c-35), which came in July 2011.

“However, managing risk with CEP does mean it affords the option of pre-trade risk for orders in real-time,” says Lovas. “It is not just your classic fat-finger (order quantity, price limit) checks, but also managing portfolio exposure.” (i.e. what portion is impacted by FX exposure and the potential hidden costs that one may be incurring).

CEP as a development tool

As regards to how FX trading firms can leverage CEP as a developer productivity tool in order to focus on business logic and go from prototyping directly into production, the technology plays extremely well to this by shortening development cycles, says Lovas. “CEP is first and foremost a development platform, one that’s highly geared towards building strategies. Many vendors provide a graphical modelling tool for the construction of strategies whether for alpha-seeking or execution. These tools have the same objective in mind, to shorten the time from idea to deployment by employing concepts that make them approachable to the non-programmers - Quants and traders themselves.”

Grant says that Sybase is currently witnessing many front-office areas within sell-side organisations where it may take perhaps six weeks or longer to go through a development cycle. “However, using CEP, the ability to visualise the model means that the business can be closer to that development process, which brings a two-fold benefit through reduced errors in the model/ analytics but also means ‘base-level’ development

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Louis Lovas

“CEP technology has ‘cut its teeth’ in the latency charged world of equities. So, buy-side firms looking to FX for alpha as a means to hedge or trade cross-border can leverage that same technology base with the assurance of precedence.”

processes don't need to be undertaken, consequently the build process can be much swifter, with testing and deployment substantially faster.”

“We have recently been involved in a number of CEP project deployments where sell-side organisations have a target to go down from 6-8 weeks to five days or less before going live. And, this shorter time horizon is not about circumventing or breaching the rules or processes, but rather speeding up what's in place by having “a faster development environment and faster test capabilities. Our CEP engine comes with a front-end for developing these models. It's almost Visio-like in terms of the way one builds these models out, which means business analysts can be building the models rather than developers. Ultimately this reduces the time taken to develop applications and significantly cuts time to market, which is another key reason for CEP adoption,” notes Grant.

Evolution

The evolution of CEP technology is likely to centre on

its changing role from a computational tool used for high-frequency processing tasks to a development tool at the heart of a firm's order management strategy, says Lovas. “The basic building blocks are there in the form of analytical functions, data filters, aggregators and other means to enrich or analyse markets and manage orders. What's required is the creativity and ingenuity to semantically assemble those functional building blocks to logically represent a strategy.”

According to Lovas the underlying CEP technology does two things in support of promoting this style of development. Firstly, it provides a means to automatically handle error conditions and thus prototyped models can be safely moved from a QA/test environment to production. Secondly, CEP infrastructure “provides a means to quickly back test models against historical and live markets to provide proof points as strategy ideas are prototyped.”

The spotlight on CEP benefits in FX may well have moved its application beyond FX aggregation, pricing, smart order routing and algo trading to new areas of trade lifecycle operations such as real-time position keeping and exposure monitoring. But, says Lovas, beyond that there are still many aspects of the trade lifecycle that share common attributes tractable to CEP. “As those working orders are managed, positions, P&L, exposure, real-time Transaction Cost Analysis (TCA), trade capture and reporting all need to be accomplished in real-time. And, CEP is the quintessential real-time platform.”

Often firms will have their own ideas on how they want to calculate specific information for working orders, says Lovas. “This list of calculated values is endless. In the past, vendors simply coded these by hand in traditional languages. Any changes/improvements had to wait for the next release and firms had to wait. Using CEP with its rapid development modelling paradigm, it becomes a simple task to change or add new data elements and calculations.”

Retail FX providers are also able to use CEP platforms in order to improve market-making, risk-management and fine grain control over their customer relationships. Retail flow is mainly about technical analysis tools. Providing greater flexibility to such capabilities is much sought after, which means real-time and historical data on multiple assets (FX, equities, economic indicators, commodities, etc.), plus a dynamic model for constructing strategies are being demanded by retail FX providers.



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“For the spot market and for more sophisticated clients that look to trade across multiple asset classes, CEP can be the basis for that - easily blending markets, and looking across the past and present,” says Lovas. “And, most CEP vendors offer approachable means to construct sophisticated analysis models, which means firms can deploy and evolve new trading models quickly.”

Auxiliary services

Commenting on what types of auxiliary services are likely to see emerge as new applications for FX are built around CEP engines, Lovas contends “The demand for large-scale data services will likely grow as firms look to understand the changes in markets, the geo-political impact and economic impact. This can impact market makers as they look to stay ahead of the market. Leveraging CEP provides a means to implement fast-evolving algos for market making and their need to rapidly re-post prices across numerous counterparties as market conditions change.”

Sybase’s Grant says: “Another area where we are seeing this technology being used is to start making personalised recommendations back out to the customer base. So, based on the trading profile of a particular customer - not just on their historical activity but on their current activity as well.”

This might take into account how clients navigate around FX sites and the position of their cursor on the screen. “Certainly some organisations are actually bringing psychology into play to dynamically build offers (e.g. price offers/alerts), rather than it just being predetermined. Dynamically they could create an offer or alert to an end user in milliseconds,” he suggests. This might help stop clients going elsewhere.

Ultra low latency FX

Referring to ways leading CEP vendors are delivering a range of high performance configurations to support the most demanding ultra-low latency FX trading applications, Grant says: “If one takes high-frequency trading, it’s not an environment where you would use CEP since you are talking microseconds and nanoseconds. That’s an example where people would write code and probably put that on to the chip itself.”

He adds: “Where the CEP engine comes in is in the performance monitoring such that if a firm is using ultra-low latency techniques, then they’ll more than likely be built and developed in-house. However, they still need to be monitored for performance and risk purposes. And, as a result of the speed of our CEP engine means that it’s an extremely robust environment for undertaking performance or risk monitoring of ultra-low latency strategies.”

Using a monitoring model via a CEP engine on the performance of such HFT trading strategies as closely behind executions as possible, alerts or dashboard functionality can be provided to evaluate the trading status. “Nevertheless, it’s important to note that this type of monitoring should not get in the way of the trading activity itself,” Grant says. In extremely volatile market conditions this can pay dividends as it could significantly improve business agility for FX firms in terms of hedging and/or changing trading limits.

Lovas points out that low-latency in FX has a “different focus” as compared to equities. “In that asset class, latency reduction techniques cut across many aspects of the trading infrastructure, most notably in the networking infrastructure and co-location. This does not apply to FX, and as a result the focus for low-latency rests higher up in the trade technology investment chain, where CEP technology plays a larger role.”

“The demand for ultra-low latency is only beginning to emerge in FX. The maturing of CEP in equities has prepared it for what FX might throw at it. CEP technology can leverage multi-threaded architectures/multi-core processors without burdening the developer with the idiosyncrasies of synchronization or the headaches of dead-locks,” says Lovas.

While leading vendors in the CEP space continue to enhance the technology tools available, both sell-side and buy-side institutions trading FX will clearly want to gain a competitive advantage, flexibility and scalability from these tools. Given the explosive growth in FX volumes, CEP providers will need to innovate to provide continuous intelligence to the market.





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Improving real-time response rates to FX Trading opportunities

When it comes to improving real-time response rates in the FX trading world a number of factors come into play in terms of the whole technology stack - from messaging and front-end technologies for data distribution to execution latency and the network layer. Handling one aspect at the expense of another rather than addressing matters holistically is flawed and ultimately could prove costly. Roger Aitken reports.

Among the range of performance challenges faced today by FX trading firms - both within the institutional and retail space - institutions are being confronted by burgeoning FX volumes, incoming price feeds that need to perform as expected and real-time prices that need to be delivered without any missing ticks or corrupted data. Dealing with zooming messaging rates as well as ensuring that no bottlenecks build up at the network layer also add to the complexity and workload involved. Kevin Lupowitz, Chief Information Officer at FXall sums it up by saying, "As we have seen in other markets, at

some point the data generated from multiple venues becomes so large that trading firms have difficulty in trying to consume it.”

So dealing with all these issues, clearly requires additional capacity in terms of bandwidth and scaling applications.

Messaging systems

If recent messaging rates are anything to go by, firms are likely to be bracing themselves for more of the same. Paul Brant, CEO, My-Channels, a leading middleware messaging vendor through its flagship Nirvana solution, commenting on the importance of messaging and messaging delivery systems in the grand scheme to improve real-time response rates for FX trading opportunities, says: “It’s absolutely paramount that messaging be recognised as a core component in the technology stack, responsible for the delivery of real-time data to clients.”

He adds: “Obviously every organisation implements their technology stack in a slightly different way. Each one layering their own business logic on top of a messaging foundation that underpins their systems. It is this messaging foundation that opens up different delivery channels while supporting the dynamic routing and filtering of data based on bespoke business logic.”

While the messaging system feeds areas including Complex Event Processing (CEP) environments, ultimately what is critical is the “unified messaging piece” according to Brant. “Regardless of whether that is to an existing internal enterprise client, to a web page running a Rich Internet Application (RIA) or to an iPhone/iPad, it doesn’t matter. A messaging foundation should be capable of supporting as many platforms and delivery channels as possible.” he says.

In delivering a common set of functionality across all delivery channels and platforms unified messaging frees clients to focus on their own know-how and knowledge and “not to worry about the plumbing”.

Delivering data

Today there are certainly more and more users trading through FX dealing platforms than there used to be, who increasingly are being offered customised prices from the leading platforms.

Eddie McDaid, Director - Business Development, My-Channels, says: “The FX landscape has changed dramatically in recent years and while the key performance challenge for FX remains the ability to deliver data as quickly as possible, the obstacles banks face in order to achieve this have changed over time.”

“Whereas in the past banks may have partitioned prices into a low number of high level classifications - gold, silver and bronze for example - some are now delivering hundreds of incarnations of the same price spread across literally thousands of users,” says McDaid. “As such this requires an underlying real-time delivery system or messaging solution capable of filtering and routing data on the fly.”

This challenge is further compounded by the fact that a typical FX dealing platform’s user base adopts and utilises a number of different technologies spread across three core delivery channels: Internal Enterprise Users, Web Connected Users and Mobile Users.

McDaid adds: “Regardless of the location and choice of end-user technology, the challenge facing FX dealing platforms is to provide the same levels of functionality, service and user experience that are consistent across all delivery channels.”



Paul Brant

"it's the messaging foundation that delivers the content out to different channels, routes data around and filters content based on whether it's important or not. And, it's the messaging system that performs all this."

Leveraging specialised solutions

Alessandro Alinone, joint CEO and CTO, Lightstreamer, a Milan-based technology provider of middleware messaging technology says, "The unpredictability of the Internet in terms of latency and bandwidth performance, and reliability with respect to disconnections and security coupled with client technology spanning differing browser versions and web specifications means that FX trading firms should leverage specialised solutions for streaming real-time FX data across multiple FX trading venues and platforms."

Lightstreamer is focused on providing a "higher level of abstraction over such unpredictability" according to Alinone, "exposing simple programming interfaces that hide the complexity of streaming data in a reliable way with high performance." In a nutshell, Lightstreamer is typically added to any existing messaging solution such as JMS, TIBCO RV or others to extend the message delivery capability to the Internet and to Internet-based technologies. It delivers real-time data via the Internet, from the servers of banks and/or other financial services institutions to end-user machines.

Alinone adds: "The separation of concerns between the application logic and the Internet transport management results in a more robust architecture, higher performance, and lower maintenance costs."

Messaging Middleware

Data transformation and integration technology - or middleware - is widely used in the most challenging high volume industries - not just financial services - and is designed to process massively high transaction volumes in less than the blink of the eye.

Messaging middleware provides enterprise, web and mobile applications with a common set of interfaces that enable different devices and system components to send data back and forth. These feature rich messaging platforms typically offer a number of different ways for communications between critical services to take place. This might include both synchronous and asynchronous communications coupled with different standard message middleware paradigms such as publish/subscribe, message queues and peer to peer communications.

Companies in the messaging middleware arena are "evolving quickly" in response to the ever-changing needs of their financial services clients, notes McDaid. He says: "While constantly striving to drive down end-to-end system latencies through innovative message distribution techniques and streamlining 'over-the-wire' payload design, vendors must also ensure that the human latency required to implement and enhance applications built on top of their systems is kept to an absolute minimum."



Eddie McDaid

"Regardless of the location and choice of end-user technology, the challenge facing FX dealing platforms is to provide the same levels of functionality, service and user experience that are consistent across all delivery channels."

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“This later latency reduction is typically achieved through the provision of feature-rich functionality that spans the widest possible range of API’s, user devices and delivery channels available,” he adds. This has been a key consideration in the design of the my-Channels Nirvana unified messaging solution which delivers a single, low latency platform to fulfil an organisation’s external middleware needs and has an internationally deployed user base in the financial services community that includes a number of the world’s largest FX dealers.

Optimising real-time FX data

The need to reduce latency and avoid network overload with resulting loss of FX data is paramount. Optimising the data and the way it is delivered is a way of achieving this. “The support for real streaming eliminates the round-trip latency of the request/response paradigm,” says Alinone. “Adaptive throttling continuously tunes the streaming bandwidth based on the actual available bandwidth, thereby not saturating the network links and avoiding data ageing.”

Alinone explains: “Dynamic conflation, batching, and compression algorithms take care of sending the smallest possible amount of data without losing information.” These and several other algorithms provided by the vendor are completely automatic and



Alessandro Alinone

“Adaptive throttling continuously tunes the streaming bandwidth based on the actual available bandwidth, thereby not saturating the network links and avoiding data ageing.”

work transparently across all the supported client-side technologies.” (i.e. for all desktop, mobile web browsers plus any kind of native apps).

This, he claims, differentiates vendors like Lightstreamer from what he calls the “dumb pipe” approach, where the streaming server moves data in an unoptimised way, so resulting in a higher latency and network overloading.

Sumeet Puri, Director, Systems Engineering, Asia-Pacific, Solace Systems, a content networking company in Ontario, Canada, that manufactures and sells middleware appliances, says: “A modern FX architecture has lots of moving pieces: price and order gateways, aggregators, algorithms/market models, and gateways that push data to the street. These components need to share data with a variety of latency characteristics.”

Such characteristics cover ultra low latency to algorithms, less onerous speed requirements for human traders and qualities of service (i.e. persistent/non-persistent delivery).

He adds: “Hardware-based messaging appliances meet this demand with a combination of performance and robustness that are only possible when routing messages just like IP routers and switches route raw packets. These applications frequently need to share data across Wide Area Networks (WANs) between datacenters.” And, he suggests that a well-designed hardware platform like Solace’s “can deal gracefully with WAN links and optimise bandwidth thanks to parallel streaming, intelligent routing protocols, and compression in hardware.”

Rich Internet Applications

The delivery of market data is undergoing a fundamental shift with the introduction of Rich Internet Applications (RIA) that give users a sophisticated real-time user experience within their web browser - without the installation of any client-side software or plugins.

In fact, even on LAN-connected desktops, Puri points out that “thick clients and browser applets are giving way to browser-delivered RIAs powered by technologies like AJAX and COMET.”

Puri says: “Mobile distribution adds the notion of dedicated smartphone/tablet apps, but the underlying delivery technologies and infrastructure are the same.



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This all adds up to the need for middleware solutions to support the APIs for these technologies, and means that middleware solutions, which can handle all of that as a seamless extension of the internal messaging environment can give companies great bang for their buck.”

As to how trading platform architectures based around a new generation of front-end technologies can help to improve data distribution via real-time streaming, it’s perhaps reassuring that new front-end technologies are emerging all the time.

“At the moment there is a growing interest in HTML5,” says McDaid. “Silverlight and Flex remain very much the incumbents. That said, many banks are now starting to use HTML5 as well.” Respective merits of the individual technologies aside, it’s worth noting that two out of these three technologies did not exist five years ago.

AJAX (Asynchronous JavaScript and XML) is another longer established front-end technology. Essentially it attempts to bridge the gap between the functionality and interactivity of a desktop application and the always-updated Web application.

McDaid adds: “It’s a safe bet that in a further five years time the list of the top three might look different again. Consequently when building strategic platforms it’s important to choose an underlying real-time streaming technology that abstracts the delivery of data from the nuanced technical complexities of individual front-end technologies.”

Puri says: “Modern browser technologies, such as AJAX/COMET or WebSockets, now let developers write rich internet applications that include business



Sumeet Puri

“A modern FX architecture has lots of moving pieces: price and order gateways, aggregators, algorithms/market models, and gateways that push data to the street. These components need to share data with a variety of latency characteristics.”

logic and leverage real-time pub/sub streaming to offer much better user experience than HTML pages.”

He adds: “For mobile channels, native applications for smartphones are becoming more and more popular as compared to mobile browsers, making messaging SDKs for native applications a big plus, especially with binary payload formats for better latencies.”

Tailored for FX

Another point to consider is rate control. FX rate streams from ECNs are usually at a very high rate to meet the needs of algos, but front-end delivery channels need much lower ‘eyeball’ message rates. “Messaging middleware platforms should be able to tailor message rate based on client profile such that

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algos can get all messages while browsers/smartphones only get a few ticks per second,” Puri argues.

“With FX spreads usually made available to different subscriber classes (e.g. gold, platinum, etc.), if the front-end can delegate the decision of the class to the middleware platform system, and automatically subscribe to the ‘right’ stream, that further eases app development and improves scalability,” he says.

Alinone contends: “Modern FX trading platforms should focus on the quality of the users’ experience and on the application logic, whilst isolating within dedicated solutions from vendors the actual streaming logic. In this way it’s possible to send low latency data to any possible kind of client application.”

For example says Alinone, iPad, Android and web-browser users “can take benefit of the same high quality of real-time data, with ultra-fast price delivery and order execution.”

Adds Alinone: “It’s key for the streaming engine to fully manage the transport layer and remove the burden from the application logic, automatically choosing the best transport on a case by case basis, for example HTTP streaming, Comet, WebSockets, Long Polling etc., and optimising the data flow.”

Trade execution

On steps that can be taken to isolate and deal with any degradation in trade messaging communications or trade execution performance associated with underlying FX technology or network infrastructure problems, FXall’s Lupowitz says: “The typical approaches firms take to solving this in the FX market involve getting bigger pipes and securing more bandwidth, scaling consuming applications, or dropping non-critical data”.

There are also challenges of proximity to the data sources, and making sure that orders do not miss markets because of latency of the applications or time on the wire.

“The best solutions will be based on intelligent Smart Order Routers (SORs) that understand the venues that they’re connected with, and will route orders - not just based on best price - but based on likelihood of a trade execution.” Lupowitz contends.

He adds: “If a trading venue has implemented an intelligent SOR, with this additional information, it



Kevin Lupowitz

“The best solutions will be based on intelligent Smart Order Routers (SORs) that understand the venues that they’re connected with, and will route orders - not just based on best price - but based on likelihood of a trade execution.”

can automatically drop slow venues to the bottom of the routing table. This natural selection process can very quickly become a competitive advantage.”

Latency

In terms of the importance of establishing latency rates across multiple FX transaction flows and early warning of potential downstream problems, Puri says: “Absolute and relative latency are both increasingly important as customers get attracted to best rates. A sell-side provider with low and deterministic latency can improve their offering and competitiveness by focusing on business logic such as algos, spreads, and market models.”

There are a range of diagnostic toolsets that can be applied to examine FX trading latency in real-time spanning FX market data feeds, pre-specified transaction performance metrics and network latency. Puri sums up by saying, “Sell-side FX platforms need to optimise execution by ensuring reliability, robustness and speed. They have to cater for a wide variety of clients ranging from FX HFTs to retail investors to corporates. Messaging platforms have to support these diverse requirements, so they need to offer low and deterministic latency, high throughput, with the ability to support LAN, WAN and Web networks.”



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Slicing and dicing – utilising new algo toolsets for increased precision with FX order execution

Now that slicing and dicing algorithms have become a common feature of the FX marketplace, Nicholas Pratt examines how traders are using the latest algorithmic tool-sets for increased precision with FX order execution.

The use of algorithms in the FX world has clearly moved beyond the standard time-weighted average price (TWAP) format where large orders are uniformly divided and executed at regular intervals during the day. Not only has the technology become more sophisticated and able to call on more intelligence, the ambitions and requirements of the market's participants have also advanced.

The leading FX algorithm providers have consequently concentrated on providing customised and tailored offerings that are able to meet the specific needs of traders. More intelligent algorithms can be configured to provide users with more flexible management and monitoring of orders during the execution process; market impact and information leakage can be minimised through greater randomisation; algorithms and execution engines can be conjoined to create more sophisticated FX order management tools; and the development of benchmarks and transaction cost analysis can influence the future creation of FX execution algorithms.

Customising algorithms to match the preferences of participants does create some interesting issues though. For example, will algorithms based on the agency-style broker model prevalent in the equities market prove to be more popular than the principal-based broker model that has long been prevalent in the FX market? Of course, the equities market is different to the FX market and any other over-the-counter market. And although there may be a convenience for those firms that have developed a suite of algo services in the equity market to look to offer the same tools to the FX market, it is widely recognised that any algorithm has to be re-engineered for the specific market it will be operating in.

Agency versus principal model

As to whether the agency model or the principal model will be the more popular in FX, the direction of future regulation and also the extent to which clients are able to educate and acquaint themselves with the workings of the FX market will likely be important factors. For example, principal-based brokers may argue that as traders become more informed about best execution and start running more TCA, they may find that the major dealers offer a much tighter spread than is often perceived.

One concern though is that some participants may begin to associate best execution too much with price. Official definitions of best execution make clear that it



Paul Aston

"Algos essentially address three preferences – liquidity, price and time. The client has to be very clear about what their preference are and the algos have to match these preferences."

is a process that takes place over time. It is an ongoing statistical analysis whereas a price is a single snapshot of a particular time in the market's daily liquidity cycle. Furthermore, in an OTC market there is not right price. An individual price could be affected by a whole range of factors – some of them observable and some of them not.

Morgan Stanley's primary offering in the FX algo space is MSFix which is aimed at large asset management clients looking to execute large block orders. "We use an algo called FlowWAP which is analogous to the equities-style VWAPs," says Paul Aston, Executive Director at Morgan Stanley. "The difference is that MSFix users will execute orders in volumes according to the relative market flow rather than at set volumes. By tracking the average intra-day liquidity cycle in each currency, MSFix aims to minimise market impact and minimise the possibility of trading on extreme prices. It is about ensuring a proportionate volume for execution."

The liquidity profile that Morgan Stanley compiles through its Quantitative Solutions and Innovations Group is based on a number of sources across the FX market. "This data allows us to estimate the arrival

time and the core cycle of liquidity of a currency on any given day, provided there is a sufficient level of liquidity available in the first place. We have undergone extensive work on transaction cost analysis and benchmarking and MSFix is an embodiment of that work," says Aston.

MSFix is a principal-based offering. While the FlowWAP algos reflect the characteristics of the FX market, there is also a demand among some traders for algos such as implementation shortfall and participation algos. As far as Aston is concerned algorithms have to be engineered for each client and their trading preference.

He says, "Algos essentially address three preferences – liquidity, price and time. The client has to be very clear about what their preference are and the algos have to match these preferences. Whereas the basic TWAP algo only focuses on time, the MSFix algo is focused on both time and liquidity. In both cases, the algos act as price takers. In contrast, a target price or implementation shortfall algo would need to prioritize price, time and liquidity to various degrees."

FX Fifty Five, the FX agency of Market Securities - Kyte Group, is an agency broker that offers algorithmic trading services to hedge funds and other professional traders. In the FX market it uses a white labelled version of FlexTrade's MaxxTrader product and its FX platform is hosted in LD4 where it cross connects with banks via a physical cable connecting its own servers to those of the banks. Kyte Group acts on a pure agency model and therefore all of its flow is passed to its liquidity providers.

"It is a business decision for us to remain an agency broker as we want to be on the side of the largest liquidity providers who are the top tier banks," says Nathan Halfon, head of FX at FX Fifty Five. "The agency model gives a very transparent e FX service as it avoids any conflict of interest and provides total anonymity to the buy-side. The liquidity providers only face the bank acting as the central counterparty. This differentiates us from brokers that act as principal to the trades and therefore internalise the best portion of the flow and pass the rest to the banks. We are passing all the flow to the banks with no intervention in order to achieve a better relationship with them."

Passing all the trades straight through demands a thorough policing of the flow, says Halfon. "The challenge is ensuring that we are distributing the right

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liquidity to the right customers. We manage it using direct APIs with the banks to cross connect to their servers and publishing anonymous identifiers in order to be able to communicate with the bank and place the right identifiers with the right streams. This way we gain the trust of the banks and they provide us with better pricing.” The Know Your Customer (KYC) due diligence process is therefore crucial in order to know what kind of trading style the end-customer uses, says Halfon. “Once a thorough KYC process is undertaken, we can then connect the customers and offer them a competitive price that also protects the liquidity providers.”

Hybrid approach

While some firms adopt an agency-based broker model and others are principal-based, there are some providers offering a hybrid approach. J.P. Morgan’s AlgoX solution was launched in late 2009. “The thought was that banks had liquidity based on either an internal model or an agency model,” says James Taylor, global head of e-FX distribution. “AlgoX is a hybrid model that offers liquidity from both our own internal order book and also a range of ECNs.”

The fact that J.P. Morgan has a large client franchise is beneficial for AlgoX clients interacting with the internal order book. In addition, clients’ orders passed outside the bank will be seen in the market as regular J.P. Morgan FX trading flow and as such entitled to excellent lines of credit with the majority of inter-bank counterparties.

Many of the banks’ FX algo models were based on the internal order model prior to 2008 (the likes of UBS and Deutsche Bank) but beyond this point the likes of Credit Suisse brought the agency model into the FX market. As far as Taylor is concerned it is not so much that clients prefer one model to the other but by offering both approaches, J.P. Morgan is able to present a wider pool of liquidity and a greater range of available prices.

“Most clients simply want to take the best price available and will leave it up to the algo to decide.

There has been some extra intelligence built in and historical data enables us to put more factors into the decision-making – such as rate of rejects and the actual liquidity that is available which involves distinguishing between liquidity and phantom liquidity where a market participant will put a price out in a small amount to gauge the level of interest in the market rather than to be executed against. Information leakage is still a big concern for many clients”, says Taylor.

J.P. Morgan also offers a crossing network for FX clients (MorganDirect Match) where clients can show interest in orders without going public or without producing any market data. “Although it is a service available to all clients, it is especially attractive to those operating in less liquid currencies where more open trading activity may be more conspicuous,” says Taylor.

There has also been new order types added to the traditional collection of TWAPs, Timeslicers, Trailing Stops and Floats. For example, there is J.P. Morgan’s ‘Panther’ algorithm, which operates almost completely by stealth in the market and also ‘Sliceberg’, which uses multiple ice bergs. Clients are also able to combine and link algorithms. The aim, says Taylor, is to be more intelligent about executing the orders to get a better fill.

For some clients, the primary use of algo orders has been to add more stealth and minimise their execution footprint. However, the majority of smaller trading shops, are just looking to get their order done, says Taylor. “They would probably use a more passive order type like a Timeslicer, whereas the banks and the larger buy-side firms who have dealing desks would potentially split the order up themselves. Some clients want to execute against a benchmark so that they can show their investors that they achieved an average price. Others may use the algos to make a market. They are getting direct access to the interbank market through our algos which makes them powerful tools. So there are some safeguards built in.”





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Nathan Halfon

“The challenge is ensuring that we are distributing the right liquidity to the right customers.”

Post trade and TCA

One of the biggest developments in the FX market in the last 12 months has been around the provision of post-trade data and transaction costs analysis. Whereas TCA has been a fixture in the equities market for some time, it is still a recent feature in FX and one that is subject to greater challenges, says Taylor.

“Providing both post and pre-trade data in the FX market is tough because there is no central repository and it is therefore impossible to capture every trade. There is also no industry standard in how this data should be formatted, so the ECNs all release data in different formats and we package it up as best we can. But with more business going through electronic channels rather than via voice trading, the demand for better post and pre-trade data will increase and the providers will devote more resources to making this data available.”

As to how the market for algorithmic FX trading develops, Taylor says it is important to make the distinction between algorithmic order types and

algorithmic execution. “An algorithm is simply a set of rules, and what we are providing is a number of rules that can be used for executing orders. Sometimes people can get very excited about the term algorithmic trading and associate it with high frequency traders and flash crashes. But in reality it is more about making peoples jobs easier, not to mention reduced costs, increased efficiency and transparency of execution.”

More precision in algorithmic execution

According to Bob Dantone, vice president of FX at FlexTrade, the FX algo market is constantly developing because its participants are always looking to pursue new and aggressive strategies. Of course different FX desks require different algos to execute their strategies. Agency desks can take advantage of VWAPs to execute significant trades in order to ascertain what the level of slippage would be. Hedge funds with multiple portfolio managers will have similar demands that will require execution at a certain price or time in order to minimise market impact. Corporates, on the other hand, may have different trading objectives, requiring



James Taylor

“Most clients simply want to take the best price available and will leave it up to the algo to decide.”

more direct liquidity provider execution. “FlexTrade’s FX trading systems are customised to allow for all of these different types of execution and price discovery needs,” says Dantone.

While these differences are reflected in the range of basic algorithms that have long been available in the FX market, they are also reflected in the work being done to add more precision to algorithmic execution, says Dantone. For those firms that are primarily looking to reduce market impact, adding more randomisation to the basic time slicing algo is important. It allows the client to be more secretive and less detectable to the rest of the market. Other order types, like pegged orders, enable firms to take advantage of better price environments through flexible execution rules, while iceberg orders enable larger orders to stay off the books. “It is all about being flexible enough to move with the market.”

Many of these algorithmic tools play on the ‘dark’ liquidity aspects and opportunistic objectives that see the trading process as a participant acting against the market and therefore looking to disguise their intentions and cover their tracks as best as possible. In the FX market, however, there are those traders that are much more relationship-based and are working with, not against, the liquidity providers. “This is why banks like systems like ours,” says Dantone. “The banks can request execution parameters from their clients which can be written into FlexTrade’s algos, making for a much more symbiotic relationship.”

Similarly smart order routers are now being fitted with more intelligence to judge the routing decision on more factors than simply price, says Dantone. “For example, if a prime broker charges you a set amount for trading with another counterparty and that counterparty is only slightly cheaper, the small price difference may make it sensible to trade with the prime broker. There are other factors to consider especially when trading with specialist banks. Some orders may be so large that only a select number of banks would want the business so the SOR system must be able to take banks on and off the system as required. It is about adding business logic to the automated process so that the SOR is not based purely on price.”

The other big development is the use of and demand for post-trade analysis tools, says Dantone. “More



Bob Dantone

“More of the buy-side firms are using e-trading tools across asset classes where post-trade analysis is a more regular feature. This demand means that a lot of the post-trade challenges are being overcome.”

of the buy-side firms are using e-trading tools across asset classes where post-trade analysis is a more regular feature. This demand means that a lot of the post-trade challenges are being overcome. In our system, if a treasury manager sends an order to an execution desk, our blotter shows exactly what that trade looks like and this makes it easier to beat the benchmark. It is about having a visual representation of what banks are offering the best prices.”

Increasing customisation

Increasing customisation is one of the primary features of the developing FX algorithmic trading industry, says Gary Stone, chief strategy officer at Bloomberg Tradebook. There are stealth algos that can be turned on and off. There are algos that help traders to ‘ladder’ their position, there are iceberg algos that enable clients to show a bit of their liquidity but keep the majority of it undisclosed. The no-show/iceberg algos are the most popular algo types for minimising information leakage. There are more effective ways to

do that but it comes down to how you engage with the market. Trigger algos are used to enable firms to react to certain market opportunities – if, for example, a large block of a currency becomes available. And then there are the discretionary algos, where a trader may set various limits but is also prepared to go beyond that limit if the right conditions exist.

Some of the customisation is determined by whether the client wants to float or stand its ground – that is, does the client want to be more passive and not stand in the way of the market should conditions and liquidity change in the course of the day, says Stone. “Some traders are very hands-on and want to control their orders, maybe by setting various triggers and using trailing stops. Others are dictated by their investment strategy of what they are looking to do, therefore the algorithms will be aimed at minimising the market impact as much as possible by splitting the order up into random patterns.”

To some degree the advances in algorithmic and electronic trading have simply enabled traders to automate the human characteristics that underpinned their trading strategies in the pre-electronic era. But the advent of electronic trading has also enabled them to do things they simply could not do before, says Stone. “When e-trading exploded it brought a lot more transparency and different ways to access and engage the market. This opened up new types of strategies and led to a massive increase in trading volume. This pattern has been repeated in every market that has evolved electronically.”

Electronic trading really took hold in the equities market. “We brought a lot of our equity algorithms over with us to the FX market but we found that most people in the FX world use us because we integrate our algorithms into our front-end,” says Stone. “It is not a black box. The algorithm is transparent so you can see it operates within the market depth and the value it adds to executions. It also allows traders to intervene and alter the aggression level of an algo to capitalise on different market conditions.”

Algo or strategy modifications can also be automated based on pre-determined rules or triggers, although most clients prefer to enact this manually until they feel are comfortable with the technology, says Stone. “It depends on the trader. They all have different behaviour. And it is a big leap to go from manual



Gary Stone

“We brought a lot of our equity algorithms over with us to the FX market but we found that most people in the FX world use us because we integrate our algorithms into our front-end,”

changes to entrusting the algorithm to automate the modification.”

Transparency of workflow

The other big issue in the algorithmic trading market is the transparency, says Stone. “At Bloomberg Tradebook we have the advantage of linking transparency and workflow. This means that we can make sure that the clients have control of their orders and the comfort of seeing the algorithms operate in the market trades at all times. Algorithm transparency has been a massive change and one that allows them to better evaluate performance and provide critical feedback for customisation and enhancements.

“We continually make significant investments in our infrastructure to ensure that we can maintain high volumes in times of market volatility.” As volatility and market complexity increases, the key to meeting clients demands, says Stone, is ensuring that there is sufficient balance between quantitative complexity and ease-of-use. “We believe you need to have a system where the user interface is simple and the complexity is on the inside.”



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Regulatory Roundup



Felix Shipkevich is Principal at Shipkevich Law Firm, PLLC
fs@shipkevichlaw.com

Last summer, the financial sector was in knots over the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The largest financial regulation overhaul since FDR's New Deal threw market participants into agonies of uncertainty about the future of the industry. One year later, and nearly two months after the mid-July deadline for many Dodd-Frank swaps rule-makings, many unanswered questions persist.

By early June of this year, it was evident that the CFTC would not be able to finalize all the necessary rules before the July deadline. The Commission granted temporary relief to two specific categories of self-effective swaps rules. This extension expires in December, at which time rule-makers will have to re-evaluate the state of rule-making. In the same notice, rule-makers confirmed that any provision of Dodd-Frank requiring a rule-making would not go into effect until such a rule was completed, regardless of any extension.

CFTC

However, the CFTC has not been idle. After a long interval between the fall of 2010 and the spring of 2011, when many rules were proposed but none were

finalized, this summer saw the passage of a host of new swaps rules. This frenzy of activity has so far yielded more than ten rules, including:

- Swap Data Repositories: Registration Standards, Duties and Core Principles
- Final Rules for Implementing the Whistleblower Provisions of Section 23 of the Commodity Exchange Act
- Agricultural Swaps
- Process for Review of Swaps for Mandatory Clearing
- Removing Any Reference to or Reliance on Credit Ratings in Commission Regulations; Proposing Alternatives to the Use of Credit Ratings
- Large Trader Reporting for Physical Commodity Swaps
- Privacy of Consumer Financial Information; Conforming Amendments under Dodd-Frank Act
- Business Affiliate Marketing and Disposal of Consumer Information Rules
- Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices - Prohibition on Price Manipulation
- Agricultural Commodity Definition

Some rules, like "Removing Any Reference to or Reliance on Credit Ratings..." make adjustments to current CFTC regulations, while others tackle new registration categories mandated by the Dodd-Frank Act. For example, 17 CFR Part 49 "Swap Data Repositories: Registration Standards, Duties and Core Principles" lays out the responsibilities of Swap Data Repositories, or SDRs. These entities will gather and store information from swap counter-parties and swap execution facilities.

The initial proposed rule requires SDRs to:

- Accept and confirm data
- Provide direct electronic access to the CFTC and other specified regulators
- Monitor, screen, and analyze data
- Safeguard data
- Create emergency procedures and system protections

SDRs would also be bound to accept all data in their selected asset class(es), protect the confidentiality of the data, and be prohibited from making commercial use of their data.

Another significant rule finalized this summer is 17 CFR Part 180, "Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices - Prohibition on Price Manipulation." It expands the Commission's current enforcement powers. The rule "prohibits manipulative and deceptive devices and contrivances, employed intentionally or recklessly, regardless of whether the conduct in question was intended to or did create an artificial price." Previously, manipulation needed to be intentional and successful to fall afoul of regulation. The CFTC has included an exception for good-faith mistakes and simple negligence. The rule also clarifies the Commission's authority to prohibit price manipulation on commodities and swaps.

NFA

The NFA, the futures industry's self-regulatory organization, has been busy adding to and adjusting its own regulations to keep pace with new rules handed down from the CFTC. This summer it issued an alert to members engaged in retail forex activities, notifying them of changes made to NFA requirements to comply with Dodd-Frank. These amendments affect NFA Bylaws, Compliance Rules, Code of Arbitration, and three Interpretive Notices, and will go into effect on October 1, 2011.

One change amends Bylaw 306 and Compliance Rule 2-39 to eliminate Forex Dealer Member exemptions. Now, all NFA members engaged in retail forex transactions must comply with NFA Forex requirements. The only entities still able to claim exemptions will be Futures Commission Merchants ("FCMs") that only use over-the-counter forex trading to hedge currency risk for other exchange traded transactions that are settled in foreign currencies. Another changes Bylaw 301(j) to require firms engaged in retail forex activities firms to have at least one principal that is registered as an AP and approved as a forex AP, in addition to current requirements. This person must pass the Retail Off-Exchange Forex Examination (Series 34).

There are additional changes to Compliance Rule 2-36 and Interpretive Notice 9053, Compliance Rule 2-10(b), and technical clarifications to the NFA's Code of Arbitration Section 1, NFA's Interpretive Notice 9058 entitled NFA Compliance Rule 2-40: Procedures for Bulk Assignment or Liquidation of Forex Positions: Cessation of Customer Business and NFA's Interpretive

Notice 9060 entitled Compliance Rule 2-36(e): Supervision of the Use of Electronic Trading Systems.

OCC/FDIC/Federal Reserve

The FDIC, OCC, and Federal Reserve have all released rules governing retail over-the-counter forex trading for regulated banks this summer. The three rules are similar to each other and to rules published by the CFTC and SEC last year. They only intended to cover rolling spot forward transactions, not traditional spot or cash forward transactions. There is no lengthy registration process involved for banks to begin forex trading with retail customers. Instead, interested regulated institutions must file a written notice with their regulatory agency and obtain written consent before engaging in any retail forex activity. The rules cover capitalization, margin, recordkeeping, and related requirements.

EU

On July 4th, European lawmakers moved to delay a final vote on the European Market Infrastructure Regulation ("EMIR") until September. EMIR is the European Commission's answer to the G-20 mandate to reform the over-the-counter derivatives market, and addresses many of the same issues as the Dodd-Frank Act in the United States. The delay was related to disagreements between the European Parliament and the Council over the final shape of the bill. However, the bill's sponsors are eager to finish EMIR this fall, whether or not the rest of the world has finished equivalent derivatives reform programs.

UK FSA

The UK Financial Services Authority will end the use of Title Transfer Collateral Arrangements ("TTCA") in forex trading with retail clients. In December 2010, the FSA introduced a prohibition on TTCAs used in spread bets and contracts for difference ("CFDs"). The proposed rule extends that prohibition to rolling spot forex contracts. TTCAs are agreements under which a client allows assets placed with a firm to be treated as collateral for any current or future obligations, essentially transferring ownership unconditionally to the firm. They are not subject to the FSA's usual client money protections, including Client Assets Sourcebook ("CASS") segregation requirements. The proposed rule requires that all money and assets from retail clients be treated as client money and therefore be subject to segregation requirements. This gives retail clients a proprietary claim to their money and assets in case of a firm failure. The Authority has also not ruled out the option of extending TTCA prohibitions to other investment types.

MT4 Liquidity Bridges – powerful new business engines for Retail FX




Nick Pratt

As Retail FX brokers look to adapt their trading platforms to cater for the increasingly popular ECN market, MT4 Liquidity Bridging applications are certain to play an important role. Nicholas Pratt looks at the challenges that lie ahead for the application developers.

The role of the Retail FX broker has often been likened to that of a bookmaker. The broker will accept a trade on behalf of a retail client and then place it onto their platform which is plugged into the interbank market. The broker is effectively acting as both market maker and dealer, making a margin on each trade. As retail traders have grown in sophistication, especially those small hedge funds still categorised as retail traders, the suspicion that their brokers are taking advantage of them through unscrupulous practices such as skewing prices and front-running has caused increasing irritation.

To try and placate this irritation, retail traders have been offered a type of ECN trading where there is greater straight-through-processing and a more direct route to the interbank market where the broker simply takes a flat rate commission on each trade. It is not ECN trading akin to the likes of Currenex or HotSpot that are used for institutional buy-side firms trading more than \$10m but it is a start.

Some commentators believe the insatiable demand for ECN type trading is likely to see an end to the



traditional market making retail broker model in a matter of years, which is something that retail brokers are going to have adapt to, both in terms of their own business model and also their technical infrastructure.

MT4 platform

The majority of Retail FX brokers use the MT4 as the trading platform offered to their Retail FX clients. It is a phenomenally successful product which was originally designed for the market making trading model and not for ECN style trading. This is where the MT4 Liquidity Bridge application has come in. A handful of software developers have created a Bridging application that enables brokers to adapt their MT4 platforms to offer a connection to the ECN market.

The success of the MetaTrader platform has been unprecedented and, to some extent, unexpected by the broker industry. “MetaTrader is one of the only platforms out there with such a well-supported user base of algorithmic traders and this creates a challenge for brokers,” says Andrew Ralich, co-founder and CEO at oneZero Financial Systems. “It is like an open source community of quants which is very different to the traditional high frequency trading hedge funds who will operate on a more proprietary basis. Not

only do the strategies and the language become more sophisticated but there are also the economies of scale. You are not just dealing with single incoming trading channels.”

It is the issue of scale that lies at the heart of the latest challenge facing the developers of Liquidity Bridges, says Ralich. The Bridges themselves are not new. They have been in the market for several years now. But the nature of the challenges are new. “As the Retail FX market grows, the MT4 platforms need to be able to



“As the Retail FX market grows, the MT4 platforms need to be able to deal with a large number of clients all using the same platform, increasing in sophistication every day and all executing at the same time.”

deal with a large number of clients all using the same platform, increasing in sophistication every day and all executing at the same time. Brokers need more than just execution speed; they need reporting, advanced routing and failover capabilities that only a few providers can offer as a complete package.”

Depending on the broker, the Bridge can be used in one of two ways, says Ralich. “Some brokers want to connect to the interbank market through a single pipe and use this for those retail client that they do not want to put through MetaTrader. Other brokers may have installed a new risk management system but do not want to spend the time re-training everyone, so they connect every client in MetaTrader directly to their back-office. This puts considerable more strain on Bridges and with enterprise level brokers, is a model very few Bridge providers have succeeded in deploying.”

Technical challenges of Bridging

The technical challenges involved in the Bridging of MT4 applications are the same old issues in many ways, says Ralich. “It is all about stability, performance and configurability. The need to be 100% stable has always been at the forefront. The need to offer flexible options for using MetaTrader is also increasingly

important. It is a constantly evolving platform and the sophistication of MetaTrader users continues to surprise brokers. The best Bridges help a broker adapt to client demands via more flexible liquidity models, more order types, advanced reporting and different instrument classes.”

Such are the demands on the MetaTrader platform that Ralich does not think every Bridge application provider will be able to keep up. “Brokers are still buying and using the MetaTrader platform but they are also looking to differentiate their flow by offering more bells and whistles to help differentiate their MT4 offering from the next broker.”

Consequently the strain falls on the Liquidity Bridges to cater for advanced order types, different commission structures, multi-account facilities and flexible trading limits. “For the brokers it is all about differentiation because it is the high-end next-generation brokers that are going to take a bigger share of the Retail FX market in the future,” says Ralich. Similarly it will be the Liquidity Bridge providers that can demonstrate scalability, reliability and flexibility that will take a bigger share of their market. “Brokers become very entrenched with their technology providers so it is an important decision. They want to be able to grow and know that they have a technology structure that can grow with them.”

Another factor that is starting to play a key role in selecting a Bridge provider is integrity, says Ralich. “Providing technology in financial markets often leads to a desire to take on risk and expand your business model beyond just offering solutions to brokers. Many of our newest clients are coming from technology solutions wherein the liquidity and Bridge got too intertwined, resulting in a conflict of interest and difficult situation for the broker. Clients need to have the flexibility to use a technology solution that is agnostic of their choice of how to manage risk, and who to use for liquidity.”

A final trend that Ralich has observed in the Retail FX brokers’ world is the demand for white label products and hosted services. “Many brokers are looking to offload not only the development of their technology, but also other aspects of their IT infrastructure. You will see more and more hosted and outsourced MT4 offerings coming into play for brokers who don’t wish to handle the burdens of hosting the platform themselves. We’ve worked closely with our clients to meet this demand with software as a service (SaaS)



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offerings of our Bridge, co-located with many of the liquidity providers in data centres such as Equinix NY4.”

High frequency and automated FX

According to Larry Levy, head of sales and marketing at PrimeXM, a Swiss-based provider of MT4 services and tools, the impact of high frequency and automated trading on the FX market has been enormous and a large contributor to the demand for MT4 Liquidity Bridging services. “In the last three years we have seen an increasing confluence, mainly because of rather more sophisticated software and regulation between the retail and institutional markets,” says Levy. “Regulation and exponentially higher volume throughput on the Retail FX end has increased the need to STP flow, and this in turn has increased the demand for efficient Bridging between industry leading MetaTrader software and the back end interbank / LP / institutional broker market.”

The fact that an increasing number of brokers are looking to reduce their exposure to high frequency traders by offering STP/ECN trading does create some issues, says Levy. “Firstly there is no guarantee that brokers who claim to be 100% STP are actually such. Some of them are either at the other side of the so called STP by setting up a third party company to do this or

they only stream part of their risk to the banks. This need not affect the quality of fills but if the broker fails to manage his book properly then he essentially puts his client monies at risk. A greater percentage of clients are now actually making money in forex in our opinion as service levels have gone up and spreads have come down. Therefore the time when you could just ‘B book’ all your trades without off laying the risk and hope for the best are riskier than ever. Brokers doing this are at increased risk of bankruptcy,” says Levy.

There are also technical challenges which the providers of Bridge applications are having to overcome, says Levy. “As a server based Bridge, the PrimeXM Bridge can support throughput of large numbers of trades per second without confirmation delays. Secondly, the Bridge is able to “take control” of the MT4 back end software to make sure that it “syncs” with the front end. Thirdly the Bridge features Non Latent Quote Streaming (NLQS). This ensures that old or stale quotes are thrown away and only the latest are processed. This makes for better client decision making on less latent data so giving better client service. Fourth - order types such as limits and nested limits are well supported.”

Ticking the boxes

Such are the challenges in creating a quality MT4 Bridging application that few companies tick all the boxes, says Levy. “The MT4 Bridge market has become a competitive place. Look very closely at latency, connectivity, security/backups, as well as the speed and reliability of the Bridge internally as well as the functionality itself in terms of price markup groups etc. Brokers all too often fall into the trap of taking a so called ‘free Bridge’, only to find, for example they are paying one to two hundred dollars a million extra in pricing while ‘saving’ four dollars a million on the Bridge. Not only are some of these so called ‘free Bridges’ rather expensive in reality - they are often very slow, leading to customer loss and all-round bad service. A good Bridge can literally make the difference between a broker’s profit and loss.”

A good Bridge can also go a long way to making STP more profitable for a Retail FX broker and therefore make them less tempted to take undue risk onto their own books, says Levy. “This reduces risk to both the broker and in turn the client. Secondly the price feed and the fills are significantly faster than the MT4 client with a correctly implemented Bridge which comes far closer to an institutional trading experience than was previously possible. Gone are the slow fills, order kills, and other daunting and demeaning experiences



Larry Levy

“Brokers all too often fall into the trap of taking a so called ‘free bridge’, only to find, for example they are paying one to two hundred dollars a million extra in pricing while ‘saving’ four dollars a million on the bridge.”

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of less efficient Bridges and old fashioned Retail FX broking. Say hello to sub millisecond, co-located price streaming and order execution previously only offered in the institutional marketplace.”

Avoiding risk and back office overload

Trading systems integrator Gold-i has developed the Gold-i Gate Bridge for MT4 trading. According to Gold-i chief executive Tom Higgins, one of the big challenges is the increasing trade volumes generated by the high frequency, automated, mobile and algorithmic traders that are trading through Retail FX brokers and the impact this volume is having on the back office and risk management operations of FX retail brokers.

“Brokers who “B-Book” or warehouse all trades run huge risks as trading volumes goes up and volatility increases,” says Higgins. “The smart brokers are covering more and more business directly with banks and brokers via super low-latency technology such as the Gold-i Gate Bridge. That takes care of the front office side of things but the back and middle office (for risk management) must not be ignored. The Gold-i Gate Link integrates MetaTrader with any back-end system by normalising everything to FIX 4.4 or FIX 5.0 messages. This allows the broker to have a proper, sub millisecond, record of all MetaTrader activity in their back-end systems. If brokers are covering some of their business and running the rest then knowing their real-time net positions and daily P&L is vital. The newly-developed Gold-i Position Keeper is a true window on their risk and profitability.”

An increasing number of brokers are looking to reduce their market risk by offering ECN trade execution platforms to their high volume clients who could be viewed as scalpers or trade robot users, something which necessitates providing access to third party liquidity providers. This change in the business model represents a further opportunity for Liquidity Bridge providers, says Higgins.

“High volume clients are smart, and getting smarter. No sensible broker wants to bet against someone who wins more often than loses so covering their business using super-fast technology in the highly-liquid bank markets makes perfect sense. Low-latency, high-performance, reliability and a large list of LPs are key to making this work well. The Gold-i Gate Bridge is measured at 99.9995% trade success rate and 1-2 milliseconds latency, processing hundreds of orders per second through a single Bridge, with more than 24 different liquidity providers.”

Business engines

According to Higgins, the latest generation of integrated Bridging and risk management solutions are able to act as powerful and consolidated business engines offering low latency, STP, flexible order routing, advanced customer profiling, and wide administrative capabilities in addition to their basic liquidity management operations. “In the early days of Retail FX all broker B-booked (internalised flow), then they all started A-booking (STP) and now, with broker consolidation, brokers are mixing B and A booking. This requires advanced Bridges and state of the art risk monitoring systems.”

The more functional Liquidity Bridging solutions offer feature-rich MT4 plug-ins and new technology that can assist brokers in capturing more business, improving customer loyalty and handling increasing trade loads more efficiently. “Our brokers can use multiple liquidity providers so that each asset class can be routed to the best execution venue but the end client still has a single account and true cross-asset margining. Multiple liquidity providers also give the broker more resilience and access to a much larger product set as demanded by their customers,” says Higgins.



Tom Higgins

“In the early days of Retail FX all broker B-booked (internalised flow), then they all started A-booking (STP) and now, with broker consolidation, brokers are mixing B and A booking. This requires advanced Bridges and state of the art risk monitoring systems.”



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Higgins says that there are a number of factors that will influence the choice of MT4 Liquidity Bridge provider. "These factors include latency, performance, reliability, liquidity provider integration, multi-asset support, partial and multiple fill support and excellent customer service around-the-clock." Gold-i has attempted to address these customer concerns by offering a series of complimentary services such as Gold-i Gate Link, Gold-i Position Keeper and Gold-i Multi-MAM.

Scalability

Customisation features are also available in the latest generation of Bridging products but perhaps one of the most pressing issues is the need for Bridging products to provide the scalability needed to meet future volume growth. "The speed of MT4 is the only real limitation in the number of transactions per second," says Higgins. "The Gold-i Gate Bridge is built for speed and reliability, and we have measured MT4 and the Bridge at around 500 transactions per second. In testing, over 5 million trades have been transacted in one day using a single Bridge."

As with oneZero, Higgins recognises that white labelling options and hosted service models are becoming an increasingly common feature in the MT4 Liquidity Bridging market. "The Gold-i Gate Bridge fully supports introducing brokers and white labels," says Higgins. "The two can be grouped into separate liquidity groups and routed to either the same liquidity provider in different LP accounts or different liquidity providers. Gold-i does not offer its own white labels as that would compete with our own clients, however we partner with many brokers who offer white labels solutions using our products."

Leverate is another broker solutions provider offering an MT4 Liquidity Bridging product. Leverate has developed its own risk management solution allowing brokers to either keep the risk on their own books or pass it straight through via STP to the best bid/offer of a multi liquidity," says director Lior Shmuely. "The risk management platform is a smart strategy

centre allowing the broker to decide how to STP the trades or alternatively keep the risk whilst checking the validity of the trade. There is a consistent demand to accept and pass high frequency trades via STP or checking the validity of the trades with logical rules for managing the risk and exposure, this is one of the reasons that the Leverage risk management system was indeed developed."

ECN trade execution

Shmuely has also recognised that an increasing number of brokers are looking to reduce their market risk by offering ECN trade execution for their high volume clients. "Brokers have realised lately that pure

B Book management may not be an optimum way to handle their risk, because of the growing number of accounts that have been successful as scalpers, robots and so on. It is for this purpose that the multiple liquidity risk management system that Leverage offers is such a popular solution."

Divisa Capital is a broker specialising in e-trading and direct market access and with a focus on margin spot FX trading. According to chief executive Michael Markarian, the company chief executive,

the increasing trade volumes generated by high frequency, automated, mobile and algorithmic traders is having a profound impact on the back office and risk management operations of Retail FX brokers, many of whom demand ultra low latency and 100% availability. "Now more than ever, brokers need to be using the proper tools to not only manage market risk but to also process the multitude of messages that most automated strategies generate. IT infrastructure, from the servers to the data centres, also need to be scrutinised."

Markarian agrees that an increasing number of brokers are looking to employ STP and ECN-based execution as a way of reducing the market risk that comes from their high frequency trading clients. "With increasing volatility and trade volumes, many larger brokers have enough scale required to STP their order flow in order to generate consistent revenues. This coupled with the fact that risk dramatically increases as do your fixed overhead costs when employing a dealing desk model."





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Ongoing development

Markarian also sees a number of technical challenges in terms of the ongoing development of Bridging MT4 server applications as these market factors take hold. “While clients love MT4 for its simple yet powerful interface, developers do not share this same opinion mainly due to the fact that the API is not well documented and it is not FIX compliant.”

Divisa Capital offers a Bridge that was co-developed by MetaQuotes and Currenex that connects directly to the liquidity, says Markarian. “Most other Bridges require an additional server or server process that re-routes the trades creating performance issues and undesired latency. Our clients are able to access our top tier liquidity available via our Currenex hub without compromising the speed and reliability of MT4. These brokers are also able to take risk if they choose on a client by client basis.”

Markarian stresses that Divisa Capital’s objective is to provide all of its brokers with the tools necessary to run a successful FX brokerage and the latest generation of Bridging and risk management solutions are a key component in this ambition. The feature-rich MT4 plug-ins and new technology can assist



Michael Makarian

“With increasing volatility and trade volumes, many larger brokers have enough scale required to STP their order flow in order to generate consistent revenues.”

brokers in capturing more business and handling their increasing volumes more efficiently. “Simply put, they reduce start-up and operational costs, while providing a better service for the end clients, which in return results in customer loyalty and business growth.”

Choice of solution

Cost, functionality and reliability are the most important factors brokers consider when evaluating Bridge solutions, says Markarian. “Another key factor is to have a knowledgeable team that is experienced with MT4 Bridge technology.”

As well as catering for in-house installations or remote hosting, MT4 Liquidity Bridge providers also have to ensure scalability as trading volumes continue to grow, says Markarian. This over-riding necessity for scale consequently creates challenges for those providers looking to offer additional features and customised functions. “Most Bridges have similar order routing features, by group or trade size, but the most important is performance under heavy load. The Bridge needs to be able to process hundreds even thousands of messages per second generated from automated strategies and expert advisors. MT4 is very picky. Additional features are nice but they also complicate the code and usually create more issues than they solve.”



Lior Shmueli

“Brokers have realised lately that pure B Book management may not be an optimum way to handle their risk, because of the growing number of accounts that have been successful as scalpers, robots and so on.”

Product Launch-

Gold-i Gate Bridge for MT5

The Gold-i Gate Bridge - which connects brokers' trading systems to global banks via MetaTrader 4 - has been such a successful product that it put Gold-i on the map as the UK's leading systems integrator to the global FX and CFD market. We caught up with Tom Higgins, CEO of Gold-i, to find out about his company's latest product launch – the Gold-i Gate Bridge for MT5.



Tom Higgins

What is the Gold-i MT5 Bridge?

The Gold-i MT5 Bridge, which launches in Q4, is a super low latency, high performance Bridge which enables brokers who use MT5 to connect to external liquidity providers in the most effective and cost efficient manner. It automatically covers all retail broker risks with banks in real time. It gives retail brokers the same tools as institutional brokers.



We launched the Gold-i Gate Bridge for MetaTrader4 in 2009 and it has become recognised as one of the leading super low latency smart routing products available anywhere within the market place today. We have high aspirations for our MT5 Bridge, too, as it will open up new markets and new asset classes.

Our new Bridge has been created in response to increasing demand for MT5. The Gold-i Gate Bridge for MT4 has evolved since its initial launch – and over the last two years we have added a number of bolt-on products and increased the number of liquidity providers.

The exciting thing about the launch of our MT5 Bridge is that, at launch, it will offer everything which is covered by our MT4 Bridge. For example, we will

launch with 24 liquidity partners, which is the largest number of liquidity providers available by any MetaTrader integrator.

Will the Gold-i Gate Link work with your MT5 Bridge?

Yes, through the Gold-i Gate Link we will offer MT5 users complete liquidity provider and back office integration in real time.

How does the Gold-i Gate Bridge differ from other Bridges on the market?

The Gold-i Gate Bridge allows full use of the order types which the liquidity provider and MetaTrader support, as well as multiple fills. Orders are executed directly by the liquidity provider and not synthetically by the Bridge, giving the client the best opportunity for order filling at the correct price.

What are the biggest benefits of your product?

I have quite a long list! In my view, we excel in terms of latency, performance, functionality, reliability and liquidity partner integrations. We offer multi-asset support, partial and multiple fill support, all backed up by excellent 24 x 7 customer service.

For further information, visit www.gold-i.com



Join the professionals –

maximise your trading and investment potential with a Retail FX ECN platform

Electronic Communications Networks (ECN) have revolutionised the Institutional FX market and many commentators believe ECN-style trading platforms are likely to do the same in Retail FX. Heather McLean explores the options available to Retail FX traders who might be looking to switch from a traditional market-making broker to an ECN platform provider.

Most FX brokers are Market Makers (operating Dealing Desks) who “make” both the bid and the ask prices on their trading systems and display them publicly on their quote screens. They undertake to execute transactions at the prices they have quoted to their customers. As counterparties to each FX transaction Market Makers must therefore take the opposite side of a customers trade. So whenever a trader sells, they must buy from them, and vice versa. This traditional DD trading model is the most commonly practised throughout the Retail FX trading marketplace.

ECN platforms on the other hand pass on prices from multiple market participants, such as banks and Market Makers, as well as other traders connected to the ECN, and display the best bid/ask quotes on their trading platforms based on these prices. ECN platform providers make money by charging customers a fixed commission for each transaction. Authentic ECNs do not play any role in making or setting prices. This means the risks of price manipulation are reduced for retail traders.

Once again ECN-style brokers serve as counterparties to FX transactions, but they operate on a settlement rather than pricing basis. Unlike fixed spreads, which are offered by some Market Makers, spreads of currency pairs vary on ECNs depending on the pair’s trading activities.

Why ECN?

Wael Salem, head of business development at FX Central Clearing, says the traditional market-making broker models offer higher leverage, lower deposits, up to 100% bonus, and the ability not only to trade micro, but nano lots. So the question always rises, why would a trader chose to switch to an ECN broker?

“In the past decade, the ECN model was only within the reach of banks, hedge funds, and proprietary traders, where account sizes had to be in millions of dollars to get access to such liquidity pools, price streaming and execution models,” comments Salem. “Now ECN brokers utilise the latest technology and clients can trade in fair and realistic market conditions, trading on tier one liquidity provided by some of the biggest liquidity providers in the FX business. In addition to that, ECN brokers have no conflict of interest between their clients and themselves.”

The number of non-dealing desk (NDD) FX trading facilities, either straight through processing (STP) or ECN plus STP brokers, has notably increased in the recent years, claims Vladimir Kisyov, head of business development at Deltastock. He says the shift from the dealing desk (DD) to NDD business model has accurately addressed the growing demand of the forex trading community for greater liquidity and best execution, so explaining the migration trend of retail clients from Market Makers to ECN-STP brokers.



Wael Salem

"In the past decade, the ECN model was only within the reach of banks, hedge funds, and proprietary traders, where account sizes had to be in millions of dollars to get access to such liquidity pools, price streaming and execution models,"

He adds: "Nonetheless, retail forex Market Makers are still in business. The DD is still a sustainable model and that is not without a reason. In that regard, the debate about DD and ECN seems to be diverting the attention from the real issue; how brokers are executing client trades. To be able to quickly enter or exit a position or trade at the requested price, such as where your order is filled, is what matters most to retail clients."

Combined offering

Deltastock offers both DD and real ECN-STP facilities under one roof, in the company's in-house developed trading platform, Delta Trading. The integration of an ECN-STP (Level 2) module in the proprietary Delta Trading platform is complementary to the option of trading at fixed dealing spreads, significantly widening the scope of trading opportunities for clients, who benefit from the advantages of both DD and NDD trading models, says Kisyov. Clients can open a position by placing a trade at the fixed dealing spread and later on close that same position by choosing to have their order executed through the ECN-STP (Level 2) panel of Delta Trading.

Kisyov states: "Ultimately, it is the trader's decision on whether and when to deal with a Market Maker

or trade in a pure ECN environment. This process has been further streamlined for the convenience of clients. They do not have to meet any additional requirements or criteria whatsoever to freely cross-utilise trading at fixed spreads and dealing at ECN variable spreads which often go down to 0.1 pips on FX majors. They just access both facilities through one trading account, in one platform."

However, Kisyov contends that Market Makers' (DD) business model is to be the buy side of the FX trade, when the client is the sell side. "Conflict of interest and trading against clients are speculations which are nourished predominantly by the marketing departments of the newly fledged ECN-STP brokers, former Market Makers that are now providing an anonymous ECN environment," states Kisyov.

"It is not serious (and far from professional) to regard the DD model as synonymous with a service offered to the detriment of clients. Market Makers manage net client exposure on an aggregate basis. They clear and offset portions of it in the interbank market by strictly following their risk management policies. They are by no means trading against individual clients. Let's not forget that the Market Makers are on the top of the pyramid, and they are the major liquidity providers of the tier one and two prime brokerages, down along the chain to the STP (NDD), ECN-STP brokers," Kisyov remarks.



Vladimir Kisyov

"Ultimately, it is the trader's decision on whether and when to deal with a Market Maker or trade in a pure ECN environment."

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Two basic broker services

George Xydas, director of international operations at FXPro, comments: "There are two basic services offered by FX brokers. The first is a service whereby a broker makes a market in currencies, and the second is the broker providing an agency service. In the first instance, the broker has to provide a constant price and liquidity flow at which clients can trade, and charges a spread between the bid and ask price. If pricing is not competitive and liquidity is not sufficient clients will be swift to change service provider. The provider must also have sufficient capitalisation to be able to accept the increasing client volumes and must have a good risk management system to be able to hedge its exposures with the broker's prime brokers."

"In the second instance, the broker provides an environment through which different Market Makers, be it banks, hedge funds or other liquidity providers provide the price and liquidity flow. In this environment the broker provides an agency service and charges an agency fee such as commission," says Xydas.

Xydas continues: "The retail trader has to carefully review the terms and conditions of each broker and the environment it offers to fully understand how each environment works. Usually the trader has to compare the bid-ask spreads offered by the Market Maker to the spreads offered in the ECN, plus the commission charged by the ECN broker. In addition there are different types of orders that can be placed in each environment, as potentially there are different leverage and margin requirements. So it is up to the trader to decide which conditions better meet his or her needs before making a final decision where to go. At FxPro we offer both environments and we have tried to make both offerings as similar as possible, using our relationships with global banks, as well as implementing technological solutions that allow the trader to use either environment."

Key factors to consider

There are three factors that should determine whether a retail forex trader should transition to an ECN Broker, states Mushegh Tovmasyan, global head of sales at Alpari (UK). The first is minimum trade size. "Historically banks have been reluctant to process small ticket transactions and that is why ECN brokers have implemented a minimum trade size for their ECN accounts. Advances in technology now enable many ECN brokers to allow mini lot trading (10k notional value) and micro lots (1k notional value)." Tovmasyan says the second reason is trade commission. He explains: "Traders should consider



"Usually the trader has to compare the bid-ask spreads offered by the Market Maker to the spreads offered in the ECN, plus the commission charged by the ECN broker."

the total cost of the trade and not only the spread. To give you an example: \$50 per one million commission charge is equal to 1 pip spread markup on a round turn trade."

And finally, Tovmasyan points to latency. "The benefit of ECN execution is that trades are executed at available market rates. If there is latency between the client and the broker's server, the trade might get executed at different rates from what was requested because markets can change in the time it takes for the information to reach the server."

While Joan Droguett, research, monitoring and brokerage officer at Dukascopy Bank, enthuses: "In our current highly volatile market, I can easily say there are only advantages in choosing an ECN broker. Apart from the dramatic difference in available liquidity, having Market Makers compete to offer their best prices can only be an advantage to the retail trader, provided they are not penalised by any order size limitations. For retail traders, micro lots are also a must, and any worthwhile ECN would make sure their execution is on par with the execution of institutional traders."

A note of caution

However, Samantha Roady, Chief Marketing Officer, GAIN Capital, warns: "On paper, the concept of a



no conflict of interest

gloves off with a unique ECN product

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Mushegh Tovmasyan

“The benefit of ECN execution is that trades are executed at available market rates. If there is latency between the client and the broker’s server, the trade might get executed at different rates from what was requested because markets can change in the time it takes for the information to reach the server.”

retail ECN sounds great; access to unlimited liquidity from multiple institutions, super tight spreads, fast trade execution, no conflict of interest, and the rest. However, it’s not guaranteed that the retail ECN offerings available today offer significant advantages for most retail traders over the direct offerings available from the large, regulated retail FX brokers.

“For sophisticated retail traders who think they would be better off trading on an ECN, it’s important to compare ECNs to regular broker offerings in five areas: liquidity; spreads; execution, tools and services; and safety of funds,” she says.

She continues: “Retail ECNs are only as good as their liquidity relationships. Therefore, it’s important to choose a provider that can provide you with access to a deep pool of liquidity to ensure your ability to see and trade on tighter spreads than you would see on a retail platform.”

Improving investment performance

On the question of how retail traders can use FX ECN platforms to improve their investment performance, Xydas comments: “I will start by Level II pricing. In

an ECN a trader can see the entire depth of all the liquidity providers that are connected to that ECN. For small orders this may not make much difference, but for a \$20 million order, the trader must be able to see if he can execute such an order and how much of the order book they will fill by placing that order, as well as the price that the order will be executed. Level II pricing helps the trader decide if they will place a market order or a limit order. If there is sufficient depth and the prices offered for such depth are acceptable to the trader, then he can place a market order to be filled instantly. Otherwise, he will need to place a limit order and wait for the order book to build at that price,”

Xydas continues. “Most of the ECN environments that are offered to retail traders do not offer expert advisors (EAs), as most EAs were and are developed for the Metatrader platform which is mostly a Market Maker solution. So if a trader wishes to use EAs he may need to trade on MT4 or MT5 rather than an ECN. As the use of automated trading increases (50% of volumes executed by clients of FxPro are through the use of automated trading or EAs) ECN brokers will have to provide such solutions. FxPro launched cTrader ECN in April 2011 and we are fast developing a solution to allow clients to write and use EAs.” Tovmasyan adds that MetaTrader provides a very flexible programming language to integrate news and third party market data into automated trading strategies. “Traders can then use MetaTrader to execute via ECN venues via brokers such as Alpari. Our MT4 Pro accounts are integrated into ECN liquidity and execution via a highly optimised bridge developed in-house.”

Aligning interests

Perhaps one of the greatest benefit of ECN platforms is that the interests of the broker and the client are aligned, comments Tovmasyan. He says the broker provides all the tools available to facilitate a client’s trading, and orders via ECN platforms are routed to the best price provider in the liquidity pool which is comprised of top tier banks and hedge funds. “It is possible for one order to go to one bank and the next to another bank,” he adds. “To the trader this means that no single price provider receives all of the trades, essentially masking the trading strategy. This facilitates the usage of high frequency and news trading.” For ECN brokers, the accessibility to real market conditions are unlimited, states Salem. “The main difference between the two models is the ‘no conflict of interest’. As ECN brokers work based on volume generated through their platforms, they strive to

provide the best and latest technology to their clients to ensure highest standards of execution and pricing.

“As an ECN broker, FXCC provides spreads on all its currencies starting from 0.1 pips with an average on majors varying between 0.4 pips and 0.7 pips,” continues Salem. “Comparing Market Maker models with the ECN model, some of the spreads can reach up to 5+ pips on majors. This means that a client is better off \$50.00 per one standard contract (100,000.00). Additionally, due to the ‘no conflict of interest’, ECN brokers allow all EAs to trade. Contrary to Market Makers high volume, profitable EAs are more than welcome. In fact, high frequency traders (HFTs) and EAs are one of the key to our own success with this business model. In Market Maker models, these EAs are banned or are given a very high risk categorisation on their books. Depth of the Markets can give a trader or a HFT a true view on where other trading portfolios have placed their pending and current orders. Many market analytic tools depend on this feature to build their strategies and analyse trends and predict price action models,” Salem concludes.

EAs, Add-ins, Level II pricing and market depth are tools among many others that, if used correctly, can help traders maximize performance, claims Droguett. He says Dukascopy Bank’s Jforex platform allows



Samantha Roady

“For sophisticated retail traders who think they would be better off trading on an ECN, it’s important to compare ECNs to regular broker offerings in five areas: liquidity; spreads; execution, tools and services; and safety of funds,”

traders to run any strategy or custom-made add-in based on Java, and to provide access to market depth. “While developing their strategies, traders can utilise the market depth as an additional resource, providing information about the current market,” he notes. “The special option for placing of Bids and Offers to the market allows traders to act as a liquidity provider by placing individual bids and offers directly to the market. As Bids and Offers are placed, they can be matched by other liquidity consumers, thus avoiding the spread costs.”

Pricing issues

On how traders can exploit increased price volatility experienced in an ECN trading environment, Tovmasyan states: “Traders are able to utilise EAs to take advantage of these fluctuations to engage in high frequency trading. Traders need to be extra sensitive about the latency between their trading station and the broker’s ECN server. It is recommended to use a VPS service or co-location to maximise the potential of these strategies.”

Liquidity in an ECN is provided by a number of sources, usually global banks, states Xydias. As each bank has its own book to manage, it can change the pricing and size of liquidity that it offers in an ECN. “This leads to greater volatility during news times, as banks tend to widen spreads just before major news events or during the night when liquidity is low,” explains Xydias.

“A trader first of all needs to know that such events happen, and so design his trading strategy and execution tactics accordingly. If a trader is using a strategy of trading the news he must design such strategy having in mind that spreads may widen, so he must design his take profit/stop loss orders accordingly so that he doesn’t get stopped out accidentally in an order that is proving profitable had not the stop out been triggered,” notes Xydias.

One of the major differences between ECN brokers and traditional type brokers is the filtration of prices, says Salem. He states that ECN brokers could have volatility over one minute up to five times the volatility on the same pair within the same minute with a Market Maker. Market Makers provide this filtration in order to eliminate traders taking advantage of mini spikes that range around five to 10 pips on average. “With ECN brokers, predicting these spikes or using a very well written HFT or EA, traders can take advantage of such trading conditions that could only be provided through a true ECN broker.”

Improved transparency

Another important feature of how ECN-STP systems benefit clients compared to the traditional trading model says Kisiov, is that each participant can act as a Market Maker, so that the other ECN participants compete for his offers. This allows clients to place orders within the spread. The limit orders submitted by the clients in the order book are immediately visible to all. Thus traders can place trade orders among themselves; Avoiding intermediaries, as there is no dealing desk and execution is fast and error free; the identity of retail clients is not visible to other market participants, which ensures that they receive the same conditions as institutional players; since there is not only one company that provides quotes (offers), but a few large institutions, there is much higher liquidity and therefore better pricing and lower spreads, even during high market volatility.

Kisiov adds: "ECNs are a transparent way of trading as clients can see market depth, which gives them much better market insight. They also receive post trade information to the detail. One feature we provide that is not typical for most ECNs, is the ability to choose a specific counterparty to trade with (valid for market orders only)."



Joan Droguett

"Apart from the dramatic difference in available liquidity, having Market Makers compete to offer their best prices can only be an advantage to the retail trader, provided they are not penalised by any order size limitations."

Market volume

Depending on the type of order, available market volume can influence the execution, states Droguett. "Banking holidays, or the overlaps of regional market opening times, can affect certain instruments. But the biggest drops in available volume are almost always the result of extremely volatile markets. In highly volatile markets, the few milliseconds separating the market orders from reaching the ECN servers can have great influence on the execution. Thanks to the possibility of selectively controlling slippage, a trader can adapt to any possible market condition."

Salem states: "When we talk about retail clients, in which 90% of the trading tickets vary between 10,000 and 5 million, volume is not an issue; clients will always get executed and what matters the most is the technology behind the execution of large orders. The question is what a broker would do if the order requested is higher than the volume available through liquidity on the specific price. In the traditional broker model, the order will be rejected or could be re-quoted three to five pips away from its current price."

Salem continues that in the example in which a client has requested an order of 20 million (200 lots), and the liquidity available from Bank X is only 5 million, FXCC will execute the first 5 million on the requested price, and take the next 15 million to the next depth of level, and so on, to fulfill the full order, and once the order is fulfilled and fully executed the average price is given back to the client. "In many cases that next best-offered price could be better than the requested price," contends Salem. "Therefore the average price could be better than the requested price. In short the client could be slipped in his favour or against his favour when a requested volume is larger than the available in one tier in the current market depth. This process is done within milliseconds. With our current structure, 99% of our orders up to 20 million (200 lots) have been executed within a range of less than 1.0 pips."

Market execution

In highly volatile markets, banks pull out their liquidity during high volatility or trading news, spreads are slightly increased and the volumes drop, says Salem. Clients that experience pending orders or try to trade during that period or event, will trade based on market execution. He adds: "Market execution is the ECN market in its simplest form; a client order is put into the system and the client will receive the best pricing available through all our liquidity pool. Clients may get slipped, although getting slipped in an ECN market is

not always bad news. Clients may experience slippage to their favour, as well as against, depending on the market conditions."

Xydas notes: "Usually for small orders execution is not an issue at the prevailing top of the book price. But for a \$30 million order on a minor currency pair, execution may take minutes and spreads may widen much more than the trader anticipated (if he places a market order). So the trader must first monitor an ECN environment offered by a broker, make sure that there is sufficient liquidity and volume executed in the currency pairs that he is interested before choosing that broker and ECN."

"ECN environments work best with medium sized tickets such as \$500,000 to \$1 million," continues Xydas. "Small tickets are not favoured by liquidity providers, as there are clearing fees involved with different counterparties, and the clearing bank charges settlement fees per ticket irrespective of ticket size. On very large tickets, the liquidity may not be there. So it is up to the broker providing the ECN environment to build solid relationships with the liquidity providers and the technology providers to manage this. FxPro has managed to be able to provide order sizes as small as 10,000 without additional charges, and usually the book offered on the FxPro cTrader is up to \$25 million each side allowing for the execution of large market orders."

Going user friendly

ECN Brokers have been taking massive steps to make sure that ECN platforms are more client friendly, claims Salem, including ease and availability of the technology, demo account accessibility, manuals, webinars, seminars, platform orientation and the integration of third party systems and tools to smooth their usage. "In addition to that, with the abundance of technology, platforms now are easy to integrate and access either through PDA and mobile devices," states Salem.

Tovmasyan comments: "Traditional ECN technology providers have been adding retail elements to their platforms such as charts, interactive buttons, technical analysis, mobile and web access and much more. Brokers in turn have been integrating popular retail platforms into ECN liquidity and execution."

Xydas comments: "An ECN broker must first understand that a retail trader has different needs than an institutional trader (for whom the ECN environments were developed). Retail traders need to have charting and technical analysis tools embedded in the platform to allow them to back test strategies. In addition they need to be able to see margin requirements and status of their portfolio. FxPro cTrader offers all those tools favoured by retail traders. In the current world of social networking, retail traders like to share strategies between themselves and comment on each other's trading techniques. FxPro offers a snapshot tool that automatically takes a picture of the trader's screen and posts it on social networks such as Facebook or Twitter."

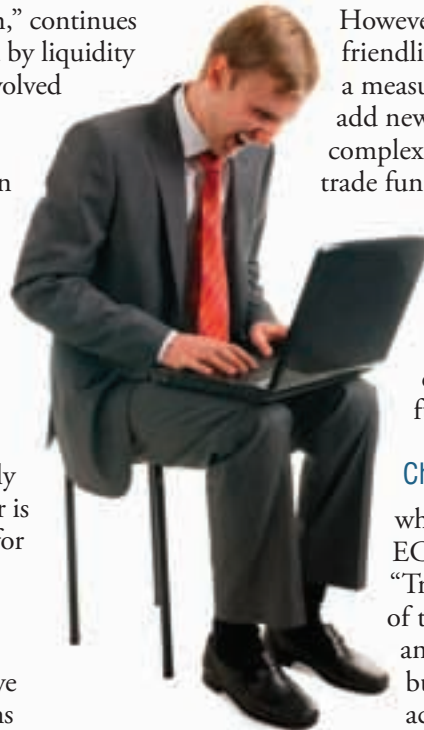
However, Droguett contends: "The user friendliness of an application is not necessarily a measure of its popularity. As the platforms add new features and tools, the level of complexity also increases. The basic click-and-trade functionality will always remain, but any use of fundamentals or technicals to create a working system will require a modicum of skills. The focus for Dukascopy Bank is to ensure the continuity and ability to meet client's demand in order to develop new functionalities and trading tools."

Choosing the platform

when it comes down to choosing an ECN platform, Tovmasyan notes: "Traders should examine the total cost of trading and not only spreads. Spreads and commission fees are important, but traders also need to be aware of accessibility (web, mobile, Windows, Mac, API language, etc).

In addition to this, it is important to analyse the broker offering access to the ECN platform, such as quality of service, counterparty risk and global presence. Low latency is essential to ensure the trader gets the full benefit of the ECN platform and execution."

On what issues should influence a trader's choice of ECN platform, Roady has several recommendations. "Be sure to compare full transaction costs. For many ECNs, the commission can be \$50 per million, which is the equivalent of .5 pips. If the USD/JPY spread at a regulated broker is 1.5 pips, you'd have to consistently trade on spreads of less than one pip to realise a saving."



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"If you're looking at an ECN because you like to make larger traders, say around \$5 million, check the fine print to understand if your margin requirements will be higher for larger trades, or if the amount of liquidity on the ECN is sufficient to allow you to trade size at the tighter spreads. In some cases, the depth of liquidity is not always there for larger trade sizes, or you'll receive volume weighted average price fills on your larger trades; either way you could end up paying more," she warns.

When trading on a retail ECN, your account and funds are held with a retail broker. Therefore, the firm's reputation, financial wherewithal, and regulatory oversight are still important considerations, continues Roady. "The broker's technology infrastructure should be firmly established to ensure connectivity, speed, and low latency. Make sure your broker is regulated by one of the primary regulators, such as the UK, Japan, Australia or the US, where you'll have added confidence knowing the broker must abide by a full set of rules and regulations, plus there is a framework for dispute resolution and, in most cases, safety of funds protection."

Roady adds that if you qualify as an eligible contract participant (ECP), your options are significantly better as you can trade on an institutional ECN. (ECP qualifications vary from region to region, but most have a net worth and investable asset requirement).

Support for strategies

An ECN platform, whether provided from a third party vendor or from in-house development, should always include an option to run a strategy, states Droguett. "Jforex, our inhouse platform, offers such functionality, and offers an API capable of handling even the most complex algorithms. Back testing and demo testing are parts of such functionalities, and are a very big part of our customer's attraction to our ECN."

Salem adds: "Trading on an ECN feed and execution model allows clients to implement more accurate strategies, with the abundance of resources clients are able to build, test and implement their own trading strategies. Theoretically these trading strategies are built to perfection to work on a fair trading basis. Previously, these clients had no access to the liquidity that would help them achieve those theoretical results." "Currently, with brokers providing ECN trading conditions to retail clients, these clients can now build better strategies and leverage opportunities from the market related to execution models and spread pricing," Salem concludes.



Mariusz Potaczala

TM S Brokers has recently launched a new FX trading platform called TMS MT4 which uses STP and NDD execution and is integrated with the MetaTrader4 platform. It allows retail customers to perform online FX operations directly, immediately and automatically on the interbank market. The new platform compliments the existing GO4X platform which TMS operates as a Market Maker. Mariusz Potaczala, CEO at TMS Brokers comments: "The requirements of Polish consumers, as well as the emergence of ECN platforms, prompted us to launch this new service, dedicated to more advanced users than those on GO4X. The most important feature for this group is access to very tight spreads and extremely fast execution, without a dealing desk. Our new product meets these requirements" He continues: "TMS MT4 sets new standards in Poland. We are the first Polish broker to offer direct access to the interbank market, with variable, often zero spreads, low commissions and extreme speed of execution in conjunction with the most popular technology in our country; MT4. What is also very important for us is the transparency of this model, in which all customers' transactions are executed directly on the market. I would like to emphasise this because I notice a negative tendency to use a hidden partial or even complete Market Maker model by some brokers, who define themselves as STP dealers. It's very bad for our industry, because it causes a lack of confidence in institutions that define their services in a fair manner."



Joe Morgan

As Social Investment Networks and associated social trading communities become increasingly popular with the Retail FX traders all around the world, Joe Morgan talks to some of leading providers to discover more about how the investment network model works and what new features and functionality are being offered to help traders more closely align their risk and investment objectives.

In search of better yields with – Forex Social Investment Networks



When the last of the pits closed at the London International Financial Futures and options Exchange (Liffe), it left legions of former floor traders to hang up their chequered jackets and build new careers elsewhere. Some would make the transition to trading on screens at the trading arcades and dealing rooms scattered across the City. But a sad lament often heard spoken by former Liffe traders was that they missed the camaraderie – and insight – of being on the floor and found sitting behind a screen a sad, lonely and introspective alternative.

Now with the advent of social investment networks, Retail Forex traders can log on to virtual worlds which have all the noise of speculation that ruled the trading pits of old. Users obtain instant access to the insight and knowledge of thousands of other traders speculating on the same currencies as themselves. Social investment networks apply a Facebook-style approach to investing, in which users can share and discuss trading strategies, while the websites have different methods for ranking the best-performing traders, offering users the chance to follow and duplicate the – thus far – winning trades made by the ‘gurus’ of each network.

Growing numbers

According to the latest research by Aite Group, the financial research and consulting firm, leading social investment networks include eToro which has 70,000 live account holders, putting it ahead of the competition. ZuluTrade is the nearest rival in terms of live account holders, having 25,000 live account holders. Tradency, Currensee and myfxbook share the lion share of the rest of the market with 15,000, 9,000 and 8,000 live account holders respectively.

The social investment market is somewhat nascent, with each provider seeking to use its brand to differentiate itself from the competition. The leading social investment networks offer customer services in a variety of different languages, matching the global footprint of the customer base. For example, the Currensee service is available in Chinese, German, French, Italian and Spanish and they recently launched their offering in Japanese. Currensee also has customer service staff available to support many of these languages. Meanwhile, eToro offers users the choice of 15 languages, including Arabic, Chinese, French, German, Japanese, Russian and Spanish.



eToro Traders Feed

The leading traders using the eToro service are displayed on its OpenBook trading platform, which displays the trade experts a user is following while also enabling an account holder to make trades manually. If an investor with \$10,000 in an eToro's copy trade model allocates \$1,000 to copy an expert trader, the level of risk for the investor's \$1,000 will be the same as the level of risk for the expert trader account – which means the investor copying a guru does not have to calculate himself how much to trade. Furthermore, as a risk management control, eToro does not allow account holders to put more than 20 per cent of their balance at risk, following one of its 'guru' traders. "You can't lose all your money on one trader," says Assia.

However, other networks such as C2 offer services exclusively in English. The Aite Group research found that most networks could improve the breadth of language services available to customers.

eToro, is an online Forex and commodities and investment network, which has registered members in countries across the globe including France, Germany, the UK and US. Traders who sign up with the eToro service can start with a practice 'dummy' account in which users get to speculate with \$10,000 of virtual money to practice trading and learn how the platform works. When a user is confident enough to trade for real, the minimum deposit for a live account is \$50, with a typical account holder having a balance of about \$10,000 – users can speculate millions on the platform.

CopyTrader™ function

A popular tool offered by eToro – and other leading social investment networks – is a 'copy trader' function, which enables users to follow its leading traders. "With CopyTrader you can put \$5,000 or \$50 on a specific trader and you are actually able to copy that trader with your money which means your money will be following each and every trade that person does," explains Yoni Assia, the chief executive officer and founder of eToro. "We are able to develop very sophisticated ranking algorithms to show you who the best traders are. So you can follow them and get updated every time a trader does many of his trades."

Assia uses a real-life example – Fatima, a top-performing euro/dollar trader based in the Middle East – to illustrate how the copy trader function works. Fatima's profile reveals her full trading statistics during the past year (which is as far back as the



Jonathan Assia

"Recognition is very entrenched in human behaviour. This is a chance to step into the light. People have strong personal recognition when they are followed by 1,000 or 2,000 followers."

trading history of a trader goes), along with comments that other traders have made on her performance.

Why would a top-performing trader such as Fatima want to reveal her strategy to the worldwide web? “Traders such as Fatima are getting a lot of feedback and appreciation about what they are doing. Being a Retail trader is a lonely task. This way you are able to have people comment and appreciate the way you trade,” says Assia. “Recognition is very entrenched in human behaviour. This is a chance to step into the light. People have strong personal recognition when they are followed by 1,000 or 2,000 followers. Some people enjoy this almost as much as the monetary incentive.”

Mirror trading

Tradency, a Forex auto-trading platform launched at the end of 2005, has helped pioneer another popular form of social investment network trading, known as mirror trading. In the ‘mirror-trading’ model, the trade signal of an expert trader is copied, but investors are allowed to set risk levels that may be higher or lower than those of an expert trader.

Tradency’s Mirror Trader platform, which features a database of different trading strategies, offers users the options of trading in an automatic, manual or ‘semi-mirroring’ fashion. Users opting for the automatic function passively follow a trading strategy which has a good track record. Users can combine such a strategy by executing trades manually. Those choosing a semi-mirroring strategy, can monitor the buy and sell trading signals of strategy developers in real-time and decide whether to mirror the trades or not. “You don’t need to set a predefined system to your portfolio. You are getting real-time signals from all



“You don’t need to set a predefined system to your portfolio. You are getting real-time signals from all the strategies that are displayed on the Mirror Trader platform.”

the strategies that are displayed on the Mirror Trader platform,” says Lior Nabat, president and CEO of Tradency. “You can pick and choose which strategies you would like to execute, signal by signal. Meaning by each trade your strategy is doing, you see the user feed and you automatically join or mirror this trade.”

Collective2 (C2) is another US-based social investment network which follows the mirror trader model. C2 offers its users a library of more than 15,000 trading systems for asset classes which include Forex, along with equities, futures and options. “You can come to C2 and propose yourself as a vendor and charge a fee of whatever you think your signals are worth. But it is a flat time-based fee, not based on account size or trading volume,” says Matthew Klein, chief executive officer at C2.



Tradency's Mirror Trader platform

In what looks like a race for critical scale in the social investing field, the Aite Group survey identified ZuluTrade as one of the fastest growing firms. It reported a quarterly account increase of 15,000 new accounts – eclipsing the 15,000



Collective2 (C2)

accounts it acquired in all of 2010. ZuluTrade's mirror-trading approach lets users manually set their own risk parameters or use a default mode that automatically assigns a trade size to a signal, which does not have to match the level of risk taken by the expert trader.



Dave Lemont

"Our Trade Leaders are hand-selected for the program based on their approach to money management and risk management."

Trade leader selection process

"A major distinguishing factor between the networks is the selection process used for choosing a trade leader," says Javier Paz, a senior analyst at Aite Group. He explains that Currensee has a unique approach to social investing, highlighting its trade leader selection process which requires a minimum of three straight months profitable trading on a live account. When Paz's recent research was published, Currensee had 16 Trade Leaders generating 20 different strategies, which averaged as a group a return of 33.8 per cent in the period from January 2011 to June 2011.

"Our Trade Leaders are hand-selected for the program based on their approach to money management and risk management. The discipline to set a strategy, stick to it and refine it over time is what makes them successful and our commitment to providing our investors with experienced traders is what makes the Currensee offering unique," says Dave Lemont, chief executive officer of Currensee.

C2 publishes all the trades made on the platform, and documents which are made from live brokerage accounts. This transparency is combined with user reviews with each service – which are not always complimentary. One disgruntled user of a trade user account accused him of leaving his computer unattended and failing to exit trades. But Klein believes the transparency of the service will enable its trading stars to rise to the top and build up substantial followings that are based on a successful track record. "As an introducing broker, we have done all the expensive regulatory, legal and compliance work and built a platform for people that do not have the wherewithal to do this themselves. We enable people to prove that they are good traders and join the financial world," says Klein. "In the past, if you were a smart guy in a basement in Moscow who came up with a really great trading algorithm and you did not have capital or go to Harvard, Yale or MIT, you were not going to get acclaim as a trader and end up getting hired by Goldman Sachs. You were not even going to be able to start a little hedge fund."

Models for engaging users

Leon Yohai, founder and chief executive officer of ZuluTrade says unlike other social networks, ZuluTrade is an "ecosystem in the Forex community" connecting about 100 broker-dealers and more than 58,000 thousand signal provider strategies to its auto-trade trade service. "Socially, people talk about it. Friends will join as a result," says Yohai. Meanwhile, Zecco, one of the leading value-players in the online



Matthew Klein

"In the past, if you were a smart guy in a basement in Moscow who came up with a really great trading algorithm and you did not have capital or go to Harvard, Yale or MIT, you were not going to get acclaim as a trader and end up getting hired by Goldman Sachs."

US-based stockbroker space, with over 400,000 investing community members, believes the Facebook model may provide the next avenue of growth for social investing. Zecco has launched a Facebook app, titled Wall Street, which enables its customers to trade directly from their Facebook accounts.

"Social investing is here to stay. We think that it is an extension of behaviour that is already happening offline and we are going to facilitate it as best as we can online," says Nicholas Britz, president of Zecco's Forex business.

As the different social investment network models refine their offerings and compete for market share, Paz of Aite Group believes there is sizeable pent up demand among Retail Forex investors for this type of service. While the size of the social investing market has about 130,000 users at the moment, Paz projects exponential growth over the next five years, with the market mushrooming in size to more than ten million investors. Furthermore, Aite Group believes that the social investing market has a potential audience of hundreds of millions of investors, made up of both

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ZuluTrade

traditional and first-time investors. Half of the firms surveyed in the Aite Group research reported triple-digit percentage increases in live account holders.

Impact of social investing

Lemont of Currensee believes social investing will significantly boost the size – and transparency – of the Retail Forex market. “Automated trading systems could dramatically increase the volumes in the Forex markets with the Forex brokers. Services like Currensee clearly reveal who the good brokers are – the honest brokers – and who are the ones who aren’t playing fair or in the best interest of their customers. We only work with the top brokers who give the best spreads,” says Lemont.

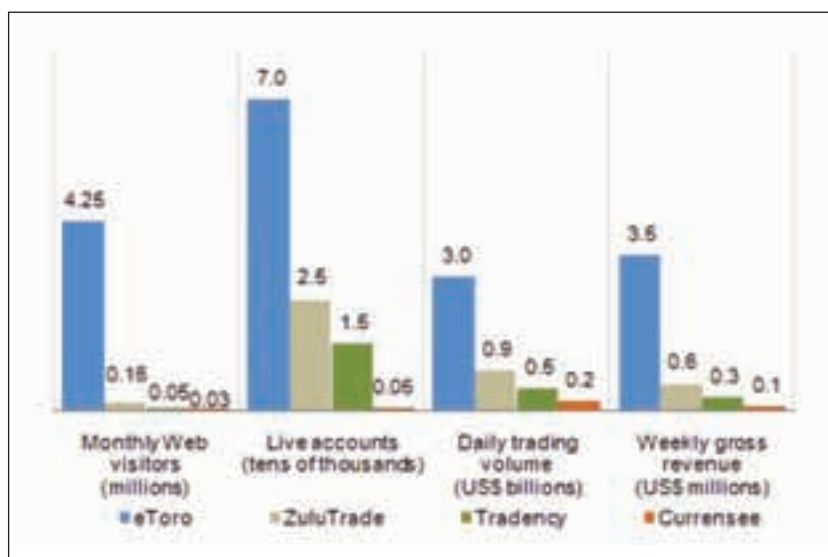
Nabat of Tradency says the growth of the social investment market will be bolstered by the positive impact the trader leader or mirror model can have on the returns of ordinary investors. He believes that the social investing model will become common place on Retail trading platform offering trading in a variety of asset classes – not just Forex – within the next three to five years. Though he feels that Forex is particularly suited to this type of investing. “Forex is the only asset that is active 24 hours a day, six days a week. There are infinite opportunities to trade. There is no other asset so liquid,” he says. Nabat believes that until the advent of social investing, Retail Forex traders were in a sense “flying alone”. “Now users can

take the knowledge of other traders that are more experienced and trade with them, either in an automated or semi automated fashion,” he says. His view is given some added weight by the Aite Group research, which found evidence to suggest that Forex social investing firms were producing a level of investor profitability of at least 50 per cent, compared with 30 per cent among US ‘self-directed traders’.

“What this whole industry is about is a way of lowering regulatory barriers that have made it very hard for good investing strategies and brains to get discovered,” says Klein of C2.

While research from Aite Group suggests that the social investing Forex market is being driven by a younger less experienced demographic of traders, the market is not homogenous. Klein suggests that C2 – which according to Aite Group research is experiencing a 500 per cent annual growth in live accounts – is attracting more sophisticated Retail Forex investors. “We appeal to a certain demographic. People who know what a Sharpe Ratio is. We are built for programmers and people that want to do black box trading. We have APIs for them. We have interfaces to popular back-testing solutions such as TradeStation or NinjaTrader,” says Klein.

Meanwhile, Aite Group research has found that eToro is attracting a younger audience than those courted by traditional banks and brokerage firms. eToro’s customer base is typically male, aged between 25 and 44.



Source: Aite Group

FX Social Networks: Key Operating Statistics - July 2011 Estimates



Nick Britz

“What is driving the investment communities is that you now have a new source of aggregated information that you previously didn’t have before.”



Zecco ForexTrader

Crowd sourcing

Investors in social investment networks are clearly attracted to the concept of ‘crowd sourcing’ – which is driven in part by a belief that the collective opinions of a ‘crowd’ of investors – made up experts and novices alike – generates a superior knowledge pool to that of a single person or small group of individuals. Paz of Aite group believes crowd sourcing could transform the way “very large masses of individuals pursue an attractive return during volatile economic conditions”.

This notion is clearly an implicit attraction for many investors in social networks.

However, Klein of C2 feels the industry should act with caution in promoting any ideas that emulate the collective wisdom of crowds and large groups of investors, as a more reliable or informed guide to making investing decisions. “The problem with the idea of ‘social’ is that it assumes everyone is good at having an opinion, which is really not true in the world of investing. The opposite is true in the world of investing. Everyone has an opinion and generally everyone is wrong,” cautions Klein.

Nevertheless, Britz of Zecco says the transparency and wide pools of investor knowledge in networks – has clear benefits – which is something all networks can use to attract new users. “What is driving the investment communities is that you now have a new source of aggregated information that you previously didn’t have before. For example, Currensee is attempting to make its community knowledge useful by picking some of the best traders and letting people follow them,” he says.

Currensee, which began operations in 2009 as a social network that encouraged traders to share their account performance and obtain insight from community metrics and other members, appears to now be attracting more wealthy users than some other networks. The average account size of \$25,000 to \$30,000 is two to four times greater than the size of many of its peers, according to Aite Group research.

Currensee’s success in attracting higher net-worth users could in part be a result of its Trade Leader Investment Program. “Currensee applies unusual rigor to the trade leader selection process. It receives

hundreds of applications each month, but so far has accepted only 16 people,” writes Paz.

According to Aite Group’s analysis of the social investing market, eToro is the only other network which has developed rigorous rules for qualifying trade experts or requiring them to issue signals from a live account. All eToro trade experts have to use live eToro accounts to generate trade signals, but its trade expert certification process has not yet been introduced.

Dummy accounts

One moot point in the social investment network model is the reliability of so-called 'dummy accounts' as a guide for investing, when the user is not risking any real money when pursuing an investment strategy.

Edwin Lefevre's classic tome *Reminiscences of a Stock Operator*, first published in 1923, sums up the difficulties such 'fake' investors have when actually putting their own money on the line. "It is like the old story of the man who was going to fight a duel the next day," wrote Lefevre. His second asked him, "Are you a good shot?" "Well," said the Duelist, "I can snap the stem of a wineglass at twenty paces," and he looked modest. "That's all very well," said the second unimpressed. "But can you snap the stem of the wineglass while the wineglass is pointing a loaded pistol straight at your heart?"

Lemont of Currensee is highly critical of automated trading systems that allow performance to be shown in demo accounts, as he argues this does not provide a

reliable guide. "There is a very big difference between pretend money and real money. Why would I close a losing position if it's not my money. Why wouldn't I just wait out the draw-down until the market comes back. Whereas with my own money, if I open up a position and it is down 50 pips, I am going to say to myself, I'm done – I can't lose any more money. But if it's not my money – just play money. Who cares," says Lemont.

Nevertheless, networks such as eToro which offer 'dummy' accounts are providing new users with a valuable self-educating tool. While users experimenting with such accounts are not prone to the base emotions of fear and greed which can drive financial markets, they will be able to see if a hunch for where currency prices are heading is true or not. Social investing networks also provide customers with tools to educate themselves and inform trading strategies. For example, Tradency offers its users a suite of informative and well-made short videos which introduce the concept of social investing and the advantages of its Mirror Trader offering.



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Risk management

Klein of C2 concedes that the social investing industry could be attacked by critics as akin to the online gaming industry. "It does concern me a little bit that people are opening Forex accounts at very high leverage without really understanding what that means. You can make money for a long time picking up pennies in front of a steamroller," he says.

However, social investment networks are developing risk management tools to help facilitate responsible investing. ZuluTrade provides its users with a 'marginallometer' which informs a trader of the odds of having a margin call with their current selection of signal providers. The platform also provides an 'auto button', which can be adjusted according to an investor's risk appetite, enabling an auto-selection of a trading size via handheld mobile devices such as an iPad, iPhone or smartphone Android App.

Currensee does not allow its customers to over leverage themselves, in relation to the positions taken by a trade leader. "We recently introduced tools which enable a trader to manage their own risk – even beyond what the trade leader does. So we allow customers to set maximum drawdowns that they are willing to tolerate by each trade leader such that when that particular drawdown level is hit, all open positions will close so the customer can not sustain any further loss," says Lemont of Currensee.



Investment networks also provide users with default profit and stop losses, which enable a user to terminate a trade once losses or gains breach predetermined amounts. "One of the things that we are going to do in the future is offer a service which will inform users – if say the EURUSD is in range – of which systems are most suitable to these types of markets," explains Nabat of Tradency. "This means when market conditions change, we can change the set of systems in order to minimise the levels of risk investors take."

Conclusion

A willingness to innovate and develop new offerings makes social investing a dynamic market, which could fuel its growth further. "Our definitions are fluid.

People who are proposing themselves as great traders often evolve to be people who are good at picking other traders and vice versa," says Klein of C2.

However, the pioneering nature of social investing may put the sector under closer regulatory scrutiny. The interaction between users in social networks can blur official boundaries and rules on the giving of investment advice and promotion of financial products.

"Social Networking is an extension of communication to the public. Regulators have recently created direction in regards to the interpretation of the existing rules. As the market innovates how it communicates and as the medium changes, the interpretation will continue to involve, but the principals will remain the same," says Britz.

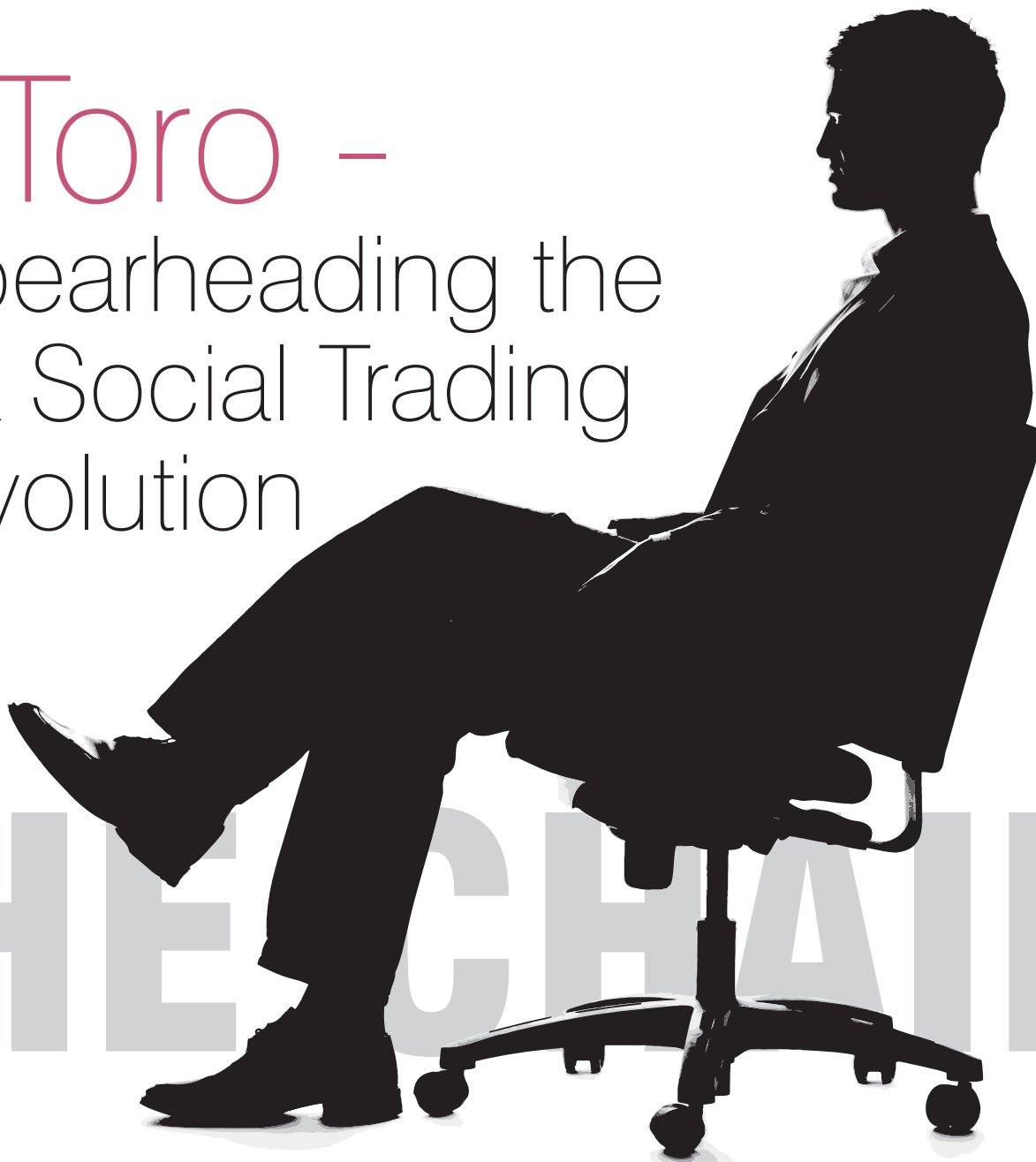
Rank	Trader	Followers	Win %	Max Drawdown	Sharpe Ratio	Profit Factor	Max Trade	Open Positions	Account Size
1	John Doe	1234	55%	15%	1.2	1.5	\$1000	5	\$10000
2	Jane Smith	987	52%	18%	1.1	1.4	\$800	3	\$8000
3	Mike Johnson	765	50%	20%	1.0	1.3	\$600	4	\$6000
4	Sarah Lee	654	48%	22%	0.9	1.2	\$500	2	\$5000
5	David Kim	543	45%	25%	0.8	1.1	\$400	1	\$4000

Currensee Trade Leaders

Nevertheless, the prospects for the social network investing market appear bright and its success could even make the model one day become a part of the Retail Forex mainstream. "Social Investing offers better clarity and better flexibility than standard mutual funds, paving the way for social investing to become a real alternative Retail asset class. We see the market developing from trading to a true alternative global asset class," says Assia of eToro.

Any data or statistics presented in this article are for illustrative purposes only and may not be accurate due to changes that may have occurred since the original figures were compiled and the article written.

eToro – Spearheading the FX Social Trading revolution



e-Forex talks with Jonathan Assia, CEO of eToro

Jonathan, eToro has traditionally offered a powerful set of FX platforms and online trading tools. Why did you decide last year to launch your social investment network, OpenBook and what vision do you have for developing this service?

eToro's vision was always to make trading accessible to everyone. The trading platforms we've created simplify trading, providing traders with the necessary tools to effectively manage their assets for themselves. Our very first trading platform incorporated a social trading aspect: our popular chat tool. Traders from all over the world used it to exchange ideas and investment strategies. Ultimately, this led us to develop our

ground breaking social trading platform, eToro OpenBook. We realized that in order to make trading more accessible we had to make it transparent, so that every trader could access the same information. That's why we provide the means for everyone in the network to see every trade that's made; in order to form better and more educated investment decisions. We're constantly developing the service and introducing new features.

How does the social investment network concept work and what types of investor can benefit from social trading?

The concept is straightforward. Joining eToro's social trading network is free. After joining, everyone in the network gets access to all the trading data and information generated by our millions of registered traders, allowing them to see every trade made in real time, follow the trades and performance of any trader and copy any trade or trader they choose. With a click of a button users can now initiate eToro's CopyTrader™ functionality and link their own trading account to one or several traders, by assigning a portion of their available funds to copying that trader. Every trade executed by a copied trader is automatically opened for the CopyTrader also. This means everyone can now trade like an expert trader and have their money indirectly handled by experienced traders.

eToro's social trading platform appeals to a wide range of traders. Novice investors will love having an expert trading for them. Beginning traders can benefit from knowledge sharing with pro traders, whilst experienced traders can use the social indicators to discover new investment opportunities and find other experts to emulate and copy.

Why do you think eToro was uniquely positioned to overcome the technological and investment hurdles involved in launching a social trading service?

From the outset we wanted to change trading, to make it appealing to everyone. We are fortunate to have the right mix of talented people in our company who all live the internet and it was for us the natural evolution to embrace the concept of social networks and interweave it into our products. We made a decision to reinvest our generated profits into the development of our social trading platform, knowing that if we wanted to make a real difference it would only happen through developing a disruptive idea. Through our large user base we were able to quickly spread the word of our social trading platform and have seen continuous growth in the past few months as a result. We have also attracted strategic investors such as Spark Capital, a major investor in Twitter and Howard Lindzon, founder of Stocktwits who have placed their trust in our ability to lead the social trading revolution.

In what ways are social networks useful in helping to break down the barriers of complex trading?

With social trading you're never alone. Traders are part of a large network that comments on their trades. eToro enables traders to tap the wisdom of the crowd and to copy the trades of the best performing traders, which makes us the easiest and most transparent way to trade. Users have the ability to approach every trader in the network and engage them with questions



Jonathan Assia

and comments about their trades. It accelerates the learning process and helps users search out the best traders to follow or copy. In addition, social trading provides a very user friendly interface for managing trading, thereby taking the pain out of the process.

In the past you have talked about eToro's commitment to promote responsible trading. What do you mean by that and how will your investment network facilitate this?

eToro takes responsible trading seriously. We want our traders to be educated about the risks their investment decisions involve, and to realize that big risks often lead to big losses. Experienced traders are better than beginners at keeping their emotions in check and making sensible investments. However, every trader lets their emotions take over sometimes. eToro has integrated a series of tools to help traders be more responsible. Automatic settings limit traders' leverage, if these are disabled, an opt out warning reminds them of the potential risks. Our Guardian Angel tool analyses market conditions and trader performance to provide relevant trading guidance. Meanwhile, social traders can invest no more than 20% of their available balance on following any one trader through the CopyTrader feature.

Has the OpenBook community grown as you expected and how many users are now taking advantage of it and building people-based portfolios?

We see great growth on our social trading platform and we see even greater growth in the adoption of CopyTrader among our traders. The number of CopyTraders and the number of automatically copied



trades is constantly growing. I don't want to disclose actual numbers but it's fair to say that 30-40% of our traders are already embracing CopyTrader.

What special characteristics have traders and investors told you that they particularly like about OpenBook?

The transparency of the trade information. Of course, traders love the CopyTrader feature and the real time interaction among the community members also. There is a lot one can learn from different traders around the world. Other advantages are access to traders in local markets that have the advantage of knowing their markets better: when this information is freely shared it creates a more equal trading environment.

What new features have you developed for OpenBook and what plans do you have for adding and providing powerful new tools and functionality?

We have an extensive roadmap with aggressive development goals. We can't share all our planned features at this stage, but new features will further develop the great user experience on OpenBook. We are integrating some of the account functionalities of our WebTrader trading platform into our social trading environment to allow users to stay within their preferred trading environment. We are also gradually expanding the scope of our CopyTrader feature, enabling users to copy from a larger pool of traders and to manage their people-based portfolio with more ease. In addition, we are now launching our Guru Trader program which incentivises traders according to the number of people copying them.

Do you expect to see interest from institutional trading firms in social investment networks which are primarily used at present by retail investors?

We certainly do. With millions of traders and executed trades there's a lot of valuable data that is just waiting to be used to create new forms of fund – investing in the traders capabilities rather than relying only on algorithms to predict the markets.

In what ways do you think social investment networks might ultimately change the way the forex market works?

Social trading networks are disruptive in every way. They offer a new way to trade based on transparency and information exchange. Social trading is breaking down the barriers that have kept consumers at bay. No longer is expertise solely reserved for corporate institutions. As social trading grows in popularity, driven by the power of the internet, it will force financial service providers to be more open about how they invest their customer's hard earned money. We foresee that social trading will mean that small groups of top traders will be followed and copied by everyone else in the network. Ultimately, these people could turn out to be significant trend makers.



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DynexCorp –

from systems to market pulse: a life long performance in currencies

e-Forex talks with Peter Panholzer of DynexCorp, one of the oldest Currency Management firms in the world.

Peter how long have you been in the Currency Management business and what attracted you to the industry?

I made my first currency trade in October 1973. After Bretton Woods, spot settlement rules were still in their infancy. At that time you had a choice of forward swaps, such as 30 days, 60 days, etc which could only be realised at expiry. At Ross Perot's Dupont Glore Forgan office in Toronto arbitraging between 30-60 and 60-90 day swap spreads was a popular strategy. After 30 days your swaps mutated to spot-30 and 30-60. If an expiry fell on a weekend and the invariably mean-reverting arbitrage happened to be in your favour, you could either earn settlement interest or roll the swap positions forward. It was a win win – now or later – situation.

That was two years after the gold standard had been abandoned – causing the big inflation of the 1970s – and one year after the creation of currency futures contracts at the IMM in Chicago. I am still in touch with *Mark J. Powers*, the father of currency futures (together with *Leo Melamed*). Mark allocated pension fund money to us in 1990. In their due diligence, he and his partner *Mike Dubin* put emphasis on knowing

the manager personally by asking him tricky questions over an extended lunch. I was impressed by this pleasant approach.

I had actually abandoned my successful career as an architect to become a commodity trader and by 1978 a pure currency trader. A highly diversified trend-following system in *commodities* during the inflationary 1970s was virtually assured to be profitable. When I started a currencies-only system with the five currency pairs then available at the IMM, everyone warned me that this wouldn't be enough diversification. They were proven wrong. While I was an account executive at ContiCommodity in Toronto, the *Magnum Program* became the company's star performer, between 1979 and 1983. I presented the program in the United States to 14 branch offices in 17 days. Conti had two thousand account executives world-wide, and the *Magnum Program* was offered on four continents.

One program unit of \$25,000 traded a total of five contracts, one for each currency (DEM, JPY, CHF, USD and CAD). We had a specialist IMM floor trader assigned (*Andy Good*) who worked our orders on



Peter Panholzer

occasion as high as 1,000 contracts. In 1981 that was a good size. During the first three years the (widely dispersed) average annual profit was 54%. Checking this out today, the *Magnum Program* used ten times leverage. No wonder the system eventually suffered the contractual drawdown limit. These were the early years of managed futures. A maximum drawdown not exceeding the average annual profit was quite acceptable for a trading system. Now we trade 0.5 to 1.5 x leverage (e.g. with no leverage, on balance).

If you ask me what made me switch from architecture to the financial markets, it was the sad fact that architects have to fight for their fees, and fund managers don't. That's too bad. There are many instances where architects have turned to all kinds of other imaginable endeavours: most curiously one went into the funeral business, another one became a clown. Among these *former architects* are celebrities such as *Paco Rabanne* and FX trader *Bill Lipschutz*.

When did DynexCorp commence operations and what services does the company provide?

In 1981 Conti moved me to their branch in Lugano, Switzerland. After the sale of ContiCommodity in 1984 to Refco who had no office in Lugano, I was looking for a new home – and found it with E.F. Hutton in London, at the firm's Mayfair office. I was hired by *Bob Scheiner*, an exacting Navy man, who generously offered a mews house for three months behind Cadogan Square until I had found my own place, a small town house on Paradise Walk near the Royal Hospital. I actually got mail posted to Peter Pan, Paradise Walk, London SW3!

After a brief stint at Refco London, I became independent in 1988 and formed my own firm, Dynex Corporation (*DynexCorp* today), with offices in Geneva. Our first corporate clients were the successful nostro accounts of two private Swiss banks. In their wake followed a slew of pension fund money from Japan and the United Kingdom. We have managed institutional funds since 1990.

Who are the key people in the firm and what are their main day to day responsibilities?

I am the chief trader concerned with portfolio and risk construction, a task I have performed for the last 32 years. Risk levels are monitored via audio alarms and also checked by other members of the team.

Marlene Harrison looks after monitoring and distribution. She has been in the investment business in Toronto since the early 1980s and also managed accounts in 1985/86 with a successful S&P futures trading system. She is invaluable with regard to client communications, overseeing performance statistics and organising promotional activities. A superb motorist, she likes driving super-fast cars, not only where there is no speed limit but also on the winding roads of the Riviera.

Jeff Boyko, with an engineering degree from his home town of Winnipeg in Canada, has been at our European trading desk for a good number of years. He developed an outstanding record in Canadian dollar hedging for commercial clients. After acquiring his CFA he took charge of product design, client relations and marketing. He recently created a Canadian approved fund awaiting seeding. Jeff's dedication to the promotion of currency markets as an asset class is exemplary.

Paul-André Jacot, doyen of the Swiss Futures and Options Association (SFOA), has been with us as Director and Advisor to the Board since 2001. He is the organiser of the annual SFOA Bürgenstock Conference convening representatives from futures



exchanges, regulators and self-regulatory organisations from all over the world. In 2009 Paul was inducted into the Futures Hall of Fame established to commemorate outstanding commitment to the global futures and options community. We have the same core team since many years, complemented by marketing, legal, accounting and IT.

What do you consider to be the key strengths and operational advantages of DynexCorp's currency portfolio management services?



Jeff
Boyko

Marlene
Harrison

Having been hooked on currency trading for almost 40 years, one could say I wear currencies like I am wearing my clothes, even like my own skin. My reaction to familiar market situations is instinctive, acquired through life-long conditioning. The new kids on the block will always come up with new-fangled ideas, but looking back, not much has changed in what really drives the currency markets. Supply and demand fundamentals do not work as easily as they do in commodities, but positioning, recursive feedback and emotions do.

I have to thank a brilliant trader, *Albert Friedberg*, President of Friedberg Mercantile Group in Toronto, for introducing me to the contrarian way of looking at markets as early as 1973. Ever since, I have used sentiment and contrary opinion to guide the non-systematic part of our trading approach. Another highly successful proponent of analysing market sentiment is *John Percival*, with whom we have been closely associated since the mid-1990s. A former Lex Columnist of the Financial Times, JP writes the weekly *Currency Bulletin* (since 1984) which must be one of the oldest currency advisory letters in existence. He is also the author of the book *The Way of the Dollar* (out-of-print, but available as e-book). This is quintessential reading! For me this book became the bible of currency trading.

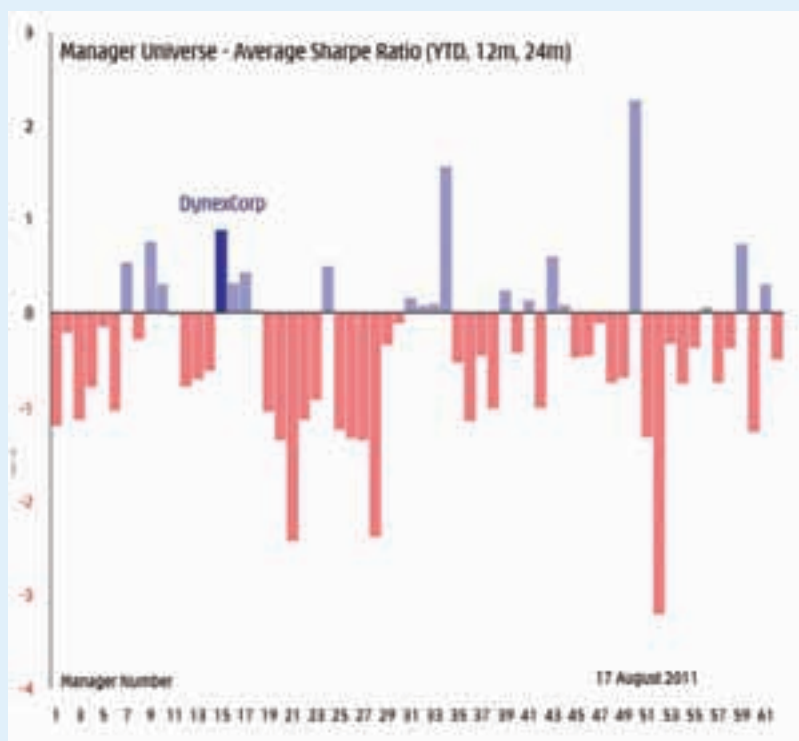
Our operational advantage is our longevity, survival power and persistence. Starting with the Magnum Program in 1979 we have a continuous track record of 32 years, 90% of which are certified or audited. There is no failure, pause or interruption. Surely this is unique? We cannot think of any other currency manager still in business who can match this record, other than Albert Friedberg in Toronto. Reliability and continuity is often the most sought after requirement by institutional clients. Our other operational advantage is our compact size. Small is beautiful, said *Leopold Kohr*, the Austrian economist, who wrote in 1957 “*There seems to be only one cause behind all forms of social misery: bigness*“, in his visionary book “*The breakdown of Nations*”. Because of the compactness of the underlying instruments, currency hedge fund managers succeed in operating efficiently with a limited number of

staff. Computerisation, electronic trading and Straight Through Processing have made this even more feasible.

How would you describe your investment philosophy and what are the main strategies which DynexCorp has traditionally employed?

Traditionally we have been trading-system oriented. But trading-systems seem to have a half life and start to decay after a handful of years. Caxton Corporation’s *Bruce Kovner* pointed this out when I had the chance to converse with him for a full evening at his Manhattan apartment (his family had gone skiing). We shared the opinion that systems are tweaked every so often, mostly of course after a draw-down. I postulated in the late 1980s that baby markets lend themselves better to systematic trading than mature markets. In effect, the *Magnum Program* which ran from 1979 to 1984 had a good chance since currencies in those years were indeed baby markets. The Magnum trading rules which worked fine for currencies would not have worked with the stock market (e.g. the S&P500 Index), the most mature market of all.

Today’s currency markets have become mature by their sheer size and liquidity. For that reason we have abandoned purely systematic trading and are putting more weight on market sentiment, positioning research and contrarian opinion, particularly in our





“It is a common misconception that the behaviour of one currency pair might be useful in forecasting the course of another.”

Tetra FX Macro strategy which has done extremely well since 2009 and puts us currently in the top echelon of the currency alpha manager universe, as surveyed over the last three years via Deutsche Bank's FX Select platform.

Another project we have pursued since 2007 is designing and managing *Dynex Dynamic Currency Alpha*, a currency manager talent basket with dynamic allocation and daily liquidity. This project was made possible through Deutsche Bank, who pioneered the FX Select Platform in 2004. Today \$5 billion are managed through this platform.

What style of trading do you undertake to execute your strategies? Do you have any particular preference for specific trading time horizons, such as medium to long term?

Our trading campaigns reach for intermediate targets within a week, but our trading horizon is also a function of volatility. Therefore risk measures may vary with the currency pair in question. We have extended our variable scale of risk windows to 8-hourly intervals, using proprietary statistical models surveying systematically 35 currency pairs, fully aware of the

auto-correlation that this may entail. It is a common misconception that the behaviour of one currency pair might be useful in forecasting the course of another.

How do you go about back-testing your proprietary currency trading systems and signals to confirm that your strategies will perform and remain relevant to the performance criteria of the firm?

I had my first computer in 1977; the biggest storage medium was a single 8 inch floppy drive! By 1983, while commuting between Europe and Canada, I owned four portable Otrona Attache, each of them costing an arm and a leg by today's standards, the first truly portable computer with a small CRT screen. NASA's Jet Propulsion Laboratories loved these machines. Computer lore has it that an Otrona Attache even flew on the space shuttle and also appeared in a Bond movie.

We have done back testing galore. Over three decades. In the early years I did my own programming. It is obviously of great advantage to have programming ideas and trading experience housed in the same brain. The trick with back testing is to have a perfect underlying data set (an impossibility). Instead of



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using early pre-Microsoft spreadsheets such as SuperCalc, I coded each application including tables in C-Basic Compiler by Digital Research. This was tedious but the output was faster than Excel today. Since the late 1980s we outsourced a lot to *SnapDragon Systems* in Oxford, England, whose principal, *Adam Hartley*, holds a PhD in Theoretical Atomic Physics at Oxford's Balliol College and keeps reminding us that "*every strategy has its Achilles heel*".

What Risk Management frameworks have you developed and how do you apply them with respect to different strategies?

Our STP-linked in-house software refreshes risk limits in time slices after each transaction, in or out. Our risk tolerance is low. This means that we use no leverage or operate at a marginal distance around the funded capital amount exposure. We also tend to step aside completely after our risk tolerance has been challenged in order to continue with a completely clean slate. Any account operated via a TRS is protected by a stop-loss amount monitored by Deutsche Bank, the counter-party to the TRS. A stop-loss protected Total Return Swap is more cost effective than Capital Guaranteed structures.



The trusty Otrona Attache

To what extent have you developed research agendas and analytical programmes to enhance your existing strategies and find new ones?

We use statistical research as well as subjective sentiment-driven techniques. In 1988 we were first in performing *Rescaled Range Analysis* and plotting the Hurst exponent of five IMM currencies, relying primarily on Jens Feder's just published textbook *Fractals*. An ominous quirk of fate would have it that 23 years

later *Hans Feder*, the author's son, is leading the FX Select team at Deutsche Bank. We demonstrated the declining memory effect in currencies since 1973 – and thus the decreasing efficiency of trading systems, leading to our concept of *baby-markets* being more useful for trading systems than mature markets (for example, *emerging markets* currencies are today's baby markets). During that time we were also first to point to the odd fact that currencies do not scale logarithmically like commodities or stocks. Think about that for a while: it makes risk-scaling easier.

Today we concentrate on obtaining intelligence about market flows, positioning changes, contrary opinion reports and sentiment analyses. We pay particular attention to information offered gratuitously. News

media are often an excellent source for contrarian positioning. Their gratuitous trading recommendations remain unpunished if they fail, since they escape the negative feedback from speculators who have followed them. When a particular market occupies a large part of public perception and becomes one-sided, alarm bells start to ring in tune with *Bob Dylan's* lyrics that *you don't have to be a weatherman to know which way the wind's blowin'*.



What sort of trading platforms does DynexCorp find most appropriate and what factors influenced that choice?

We developed a fruitful relationship with Deutsche Bank, worldwide leader in FX liquidity, as early as 2002. Our preferred dealing platform is Deutsche Bank's *Autobahn FX*. Not only has it become a benchmark for liquidity and pricing, it also has the most down-to-earth interface design. We consider the learning curve for most electronic retail platforms too onerous. Since the start of eFX, bid-ask spreads have collapsed, for the benefit of our clients. We favour single click-and-deal transactions or through our API, not revealing our intentions. The advantages are obvious: tighter spreads, faster fills, tighter risks. Our trading room used to be a lot louder during the 1980s.

How did you go about building your trading desk IT infrastructure and was the trading software and connectivity technology provided by third party vendors?

With regards to operational computing we always have an IT consultant at hand. Everyone in the company works with the same computer or laptop model. We have commissioned *SnapDragon Systems* to design custom applications for charting, APIs and robotic trading. The problem with robotic trading is its extreme reliance on connectivity and monitoring. Once you have to look after both, the robot is not so much a robot any more, or is it? As in the kitchen, a robot is just a friendly beast that has the knack of breaking down when you most need it.

Trading technology has come a long way during the last 20 years. How much reliance does DynexCorp place on the latest automated trading toolsets and execution algorithms?

Technology can only improve our lives. An e-platform is the difference between having a car and having

to travel by foot. I do not believe we could trade the volume we do, without eFX platforms. Trading electronically has greatly reduced the chance of human errors. Online trading is linked to Straight Through Processing. That's an immediate relief for the back office, with a 70% reduction in time. eFX technology allows systematic trading to be executed more accurately via an API and also generates a data stream that is an important research material for us. We store it for future research.

As you know we also publish *Currency Investor* magazine and so are great champions of currencies as a tactical asset class. How difficult have you found it to persuade investors that currencies can be leveraged not just for risk mitigation by institutional asset managers but are also as an excellent means for achieving more balanced and diversified personal investment portfolios?

In the world of alternative investments, pure currency alpha should have moved much sooner into the limelight as an asset class. It compares favourably in terms of *a) return, b) risk and c) correlation statistics*. The currency market is after all bigger and more liquid than any other. It has been difficult for a reason, to persuade institutional investors to diversify their portfolios by adding uncorrelated alpha returns from currencies.

Pension and endowment funds giving pure *currency alpha* a try may have typically made the mistake of turning to currency overlay managers they are familiar with and basing their decisions in large part on the size of the manager. Unfortunately asset size is not a good criterion for handing out mandates for pure *currency alpha*.

Overlay managers as well as banks have delivered disappointing currency alpha results, thus creating misleading market lore among institutions about

Geneva



unhappy currency alpha experiences. Without applying the selection criteria described below, naively allocated currency alpha would actually have been flat over the last five years and might as well be equivocated with cash, e.g. zero return.

Yet there is a really very good reason why institutional investors should move into currencies as a non-correlated asset class – if they pick the top performers, an *elitist group* with a long historical background and a remarkable *knack for persistence*, rotating inside the top 1-, 2- and 3-year rankings over extended time spans. They do not include – nor does their asset size compare with – overlay managers or banks. Trading systems, unless applied to emerging (“*baby*”) markets should also be avoided, for the reasons cited earlier.

Over the last five years, a portfolio composed of these inherently superior managers returned much higher rewards than the currency manager universe. Their selection does not rely on the benefit of hindsight: it is based purely on their pedigree and the intelligence gathered about their investment teams. DynexCorp is currently among the top five performers for the last 12, 24 and 36 months.

What new strategies and products has DynexCorp been exploring as part of your continuing efforts to widen the range of investment solutions and tailored services you make available to clients?

We consider our investable *Dynamic Currency Alpha Index* a very promising idea. Cost-effective currency alpha may be obtained via dynamically managed currency manager talent baskets through the *FXSelect Platform* (pioneered by Deutsche Bank in 2004) which also allows

notional funding. Deutsche Bank is the Prime Broker and the product is available via a *Total Return Swap*. FXSelect manager performance data, accessible on demand and reported at the end of each day, are *hard performance data*, e.g. not performance communicated by individual managers “*on a reported basis*”, which is often curiously different from their “real” data on FXSelect.

Looking ahead, what are the main challenges facing DynexCorp as you seek new ways for capturing and exploiting investment opportunities with currencies?

My guess is that a tremendous challenge lies ahead: just look back at the huge inflationary effect of abandoning the Gold Standard and Bretton Woods in 1971 – with the main purpose of financing the Welfare State. During the following ten years the US dollar fell from 4.3 to 1.6 Swiss francs and gold rose from 42 to 460\$/oz.

We might eventually face violent consequences of the recent seemingly bottomless bailout barrel of the EU and the threat of sovereign default in the United States.

Volatility will invariably increase in the aftermath of such critical events. These are the seeds of *hyper-inflation* further down the road, if you care to follow the writings of *Steve Hanke*, Professor of Applied Economics at The Johns Hopkins University in Baltimore. During such upheavals exchange rate volatility typically increases. Volatility is good as long as it is matched by liquidity. If that happens then eFX technology has put market liquidity on a winning road for us all.



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