15 years into the 21st century, how has retail FX changed and evolved?

JANUARY 1, 2015 —BY ANDREW SAKS-MCLEOD

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A new year begins today, concluding the fifteenth year after the turn of the millennium, and consigning even further the topics which surrounded the beginning of the 21st century even further to distant memory.

Terminology such as Y2K and the Millenium Dome is as obsolete as the corporate concern at the time over potential computer and server inoperability as the nineties gave way to the year 2000.

Fifteen years on, a sixth of a century, the FX industry has evolved exponentially from almost non-existent to being one of the most lucrative and profitable online businesses worldwide.

Back in 1999, Matchbook FX was established, which was effectively an open and inclusive internet ECN for FX trading, available to all willing FX trading participants including hedge funds, CTAs, banks, corporations and, uniquely at the time, retail FX traders as well. This represented the dawn of FX trading being made available to retail customers.

Matchbook FX was initially conceived by Daniel Uslander, Ron Comerchero, both of whom were commodity futures and equities traders, and former Goldman Sachs FX trader Josh Levy. It also comprised of the New York based proprietary FX trading firm Valhalla Forex Inc and Mark S Smith of the Florida based equities-trading technology firm NexTrade ECN. Several months later, GlobalNetFinancial.com, a NASDAQ-traded financial news and technology firm, bought in as the third major equity partner in the three-way joint venture.

As one of the earliest providers of open-access FX e-trading, Matchbook FX received considerable acclaim for its efforts to instigate change and level the playing field in the insular, closed, club-like and highly profitable domain of interbank Forex dealing, likely to the chagrin of the major international money center banks. Matchbook FX was recognized in 2000 as one of Silicon Alley Reporter Magazine's "12 to Watch", its annual listing featuring top internet companies.

Since then, the entire trading landscape moved away from banks, with introduction of specific retail FX trading platforms such as MetaTrader 4, which came about in the mid 1990s, designed mainly for closed systems in which a non-bank entity could establish a brokerage, buy an entire system from MetaQuotes and offer fixed-spread FX trading to retail customers, via an integral dealing desk, signaling the rise of b-book brokerages which operated a profit and loss model.

Prior to Matchbook FX, most FX trading was transacted mainly by phone or among large banks such as Chase, Goldman Sachs, UBS, Deutsche Bank or Citibank in the "interbank market" or by phone between large banks and their multinational corporate clients (such as IBM, Intel, Coca Cola, etc.) or institutional clients (such as hedge funds, pensions, mutual funds and other asset managers).

Despite on-line FX "e-trading" being rare at the time, Matchbook FX's approach was also considered unique by market participants because of its stated aims to democratize the FX market by empowering all buy side FX participants including retail traders and institutions to be, for the first time, "Price-Makers" instead of only "Price-Takers."

Matchbook FX functioned as an open limit order-book, similar to an online exchange, where any participant subscribed to the network could either post its own bids and offers just like a market maker, or immediately trade on any other existing bids and offers for a given currency. This process allowed users to join or better the prevailing prices in the network and thus directly impact (and tighten) the bid/ask spread widths on which they traded. As such, Matchbook FX was considered to be one of the main catalysts that presaged rapid technological advances, sharp compressions in bid/ask spreads and other sweeping changes into the currency market.

Whilst this model was not followed by the vast majority of retail FX brokerages which rapidly sprung up across the world for some time, it all began with Matchbook FX's A-book model.

It is most certainly fair to say that fifteen years on, the retail FX industry has gone full circle, with most firms embracing the direct market access model, largely driven by the need to serve an increasingly international client base as another factor which has improved dramatically since the turn of the millenium – connectivity – has allowed retail traders from all over the world to select a broker of their choice in any location.

With the shift of interest from North American retail clients toward the Far East, many brokerages are aligning themselves with the hard bargain posed to them by Chinese clients and introducing brokers in which spread must be very low, execution fast, and IB commission attractive – three factors which were of little or no concern fifteen years ago. Indeed latency was somewhat irrelevant among many firms until very recently – with spread often fixed at 3 pips and dealing desk slippage commonplace, it was of no consequence. Today, within some companies, clients cannot even begin to imagine EUR/USD spread of 0.3 pips, let alone 3 pips.

Full scale regulatory reforms had become the subject of global government concern with relation to the rapid changes within the retail investment industry which in the space of just fifteen years has progressed from a local man in a suit with a briefcase visiting his clients with paper application forms for fixed asset bonds and endowment policies to electronic systems which execute transactions from hand held devices across many continents within a fraction of a second, operated by all manner of electronic trading firms across multiple jurisdictions.

This rapid development resulted in much bureaucratic head-scratching from within the traditional government officials' offices, subsequently bringing forth trans-continental regulatory reforms including the 2010 Dodd-Frank Act in the United States, and the establishment of a pan-European regulator for electronic trading, operating under the acronym ESMA. These authorities work together, along with the Financial Conduct Authority (FCA) which was established in 2013 to dedicate its resources to non-bank financial services, taking over from the 28 year old Financial Services Authority which was invoked in the mid 1980s by Prime Minister Margaret Thatcher.

With the new regulations which involve technologically sophisticated surveillance systems to monitor the activity of brokerages, and global collaboration between regulators, came a new set of parameters for institutional firms which now are required to report all OTC transactions via central counterparties and trade repositories.

Back in 2000, things were somewhat different. One of the major trade clearing firms back then was Clearstream, which was created in January 2000 through the merger of Cedel International and Deutsche Börse Clearing. Its main function was to perform the task of International Central Securities Depository (ICSD). Clearstream today acts as the Central Securities Depository (CSD) for Germany and Clearing House for a number of securities. It is one of the biggest custodians and clearer of the eurobonds market.

Clearstream has been criticized for allowing banks to move money undetected and has been accused of involvements in a number of cases involving money laundering and tax evasion.

Two notable cases have become known as the Clearstream Affair which started with the release of the book Revelations in 2001 by the investigative reporter Denis Robert and ex-Clearstream banker Ernest Backes and the Second Clearstream Affair which started in 2004 when anonymous denunciations were sent to magistrate Renaud Van Ruymbeke accusing a number of major French political figures of having received kickbacks.

Whilst Clearstream dates back to 1971, it obtained its own banking license in 1996, becoming Clearstream in 2000, before being sold to Deutsche Boerse for 1.6 billion euros in July 2002.

Unencumbered by today's highly sophisticated reporting environment, regulators had to take shots in the dark if they wanted to investigate practices.

The book Revelations asserted that Clearstream played a major part in the underground economy, was a main platform for money laundering for hundreds of banks, and "operated hundreds of confidential accounts for banks so they could move money undetected," according to Business Week.

Bloomberg Business Week also said, in 2001, "Earlier this year, Clearstream, which handles the back-office paperwork for some 40% of European stock and bond trades, was found to have overstated its assets in custody by $1.5 trillion. (It has $6.5 trillion.) If Clearstream makes $1.5 trillion math errors, customers are understandably nervous–and some have moved to rival Euroclear."

Backes and Le Figaro were sued by Clearstream and found guilty of libel on March 29, 2004. Denis Robert was sued for libel and found guilty three on three counts on appeal on 16 October 2008 for the books Revelation$ and Black Box, as well as the documentary "Les Dissimulateurs" (The Deceivers). However, in February 2011, in a final judgment, the Court of Cassation overturned all convictions, ruling that his work was protected by freedom of speech and of the press.

Today, episodes like this are almost entirely unlikely, as all transactions are reported and can be looked up within a matter of seconds by corporations and regulators, just as all systems are seconds by corporations and regulators, just as all systems are connected via data centers and networks, thus making transactions very similar globally. It is entirely possible to execute trades in Moscow between London and Frankfurt via TMX Atrium's dedicated point to point connectivity, thus giving traders across multiple regions access to the same liquidity without having to use clogged, multi-use data transfer. This same topography allows regulators to keep a watchful eye on a real time basis.

With the advancement of clearing systems, exchanges and executing venues, the retail FX industry began to follow in these footsteps.

By the beginning of 2011, a vast majority of retail brokerages sought to move toward the A-book model, adapting their systems to be able to A or B book order flow according to internal risk management.

This gave rise to a plethora of third party software companies which developed liquidity bridges for the MetaTrader 4 platform, allowing it to operate with the direct market access business model for which it was not initially designed, thus allowing a breakthrough in client accessibility to the real FX market, whilst retaining the EA-friendly functionality of the familiar MetaTrader 4 platform.

Following this development, a whole host of software companies providing services which link to the MetaTrader 4 platform including signal trading providers, copy trading companies, social trading communities rose to prominence, giving clients across the world a fully comprehensive trading experience, with top tier liquidity from quality companies such as Sucden Financial and LMAX, with sophisticated exchange-like execution. LMAX itself has recently made a foray into the now fiercely competitive interbank market.

Evolving further was the development of new retail platforms which were connected to brokerage systems by a single API, designed specifically for A-book execution in retail FX, such as Spotware Systems' cTrader which has advanced algorithmic trading capabilities, and Tradable, which is designed for traders to create their own applications.

Algorithmic payment solutions were developed to mitigate risk and allow transactions from across the world to be made to retail brokerages, Cyprus became a gateway to Europe, Japanese traders remained accountable consistently for 30% of all retail FX order flow, and the retail FX volumes increased exponentially from the pioneering days of Matchbook FX to today, in which it is not uncommon for just one company alone, in a domestic market, to reach $1 trillion per month, as depicted several times by Japanese giant GMO Click Securities, which recently rebranded to become one of only three single-letter domains on the entire world wide web.

This leads nicely onto the latest dynamic – branding. Retail FX fifteen years on from its inception has become such a fast moving, online-orientated business that branding and naming conventions are paramount, with GMO Click's rebranding to Z.com being a prime example of this.

The company purchased the domain for $6.8 million from Nissan Motor Company in the latter part of 2014, clearly demonstrating that the online industries are the way of the future.

In the 1980s and 1990s, companies which sold retail financial services products would allocate similar sums of money toward traditional client acquisition methods such as leasing fleets of company cars for their financial advisers to drive to their clients homes, harking back to the days of Lloyds Bank's fleet of 3,000 Ford Sierras which were replaced every three years. Nowadays the only traffic that a company representative is concerned with is the traffic within the network by which clients sign up online and trade remotely.

It is fair to conclude that the FX industry has been one which has demonstrated an exponential development since its inauguration at the beginning of the millennium.

Where will it be in 2030? Interesting times lie ahead.

LeapRate wishes you all a very happy, healthy and prosperous new year.