

# Bridging the gap

## Retail meets Institutional FX



Heather McLean

The retail forex trader segment is now a client base as highly sought after as the institutional market. Banks and brokers are bending over backwards to make these smaller players feel like part of the forex family, providing them with the tools of the trade more commonly associated with institutional traders and investors. Heather McLean takes a look at how retail providers are bridging the gap between institutional and retail.

### Different breeds?

Ross Ditlove, CEO of MB Trading, says his company sees little difference between professional and semi-professional, also known as very active retail traders, other than committed capital. As a result, MB Trading's professional grade technology platform services both retail and professional FX traders alike. "It was a long standing industry belief that larger accounts should receive tighter spreads. Our firm considers this a preposterous notion and one which

has no relevancy in today's forex market place," he states.

John Moran, COO at Advanced Markets, states that never before have retail traders and investors been exposed to such a high level of technology, liquidity and brokerage options in foreign exchange. He notes: "The retail space has become a highly sought after segment for banks and brokers alike.

MAREX Financial has been drawn to the retail client world now because of demand. Previously, it was in the business of servicing and facilitating the needs of prop shop traders, notes Farooq Muzammal, head of foreign exchange and bullion at MAREX Financial. He says that until recently, this was done only for Financial Futures traders, while the foreign exchange division of MAREX traditionally catered solely to institutional customers such as banks, hedge funds and other financial institutions.

On MAREX's retail client base, Muzammal remarks: "For these customers we have developed a private client group of seasoned professionals who know the retail client world very well. It is their remit to offer these customers the same high quality service that we offer our institutional customers. We are not looking for short term, small deposit and highly leveraged customers, but are offering whatever services are needed to maximise the longevity of our customers. We are looking for long term relationships; this is why we look to protect clients' interest by not offering margin levels that are unrealistic for long term success."

Within the retail space, Muzammal notes there are two distinct types of customers. "There are those that we consider true 'retail', with small deposit sizes, usually looking for leverage greater than 100:1, who are consequently high risk and have a high propensity to lose their deposits. Then there are those which we at MAREX term 'professional' private clients; they will have a higher deposit, may ask for 100:1 / 50:1

leverage, but will very rarely use it and have a disciplined approach to trading. MAREX's typical customer is the latter."

Muzammal says that retail clients rarely have the same access to charting, news and back offices that an institutional trader will have, so for that reason, retail platforms have to offer these functions built in. "We have seen from our own customers that the more sophisticated ones will in the end get their own, more complex, charting packages, and use our professional stand alone back office system. For these customers the cost of execution is key, so we offer MAREX FX Black, a multi-bank, multi-liquidity source platform that make sure that our retail customers are not the poor cousins of their institutional counterparts."

Moran adds a word of warning in light of traditional institutional services being filtered down to the smaller end of the trader market, however: "Increased levels of transparency and technology provide the tools to make every retail investor feel as though they can be successful and beat the street," says Moran. "That being said, there is a cost, or barrier to entry. Whether it is educational seminars, signal software or developing an API or FIX connection to a slick home-based trader, professionally built operating and hardware systems are becoming the norm. But the cost can be high; in the tens of thousands to trade FX liquidity."

### Tools of the trade

On how retail FX brokers are providing innovative institutional FX pricing and leverage structures to give retail traders more precision and trading power, Moran states that retail clients are only now grasping the positive impact of direct market access (DMA) and what that can mean to their liquidity and execution. He says they are migrating away from a 'broker trading against' model of the dealing desk, because they know that their broker is on the other side of every trade they execute.



**Farooq Muzammal**

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Moran notes: "The DMA model has afforded the retail investor complete transparency direct to the interbank market, and in some special cases to bank-only liquidity portals, such as Advanced Markets. The bank participants in these portals embrace the flow because it is a natural liquidity source that they have not had access to previously through their normal distribution. This mutually beneficial environment allows the banks to price the bank-only DMA pool very aggressively, commit to very limited slippage, and complete all fills. The backend order management system (OMS) plumbing benefits derived from the years of capital and time that the banks have invested, makes the routing of trades untouched, straight through the settlement process."

OMS were originally developed to handle post trade activity, but over the last 10 years OMS has increased efficiency and returns as a front end tool, to capture trade flow from one piece of technology to a broker or settlement engine. Moran remarks that retail brokers have had to develop interfaces to accept trade activity from the more highly sophisticated technology drivers, but also be able to handle a simple flat file download.

"This has given retail clients the ability to create a more cohesive, low-touch trade entry option that dovetails well with DMA technology. While this option has its obvious advantages for the retail space, it can be a daunting task for the less sophisticated trader to manage the intraday trade and settlement activity," says Moran. "In an effort to effectively manage trade flow, access to a front end application, trade blotter or GUI, is still a necessity. Retail brokers now offer many connectivity options including multiple front and middle office applications. We feel this will continue to morph as retail clients' increase their reach into DMA liquidity."

### Reducing latency

Retail FX brokers are also pioneering advanced and low latency trade execution for retail forex, Moran continues: "The entire DMA model was built to level the playing field for retail traders. It brings a completely different product to the market; I equate it to using dial up internet access versus internet access through a t-1 line. There is no comparison. Retail brokers have looked at gaining the edge with the retail segment by offering value added services, such as research and news services. While those value-add services are a nice to have, there is nothing that beats tight spreads and instant execution. The DMA model offers the best of both worlds; a value-add service, but with direct access to a multi-bank, unobstructed liquidity portal."

Prior to the advent of DMA in the world of FX, retail traders had very limited, if any, access to the interbank market. DMA has created an E-Harmony, match-making style environment, where it matches approved broker clients to approved bank liquidity. This is only accomplished through a strong communication conduit between the retail clients, anonymously vetted, with a strong interbank partner, says Moran. This type of transparency ensures that clients are not deliberately trying to harm the liquidity pool,

while at the same time giving them an environment that is anonymous, provides deep liquidity and uber tight spreads, all afforded by participating banks and managed by the broker.

There are several factors that have played a role in reducing latency to the end retail clients that Moran separates in two parts: what measures have the brokers used to reduce latency for retail clients; and what steps the retail clients have taken to reduce latency to their brokers. He explains: “The brokers have used proximity to bank servers, wider bandwidth and more sophisticated technology in the API, but perhaps the most critical factor is and has always been how long the broker holds on to the trade.

“Retail clients that use a GUI have also increased their bandwidth to speed their internet connectivity, and additionally invested heavily in bypassing the GUI completely. They have developed FIX connectivity direct to the broker systems. This bypass not only gives them better access to liquidity and execution, but allows them to use more sophisticated signal or algorithmic technology, previously available only to the most sophisticated investors.”

### Control with an ECN

The MB Trading model is designed to give the client the most control possible, says

Ditlove. This design is based on the notion that full transparency to the marketplace is the only way to interact fairly. MB Trading aggregates liquidity from multiple sources, which includes: banks, automated trading systems, and dark pools of liquidity. The best bid or ask price at any moment can come from any combination of these sources, says Ditlove.

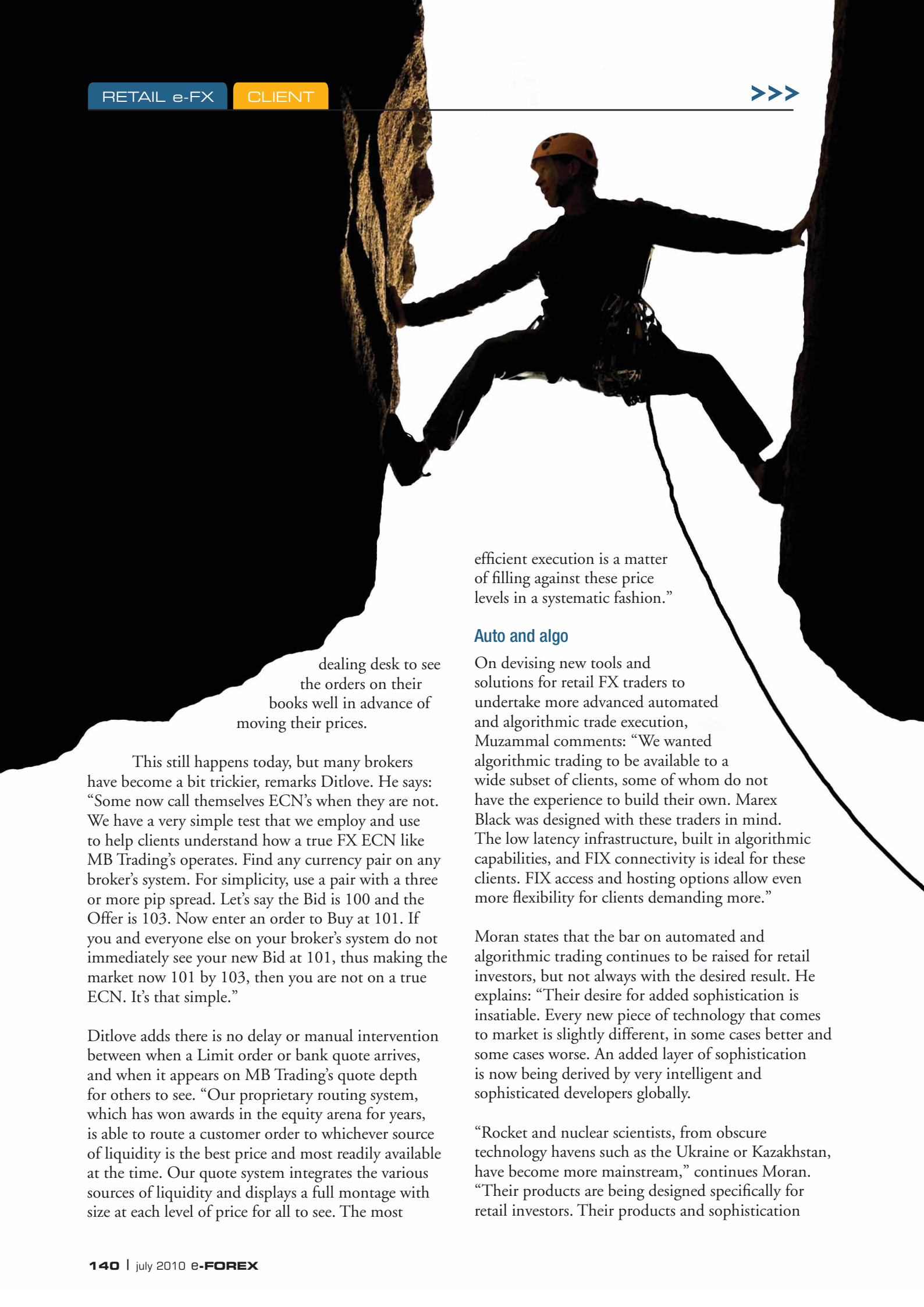
In the 1990s, MB Trading was part of the movement from exchanges to ECNs in Equities, to put the power of execution in the hands of the traders. Its forex system was designed to be a non-deal desk (NDD) system from the start. MBT then aggregated STP executions with its bank partners and added ECN components into the mix by showing the customer the full Limit order book. By maintaining a centralised order book, including stop and trailing stop orders, and keeping Limit orders on the ECN directly, the business lowers the latency of trading considerably. Further, says Ditlove, MB Trading offers software development tools, API's and FIX 4.4 integration. He says this allows more technologically advanced clients to write their own trading software and to interact with the company's systems in a fully electronic manner.

Forex traders were previously limited to three basic order types when working with a deal desk: Market; Limit; and Stop. In addition, many deal desks brokers would not allow a trader to place a Limit or Stop order if it was too close to the current market price. This is done to allow the brokers



#### John Moran

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dealing desk to see the orders on their books well in advance of moving their prices.

This still happens today, but many brokers have become a bit trickier, remarks Ditlove. He says: “Some now call themselves ECN’s when they are not. We have a very simple test that we employ and use to help clients understand how a true FX ECN like MB Trading’s operates. Find any currency pair on any broker’s system. For simplicity, use a pair with a three or more pip spread. Let’s say the Bid is 100 and the Offer is 103. Now enter an order to Buy at 101. If you and everyone else on your broker’s system do not immediately see your new Bid at 101, thus making the market now 101 by 103, then you are not on a true ECN. It’s that simple.”

Ditlove adds there is no delay or manual intervention between when a Limit order or bank quote arrives, and when it appears on MB Trading’s quote depth for others to see. “Our proprietary routing system, which has won awards in the equity arena for years, is able to route a customer order to whichever source of liquidity is the best price and most readily available at the time. Our quote system integrates the various sources of liquidity and displays a full montage with size at each level of price for all to see. The most

efficient execution is a matter of filling against these price levels in a systematic fashion.”

### Auto and algo

On devising new tools and solutions for retail FX traders to undertake more advanced automated and algorithmic trade execution, Muzammal comments: “We wanted algorithmic trading to be available to a wide subset of clients, some of whom do not have the experience to build their own. Marex Black was designed with these traders in mind. The low latency infrastructure, built in algorithmic capabilities, and FIX connectivity is ideal for these clients. FIX access and hosting options allow even more flexibility for clients demanding more.”

Moran states that the bar on automated and algorithmic trading continues to be raised for retail investors, but not always with the desired result. He explains: “Their desire for added sophistication is insatiable. Every new piece of technology that comes to market is slightly different, in some cases better and some cases worse. An added layer of sophistication is now being derived by very intelligent and sophisticated developers globally.

“Rocket and nuclear scientists, from obscure technology havens such as the Ukraine or Kazakhstan, have become more mainstream,” continues Moran. “Their products are being designed specifically for retail investors. Their products and sophistication

making some retail traders much better at what they do, but in some cases, it is like putting a nuclear reactor in the hand of a third grade science teacher - no disrespect intended for elementary school teachers! My wife is a wonderful kindergarten teacher, but given a nuclear reactor...one can only wonder."

#### New trading relationships

To develop new trading relationships that more closely align the interests of both trader and service provider, MB Trading has recently launched MBT World, its new online community. Here, traders can talk and chat with support representatives and with each other, can request new features they would like to see MBT develop, and vote on other people's suggestions. One of MB Trading's new platforms, MBT Lightwave, allows traders to create strategies. "We want to hear from our clients, and obviously, we use our technology to give them the tools that they need to accomplish this. MB Trading continues to support clients in their endeavours. We understand our success is completely based on our clients' success," comments Ditlove.

MB Trading has created a central hub that acts very much like a stock exchange does today. It has successfully centralized a great deal of retail liquidity. The more clients MBT has, the more level and efficient the playing field is for all, claims Ditlove. As MB Trading continues to grow, its spreads get tighter and its cost to transact falls, Ditlove continues; last year MBT passed on a 40% reduction in commissions to its clients. "Many incorrectly believe that such a model prevents the smaller retail trader from fairly participating; nothing could be further from the truth," he continues. "Mini-sized orders, routing to all banks, sub-pip increments, and fairness in quotes were all once believed to be something reserved for the large trader. We have shown this to be a fallacy and thus available to all our clients."

Muzammal adds: "As clients get more advanced, they expect more from their broker. We see this as a good thing. Our key strategy is to build long term relationships with all our clients. We therefore we provide a range of tools to meet their ongoing requirements. We have a platform available with built-in algorithms allowing them to trade based on their view of the market. We also allow clients to connect using systems with Expert Advisors, allowing them to easily plug in their own trading strategies. For more advanced clients we are able to provide API access to enable them to plug their own trading application directly into the MAREX Black liquidity hub."

On how brokers are devising new tools and solutions for retail FX traders to undertake more advanced automated and algorithmic trade execution, Ditlove comments: "All three of our platforms (MBT Desktop Pro, MBT Lightwave, and MetaTrader 4) have different versions of scripting languages. Obviously, in a liquid, 24 hour market like forex, the ability to write scripts that behave appropriately is critical to everyone, from the small retail trader to the big funds and systems traders.

"We also feel that it is important that we make it easy for traders to connect to our execution and account systems in whatever manner suits them best. We offer an SDK kit, Quote API, and FIX 4.4 connectivity to developers so that they can concentrate on what matters most to them, which is taking their own vision of a trading system or frontend GUI and connecting it to the marketplace. The underlying foundation is that clients trust that MB Trading is facilitating real time market executions without intervention," sums up Ditlove.

#### Raising the communications bar

Looking after the client is the key to brokers raising the bar in retail FX service provision, observes Moran. "In many cases it does not matter how much investment you make in trading technology, it comes down to how you service the client. While automation has changed the way we communicate, it has not changed the fact that people want and need to communicate. Brokers today do not just need to



**Ross Ditlove**

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have call centres, 1-800 numbers, or email; they want instant messaging or Skype.

"When you have a trade that is about to reach a resistance level and you are having trouble with your platform, you do not want to have to wait in a call queue or send an email; you want to hop on Skype and tell the representative 'get me out' of a trade. Traders want to feel like they have a direct, real time connection with someone sitting at a desk that can get them out of the trade if necessary," concludes Moran.