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Electronic Trading

Opinion: FX Trading – Managing the Boom Times

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The Foreign Exchange markets have enjoyed a major boom in volumes over the past five years, leading to buy-side interest in pursuing short-term profit opportunities. Naturally, the sell side wants to profit effectively from that business as well.

The changes in the sector have been dramatic. In 2001, about 35% of FX trading was electronic, but this figure is expected to reach 70% by the close of this year. In addition, recent statistics announced by consultancy Aite Group show that the rise of High Frequency Trading in FX alone will represent 35% of total volume in 2010.

FX is the most liquid financial market in the world and, while it is undoubtedly more accessible today than ever, the sheer size of the market and proliferation of trading venues increases the complexity of trading for everyone.

Despite these complexities, trading FX has become increasingly attractive for creating alpha-generating opportunities. As a result, new types of investors and speculators are beginning to dominate the trading activity in this market.

Advantages of FX to Investors

FX is a unique asset class in many respects. It is almost totally free from regulation, and benefits from high liquidity on a global scale. There are a variety of features that impact exchange rates, such as their relationship to bond prices and interest rates. Traders – wholesale, institutional and retail – are attracted by the ease and convenience of online currency buying and trading. The statistics bear this out with an average turnover of around $1.5 trillion per day – a clear indication of the strength of the market.

Now that FX is recognised as an asset class, tradable as and of itself for profit, its liquidity and volatility is growing day by day. Previously, participants in FX trading were involved mainly to do business in a foreign country, for travel, or purely as a hedge against trades made in other asset classes. While there are many clear advantages to FX trading there are also risks, of which organizations and investors need to be mindful.

The Risks of FX Trading to the Sell Side

Despite clear benefits, trading foreign exchange in fast-moving, highly volatile times carries a high level of risk. As such it may not be suitable for all types of investors, institutions and buy-side firms. It's important to remember that FX trading is high risk and high reward. As a result, sell-side organisations that are serving the fast growing needs of hedge funds, proprietary traders, and other firms that take on these risks take on their own additional risk. There is a need to manage their own increased risk intelligently – by building rules within their FX trading systems to identify and manage risks without erasing their competitive advantages.

At the same time increased au-

tomated order volumes from the buy side represent revenue opportunities for sell-side firms. But attracting that order flow away from competitors requires unique services, aggressive pricing and the ability to find the best prices in a highly fragmented market – not to mention the speed and scale needed to keep up in a high-risk environment.

There are technologies available which enable sell side institutions worldwide to rebuild their FX eCommerce platforms in line with the requirements of the most challenging customers and prospects. This is with a view to automate and customize their trading operations to become more competitive.

Making the Most of FX eCommerce

There are now technologies that combine FX trading venue connectivity with a bird's eye view of the market in real time; aggregating fragmented liquidity and enabling every element of an eCommerce platform to automatically find and leverage the best prices in the market.

In addition, these technologies

also offer a set of foundation FX trading and smart order routing algorithms. And, a very few include a rich development framework for both business users and IT. The flexibility for the business user allows traders to create and rapidly deploy proprietary FX and cross-asset trading strategies that help them competitively engage with clients.

Early adopters of FX products like this were banks – consolidating various trading screens on the dealing desks. More recently, we have seen a shift to banks deploying liquidity aggregation products – with embedded smart order routing – as the foundation of a broader platform for their FX eCommerce operation. In addition to direct dealing, price formulation, distribution, credit limit checking, pre-trade risk controls, auto-hedging, and flow internalisation are all components of this broader eCommerce infrastructure.

The FX market is often volatile and presents participants with tremendous opportunities for profit. However, in order to tap into profits, organizations require a more granular view of market activity in real time. To do this, financial institutions need get to know their customers well and present them with unique, compelling services, the most competitive FX prices, and minimise their own risks of doing so in the meantime.

There have been numerous recent examples of banks looking to take advantage of these technologies. For example, Royal Bank of Canada (RBC) recently deployed a new FX Aggregation solution accelerator to support its foreign exchange dealing operations. The accelerator is completely customizable and has been modified for RBC to meet its specific requirements. RBC's new system has significantly increased the efficiency in which its traders obtain the best FX prices for their clients.

RBC is the latest in a growing list of global and regional banks, which have deployed this type of platform. Other organizations that have deployed FX aggregation technologies from Progress Software (namely its Apama product) recently include BBVA, UniCredit and ANZ bank, who can now access multiple sources of liquidity and dramatically improve their ability to handle increased trade volme.