

Seize the Day

For retail FX brokers, why is now the best time to optimise your business?



It would be an understatement to say that retail FX brokers have suffered a few reversals recently, and they won't need reminding that their traditional business model is under threat. To remain competitive, and in some cases even to survive, they must adapt and reposition themselves. But before discussing how brokers can optimise their businesses and build for the future, it would be useful to highlight some of the main industry pain points and the way the marketplace is evolving.

GLOBAL GROWTH AND COMPETITION

The FX industry has come a long way in a short time, and the rapid rise of online trading has spawned a thriving retail sector with a growing number of brokers. Today, it's a crowded and highly competitive marketplace – some might say cutthroat – where brokers must work hard to gain an edge. FX trades 24 hours a day worldwide and depends on the latest technologies to achieve ever-greater speed, precision, and of course profit. Moreover, it is one of the least regulated marketplaces – until now, that is.

THE NEW REGULATORY LANDSCAPE

Regulators have been catching up – and decisively so in the case of the European Securities and Markets Authority (ESMA). In 2018, it introduced a slew of reforms that have unsettled the broking community and forced brokers who operate in Europe to adjust how they work and find new and more innovative ways to protect and grow their revenue.

In short, there has been a huge change to leverage and margin, with brokers now obliged to offer a negative balance protection to retail clients, comply with rigorous anti-money laundering procedures and ensure best execution for client orders. And where ESMA leads, other jurisdictions may follow.

This is unquestionably a good thing and a much-needed shakeup that provides greater transparency and fairness; however, the increased oversight and accountability, which also includes restrictions on advertising and how brokers market themselves, is impacting the bottom line and prompting brokers to look for opportunities beyond Europe where there are fewer shackles.

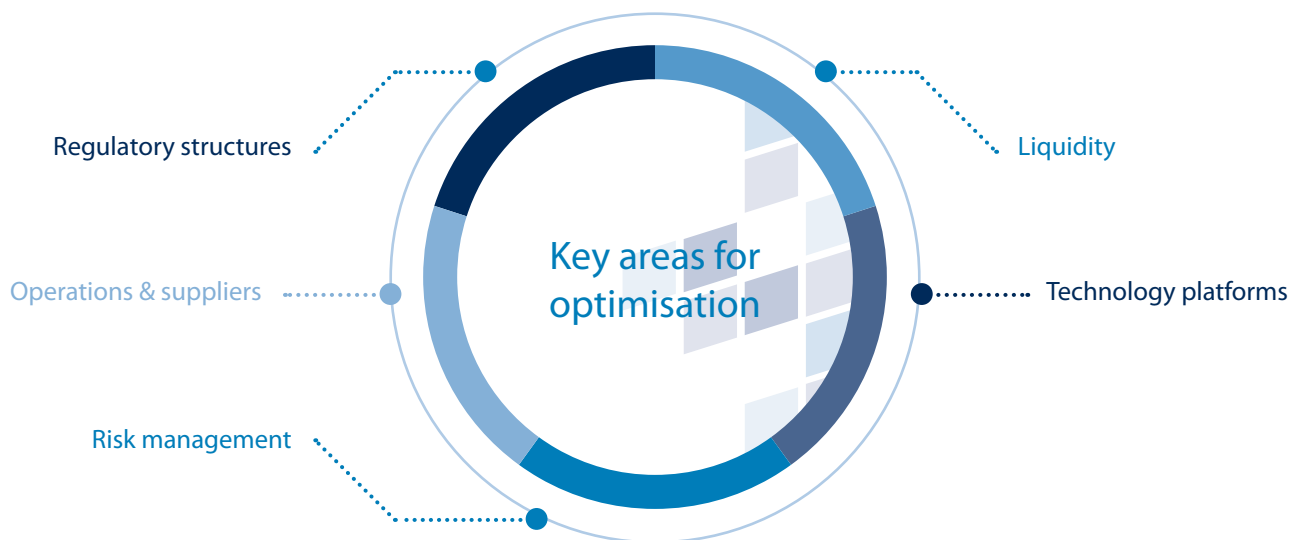


That said, the quest for greater scrutiny and control is a worldwide trend, and we are seeing restrictions tightening elsewhere – not least in China. Wherever your FX business takes you, you need to think ahead and focus on optimisation.

MULTIPLE MARKET CHALLENGES

This challenging environment is compounded by other trends that are adding to broker woes. In particular, in the first half of 2019 there has been a lack of volatility despite the unresolved issue of Brexit and the ups and downs of US-China trade relations. Bad pricing and inconsistent liquidity have also played their part, while poor risk management and shady practices have damaged reputations and client confidence. Finally, there is a constant need to keep up with the technology curve and protect market share from fast-moving competitors.

There have also been regulatory pressures with the implementation of the EMSA Product intervention measures causing a decline in volumes for many brokers, combined with FX traders suffering their worst first quarter in more than a decade. As a result, to succeed in this new and more demanding marketplace, brokers must take a very close look at their operations and systems, and they must optimise across regulatory structures, risk management, liquidity, and technology platforms.



KEY SUCCESS FACTORS

The goals may be clear – higher revenues, lower costs – but there is only so much that retail brokers can do to generate business in today's tough trading conditions. That's why they must seek help to improve their internal processes, their systems and set-ups, and their supplier relationships, so they can squeeze as much revenue as possible from current volumes. The aim is to strip out inefficiencies at every stage, which is where IS Prime comes in. Combining liquidity services with risk management, technology and analytics, the company offers a comprehensive end-to-end broker solution.

This market report looks at current trading practices and describes some of the many ways IS Prime can help brokers to protect their businesses, provide a better service to clients, and maximise revenues.

REGULATION AND OPTIMISATION

Faced with the new European restrictions, the immediate reaction of many brokers has been to diversify and seek additional licences in more accommodating jurisdictions. This is understandable but can increase complexity and lead to further costs because many vendors will charge brokers for each separate licence and require a new bridge or a new application.

CONSOLIDATE AND CONQUER

IS Prime takes a more holistic approach: it ensures clarity and precision by looking at customers from a single viewpoint. A broker may have 10 different licences across the world, but IS Prime will consolidate structures and provide a single, high-quality service for each entity. When brokers chase leverage in new jurisdictions, the advantages of diversifying can be undermined by set-up costs and complex administration. IS Prime makes sure that trading structures are streamlined and cost-effective. It helps brokers to navigate multiple jurisdictions, avoid convoluted technology implementations, and amalgamate costs to provide overall reductions. In other words, it provides optimisation through consolidation, enhancing commercial and systems efficiency.

OPTIMISING WITH SPECIALISTS

INSIDE KNOWLEDGE AND EXPERTISE

It's vital for service providers in this industry to fully understand brokers' needs and the challenges they face. Optimisation begins with detailed inside experience and knowledge – knowing all the business drivers, whether technical, commercial or regulatory, and being able to make refinements where and when they are most needed. Few specialists can match IS Prime's sector knowledge and resources. Part of ISAM Capital Markets Group, IS Prime combines industry and technical experts who have an intimate understanding of what brokers require day to day. The team includes specialists from tier one banks, brokers, hedge funds and technology providers. Quality is never sacrificed to quantity, because IS Prime always focuses on the level of service and the market insight behind the numbers.

IS Prime's specialists work very closely with clients to understand their workflow and what happens to their orders, advising at every stage of the trade cycle. To take one example, when a customer's risk manager calls IS Prime, they will be talking to a member of the IS Prime's coverage team, rather than 'customer support', all of whom have the background and skills to fully grasp the issue or requirement and thus find the best solution.

IS PRIME HEALTH CHECKS

IS Prime's high level of specialist service includes detailed 'health checks', a consultancy approach that is very much geared toward optimising a client's book. Jonathan Brewer, co-founder of IS Prime, describes it as a personalised service that looks at all aspects of a client's business:

"We can upgrade your technology, improve your risk set-up, clean up your risk-adjusted returns – in fact, whatever needs attention. Many clients have very complicated bridge infrastructures, and sub-optimal liquidity structures. Our health checks will highlight these and other weaknesses, and then we can find the best solution for your brokerage."

OPTIMISING RISK MANAGEMENT

INTERNAL VERSUS EXTERNAL

Alongside regulation, risk management is one of the main areas where brokers can optimise their businesses. It's not practical for brokers to rely solely on internal risk teams, because although internal teams play a valuable role, their view will always be limited. For many brokers, the vision of their internal risk managers will be restricted to the data in front of them and their own experience managing their books. When brokers widen their perspectives with the global view and controls that IS Prime and IS Risk Analytics (ISRA) provide, they increase resilience and will be in a much stronger trading position.

VOLUME WITH RISK SERVICES

Whereas an internal risk manager may take hours or days to figure out what's caused an issue, such as latency arbitrage or a toxic activity, only for it to be too late to resolve, IS Prime can respond immediately. This is where ISRA comes in as a natural complement to the company's prime of prime business, maximising efficiency because it has the full picture.

Customers that trade sufficient volume with IS Prime can automatically have access to these risk management services with sophisticated analytics at no additional cost. This can have a direct return on investment, as Jeff Wilkins, MD of IS Risk Analytics, explains.

"It's a virtuous circle, because if you trade enough volume to get access to our services, you're going to see a return that can feed the business. In many cases the investment for your return is just sending volume to IS Prime. You're likely going to save money on your book and you're going to be managing it more effectively, enabling you to plough that revenue back into marketing and sales – and ultimately you grow the business."

FINDING THE RIGHT FOCUS

Wilkins adds that few brokers really excel at risk management, and if they use IS Prime to manage their book of business and handle the risk side, they will be better able to focus on their core business.

However, this doesn't mean that IS Risk Analytics will replace a broker's own risk management. The real value comes from working alongside the broker's team, providing a bespoke service combining ISRA's experience and expertise with that of the broker, and leveraging ISRA's broad market reach. While the concept of a third-party risk management service is hardly new to the retail FX space, IS Risk Analytics raises it several levels and gives brokers an exceptional range of services and industry experience.

ISRA's services include risk analysis and book optimisation; client profiling; broker/liquidity provider analysis; independent analysis of swaps, commissions, spreads, and IB agreements; outsourced risk management; white labelling; and proprietary MT4/5 bridges.

ASKING THE RIGHT QUESTIONS

Brokers should ask searching questions about their risk structures. For example:

- Is there any toxic activity on the book?
- Do we know our exposure?
- Is our book positioned to take advantage of volatility?
- Do we know the negative balance risk at any given time?

Risk teams need to have clear answers and a firm grip on all these areas, and this is best achieved with the comprehensive risk management service that IS Prime and ISRA provide.

When it comes to toxic risk, IS Prime and ISRA's proprietary tools help brokers to identify toxic clients before or shortly after they trade, drawing on an extensive database of IP addresses and trading characteristics to isolate and neutralise previously identified toxic strategies before they do significant damage. The ability to identify toxic clients is one of the core strengths of IS Prime's risk management services, and ISRA now provides this as a standalone service to help brokers and liquidity providers avoid losses.

OPTIMISING LIQUIDITY

WINNING THE NUMBERS GAME

Liquidity is of course a key determinant of success in FX markets, with many brokers opting to use multiple liquidity providers. IS Prime believes this is a mistake, as it splits resources and capital requirements, which is unwieldy and makes the business susceptible to errors. The more liquidity providers you have, the greater the probability of receiving an inaccurate or latent quote. Although adding liquidity providers can improve spreads, execution will usually suffer, resulting in poor fills, delays, rejections, and prices sometimes disappearing altogether at critical moments.

KEEPING IT TIGHT

IS Prime's approach is to concentrate on quality rather than quantity. The company provides aggregated pricing sourced from the top tier one liquidity providers, and it is a small and tight-knit group. When assessing liquidity providers, the group looks for key performance indicators such as spread, response time, fill ratios, latency of pricing, market impact and cost of rejections.



IN-BUILT PROTECTION

A key differentiator is how the group builds and protects liquidity, providing pricing sourced from customised liquidity pools, and routing customer flows to ensure that clients are executed on the best possible liquidity for their trading styles. As a result, feedback from clients is that IS Prime provides tighter, more consistent pricing than any of its competitors.

The benefit of protection is often not understood by clients but it is something that the group's Liquidity Providers value very highly and, to that end, work with us very closely. Every single trade that comes in is immediately measured for decay after the trade is made – and if IS Prime notices anything undesirable, impacted clients can be routed to pricing pools specifically designed for toxic or predatory flow

MONITORING THE FLOW

IS Prime's quant teams are in regular contact with their peers at the major bank and non-bank liquidity providers. They discuss all elements of the flow directed to IS Prime, and this open and transparent dialogue helps to ensure the best pricing available.

OPTIMISING TECHNOLOGY

The rise of the internet and the huge advances in digital tools have fuelled the FX marketplace and created opportunities for many new participants. And with fintech continuing to develop at a rapid pace, brokers must constantly refine and upgrade their systems to ensure they have the latest technologies.

NEXT GENERATION SOLUTIONS

IS Prime has a long pedigree of developing systematic and quantitative trading tools, and it leads the market by investing heavily in trading and risk management architectures. For instance, it recently announced the launch of a next generation risk engine and bridge software. The new IS Risk Analytics bridge is fully compatible with both MT4 and MT5 and has the very latest risk tools, including the ability to detect and mitigate toxic activity before the first trade, which helps brokers to avoid significant losses.

THE POWER OF PROPRIETARY TECHNOLOGY

IS Prime is committed to developing in-house software, enabling it to tailor technology to meet a client's specific requirements for liquidity, execution and risk management.

Because IS Prime uses proprietary technology, there are cost as well as efficiency gains. As Brewer explains:

*"Other prime of primes use an off-the-shelf aggregator, an off-the-shelf hub, so their cost of doing business is typically on a per-million basis. They bake that into the client's price, which makes it more expensive to deal with them. With IS Prime's proprietary technology, **we don't have a set per million fee structure and can be much more flexible and therefore more competitive, if needed, for the right business.**"*

IS Prime's technology platform affords clear oversight and control of liquidity, enabling it to manage diverse flow styles, route orders, and closely monitor the behaviour of liquidity providers. All price improvements are automatically passed on to IS Prime's customers, which is something not all prime of primes do. The group also has fully independent matching engines in London and New York, with global distribution and access.

THE PARTNERSHIP APPROACH

As IS Prime takes care of the technology base as well as the risk management strategy, brokers have more time to focus on their core skills, whether sales, marketing or other business development activities. One of the best ways to optimise a business is to free up resources by using a technology partner to build the systems and tools that would be challenging to build internally. Outsourcing to a dependable technology specialist avoids convoluted and messy technology set-ups and ensures you have access to the latest developments.

CONCLUSION

To succeed in the current marketplace requires remedial action. In the past, thanks to a less stringent regulatory environment and more favourable trading conditions, it was far easier for brokers to grow their profits. This is no longer the case, which is why brokers must take steps to optimise their systems and operations. Now is the time to act, because those who wait too long will see further decline, while those who do nothing may not be around in the future.

By addressing the issues in this report, brokers will benefit from a multiplier effect. Technology, liquidity, risk management, compliance – all these things are linked and mutually reinforcing. When you optimise one area the benefits spread throughout the business, and if you can run regular health checks and optimise at all levels, so much the better. For brokers who work with IS Prime, optimisation becomes a long-term strategic advantage that will help the business in good times as well as bad.

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