Single-dealer platforms: staying ahead in the FX game

By Nicholas Pratt

The electronic FX market started to develop back in 2000 with the launch of a number of multi-dealer trading platforms or portals that exploited the development of online and web technology to enable traders to see multiple prices on one screen and to execute on these prices electronically. At the same time as contributing to these multi-dealer portals, banks were also busy developing their own single dealer electronic platforms. Nicholas Pratt examines why the value proposition of these single-dealer platforms continues to strengthen for many trading firms and FX buy-side participants.

Ten years after the arrival of electronic FX, banks are continuing to invest in their single-dealer platforms which have been enjoying a resurgence of late. According to Paul Caplin, chief executive of Caplin Systems, a provider of e-commerce technology for use in single-dealer platforms, there are numerous factors driving clients to single-dealer FX platforms. "Firstly there is the speed and reliability of execution which are more critical factors than price in a liquid market like FX. Then there is the ability to execute more complex trades and the ability to set up multi-leg trades. Integration of research and technical analysis is also more easily supported through a single-dealer platform – this includes both the contribution of a trade idea and also the analysis to support when exactly a pre-determined trade should be executed to maximise profit and minimise market impact. And single-dealer platforms are rapidly catching up with or even overtaking multi-dealer platforms in terms of post-trade processing, allocations and straight-through-processing."

Unsurprisingly it was the established FX banks that first realised the potential of single-dealer platforms and built powerful engines that have done very well. However, says Caplin, as client delivery of trading services has become more important and as the technology in this area has improved, it has given new entrants an opportunity to challenge the established banks. "It is entirely possible for a relative newcomer with a reasonable budget and a clear focus to produce a very compelling offering."

Focus on client service

Although it takes time to build market-share, Caplin says that the renewed focus on client service that is evident across the capital markets does present an opportunity for ambitious firms to establish a roster of new customers. "And in the FX world there has been rapid growth in the number of users, particularly in retail FX trading, and they are the ones demanding a greater level of service and functionality."

In order to meet these demands, a single-dealer platform provider will have to invest enough time and resources in taking its offering to the next level, which means ensuring that it can be tailored to meet the specific preferences of different customers, says Caplin.

"On the retail side we are seeing a demand for more research-driven FX which starts with a number of trading ideas and then allows the client to pick one from the screen, read the relevant research notes, perform technical analysis, engage in on-screen and real-time dialogue with an advisor and then automatically populate a trade ticket."

Alternatively a single-dealer platform may also have to cater for the contrasting corporate customer who has a series of payments that have to be made and is looking for a series of currency hedges and an efficient way to process these trades. "These are two different trading objectives but they can be serviced through the same system," says Caplin. "This has been made possible by improvements in front-end technology and a rapid development environment that can produce a different look and feel for two different users of the same system."

User experience

Caplin refers to the emergence of user experience (UX) design, which is helping front-end users to have a more involved role in the development of user interfaces. "It used to be that the user interface was designed by programmers, which was perhaps why they tended not to look very nice. And banks used to think that users didn't care what their interface looked like but all the recent research indicates that they do. So now we are seeing not just graphic designers joining the development teams but also UX designers who are able to analyse users' behaviour."

The design element could be particularly important for the next area of development for single-dealer platforms that Caplin foresees – mobile platforms. "We have seen some iPhone applications in the FX area but what the banks are very serious about is the iPad and other similar devices. They see these as must-have platforms. It is not so much about the ability to execute on these devices but using them as a way of staying in touch with the market and being able to keep an eye on positions and breaking news at all times."

For some, the recent success of single-dealer platforms is down to market conditions. For

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example, the credit crisis created an opportunity for banks to promote their single dealer FX trading platforms and when credit was very constrained, banks could exercise more influence over where their clients chose to access liquidity and direct them to their own single-dealer platforms, says Justin Geaney, who works in the e-commerce foreign exchange team at Citigroup Global Markets.

"The single-bank platforms offer a number of savings that are not available in the multi-dealer platform environment. For example, there are no brokerage fees with a single-dealer platform or additional fees that are charged to the bank, and many banks then build this into the price they show their clients."

Additionally, banks can generally cover flow on their own single-dealer platforms much better than on any other channel. "It is their technology, they know how it behaves and they understand the algorithms working in the background used to hedge transactions. There is also less latency because there are fewer hops. And the banks own the applications that sit on the client's desktop so they can build in client-specific logic that ensures they get a lower rejection rate and more targeted pricing."

Benefits

The most important benefit of a single-dealer platform, says Geaney, is the enhanced relationship. "Up until a few years ago there were several banks that did not have a viable, single-dealer platform to offer their customers. But now we have seen a lot of banks come out with new and improved offerings and new ideas and there is no better way to have constant contact with your bank than trading on their single-dealer platform."

These improvements have focused on areas such as speed of execution, says Geaney, which has been driven by two factors. "Firstly you have more players in the market so your platform's performance is being benchmarked against more venues than before. More importantly though is that firms became more sensitive to the efficiency of the post-trade process because the of credit crisis. If there were any delays in updating a client's credit status, positioning or risk metrics this would be a big issue. So banks have spent a lot of money on improving the straight-through-processing in this area."

Direct connectivity to single-dealer platforms has also improved says Geaney. "Everybody these days has FIX but the way that we provide liquidity over FIX has certainly improved. Previously banks would provide single tiers of their order book, then this became selected tiers and now a few banks, Citi included, can offer clients a much more flexible FIX solution and they can send in requests for a set of dynamic tiers of an order book. Liquidity can fluctuate between tiers and clients can get a real-time and transparent picture.

The demand for real-time risk metrics and post-trade analysis tools has been driven by a decreased risk appetite among clients, says Geaney, particularly within banks. "Previously it used to be much easier and much simpler to provide clients with a line of credit. Most banks would have a single, flat margining rate across all of their currency buckets. But the world is now much more sensitive to credit provision and it has become a more complex world and harder for clients to calculate their margin rate."

He goes on, "Some banks are still not able to provide their clients with a constantly updated calculation

of their margin rates and their positions and clients are increasingly sensitive about this. Regulations are not yet calling for this information to be made available in real-time but it is something that could happen and this is putting added pressure on the banks to improve in their provision of real-time risk metrics and positioning information."

Tailored offerings

Another advantage that single-dealer platforms hold over their multi-dealer counterparts is the ability to tailor their offerings to match different client segments. "If a client is trading on a multi-bank portal they get what they are given," says Geaney. "At Citi we are pretty good at knowing whether a client's demands are viable and also whether these demands may be useful for other clients or other client segments because it makes sense to incorporate these new services across the organisation whenever possible."

Geaney points to the example of uploading client orders. "We can do this on a specific basis but because we have a global client-base we can usually find synergies where it makes more sense to create a series of templates that will work with multiple order books and not just single clients but also gives the clients a more tailored service than a simple one-size-fits-all approach."

Despite the clear advantages that single-dealer platforms potentially offer banks, there is a significant investment required if they are to remain competitive in an increasingly crowded market, or if they are to try and dislodge any of the established incumbents in the market. "In terms of our FX technology budget, our single-dealer platform would be in the top level of investment," says Geaney. "We have been in the market with Velocity for just over 2 years, but our behind-the-scenes pricing technology has been around significantly longer. Our overall client solution is very mature but we are constantly tweaking it in line with new client needs, and we are now ready to take that next big step. A lot of our competitors are bringing out new systems but it is always a balance of the time to market and the quality of system. We are seeing other banks bringing out an interim solution that is more or less off-the-shelf but we know from experience that it takes three to four years to develop a fully functional, high quality system."

There is also, of course, the fact that the FX market is known for the strong and loyal relationships between buy-side firms and their FX banking partners with which many firms will conduct almost all of their FX business. So what is to say that these same firms will not similarly direct all of their electronic FX business the same way, regardless of the quality of the bank's single-dealer platform? "The decision will never be based on the system alone and where you have two systems that are very similar, then the relationship will be a factor," says Geaney. "But you have to look behind the system and a lot of the success is down to the quality of the sales people and the ability to get in front of clients."

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Justin Geaney

Changing client requirements

Clients' requirements are constantly changing and the key for any bank with a single-dealer platform is to invest in the right technology to keep up with these changing requirements, says Mark Burroughs, executive director, FX e-commerce sales at Nomura. "Clients still value relationships and single-dealer platforms can deliver the bespoke offerings that so many firms are looking for. I don't think a one-size-fits-all approach works in today's market. We are seeing increasing requirements for pre-trade, trade and post-trade workflows to be integrated with research, live market commentary and, above all, consistent pricing."

There are more multi-participant platforms that are catering for the growing number of non-bank entities in the FX market, and, says Burroughs, one would expect some clients with lower requirements to move to these platforms. "But we continue to see volumes on single-dealer platforms grow rapidly as clients are seeking stability and consistency in the current market conditions and turning to the single-dealer platforms to find this."

As for whether the single-dealer platforms have had to undergo a step change in the speed and transaction processing capabilities that are on offer in order to compete with the multi-dealer platforms, Burroughs says that Nomura's platform has always sought to be strong in this area. "Speed, reliability and the ability to process transactions efficiently are all things that our clients expect from day one."

That said, there are probably some banks that have been using older technology for some time or have been white-labelling platforms and technology from more commoditised sources, says Burroughs, and have had to revamp this in order to protect their franchise. "I think in the last couple of years these banks have had to improve things because clients' expectations have risen and there is increasing competition in this space."

Clearly the benefit of multi-dealer platforms is that trading firms are able to see multiple bank prices on one screen and without having to support a range of single-dealer platforms. But for those firms that favour single-dealer platforms, are they relying on just one bank's platform or using a number of different bank offerings?

"We do not see many clients these days with multiple single-dealer platforms on their desktop and trying to

juggle them all" says Burroughs. "Many of these type of firms have moved to aggregation services. But we like to think that our clients like the functionality and performance of our platform and value their relationship with the bank and are rewarding us by putting most of their business through our single-dealer platform."

More flexible connectivity

Single-dealer platform providers are also having to invest on meeting the demands for more flexible and direct connectivity options to their platforms. "There are a whole host of different protocols out there for both liquidity provider platforms and liquidity takers and we need to be able to connect to them all very quickly. There are also a number of clients that have developed their own internal trading systems with their own protocols and specifications so the technology team spends a lot of time developing the best way to connect to and work with these systems," says Burroughs.

The development of the FIX protocol is making this connectivity an easier thing to achieve, however, a lot of the internal systems used by trading firms are based on internally developed algorithms that exhibit precious little standardisation or flexibility creating farmore work for the single-dealer platforms. However as standard protocols such as FIX become more ubiquitous and as trading firms realise the benefit of standardisation and the economic merits of a streamlined operational set-up, connectivity is likely to become less of an issue in the long-term.

A lot of effort has also been made by single-dealer platform providers to improve client access to real-time risk metrics and non-generic trade information, says Burroughs. "There is a lot that goes into building the relationship with clients, such as providing them with access to research and trading ideas. With a single-dealer platform this information can be provided in real time which is something that clients value and helps to attract more trading volume on the single-dealer platforms."

A lot of clients already have the real-time risk metrics built into their own trading platforms. But pre and post-trade analysis tools that

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enable them to look at how they trade with a bank is something that clients are increasingly interested in and something that single-dealer platforms should be looking to provide, says Burroughs.

Single-dealer platforms also have to cater for the varied client-base that many of them attract. Much of this tailoring takes place on the front-end and fortunately technology known as rich internet applications (RIA) are enabling banks like Nomura to address these concerns. "We use Microsoft Silverlight which allows us to deliver flexible and tailored solutions direct to the clients' desktop via the internet. It all runs on a web browser and is very easy for us to deploy. At Nomura we are very lean and nimble and able to build bespoke solutions which is a very strong focus for us. On the technology and financial engineering side we are developing core components to help us build a variety of cross-asset class trading systems and services that take very little time to get to market and are very attractive to clients," says Burroughs.

We can also expect to see more integration between the execution applications of single-dealer platforms and the payment and cash management systems of clients, says Burroughs. "There is definitely room for more efficient work-flows in that area. There is a growing demand from money managers for aggregation and execution tools provided directly by their order and execution management systems and banks are continuing to offer more in the pre and post-trade space with analysis and reporting so it is becoming more compelling for money managers to look for direct execution from these type of venues because these tools are not available from multi-dealer venues."

Levels of investment

Keeping pace with all of these developments necessitates a significant level of investment and raises a question about how many banks are able to maintain the commitment needed to remain competitive in the single-dealer platform space. "At Nomura we have around the clock client coverage combined with continuous information flow and the technology needed to do that involves substantial investment. Competing on price alone is no longer an option and everyone in the top tier has similar G10 currency coverage. So we think the key to success is the provision of advanced risk management and pricing models. We have seen a lot of banks move into the single-dealer platform space and have attracted significant flow but I think any bank that does not invest in their pricing infrastructure and risk management will struggle to monetize any flow that they manage to capture," says Burroughs.

Furthermore, Burroughs also believes that the need to provide strong pricing infrastructure and powerfully performing algorithms creates a possible advantage for a relative newcomer such as Nomura against the established FX banks that have been working with a single-dealer platform for many years. "We have made a firm commitment to develop our e-commerce offerings. Eighteen months ago, Nomura effectively started from scratch in FX e-Commerce and for six months during the infrastructure build out and whilst client's were being on boarded, we had an opportunity to re-write all of our price models and risk management algorithms. This time has been extremely valuable and allowed us to grow our distribution channels quickly and immediately monetise that flow."