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## **Volatility's impact on e-FX**

- What's the Upside?

## **Database integration**

- the next big challenge for FX risk management?

## **FX Alpha strategy development**

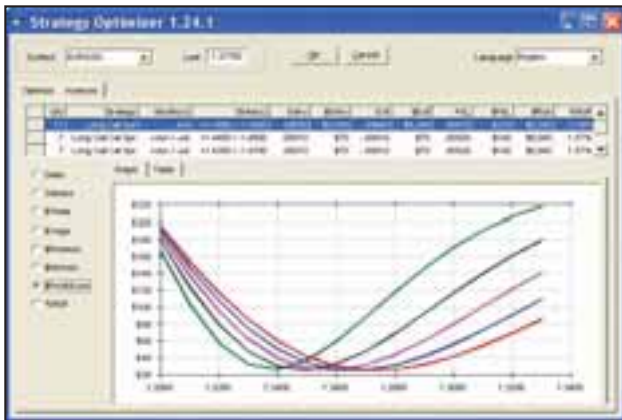
- taking a new approach

## **FOCUS on The post trade FX problem**

- is it time for radical surgery?

## FX Bridge launches Strategy Optimizer™

FX Bridge further empowers Forex traders with Strategy Optimizer — joining Risk Manager™, Pricing Modeler™, and Margin Calculator™ as the latest addition to the Total Position Awareness™ suite of analytics on its ProTrader Plus™ spot and option platform.



Strategy Optimizer gives traders an automated tool to find the highest profit/lowest risk combination of options for any given strategy. Strategy Optimizer scans and analyzes the profit/loss profiles of thousands of permutations of long and short puts and calls within all strikes and expirations to arrive at the top selections ranked by rate of return.

It also has analytical tools to evaluate and compare each strategy's potential performance under various time and price scenarios, eliminating tedious analysis and insuring the optimal strategy every time.

## Barclays Capital launches Trade-Weighted USD Indices

Barclays Capital has launched the Barclays Capital Trade-Weighted Dollar Bull Index™ (“Dollar Bull Index”) and the Barclays Capital Trade-Weighted Dollar Diversification Index™ (“Dollar Diversification Index”). The Dollar Bull Index aims to provide investors with the opportunity to establish a long position in the USD versus a short position in a trade-weighted basket of up to 10 currencies.

The Dollar Diversification Index aims to provide investors with the opportunity to establish a short position in the USD versus a long position in the same basket of up to 10 currencies.

## SunGard releases Front Arena 4.3

In SunGard's Front Arena 4.3, FX functionality has been enhanced to include high volume FX trading capabilities, straight-through processing, scalable architecture and real-time pricing. Front Arena has benchmarked capabilities for handling high-volume trading and for helping improve workflow efficiency. It can also handle highly complex cross-asset trades, helping traders, sales desks, risk managers and the back-office to better control operational costs and risks.

Tim Dodd, head of product management for SunGard's Front Arena business unit, commented: “FX trading systems are moving quickly towards the concept of a single and transparent process, one which allows for more comprehensive management of profit, risks, cash flows and workflows across all asset classes and desks. SunGard's Front Arena can handle high-volume trading quickly and efficiently, whilst providing traders with pre-trade risk analysis and optimal trading scenarios.”



Tim Dodd

## MetaQuotes opens UK office

MetaQuotes Software Corp. continues to expand with the opening of a UK office in February 2009. The new UK base is in partnership with Gold-i Ltd – the exclusive UK agent and US agent for all MetaQuotes products. In line with spiralling demand MetaQuotes clients in the UK, Europe and the USA can now access UK technical support, full system integration, a sales service for the growing range of MetaQuotes products plus bespoke consultancy all under one roof. Brokers will benefit from the expert knowledge of the new UK office head and Gold-i's CEO, Tom Higgins who comments, “The MetaTrader platform is the gold standard in retail foreign exchange and CFD trading. The combination of our expertise and this hugely successful platform will bring significant advantages to brokers and banks. Opening a MetaQuotes office in the UK offers both local presence and local market knowledge, which is a really exciting step.”



Tom Higgins

# Optimising Options: new developments in currency derivative platforms



Frances Maguire

The recent volatility has put FX options trading firmly in the limelight. The technology to price and trade these instruments electronically is available, but whether the appetite is there for the automation of the more exotic structures remains to be seen. Frances Maguire investigates.

**N**ow, more than ever, FX options seem poised for unprecedented growth. The timing of the more risk-averse market conditions, coupled with the fallout from the economic slowdown, has meant that both institutional and retail traders are turning to options strategies for greater control over market swings and risk.

At the same time, technological developments in the past few years have meant that there are now more sophisticated pricing and trading techniques available electronically. The fact that options trading in other asset classes has witnessed year on year growth bodes well for the trading of options in the world's largest market.

James Friedman, COO at FX software developer, FX Bridge Technologies, believes that recent volatility in the currency markets has brought into sharp relief the critical need to offer FX option products to retail traders. He says: "As it stands now, most retail trades have one form of risk management in their spot trading accounts: stop and limit orders. FX options answer a growing demand from retail traders for more trading and risk management strategies."

Furthermore, he adds, fund managers routinely employ the use of long and short puts and calls in conjunction with spot positions to build trading strategies that optimise their positions in light of their perception of future price movements.

For professional traders, the recent turbulence has most likely resulted in higher hedging costs for market

participants who must implement and manage a currency overlay to their core business. "Utilising options as part of that hedging process may offer added flexibility to some of those hedgers. Trading platforms may have to either add features or offer integration paths so that added option trading can be monitored in the context of the other assets and products that it is hedging," says Friedman.

## Dealer perspectives

From a dealer perspective, options solve the need for an evolved business strategy for the increasingly crowded and maturing retail FX marketplace, because they are dollar-for-dollar, trade-for-trade more profitable than conventional spot dealing, they differentiate a dealer from its competitors, who are offering an essentially homogeneous spot product, and they answer the growing demand from retail traders for new trading and risk management strategies.

But Friedman says the need for greater transparency is a key factor



driving the demand and growth for e-FX options products, online trading and new features and functionalities. He says the traditional RFQ model does not always allow for smooth and speedy execution and suffers from a lack of transparency.

“This execution method is already out dated in any other trading venue and entirely out of step with today’s instantaneous FX online trading world. Notwithstanding institutional inertia, the future of RFQ (due to evolving online developments including, but not limited to, dynamic volatilities surface modelling) is that of the old-style Chicago open outcry pit.”

### Standardised options

Debate has all but ceased over what is the ‘right option contract’ to offer to retail FX traders and standardised options appear to be the clear winner.

Standardised vanilla, or ‘exchange-style’, options are a proven trading product with a tremendous history of success with retail traders. He says: “Retail FX traders today are the same investors that have traded stock and futures options and will quickly and easily embrace FX options and the exchange-style option seems the FX derivative most likely to achieve widespread acceptance and usage.”

Many firms have already introduced product derivation like digitals, binaries, boxes, one- and two-touch exotics. However, so far, these new products



**James Friedman**

*“FX options answer a growing demand from retail traders for more trading and risk management strategies.”*

have failed to gain real traction with retail traders, and due to their unfamiliarity, complexity, and difficulty to integrate into spot strategies, Friedman doubts they will.

FX Bridge has recently released Strategy Optimizer™, the latest addition to the suite of options analysis utilities on its ProTrader Plus™ spot and option platform. Strategy Optimizer gives traders an automated tool to find the highest yielding

combination of options for the strategy they want to deploy. This utility eliminates tedious error-prone option analysis by quickly honing in on the best possible risk-reward profiles, and insures the optimal strategy every time.

Friedman says that FX Bridge delivers full electronic pricing of online FX options today and believes evidence points to the fact that the traction rate of exchange-style FX options will quickly meet and exceed that of futures options.

He adds: “The standardised option is more than 25 years old and already very familiar to retail traders. Furthermore, manual order execution and margining for options on futures is still fraught with delays and difficulties, yet daily volume is in the millions. Automated order execution and margining with FX options is immediate and easy, making it likely that FX options will be used by retail investors at a greater frequency than futures options.”

According to Friedman, options are about to take on the same growth path in FX that they have in the stock and commodities markets. With the current size and anticipated growth of the retail FX market, option volumes will likely rival those of stock and commodities markets as well.

### Increased appetite for online FX options

Kurt vom Scheidt, COO of FX Options at Saxo Bank, says that the current global uncertainty is undoubtedly evident in the recent movements in the FX markets. “Large spot moves are more common now than ever,” he says. “This has resulted in implied and historic volatilities at record levels and savvy investors recognising that now, more than ever, is a great time to express at least part of one’s directional view via an options strategy, rather than solely in the underlying.”

vom Scheidt believes that an increased appetite for online FX options trading will naturally spur development by trading platforms, in order to offer liquidity in the easiest and friendliest fashion. Saxo Bank is doing this by improving not only the distribution tools themselves, but also the depth of available pre-trade information, e.g. showing the client ahead of time what their margin requirement and updated account balances would be should they elect to execute a trade they are evaluating during price discovery.



**vom Scheidt**

*“..now, more than ever, is a great time to express at least part of one's directional view via an options strategy, rather than solely in the underlying”*

As a result the bank, and trading platform, is starting to see the same revolution in the options space as Saxo Bank started in the retail FX spot space some years ago. “Facilitating professional market access via a multi-product platform that offers effective netting and client position management is critical in promoting the benefits of options trading to the relatively newly developed retail segment of the broader FX market,” he says.

According to vom Scheidt, private clients are also pushing market interest and growth themselves, resulting in increased market turnover, by leveraging online educational material as well as by participating in blogs and online communities..

However, obvious barriers to price aggregation across multiple price providers exist due to the number of underlying market data variables as well as the non-standard way that individual market makers will often uniquely interpolate along volatility surfaces. However, vom Scheidt does not believe these are real barriers to provision of option prices or to the electronic execution of options as an increasingly important channel in a direct bank to client relationship.

He says: “Saxo’s clients are able to transact and manage their positions via a number of different platforms, ranging from a functionally rich thick client to a web client, even via mobile devices. We are continuously investing in and improving options distribution and trading capability across all these platforms.

“In the early part of Q3, we will be offering clients a much more streamlined tool that shows a range of option prices across a strike and maturity matrix, enabling fast execution of one or more options.”

But vom Scheidt believes that the delivery of an FX options trading platform is not just about the system delivering real-time position information, in terms of open trades, margin requirements and profit/loss. He says: “We find that our client base is even more impressed by our ability to provide this infrastructure, alongside top quality, multi-lingual customer service, in conjunction with price consistency and speed of execution. It is all of these elements together that are paramount in offering clients a truly high quality options product.”

Added to this, he says it is the ability to service the different requirements of corporate, institutional and retail FX customers with the appropriate combination of electronic tools and personal assistance that is a crucial element to Saxo’s growth.

### **Simplifying price discovery and execution**

“We are looking to grow our distribution capabilities by focusing on simplifying the price discovery and execution process,” he says. “As self-directed investors increasingly recognise the benefit of the inclusion of options positions and strategies in their portfolios, we are expecting that growth in volume will continue at pace. As we traverse the step function of volume growth with respect to vanilla options, we will also look to make certain exotic options more accessible by standardising terms.”

In terms of the development of electronically traded FX options, vom Scheidt is clear that it is difficult to imagine that any exotics will be streamed electronically in the interbank market any time soon. In terms of vanillas, the issue is most likely down to how much of the interbank market is transacted as at-

the-money’s and how much of the market turnover trades as specific interests.

He says: “Since a considerably large portion of the market is trading in specific strike and maturity combinations, one has the challenge of creating a best-bid, best-offer stack of prices in an environment where all liquidity providers will have, at a minimum, different day-weighting factors used to interpolate along a quoted volatility surface.

“What is clear however, even if there has not been a mass migration to electronic trading of options between professional counterparties, is that bank to client trading via electronic mediums is definitely on the steep part of the ‘S-curve’.”

While he believes FX options’ electronic trading will grow, particularly in the private client segment, Saxo Bank’s aim is to increase liquidity and turnover in the overall market by growing a segment of the market, which has not yet fully developed.

Mark Suter, co-founder of multi-bank FX options platform, Digital Vega FX (DVFX), says that the use of option transactions, specifically the net purchase of options and related structures increased as participants from all market segments have sought to protect existing exposures or benefit from protracted underlying market volatility, rose in 2007. However while options market turnover started to decline last year, as the liquidity in underlying forward markets rapidly evaporated, evidence suggests that, as markets slowly recover, regular users of FX options would support any initiative that would ultimately improve transparency and increase liquidity.

He says “History has shown us that as transparency improves and liquidity in a single venue becomes more consistent, acceptance, participation and ultimately turnover all progressively start to increase for the benefit of all participants”

### **Features that drive adoption**

According to Suter, in light of recent market developments, cost of entry still remains the main barrier to increased adoption. While several of the major banks have made significant investments in technology, allowing them to deliver successful,



**Mark Suter**

*“Comparing the FX options market with the recent explosive growth in the underlying cash markets, the cost /benefit considerations are more complex,”*

integrated solutions, for others, which have not already created a solution, the answers are now less obvious.

“Comparing the FX options market with the recent explosive growth in the underlying cash markets, the cost /benefit considerations are more complex,” Suter says. “Although the market for FX options is much smaller, the underlying technological needs and the necessary methodologies are much more sophisticated.”

For these reasons, he believes the ability to deliver consistent and competitive pricing to a wide client based via a dedicated multi-bank platform, which requires minimal capital expenditure, creates an increasingly compelling argument.

He says: “History has shown that as transparency improves and liquidity in a single venue becomes more consistent in a single venue, then acceptance, participation and eventually turnover all progressively start to increase for the benefit of all participants.”

As a result, DVFX has experimented with a wide range of functionality and tools, whilst engaging in dialogue with a strong cross-section of the active user

community. Based on this, it has returned to simplicity and developed a clear simple interface, combined with intuitive pricing and execution tools, which allow users to carry out what were once complex transaction requirements in a few mouse clicks.

Suter adds: “As with successful single and multi-bank cash trading platforms, the key features that drive adoption remain constant: stability, ease of use, standardised comparative pricing, consistent liquidity, proof of best execution and increasingly a strong STP solution.”

The Medusa platform has evolved from experience in building web-based FX e-commerce and derivative systems. As such, ease of adding new products and functionality has been designed from the outset. Similarly, the system has a highly flexible workflow engine which allows it to support simple and complex client/bank interactions and continue to evolve dynamically. “Our aim is to provide FX option traders with all the online benefits that currently exist in the already established cash markets,” he says.

In the first release of the Digital Vega FX platform, Medusa will deliver aggregated pricing and execution of vanilla options and structures across full volatility surfaces from overnight to one year, using a combination of manual and automated pricing and execution tools.

A planned subsequent release will support single barrier options and structures but that is as exotic as the company plans to go. Suter says: “A key tenet of the company is that DVFX will never venture into second and third generation exotics; this will remain firmly in the domain of the large banking institutions.”

But while he firmly believes that online FX options trading will continue to grow it is difficult, in light of the current economic conditions, to provide any specific growth estimates. However, the detailed research DVFX has carried out, and the feedback received to date, continues to point to increasing levels of acceptance and adoption from all segments of the institutional and retail FX markets.



## OPTIONS: Catch the Next Wave in Retail Forex

*"Why doesn't my Forex broker offer options, like I have in my stock and futures accounts?"*

Recent market volatility makes options vital for retail traders.

**Catch the wave NOW.**

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Our ProTrader Plus™ dealing platform lets you offer retail traders same-account spot and options trading in a feature rich environment right out of the box.

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