

Retail FX Margin Trading

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Agenda for today

1 What is Retail FX Margin Trading ?

2 Size and Growth of Retail FX

3 Views on trends in Retail FX and their Implications

4 Summary of Points for Take-Away

SECTION 1

What is Retail FX Margin Trading ?

Retail Investors in FX

- ◆ Retail participation in the FX markets has so far mainly been a by-product of other activities such as travel, credit card purchases and cross border equity investment.
- ◆ Now Retail Clients can actively trade FX as an asset class on similar prices that wholesale clients get.
- ◆ Retail Aggregators, acting as intermediaries between retail clients and larger foreign exchange dealers have brought the FX asset class within the reach of retail clients. The pioneers of Retail FX (e.g. OANDA, FXCM, GAIN, SAXO etc.) are independent firms, who have quickly built a credible offering in a segment outside of traditional banks' coverage models.
- ◆ Retail FX is growing at about 30% per year, helped by the rapid growth in affluent and high net worth individuals, especially in Asia, where Retail FX Margin Trading is particularly popular.

Key Features of Retail FX Margin Trading

Real-time margining and automated close-out

- ◆ Platforms offer leverage between 1:20 and 1:200

Cash-for-Difference instead of Settlement

- ◆ No foreign currency accounts held for clients
- ◆ Automatic roll-over of positions
- ◆ Automatic PnL Conversion

Integrated Workbench

- ◆ Dealing and Limit Orders
- ◆ News
- ◆ Charting
- ◆ Overview of PnL and Positions

Competitive Spot Spreads

- ◆ Spreads are only slightly wider than on wholesale platforms (e.g. EUR/USD typically between 1 and 2 pips)
- ◆ Spread on rolls still rather wide

Different Product Ranges

- ◆ Some platforms focus on FX Spot only
- ◆ Others offer options and forward outrights or future-look-a-likes
- ◆ Trend towards cross-asset offerings

Example of a Retail FX Screen

UBS Trader - test0 - Primary (5395295)

UBS UBS Trader

Connection Account Tools Help

Quote List **Quote Panel** F

EUR/USD		CHF/NOK	
1.36	1.36	4.87	4.87
37¹	39¹	75⁶	77⁶
SELL	BUY	SELL	BUY

CHF/SEK		CHF/JPY	
5.58	5.58	98.	98.
57⁶	59⁶	14⁰	16⁰
SELL	BUY	SELL	BUY

EUR/AUD		AUD/USD	
1.60	1.60	0.84	0.84
55⁰	60⁰	90⁵	92⁵
SELL	BUY	SELL	BUY

Account Summary (EUR)

Collateral Balance	291,436.65
Realized P&L	-7,390.65
MTM	-162.87
Total Required Margin	666.33
Free Margin (99.77%)	290,607.44

EUR/USD 1 min Close Price

EUR/USD (Close)

RSI (14)

Add Study Buy/Sell

Trades	Orders	Positions	Exposure	Activity					
	TICKET	MARKET	UNITS	S/L	T/P	PRICE	CURRENT	DISTANCE	EXPIRY
Short	776619	EUR/USD	10,000	1.36625	1.36215	1.36420	1.36371	4.9	Aug 06, 07:03
Short	776618	EUR/USD	10,000			1.36420	1.36371	4.9	Aug 06, 07:02
Long	776617	EUR/USD	10,000	1.36035	1.36443	1.36239	1.36391	15.2	Aug 06, 07:00

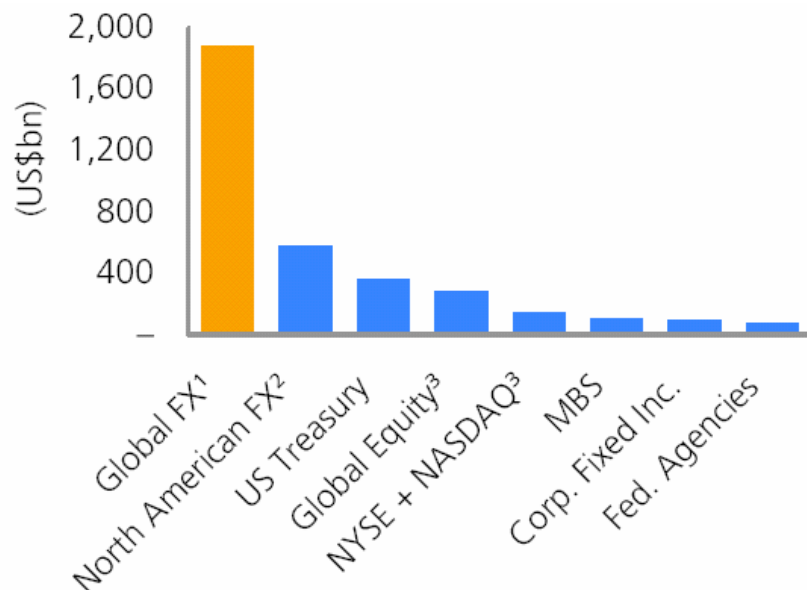
Connected

Warning: Applet Window

Section 2

Size and Growth of Retail FX

How big is Retail FX? – At first and second glance ...



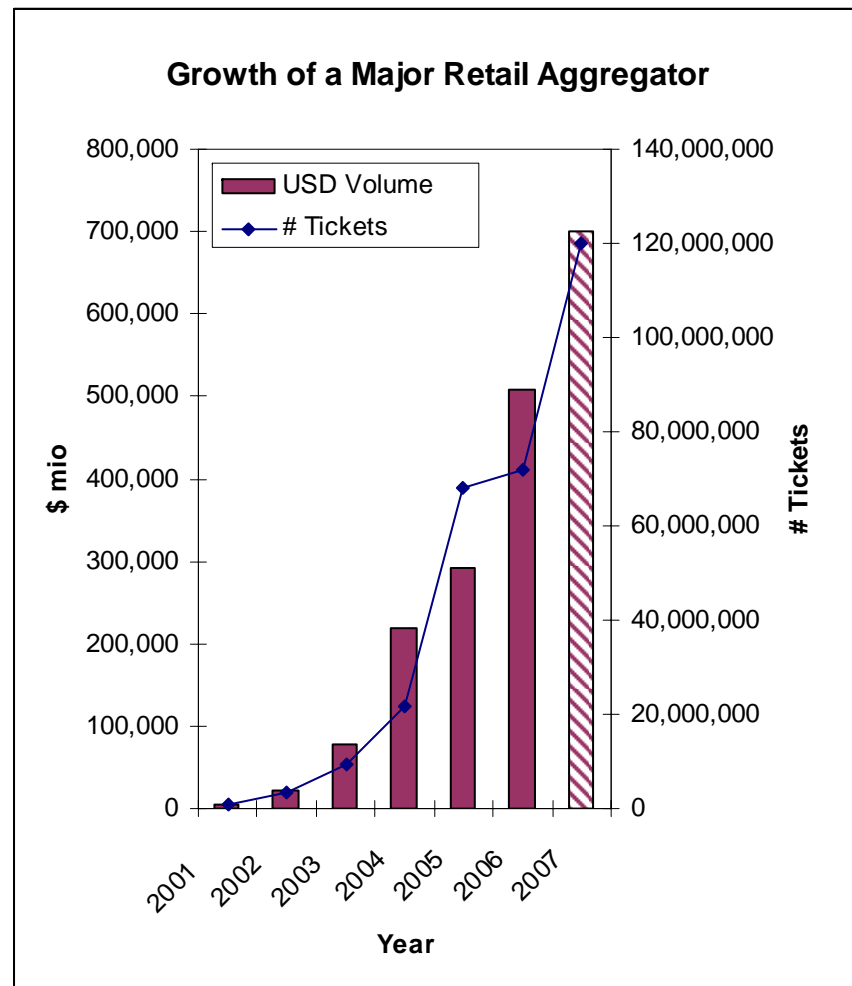
Sources: BIS, Federal Reserve Bank of New York, Bloomberg and World Federation of Exchanges

Notes:

- 1 For April 2004; includes only traditional FX markets
- 2 For April 2006
- 3 For June 2006

- ◆ Average daily Retail FX Volume is estimated around \$50 bio
- ◆ At first glance Retail FX seems small at only 2% of the \$2'000+ bio global FX market
- ◆ Taking into account that about two thirds of the global FX volume are Swaps and that about 50% of the remaining Spot volume is interbank trading, the more relevant daily buy-side spot volume is about 300-400 bio, of which retail is more than **10%!**
- ◆ A lot of Retail FX volume is concentrated in “carry pairs” such as AUD/JPY, NZD/JPY etc. and there is anecdotal evidence that Retail flow had a significant impact on price action in those pairs over the last months.

Example of Retail Aggregator Growth



- ◆ Recent average annual volume growth is pretty stable at 30% per annum
- ◆ Increasing number of high-end retail clients
- ◆ Stable to slightly increasing ticket size
- ◆ Client burn-out rate stable over last couple of years (but this varies across different platforms in the market)

How Retail is Retail?

Risk / Liquidity

- ◆ More and more “Retail” clients reach well into wholesale territory in terms of trade and position sizes.
- ◆ Scientific studies by a retail aggregator show hardly any differences in trading styles between truly self-directed retail clients and professionals

Tools and Services

- ◆ Clients of retail aggregators start connecting over APIs and trade algorithmically
- ◆ Demand for highly professional executing and charting tools
- ◆ Several platforms start to support managed accounts

Spreads

- ◆ Pricing difference between retail and wholesale e-FX diminishing rapidly (some institutional clients still trade on 2 pips EUR/USD rates ...)
- ◆ Provider firms still have pricing power on the rolls

SECTION 3

Views on trends in Retail FX and their implications

Challenges for Retail Firms

High Service Requirements

- ◆ Large scale account openings
- ◆ Margin management on high leverage
- ◆ Risk and Position Information
- ◆ Day-to-day queries, increasing demands on execution quality
- ◆ High demands on scalability and stability of IT platform
- ◆ Credit Quality to attract larger customers



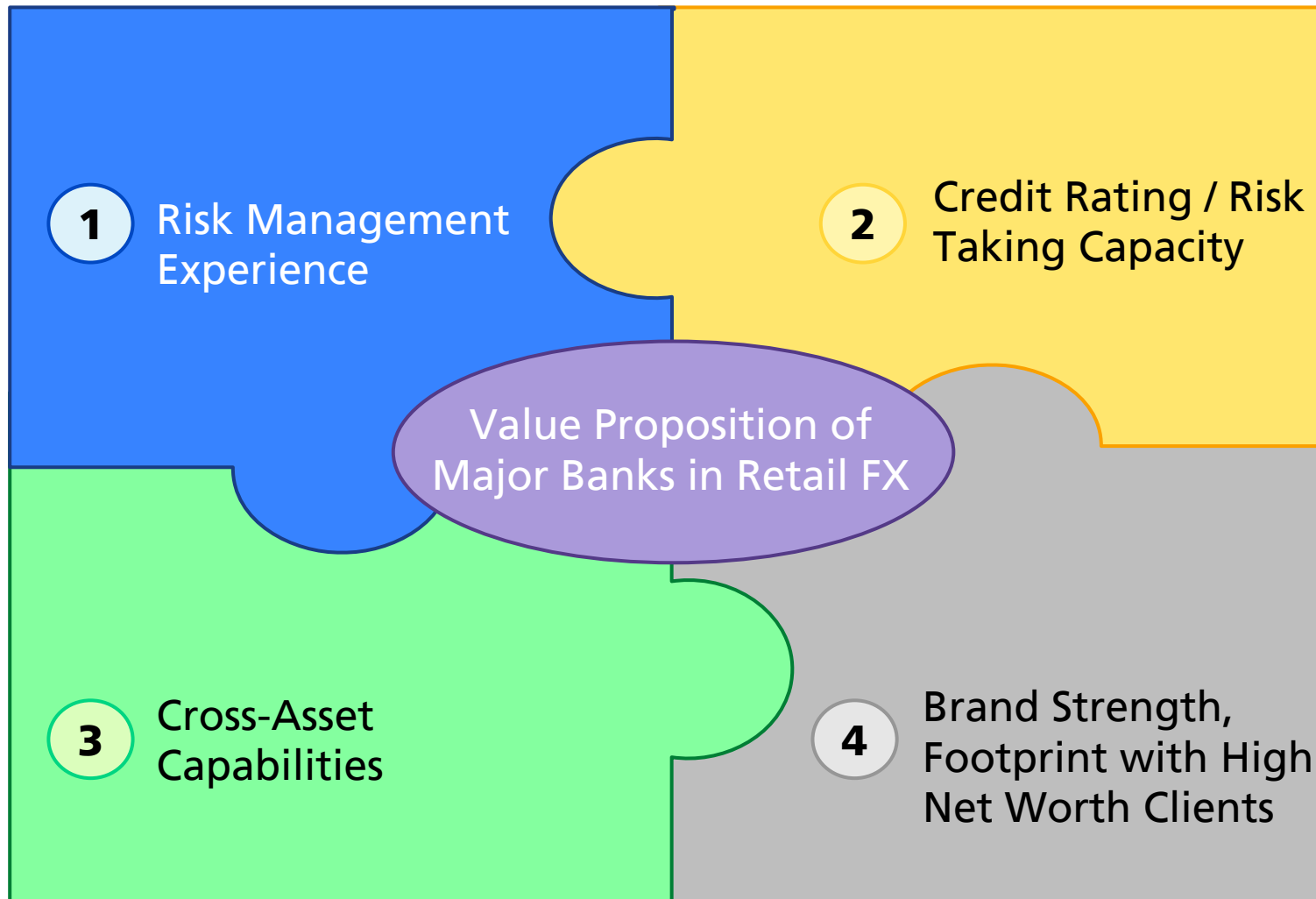
Low Margins

- ◆ Small tickets (e.g. OANDA alone has about 500'000 tickets a day, which is 3 times the EBS ticket volume)
- ◆ Tight spreads on all major currency pairs
- ◆ Competition to increase with big banks entering the market

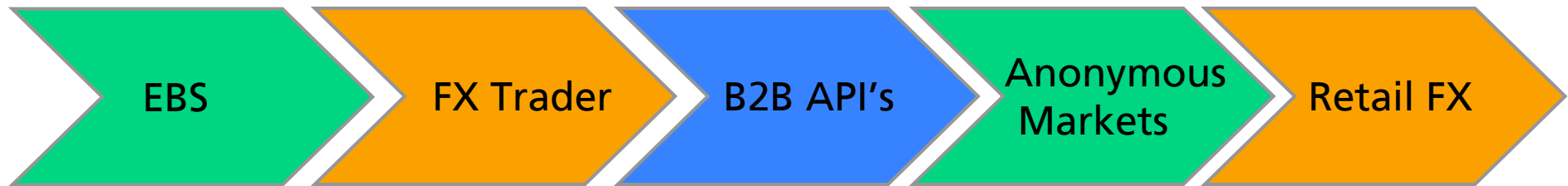
Challenges for Retail Firms

- ◆ Highly efficient processes for client set-up, service and back-office
- ◆ Scalability of IT Infrastructure
- ◆ Making money from the flow, increasing risk management demands

Major Banks entering Retail FX (1)



Retail FX – The next Mega-Trend in FX?

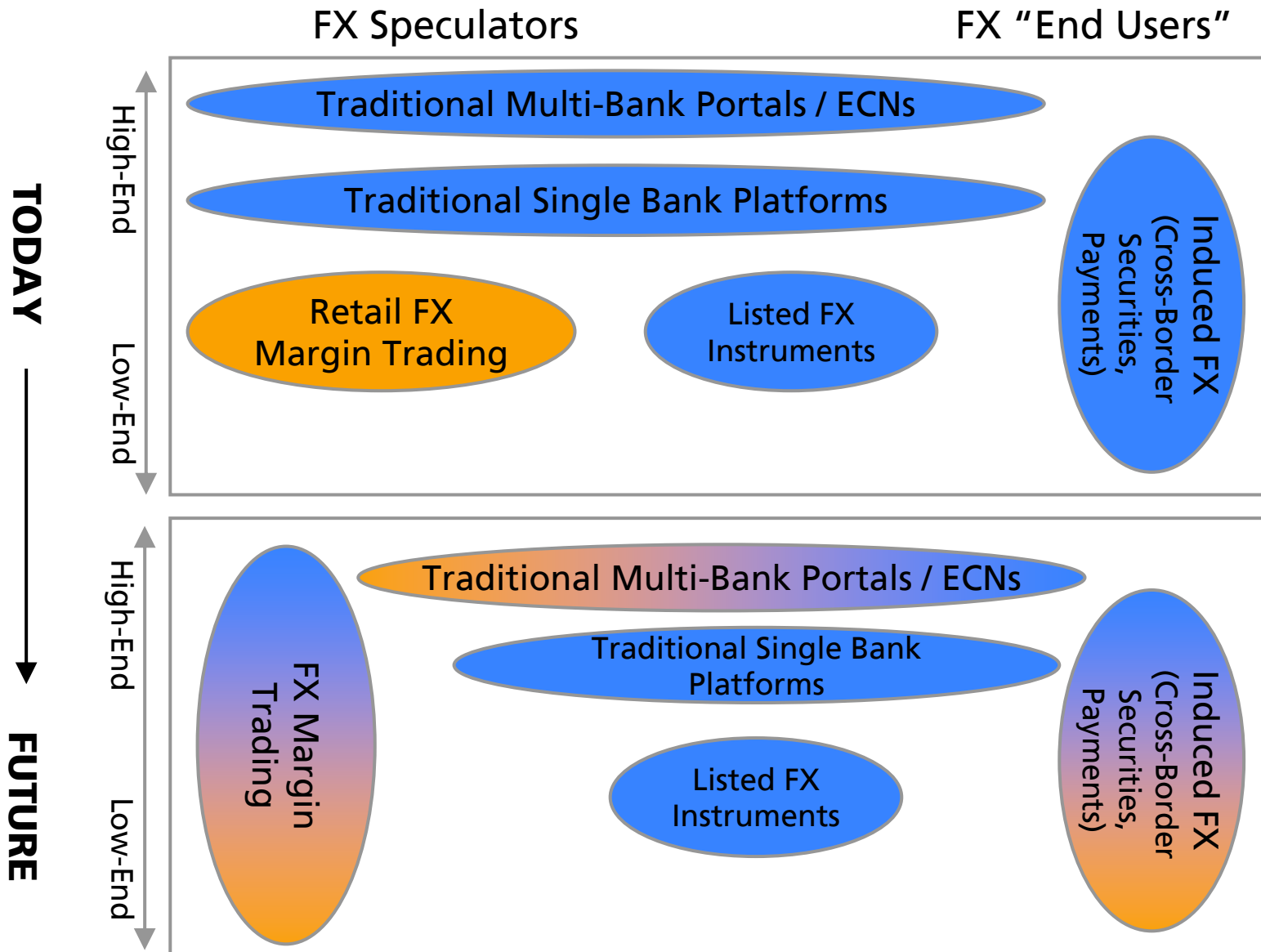


- ◆ Will Major FX Banks change the Retail Market or will the Retail Market change them?
- ◆ After the advent of electronic brokerage, e-Tools, API's and anonymous buy-side access to markets, we think that Retail FX could well be the next big revolution in FX.
- ◆ Retail FX will force players to a thorough re-engineering of systems and processes. Retail volumes will enforce simplicity and transparency in all processes along the value chain, from on boarding over order execution to margin management and settlement – and this will not remain limited to the retail side of the business.

How Retail FX could change the FX Market

- ◆ In general scaling up to Retail Volumes will impose simplicity and standardisation in
 - Order execution (reference, protection, slippage).
 - Client spreading
 - Margin Management and Close-Out
- ◆ Increased usage of CFD-like products in the overall market – in the longer term time-weighted interest accrual as implemented by OANDA is likely to be an interesting option for the overall market
- ◆ Strong IT requirements in terms of system availability and flawless pricing. A single price misprint can cause tens of thousands of spurious executions. Retail customers have no alternative channel during outages.
- ◆ Self directed private clients are a new class of market participants, where direct relationship and interaction is very difficult for liquidity providers and regulators.

Current and Futures Landscape of FX Services and Providers



Major FX Banks

- ◆ Risk Management
- ◆ Balance Sheet Capability
- ◆ Wholesale Liquidity Access
- ◆ Process Expertise for physical settlement

Retail Aggregators

- ◆ Technology-led entrants
- ◆ Automated Margining
- ◆ Multi-bank Pricing
- ◆ Process Expertise for Retail Volumes

SECTION 4

Summary and Take-Away

Key Points for Take-Away

Retail FX accounts for around 10% of buy-side spot volume and is growing at about 30% a year

Boundaries between Retail and Institutional FX are getting less clear

Rapid spread compression (but still some good margin on rolls)

Entry of major FX banks will add further momentum to Retail FX

Focus on Retail FX is likely to change the wholesale market too

Further Reading

In addition to various UBS internal sources, the following materials have been used in this presentation:

- ◆ “Retail FX – Understanding the trend; leveraging the opportunity”, Client Knowledge, 2007
- ◆ “Taking the Client’s Perspective”, Boston Consulting Group, 2006
- ◆ “Commenting on Retail FX Market”, Federal Reserve Committee Letter, 2005
- ◆ Interview with Richard Olsen, Co-Founder of OANDA

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