Brokers need to be large, well-capitalized and do a lot of volume in order to be held in high regard by their PB (Prime Broker)

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Ashley Jessen is one of the FX industry's urbane product and branding executives. He has founded and operated companies which specialize in various aspects of digital content and marketing, his current enterprise being Learn CFDs, which is an Australian company five years in establishment that operates as a learning portal for retail customers to understand leveraged trading products.

Mr. Jessen has had various books published on the subject of electronic trading, and was recently Director of Communications at Invast Financial Services, the Australian division of Japan's Invast Securities, one of the largest FX brokerages in the world.

Following his two-year tenure at Invast, Mr. Jessen Co-Founded and is currently CEO of Profile Booster, where he manages digital marketing projects for financial firms.

With a great deal of knowledge on the structure of retail FX, Mr. Jessen is keen to express his perspective on how a relationship between a Prime Brokerage and a retail FX company should be, as well as the way a retail company should be structured.

In this guest editorial, Mr. Jessen debates this subject in great detail, with ***anecdotes from senior industry figures.***

Thin margins, the high price to acquire new clients and the increased costs of designing and implementing robust risk management procedures have completely altered the Forex landscape over the last 2 years.

More specifically, the Swiss National Bank event made the dominant prime brokers (ie Citi, Deutsche Bank) re-evaluate their business model and opened a whole new world of opportunity in the prime of prime broker space.

Forex has always been a competitive space, with many brokers offering the most popular trading platforms, including MT4, NinjaTrader & cTrader, and as a result, it has been difficult for professional money managers, hedge funds and high end clients to find the best all-round trading solution for their needs.

Ashley Jessen

Today we'll take a look at how the new breed of Forex brokers are building relationships with their prime broker and technology providers. We'll also cover how firms are strengthening the connection with their high end clients and what mistakes some brokerage firms are making when dealing with their clients.

Prime brokerage relationships

Following the market altering Swiss National Bank event on January 15 this year (2015), the prime broker space had a massive transformation in respect to who they chose to deal with and the prime brokers began pulling credit, fast.

Brokers, money managers, hedge funds and liquidity providers were left scrambling to find an alternate prime broker as the leading PBs raised their credit requirements from circa $5 million, to in excess of $25 – $50 million.

As a result, significant opportunities opened up in the Prime of Prime broker space, creating a tiered landscape that few retail traders would be familiar with. Roughly speaking, you can classify Forex brokers into 3 main tiers.

Tier 1 Prime of Prime (PoP) brokers are those with a direct relationship with the Prime Broker (PB).

Tier 2 PoP brokers are unable to meet the increased capital requirements, are unable to get preferred pricing and will pass on prices from their negotiation with the Tier 1 PoP broker.

Tier 3 PoP brokers are your B book brokers who are at the lower end of the scale. These have the largest risk as they are smaller and in many cases rely on client losses. In addition, if one of their large client’s wins a significant amount, it could post a significant threat to their business.

Typical of nearly every business in the world today, the larger you are and the more volume you put through, the more favourable the conditions. As a general rule, high end forex traders who deal with the larger Tier 1 Prime of Prime brokers will have better pricing, support and access to superior technology.

Gavin White, one of the thought leaders in the Prime of Prime broker space and Chief Commercial Officer at Invast Financial Services said, “Simply put – brokers need to be large, well-capitalized and do a lot of volume in order to be held in high regard by their PB.”

Depending on the size of the firm and their capitalisation, some firms will have access to multiple PBs. “That’s why STP brokers like Invast have such solid relationships with numerous PB’s. We hedge client trades with our multiple Liquidity Providers. These trades are then given up to one of our PB’s. It’s easy to see why PBs prefer to have STP brokers as clients and why STP brokers end up getting the best conditions from their PB’s,” continued Mr White.

Platform technology & point of differentiation

Behind the scenes, your broker will be negotiating with the owners of the trading platform you are using in order to provide a point of differentiation in the service they offer.

A quote from Chris Evans suggests… ‘If you want to be around in 10 years you’ve got to do something to differentiate yourself from the pack.’ Granted, he was likely talking about his acting career, but the same applies to every business and especially so in the ultra-competitive Forex space.

In fact, the relationship a broker can forge with their technology provider is important as new tools can be made available to make your trading life easier.

“If you want to be around in 10 years you’ve got to do something to differentiate yourself from the pack” – Chris Evans

Starting a brokerage firm and offering MT4, cTrader & other platforms like NinjaTrader, has become common place and so being able to differentiate the other tools and add-ons is what helps companies shine.

Strong channels of communication

Mr White added, “From a broker’s perspective, the most important thing to focus on is maintaining strong channels of communication with each vendor (trading platform suppliers). The role of the broker is to convey the client’s needs to the vendor so the technology solution can be optimised to suit the client requirements. A good broker coordinates multiple vendors efficiently so systems are aligned to deliver the best possible outcome for the client."

Professional money managers are not looking for free platforms but instead are looking for tools and solutions to help them manage their risk, allocate trades across client accounts and seamless reporting to make their end of month communication with their client's easier.

"Brokers need to respond quickly to client demands, especially in the Premium/Institutional space. Having an open dialogue with vendors not only makes for a stronger relationship, it ensures brokers are able to be more responsive to client demands," continued Mr White.

Ten years ago, the trading solutions available for an online Forex trader were relatively limited and spreads on markets like Cable were quite wide. Today the landscape has changed completely and it is becoming more common to see brokers offer customised solutions for high end clients. The good news for retail traders is that many of those customised options are now offered to them without having to meet the initial capital requirements once requested.

What mistakes are firms making?

Success in any relationship usually comes down to strong communication. Keep the channels of communication open and things move along smoothly. Once those lines of communication start to falter, breakups are quick to follow.

The biggest area in which Forex firms are making mistakes is by restricting their lines of communication with their PB's, their technology provider and their clients.

The most dangerous one for a broker is to cause friction with their prime broker. Mr White added, "Like all relationships, the relationship between a broker and Prime Broker should be viewed as a long term, mutually-beneficial one. The SNB event in January this year has shown that brokers who are unable to cultivate a strong, long term relationship with their PB risk finding themselves pushed off a PB platform, with significant adverse consequences."

Next is the relationship with the client. For high end clients, all of the key questions have to be answered before the account is opened. Despite the fact that opening a new trading account is quite easy, it is more the hassle of transferring all the bespoke solutions, add-ons and customised reporting tools that makes the process as unpleasant as moving house.

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