

My word is my bond

in a New Currency Environment

The type of people who had the luck to grow up in the trading culture that existed in the last decades of the past century developed a very special code of ethics that was based on the very important concept that “my word is my bond”.

Actually there is no other market that you can call and say “Hi, am Charis from TFI” and buy 20 million EUR/USD, hung up and go home knowing in full confidence that the transaction will be kept without any need for lawyers, contracts or witnesses. And it couldn't have been otherwise, as the market was so fast and without the latest computer processors, trading would have otherwise been impossible. If it were for a mere house sale, it could have taken days or even months and a lot of signatures and legal documents. The values that all those traders were raised up were those of honesty and integrity to the firm, their co-workers and especially the client.

That philosophy is so deep that has inspired even the way trading floors are designed. Corporate environments are made up of offices with closed doors, partitions and compartments while all trading floors are open spaces, an extension of the transparency and trust needed in order to do business.

The foreign exchange trading primarily used to be a game of bank dealers, brokers and big hedge funds. Clients were big corporations with huge currency exposures which could indeed move the market with hundreds of millions of transactions.

That is why spot forex remained until recently unregulated. It was however inevitable that the most liquid and efficient market in the world would at some point go retail. The new trend started on the first years of this century but nobody could at the time imagine that it would become so big. The faster computers and internet did make this possible, and a lot brokers and in the recent years banks, have jumped on the bandwagon of offering the retail margin forex trading as everyone knows it today.

Hundreds of new brokers had emerged during the last years, others being regulated and others not regulated, with multimillion marketing budgets and almost everyone competing on pricing. What strikes me as a professional dealer is that competition in pricing has gone far more than the typical spread pricing and has introduced to the market the casino-like promotions of bonuses and kick-backs based on the amounts deposited as margin.

How can anyone offer bonus funds on client deposits? Does anyone believe in free money? Well I have personally traded billions in forex since 1997 and nobody ever offered me \$1 bonus.

Some months ago I had the experience of talking to a 23 year old guy from the Middle East who was claiming and being very proud of closing 3 forex brokers with his trading skills. That was his marketing statement in order to attract more money under management. It reminded me of a movie I watched with Kevin Spacey (a real story) that he and his team were trying to take down a casino.

He kept asking me about slippage, and I said in all honesty, that the last time we did slippage was six months ago on a Monday morning that the market gapped 80 pips higher and that his orders in the rare case of gaps will always be filled at the first available best price.

This is the way all orders are treated in the interbank market, fair and square! He was happy with my answer and immediately opened an account. I soon found out that this guy has developed a software that was trying to take advantage of gaps in prices during market releases and make arbitrage profits by sending out-of-the market orders.

Of course, after getting the fair market price he closed the account. Am sure there are many people like this in the forex market that like watching Texas holdem poker tournaments and dreaming of becoming pros (I do like Texas holdem as well, even the professional finance channels are showing tournaments every night!) but if someone really wants to succeed in forex trading he will need more than good luck, steady nerves and bluffing.

The forex market was and remains the most efficient market to trade in the world. The problem here is that the new retail environment gives the impression that someone can take advantage of it. The fierce competition in pricing and other offers between brokers is taking the forex market on a different path that emerges as a war between the brokers and clients which is fundamentally wrong.

It is astonishing how many people from different backgrounds are making money on forex. And I am not talking about the traders. Banks, brokers, I.B's, technical and fundamental analysts, automated model providers, news and tv networks, advertising agencies and many others. If the interbank spread is at 1 pip in EUR/USD then how do all these people make money?

I am a strong believer in the traditional broker business model where the broker makes money from the spread difference. The broker can aggregate a lot more volumes than a single client, thus can get better pricing from the banks and make his profit without the need to take a view on the positions initiated by the clients which creates a fundamental conflict of interest. Competition in price is a good thing to the extent that it does not create the incentive for brokers to act against the interest of the client.

A resurgence of the traditional broker model where brokers mark up the interbank price but cover client positions will have a small direct effect on the spread as it will have to be wider than some of the current offerings in the market, but in turn I believe, that this will result in an improved trading environment for clients and a significant decrease in the negative publicity that the industry receives.

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