

Ceslovas Bartkus

Panevezys University of Applied Sciences
Faculty of social sciences
e-mail: ceslovas.bartkus@panko.lt

Reliability Trends in Retail Foreign Exchange Brokers Market

JEL Codes: G02, G18

Keywords: financial markets, FOREX, brokers

Summary. Foreign Exchange market is always affected by huge amount of economic and political events, such as decisions of Central banks, changes of various economic ratios, elections, leaders official announcements and etc. Ten-fifteen years ago only big investors could invest in currencies and get a positive return on differences of their rates. Invented new financial instruments and technologies allowed creating a retail foreign exchange market, which has been made available to every human being. The paper discusses the structure, changes, trends and its causes of Foreign Exchange market intermediaries.

Introduction

Daily turnover in the Foreign Exchange market (FOREX) is 4–5 trillion dollars. Such huge transaction value attracts professional and non-professional investors. Some of them expect keeping their assets by investing in the safest and most valuable currencies. Other hopes to earn a return on the difference of currency exchange rate. Both goals would be difficult to reach without financial intermediaries, and this created a niche, where foreign exchange market brokers live and die. With careful steps these subjects increasingly gain in amount and become self-evident financial institutions which offer financial services.

The article resumes the retail Foreign Exchange market intermediaries (FOREX brokers) analysis. In 2014, more than 42% of those financial institutions worked without official supervisors or had licenses issued by offshore zones financial supervisors. However, over the past two years, people's financial sophistication and financial regulation

is changed considerably. The article revealed how it changes the structure of the brokers. In addition, new technological tools allow us explore the web sites traffic of these financial companies. The exercise of such data, let us compare the flow of traders attracted by reliable and unreliable brokers.

1. Foreign Exchange market brokers, trading instruments and trading conditions

Foreign Exchange market (FOREX) – a place where buyers and sellers meet each other. Also, it is the place where supply and demand set the exchange rate (Bartkus, 2014). Most of this market has to support international trade and capital movements. Governments, states, international corporations and financial institutions make their trades of currency in this market (Ovsianikas, 2008). Retail Foreign Exchange market – it is foreign currency transactions carried out without large capital investors, with the help of marginal trading opportunities (Bartkus, 2015). Retail FOREX brokers – a financial link between the dealer and the currencies in the FOREX market. These dealers transaction object – currencies of different countries. The trader earns a profit or suffers losses from exchange rate fluctuations. Brokers profit – the commission, which gained from the executed transaction of currency buying and selling price difference.

The main objects of FOREX transactions are US dollars, euro, Japanese yens, British pounds, Swiss francs, Australian and Canadian dollars. However, there are currency trades of all other countries of the world, only trades turnover is not high. There are a number of instruments that can be used to trade in the foreign exchange market:

1. *Spot*. This is the immediate deal in the market. It can be carried out with financial institution (bank) by the bank's daily exchange rate. Meanwhile, FOREX broker can make the transaction according to the exchange rate of real time, which can change in every second. Broker's client can access to currency pairs and their prices and can monitor it in real-time via mobile phone, online platforms or installed programs in personal computers.
2. *CFD*. This is Contract For Differences. It is the agreement between the buyer and seller to pay the difference between the underlying asset's (shares, currencies, commodities, indices) initial price and the price of the transaction at the end (European Securities..., 2013). CFD is most prevalent among retail brokers, because it is not necessary to withdraw customer's transaction in the real FOREX market, which would cost the broker substantial licensing fees. In addition, the financial intermediaries, could make earnings from the inexperienced traders losses.
3. *Forward*. This is an arrangement to change (buy – sell) currency amounts in the future according to the rate agreed in arrangement date. Settlement of the transaction takes place a fixed date in the future, but the rate is agreed in arrangement date. Forward is useful to hedge against negative currency rate in future

and is popular among the non-financial business companies (Kancerevyčius, 2009). Such financial instrument is commonly used by business entities which have trade relations with partners who are using other currency than the entity, which set up the forward arrangement.

Together with the listed financial instruments, FOREX broker can offer the following additional measures, which in the case the investor behaving carelessly, greatly increase the trading risks. First of all, it is leverage. Leverage is the broker's loan to the investor (Luenberger, 1998). The higher it is, the investor can invest and earn more. However, the risk of losing the invested capital is the same size. If currency slightly will change its rate, high-leverage impact very quickly could "burn" the investor's capital. 2014 study (Bartkus, 2015) found that the vast majority of unlicensed and unsupervised brokers offer its customers to use high leverage service at encouraging them to take risks and it influences to lose the invested capital in favor to the broker. Other service of this financial intermediary is minimum deposit requirement. First of all, this requirement provides an opportunity for people who do not have a high initial capital to participate in the financial markets. However, with a small amount of money in investor's account, this condition significantly increases the risk of losing the entire balance in cases where the open commercial transaction losses reach the available money in the account size. In this situation, brokers will automatically close the transaction and take the trader's money. The third service for customer – convenient and fast money transfer operations. In order to do it, FOREX brokers employ both: traditional (bank transfers, credit cards) and a new electronic (PayPal, Skrill, Neteller, Webmoney) up to the modern (Bitcoin) methods of payment. List of available payment methods also describe the brokers. Payments organizing companies have its own criteria according to which they provide or do not provide their services. For example, one of the most famous company of electronic payments – PayPal's¹ criteria meet only 28 retail foreign exchange market brokers from the total of 246. Meanwhile, less-known and popular – Skrill² organizes payments for 150 brokers. 25 brokers accept payments by Bitcoin payment system, the controversy system because of use by the criminal world and known that has been banned in few countries. Hence, the reliability of the brokers can be visually identified by payment icons on their websites.

2. Reliability and popularity trends of FOREX brokers

In the late of 2014 there were 222 FOREX brokers around the world. In the late of 2016 the amount of them rose about 11% and reached 246 units. Basic of economic let us know that, companies tend to grow when the business generates large profits.

¹ Since 2002 the PayPal company owned by eBay.

² Skrill – United Kingdom company, which globally organizes electronic payments. The company started its business in 2001 and currently has 10 times fewer customers than PayPal.

So, the growth says that the last two years were profitable for the retail foreign exchange market participants. The main causes of this trend are several. The Internet and mobile technologies made it possible to trade currencies for an increasing number of people. The same Internet technology has contributed to a greater humanity financial literacy. Another reason can be continuously growing money supply. Japan's Central bank in 2001 invented a monetary tool "quantitative easing", which was more analyzed by Ugai (2007) and Shiratsuka (2009). Since 2008, an increasing number of national Central banks have started to use this program. United States, United Kingdom, Japan, the European Union, one after other are constantly increasing the money supply to stimulate economic. Of course, the brokerage business was not left behind. Investigation in 2014 showed that 1/3 of all retail foreign exchange market intermediaries worked without financial licenses. Another 7% purchased licenses in offshore countries with very weak controls (Bartkus, 2015). These unreliable brokers have 42.4% in all structure of the brokers.

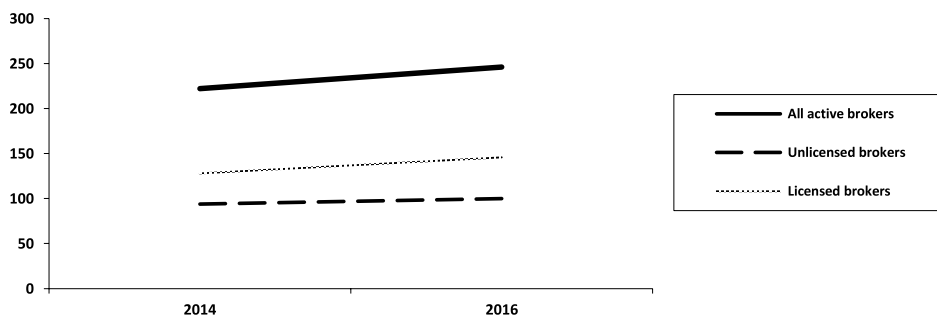


Fig 1. Dynamic in FOREX brokers structure 2014–2016

Source: author.

In the end of 2016 the number of unlicensed and offshore brokers grew to 100 from 94 pieces. The increase in this amount is 6.4%, which is lower than the dynamics of the whole sector of financial intermediaries, which is 11%. So, now unreliable brokers occupy 40.7% in all structure. Licensed brokers has increased their number from 128 to 146 units and the rise amounted up to 14.1%. A small but noticeable trend is developing in favor of the trader's security. Potentially, this trend most affected by the increasing financial sophistication of e-consumer's behavior. Modern e-consumer is willing and can instantly spread both positive and negative views on the Internet. The other e-consumer can instantly find all the information. Hence, the having of license and its publishing is positive feature for the prospective client. Inadequate broker action against the client will be known in the FOREX community and respond negatively.

Modern technology enables to track the flow of the users in particular website. Google Analytics – a tool, that allows tracking web traffic of a particular site for administrator,

but do not allow doing it for external research analysis. Similar Internet flow analysis tool – Similar Web was launched in 2011. This tool allows you to analyze web traffic to online websites by using personal computers and mobile phones³, without being site's administrator. Knowing that every FOREX broker offers online access to currency exchange, let us identify – licensed or unlicensed brokers are more popular among the dealers and what is there the trend of this phenomenon.

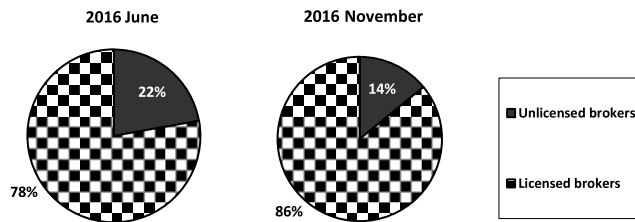


Fig 2. Traffic structure of FOREX brokers websites

Source: author.

Structural research of all FOREX brokers web traffic, according to the data obtained using Similar Web program, noted that of the total visits in November 2016, 86% owned by licensed financial intermediaries (Figure 2). Only 14% belongs to brokers who work without a strong financial supervision, even though they have about 41% in the all amount of FOREX brokers. Visitors flow units ratio is 50.197.700 visits against 8.258.000 visits. It could be said that unlicensed brokers are attracting much less customers then licensed ones. One such unit, on average, in November 2016 had 82.580 online visits. Most popular unlicensed intermediaries websites are Instaforex⁴ (1.200.000 visits) and Bforex (929.000 visits). One licensed broker, on average, had 343.820 visits. Most attractive for traders are Oanda⁵ (9.200.000 visits) and IG⁶ (5.500.000 visits). The analysis of traffic trends for now let us compare the change from June 2016 and in over a half of year FOREX traders traffic decreased of 14.6% (Fig. 3). For now, in a short period, the data can't be very trustable to say that this is a real long-term trend and determine the reason of it.

³ Analyzing of attendance using mobile phones has been made possible and available from 2016 in March.

⁴ Instaforex works since 2007 and their website is translated into 25 languages.

⁵ Oanda was established in 1995 and has developed one of the first commercial applications that make the FOREX market more accessible.

⁶ IG was established in 1974. It is unusual in FOREX market that traders allow to trade securities even on weekends.

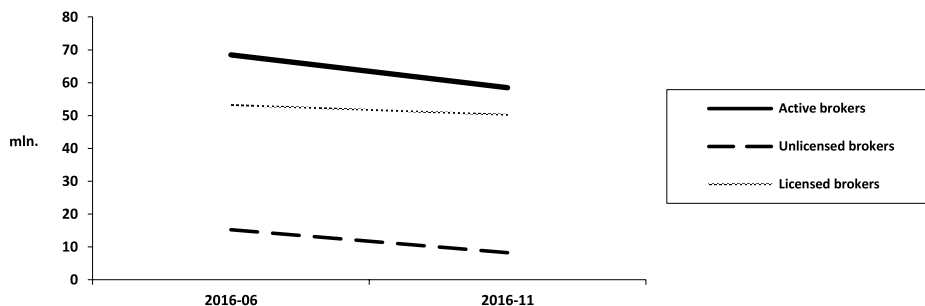


Fig 3. Trends of FOREX brokers website's and mobile application's traffic

Source: author.

It is positive that the percentage of customers flow to unlicensed financial intermediaries fell by 46% (6.94 million). Licensed brokers websites visits during the analyzed half a year fell less as a percentage (5.7) and as a unit expression (3 million) (Fig. 3).

Is Similar Web data trustable? It is very young and unstudied Internet intelligence program. In this moment, to decide how it is trustable, we have to use special reviews only. So, the program needs future investigation.

Conclusions

1. The whole world has about 246 retail financial intermediaries of foreign exchange market. Within a month 60–70 million FOREX traders visit their websites and mobile applications. Nearly 41% of these brokers work without a permit to carry out such activities or registered their offices in offshore areas, where financial supervision is very weak. Their websites have from 14% to 22% of the total flow of the currencies dealers.
2. Comparing the data with the 2014, in 2016 amount of these unlicensed financial intermediaries increased by 6 units, but their share in the structure of brokers decreased by 2%. After examination of brokers web traffic, in the battle for the consumer, Internet traffic on theirs websites and mobile applications is noticeable smaller then traffic on legal brokers websites and has a tendency to decline in the future due to the increasing traders sophistication of finance and modern e-user behavior.

Summary

Financial markets are getting closer and closer to ordinary people. Part of financial brokers make benefit from lack of financial knowledge by very small investors. The main aim of this work was finding the number of brokers who provide financial services without licenses or with licenses given by offshore high risk countries. According for this aim, here were investigated 246 retail brokers around the world and were discovered that around 40% have no licenses or have offshore licenses with lack of regulation. The decrease of fraud FOREX brokers share in all brokers structure was noticed and calculated. Especially big decrease was estimated in Internet traffic of following brokers sites. All work was based on literature analysis of different authors from different countries and information from financial services authorities by different countries. Also was used Similar Web tool for estimation of internet traffic.

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Cytowanie

Bartkus, C. (2017). Reliability Trends in Retail Foreign Exchange Brokers Market. *Ekonomiczne Problemy Usług*, 2 (127), 7–13. DOI: 10.18276/epu.2017.127-01.