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AN OVERVIEW OF RETAIL FOREIGN EXCHANGE INVESTORS BEHAVIOUR

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Abstract: The world's largest and most liquid market is the Foreign Exchange Market (FX market, Forex). Financial institutions and large organizations dominated the FX market until the late 1990s, when it was driven by hedging, speculation, and arbitrage. Today, the Forex market (FX) is the world's largest financial market, with a daily volume of almost $5 Trillion. Banks, Commercial firms, Central banks, Investment management firms, Hedge funds, Retail Forex brokers, and retail investors all participate in the currency market. While Institutional Investors continue to dominate the market, Retail Investors' influence has grown since the early 2000s. Participants in the Forex market, such as banks and individuals, can buy, sell, and exchange currencies for hedging and speculative purposes. The number of retail investors participating in foreign exchange markets has risen dramatically in recent decades (Rime & Schrimpf, 2013). In this paper, it throws a light on the retail investors trading behaviour & their trading terminologies in the Foreign exchange market.

Keywords: Foreign exchange market, FX market, Forex market, Trading, Retail Investors, Investment behaviour, Forex Transactions Maturities

1. INTRODUCTION:

The foreign exchange market (commonly known as FX or Forex) is a global marketplace for exchanging national currencies. It encompasses all aspects of purchasing, selling, and exchanging currencies at current or fixed prices. In terms of trading volume, it is by far the largest market in the world, followed by the credit market. Participants in the Forex market, such as banks and individuals, can buy, sell, and exchange currencies for hedging and speculative purposes. Banks, Commercial companies, Central Banks, Investment Management Firms, Hedge Funds, Retail Forex Brokers, and Retail Investors make up the Forex market.

When one counterparty to a trade delivers a currency payment to the other before obtaining the currency it is buying, it can result in severe principle risk. Because the delay between trade execution and final settlement is not fully taken into account, principal risk and other associated risks are frequently overestimated.

2. GROWTH OF RETAIL INVESTORS

Electronic trading has opened up the foreign currency market to retail investors more than any other client sector (Galati and Heath, 2007). Household and small non-bank entities trading has increased dramatically, with market players stating that it currently represents for 8–10 percent of global spot FX turnover ($125–150 billion per day). Japanese retail investors are the most active, accounting for 30 percent or more of spot Japanese yen trading (i.e. more than $20 billion a day) according to market estimates (King, Osler, and Rime, 2011).

The retail aggregator, a new type of financial organization, facilitates retail FX trading over the internet (King, Osler, and Rime, 2011). A retail aggregator is a financial firm that operates as a foreign exchange middleman, gathering bid-offer quotes from the leading FX dealing institutions and enabling trades by retail investors. Some retail aggregators only act as FX brokers, linking retail trades to bank prices. Other retail aggregators combine a broker and a dealer model, acting as the counterparty for some retail trades while sending others on to banks directly.

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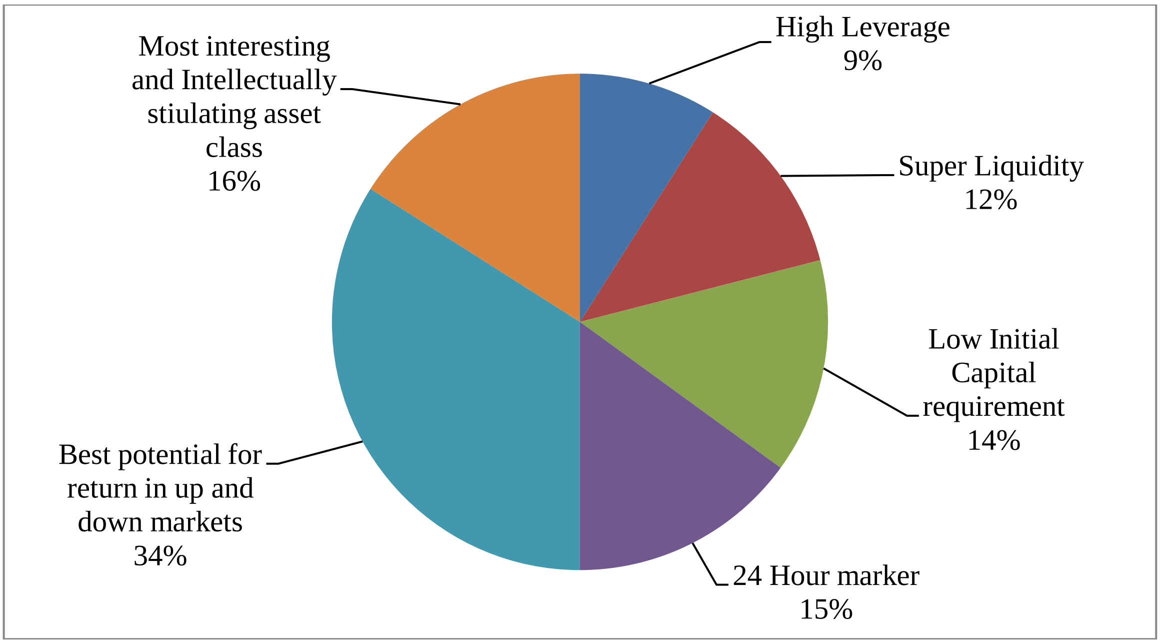

Reasons for choosing FX market by retail investors Source: (Maitra, 2014).

The Forex market is also known for being the most liquid. Trade is possible even in low, volatile market conditions since there is always someone on the opposite side who is continually providing trading opportunities (Lee, 2010). Manipulation is prevented by the market's strong liquidity, especially when trading big currencies. From the standpoint of the ordinary investor, this is another key feature of the FX market.

3. FOREX TRANSACTIONS

3.1. SPOT TRANSACTIONS

Single outright transactions (Spot transactions with T+0 (same day) and T+1 (next day) settlement) involving the exchange of two currencies for value or delivery (cash settlement) within two business days at a rate established on the date of the contract. Even if they are expected for settlement within two days, spot legs of swaps should not be included among spot transactions and should be reported as swap transactions. This indicates that overnight swaps and spot next swaps, as well as other "tomorrow/next day" transactions, should be excluded from spot transactions. Cash and same-day transactions should be reported as spot transactions.

3.2. FORWARDS

Transactions involving the exchange of two currencies at a rate agreed upon at the time of the contract for value or delivery (cash settlement) at a future date (more than two business days later). Forward foreign exchange agreement transactions (FXAs), non-deliverable forward contracts (NDFs), and other forward contracts for differences are all included in this category. Forwards aren't typically traded on organized exchanges, and their contractual terms aren't uniform.

Reporting dealers are asked to specify NDF volumes for six currency pairs with considerable turnover: USD/CNY, USD/INR, USD/KRW, USD/BRL, USD/RUB, and USD/TWD in a "of which" item to cater to specific interest in NDFs – Non deliverable Forwards. Other less well-traded pairs' NDF turnover will also be tracked, but only in aggregate.

3.3. FUTURES MARKET

The futures market transactions necessitate future payment and distribution at a previously agreed-upon exchange rate, referred to as the future rate. The transaction or agreement is more formal, ensuring that the transaction's terms are set in stone and cannot be changed. The majority of the transactions are conducted by traders who earn a consistent return on their assets. Regular traders prefer to transact on the futures market.

3.4. FOREIGN EXCHANGE SWAPS

Transactions involving the actual exchange of two currencies (principal amount only) on a specific date at a rate agreed at the time of the contract's conclusion (the short leg), and the reverse exchange of the same two currencies at a rate

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(generally different from the short leg) agreed at the time of the contract's conclusion (the long leg). "Spot/forward swaps" and "forward/forward swaps" are two types of FX swaps, as are short-term swaps like "overnight swaps," "spot next swaps," and other "tomorrow/next day" transactions.
Any FX swaps should only be disclosed once in the turnover section of the survey. The forward leg of the exchange should be used as the basis for reporting. Either as spot or as foreign exchange swap transactions, the spot leg should not be reported. CLS member in/out swaps should be prohibited.

3.5. OPTIONS

Option contracts provide you the right to purchase or sell a currency against another currency at a set exchange rate for a set period of time. Exotic foreign currency options, such as average rate and barrier options, are included in this category.
Contracts in which two parties agree to exchange streams of interest payments in multiple currencies for a specified length of time and/or to exchange principal amounts in different currencies at a pre-determined exchange rate upon maturity.
Among the over-the-counter possibilities are:
• Currency swaption: A currency swap contract can be entered into over-the-counter (OTC).
• Currency warrant: an OTC currency option with a long term (over a year).
An option strategy should be broken down into sections and reported individually.

4. MATURITIES

Transactions in outright futures and foreign exchange swaps shall be recorded on an original maturity basis in the turnover section of the survey, according to the following maturity categories:

- One day
- Over one day and up to seven days
- Over seven days and up to one month
- Over one month and up to three months Over three months and up to six months
- Over six months

The table below shows how standard-maturity transactions are classified into different categories:

Market convention	Maturity category in the BIS Survey
O/N – overnight	One day
T/N – tomorrow next	One day
S/N – spot next	One day
S/W – spot week	Over one day and up to seven days
1W – 1 week	Over one day and up to seven days
2W – 2 weeks	Over seven days and up to one month
1M – 1 month	Over seven days and up to one month
3M – 3 months	Over one month and up to three months
6M – 6 months	Over three months and up to six months
9M – 9 months	Over six months
1Y – 1 year	Over six months

Source: BIS Triennial Central Bank Survey

5. FOREX TURNOVER

The 2019 BIS Triennial FX Survey (Triennial) reveals that the risk of FX settlement remains high. In April 2019, global FX trading volume was USD 6.6 trillion per day, resulting in gross payment liabilities of USD 18.7 trillion. According to a related study, the share of trades protected by payment-versus-payment (PvP) protection has decreased in recent years. (Triennial Central Bank Survey)

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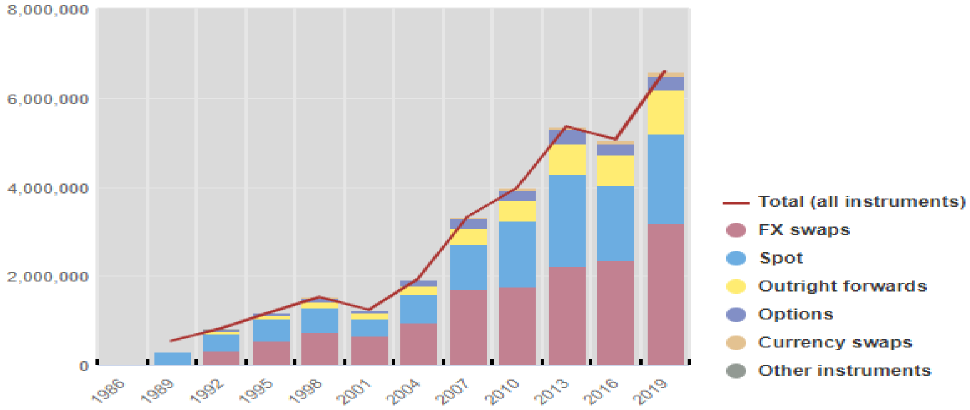

Source: BIS Triennial Central Bank Survey of Foreign Exchange and Over-the-counter (OTC) Derivatives Markets.
When one counterparty to a trade sends a currency payment to the other before receiving the currency it is buying, settlement FX trading can expose one to high primary risk. The duration of time between trade execution and final settlement is not fully taken into account, hence principal risk and other associated risks are frequently overestimated.

6. RETAIL-DRIVEN TRANSACTIONS

Electronically executed retail-driven transactions can be of two types from the perspective of a reporting dealer:

6.1. DIRECT TRANSACTIONS

Online or other techniques of initiating direct transactions with private individuals ("nonwholesale" investors) (eg phone or email). When private investors trade using the reporting dealer's electronic margin brokerage platforms, the reporting dealer's immediate counterparty is a natural person. These trades should be classified as "with non-financial consumers," and the turnover from them should be reported in the "of which retail-driven" category.

6.2. INDIRECT TRANSACTIONS

Transactions conducted indirectly through third-party platforms that cater to retail investors, such as electronic retail trading platforms and retail margin brokerage businesses (wholesale financial counterparties).

The direct counterparty for the reporting dealer is often a wholesale financial institution when retail investors trade FX instruments for speculative reasons using electronic platforms (e.g., Oanda, FXCM, Saxo, Gaitame.com, or Gain Capital operating as "retail aggregators").

This form of trade should be classified as "with other financial clients / other," with the amount specified in the "of which retail-driven" category.

Branch retail spot transactions ("today" delivery date), transfers of funds denominated in different currencies across any two accounts, and electronic transactions using ATM, credit card, and stored value transactions that are executed in a foreign currency are not included in the "non-wholesale" transactions.

They would also exclude retail client transactions that are part of a commercial transaction, even if the transaction is priced in a foreign currency.

These transactions are excluded for reporting purposes and because they are not often connected with FX trading for investment or speculation.

In the reporting template, the table below shows how to record direct and indirect electronically completed retail-driven transactions.

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	Direct transactions	Indirect transactions
Total	X	X
with reporting dealers		X (if retail broker/aggregator is reporting dealer)
with other financial institutions non-reporting banks institutional investors hedge funds and proprietary trading firms official sector financial institutions others		X (if retail broker/aggregator is not reporting dealer) + in the relevant subcategory (typically "others")
with non-financial customers	X	
o/w retail-driven	X	X

Source: BIS Triennial Central Bank Survey

7. EXECUTION METHODS

The organising concept for foreign exchange data on execution techniques divides execution into two categories:
1. "voice" vs. "electronic"
2. "direct" vs. "indirect."

Voice-direct, voice-indirect, electronic-direct, and electronic-indirect are the four primary kinds. The last two "electronic" categories are reinforced with subcategories: single-bank proprietary trading system, other direct electronic means, anonymous venues, and revealed venues, to continue to collect turnover on diverse types of electronic platforms as done in previous surveys.

7.1. VOICE-DIRECT

Trades began in person, over the phone, over telefax, or via general message services (eg Outlook, Gmail or Yahoo mail) irrespective of how trades are later matched, and without the use of a third-party intermediary

7.2. VOICE-INDIRECT

A speech approach is used to agree on trade, which is then mediated by a third party (eg a voice broker)

7.3. ELECTRONIC-DIRECT

Trades that are completed through an electronic trading system and are not mediated by a third party. Transactions initiated through specific messaging systems that are part of trading platforms are included in this category.

7.4. ELECTRONIC-INDIRECT

Trades that are conducted via the internet and are mediated by a third-party electronic platform (eg via a matching system)

8. CONCLUSION

Retail foreign exchange trading is a small part of the wider foreign exchange market. Individuals trade on the exchange rate between different currencies in retail foreign exchange trading. Retail investors have increased their participation in the foreign exchange market in recent years, thanks to internet-based trading platforms. Retail-driven transactions are ones that are launched by retail investors, where "retail investors" refers to private people who execute speculative, leveraged, and cash-settled foreign currency transactions on their own behalf (not for any institution). For each instrument and currency pair, reporting dealers are asked to give data on retail-driven transactions.

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