Credit Exposure management in Foreign Exchange

Financial Institutions offer forward forex products to their clients as part of currency risk management platform. This is an integral part of currency exposure mitigation which allows corporate clients to hedge anticipated currency payables or receivables and thereby protect profit margins. A mitigant to manage the resulting credit risk typically involves collecting a small percentage of the outstanding contract as margin or collateral. As the Financial Institutions compete, the amount of margin collateral collected faces downward pressure and is typically less than 5% - often closer to 2% or even less.

Currency markets have recently been unpredictable and most major currencies have seen unannounced wild volatility in short bursts. In the past few years, weekly (or sometimes daily) volitilty has exceeded 5%. During times of such volitility, the foreign exchange market sees spikes in trading volumes and typically Financial Institutions can capitalize on revenue opportunities from higher volumes. At the same time, inadequate management of credit risk can be devastating and without the appropriate reporting and controls, massive losses can ensue very quickly.

Without the right tools, the complexity of measuring credit risk leads to delayed reporting. Non-integrated systems prevent decision-makers from seeing current and accurate information which is especially dangerous during volitility. Financial Insitutions that offer forward products will have many outstanding forwards with varying value dates. In addition, clients may transact in multiple currency pairs and even hold margin collateral in multiple currencies. Performing mark-to-market valuations of transactions is complicated and requires value-date extrapolation of forward discount/premium points. Measuring client credit risk and composite credit risk can be very challenging when rates are swinging.

Datasoft FxOffice and Credit Risk Management:

Datasoft Fxoffice Suite runs on a single platform and all transactions are transparent to risk management and financial modules. With the ability to see in real-time client margin deposit balances, outstanding deals and partly settled transactions, FxOffice can report the quantum of credit risk for each deal. Moreover, the streaming of real-time forex rates allows decision-makers visibility into each client's margin position by performing mark-to-market processes on every transaction and all currency deposits. The result is a powerful up-to-the-second margin monitoring plaform. Credit managers can utilize Datasoft's business modelling tools to define limits and alerts as well as Datasoft Analytics to view overall composite risk and granular client credit risk on demand.

As currency risk hedging strategies get more elaborate, the manner in which forward transactions are booked can get complex. Often, take-profit or stop-loss scenarios will create a set of forward transactions in different currency pairs and in different directions. The quantum of a single client's volume of outstanding transactions is very relevant to credit risk management. Quantum is often ignored in calculating credit risk so long as cash margin collateral exists; this is a dangerous pitfall. Depending on the nature of clients, Financial Institutions will extend to clients forward credit facility lines to control the quantum of risk. Datasoft has integrated into its platform the ability to calculate a forward-line quantum using a number of methods as follows:

Gross Line: all outstanding deals are factored into an aggregate line irrespective of whether the transaction is a buy or a sell.

Net Line: outstanding deals are netted against each other where the buy-currency is netted against the sell-currency per currency pair and represented as a base currency.

Same-day Netting: outstanding deals are netted against each other where the buy-currency is netted against the sell-currency per currency pair and where the deals mature on the same value date.

Having the ability to choose from these options give you the ability to control your credit risk exposure and at the same time remain nimble and competitive to serve the client's specific needs. These three models are applied to clients based on their specific needs as well as counterparties and thus maximizing counterparty forward facilities.

Datasoft provides you with powerful tools to manage all foreign exchange credit exposure risk.