

Regulatory measures and real-time FX margining



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Mark Biezup, FX product Manager – SunGard Sierra, outlines why recent and projected regulatory changes along with a focus on risk management will have significant implications for FX brokers.

The FX market has endured the financial crisis significantly better than most other asset classes. Nevertheless it has not escaped the eye of regulators. Previously FX firms have not faced many restrictions on either margining or leverage, but the FX market has grown enormously in a short time thanks to the adoption of electronic trading. Regulators are keen to ensure that adequate protection measures exist, from the day trader up to larger firms, as the market continues to grow. These changes also attempt to prevent systemic risk from seeping outside of the FX market and, by domino effect, affecting any underlying companies or retail investors.

New requirements

Many of these new requirements come from the US and the National Futures Association (NFA), which regulates the FX industry in the US. The NFA has proposed some specific measures regarding margining and leverage, so that both customers and brokers can reduce the risks created by rapid market fluctuations

and potential liquidations. FX firms will now have to collect a minimum 1% margin on the G7 currencies and 4% on minor currencies. Meanwhile leverage will be capped at 100:1. Another recent regulation, enforcement of First In First Out (FIFO) position management, will prevent hedging strategies in the same trading account.

These regulatory measures will have a direct and significant effect on margining techniques, forcing them to be both more flexible and granular. The move from static to variable methodologies, such as from flat rate margining to variable currency margining, has already started to branch into product, tenor, volume, concentration and customer type margining capabilities. Another such trend will likely involve customer configuration, both a narrowing towards multiple sub-accounts, which would allow users to hedge across accounts, and an expansion of customer groupings for higher level monitoring of risk.

Benefit to margining

The benefit of these changes to margining will be more than simply compliance. Trading firms can also reduce their own market and credit risk on a global scale. More granular margining, by product and across products, will enable firms to expand their product offerings with increasingly sophisticated FX instruments, as they can better manage the risk associated with those products without affecting their vanilla FX margining.

For FX options, risk managers have traditionally relied on delta notional margining. This is a good starting place, but in the current environment where both investors and regulators are focusing more on risk management, this may not be enough. Firms will have to go further by taking more complex pricing and revaluation models and applying this sophistication to the margining calculations.

At the same time that firms expand the complexity of their product offerings and with algorithmic trading becoming increasingly popular in the FX market, margining systems must be able to both manage the risks associated with complex algorithm-driven strategies and the higher trade volumes without sacrificing the speed of execution and the speed of margining calculations.

More flexibility

Faced with a future of increased regulation and ever increasing trade volumes, margin systems must be able to handle both of these trends without compromising risk management or performance. More flexible margining configurations allow broker/dealers to comply with regulations out of the box, while allowing them to better manage their own risk. SunGard anticipates the effects that new regulations will have upon the margining sphere, and is proactive in enhancing its Sierra Advanced Margining solution to meet these new requirements. www.sungard.com/sierrafx

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