

**MANAGING CORE RISKS
IN BANKING**

**FOREIGN EXCHANGE
RISK**



Janata Bank

Head Office, Dhaka

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RISK**



Janata Bank
Head Office, Dhaka



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FOREWORD

Foreign Exchange Risk Management is one of the five core risks identified by the Bangladesh Bank. This manual of Foreign Exchange Risk Management (Foreign Exchange Dealing Room Operation) has been prepared with a view to identify the different aspects of the Dealing Room Operation and the functions and responsibilities of the Dealing Room Officials.

The Bangladesh Taka was declared convertible in the current account in 1993 and most of the restrictions imposed on commercial banks on current account activities were relaxed and the responsibility of exchange rate quotation was left to them. Thus the necessity of a Dealing Room was felt by all commercial banks in order to better manage the foreign exchange market risk.

This manual also outlines the dealing policy of Janata Bank and the responsibility of the management in dealing activities.



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Managing Director
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FOREIGN EXCHANGE RISK MANAGEMENT

(Foreign Exchange Dealing Room Operation)

01.00 Introduction :

The Foreign Exchange Dealing Operation in Janata Bank is performed through Dealing Room (Front Office), Mid Office and Back Office. The main function of Foreign Exchange Dealing Room is to manage market risk. At the same time dealers have to look for increase of bank's profitability, avoid risk exchange fluctuation, look for better investment of funds and maintain sound liquidity. The dealer's job is to take into account market volatility and large scale of transaction. That is why an effective controlling system is required over Foreign Exchange Dealing Room Operation. In the following few pages the different aspects of Foreign Exchange Dealing Room Operation, Mid Office functions as well as the Back Office functions of Janata Bank have been spelled out.

02.00 Objectives :

A manual for the Dealing Room has been a long felt necessity for specification of duties and responsibilities of the members of the team working in the Front Office, Mid Office and Back Office in particular and Fund Management Department in general. Though the principal objective of every Dealing Room is to earn profit for the bank. Janata Bank has a role to play for stable Foreign Exchange Market in Bangladesh. It is hoped that this endeavor of preparation of the manual will serve as a guide to dealers and others working in the Foreign Exchange Market as well as Money Market.

03.00 Foreign Exchange Dealing Policy :

In the modern age, all financial institutions conduct complex financial activities, which involve a certain level of risk. The key risk categories are credit risk, market risk and operational risk, etc. Today's financial institutions engage in activities starting from import, export and remittance to complex derivatives involving basic Foreign Exchange and Money Market to complex structured products. These activities require high level of skills, expertise and specialization.

For significant risk exposure, an effective control over the financial arena is a prerequisite. However, the main features of the foreign exchange dealing policy of Janata Bank are as follows :

- Total segregation of the Front Office, the Mid Office and the Back Office
- Development of inter-bank cross currency market.
- Development of inter-bank BDT/USD market.
- Emphasis on various market risk exposures.
- Emphasis on bank's profitability.
- Emphasis on bank's liquidity.
- Control over dealers' activities.
- Maintenance of different internal and regulatory limits.
- Ensuring regulatory procedures required for exchange position.
- Generating highly skilled dealing professionals through extensive training at home and abroad.
- Maintenance of high level of performance, prudence, ethics and reliability of the dealers.
- Ensuring transparency and proper accountability.
- Prompt and accurate decision making.
- Dealing Room to be equipped with modern sophisticated equipment and technologies including modern communication technologies.
- Dealing Room to be considered as a restricted area.
- Implementation of dealer's mandatory leave.
- Dealers to be considered as privileged employees in respect of promotional financial benefit and other facilities.
- Dealers' job is to be considered compulsory for at least five years.
- Emphasis on various management information systems.
- Establishment of dealers' code of conduct.

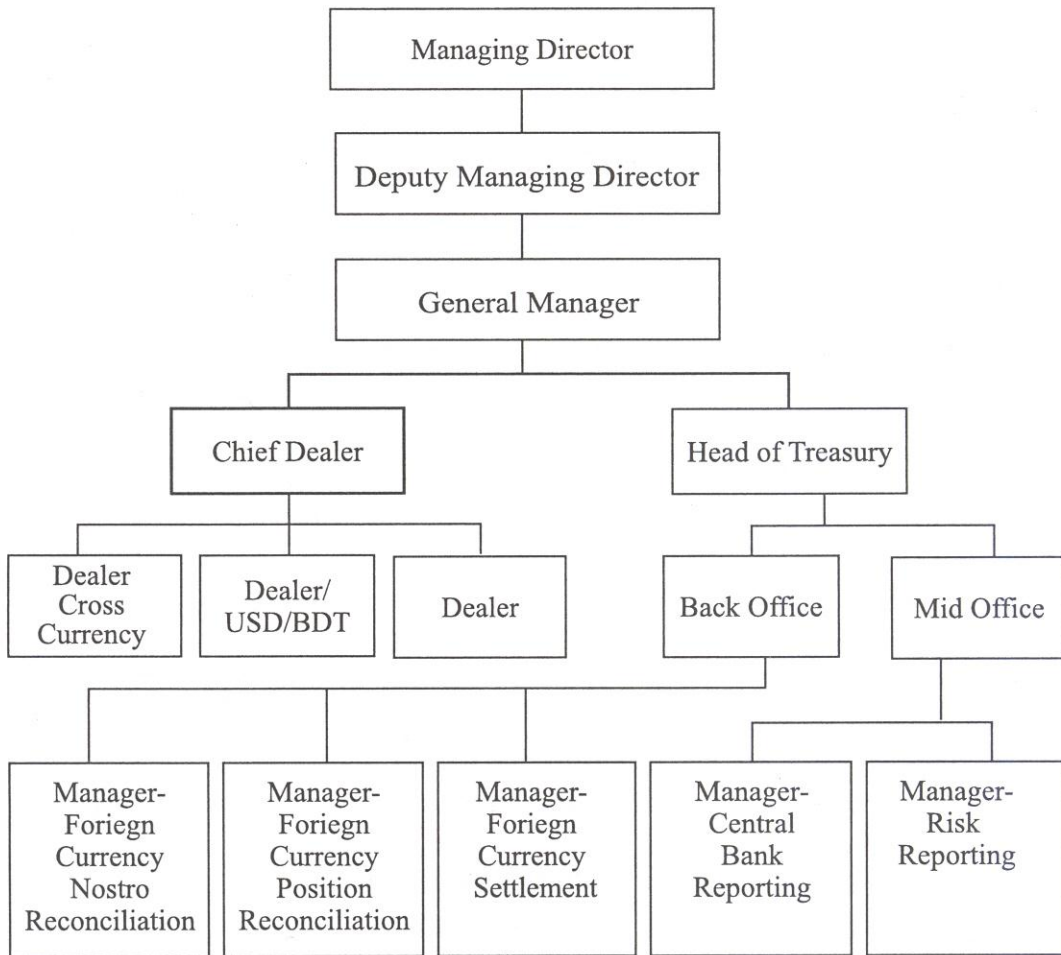
04.00 Departmentation Style of Foreign Exchange Dealing Operations :

In order to run the respective functions in an well-equipped manner depending on the nature of business of the financial organization and its size organization needs to determine the size of its Treasury Front Office, Mid Office and Back Office and its functions. However, regardless of the size, nature of business, all treasury functions require to have clear demarcation between direct dealing and all settlement and support functions, i.e., the Front Office is involved in dealing activities. The Mid Office and Back Office are assigned responsibility of related support functions. This is required for control purpose

04. 01 Linkage Between Foreign Currency Management and Local Currency Management in Janata Bank :

In Janata Bank, there is an internal co-ordination between Foreign Currency Management Department and Local Currency Management Department for BDT/USD transaction. Dealers conduct BDT/USD deal and send deal slip to the Back Office. After getting the deal slip, the respective Back Office personnel prepare deal confirmation and send it to the counter party. At the same time he receives the deal confirmation as well as BDT cheque from the counter party and sends the cheque to the Local Office for clearing and vice-versa. The respective person for BDT/USD transaction reconciliation reconciles both nostro account and the local currency account.

04.02 Departmentation Style of the Foreign Exchange Dealing Operation of Janata Bank :



05.00 Functions of Foreign Exchange Dealing Room (Front Office)

Dealing Room is designed for dealing in foreign exchange. It is provided with a required facilities such as telephone, computers, Reuters Dealing System and other information services. Dealers are the market players. They are supposed to discharge duties in a prudent manner to earn profit through availing the opportunity of price movement and managing market risk. The dealers have to perform duty from 8:00 a.m. till late hours of opening of New York market. The following are the functions of dealing room :

- Forming market views through fundamental and technical analysis.
- Preparations of foreign exchange rate circular as well as quotation of various foreign exchange rates (two way rates are to be quoted).
- Taking different cross currency trading position and squaring profitably in accordance with prevailing guidelines.
- Selling surplus foreign currency in the local inter-bank market including central bank.
- Buying shortfall foreign currency from the local inter-bank market.
- Trading of local currency versus foreign currency, specially USD/BDT.
- Monitoring exchange positions.
- Maintenance of all internal and regulatory limits.
- Maintenance of counter party credit limits.
- Maintenance of all dealing records.
- Maintenance of intraday limit, dealer's individual limit, stop-loss limit.
- Engaging in other foreign exchange market activities as permitted by Exchange Control Authorities.
- Helping the back office for any unreconciled entry due to any discrepancy

06.01 Functions of Back Office :

- Preparation of exchange position.
- Preparation of daily position and reconciliation with front office.
- Recording deals.
- Processing and sending deal confirmations.
- Receiving deal confirmations from counter parties and checking with record and follow-up.
- Preparation, verification and sending payment instructions.
- Preparation, checking and passing of vouchers.
- Ensuring accounting entries.

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- Checking nostro payments and receipts.
 - Claim/Pay good value date effect of the settlement.
 - Managing discrepancies and disputes.
 - Revaluation of all foreign exchange positions at a particular date.
 - Justification of rate reasonability for all deals done.
 - Daily calculation of exchange position for adherence to statutory maintenance.

06.02 Functions of Mid Office :

- Monitoring dealer's compliance to various internal and regulatory limits.
- Monitoring dealer's compliance to various counter parties limits.
- Reporting any limit excesses and follow up for measures.
- Various internal regulatory limits.
- Revisions of counter party limits, dealer's limit, stop-loss limit with the approval of the appropriate authority.

07.00 Operational Set-up :

07.01 Front Office Equipment :

- Reuters (Dealing) 3000 Extra Work Station
- Internet connection.
- Financial TV Channels.
- PC with necessary office package software.
- ISD Telephone with fax.
- NWD Telephone with fax.
- Mobile phone for the dealers/supervisors.
- Voice recorders (under process).

07.02 Back Office Equipment :

- SWIFT station.
- Telex.
- PC with necessary software.
- Telephone with fax.

07.03 Products Offered (Subject to Exchange Control (Regulations)) :

- Ready/Spot cross currency deal.
- Forward cross currency deal.
- Ready/Spot BDT/USD deal.
- Forward BDT/USD deal.

07.04 Dealing Hours (Subject to guidelines for foreign exchange transactions) :

Saturday and Sunday	: 8 a.m. to 1 p.m. for BDT/USD deal only.
Monday to Thursday	: 8 a.m. to 1 p.m. for BDT/USD deal. 8 a.m. to 8 p.m. for cross currency deal.
Friday	: 10 a.m. to 7 p.m. for cross currency deal only.

07.05 Dealing Room Limits (To be fixed up by the competent authority) :

- Intra-day dealing limit.
- Monthly stop-loss limit.
- Intra-day stop-loss limit.
- Overnight holding limit.
- Counter party limit.

07.06 Dealer's Individual Limit :

- Maximum dealing limit per day.
- Maximum limit per deal.
- Maximum stop-loss limit per deal.
- Maximum stop-loss limit per day.
- Maximum stop-loss limit per month.

07.07 Off Premise Deal (Subject to specific permission from the competent authority) :

Off-premises' Dealing for squaring up any position is permissible for individual dealer. The chief dealer would designate particular dealer(s) with the authority for off-premises' dealings in case they decide to carry out such activity for some specific business reason/justification and it must be treated separately since no immediate confirmation is done.

07.08 Get-up of the Deal Slip :

The deal slip should contain the following :

- Deal no.
- Deal date.
- Base currency.
- Dealing amount.
- Exchange rate.
- Value date.
- Signature.

07.09 Dealer's Position Sheet :

Dealer's position sheet contains the following :

- Counter party name.
- Amount purchased/sold.
- Exchange rate.
- Value date.
- Signature.

07.10 Dealer's Mandatory Leave :

The dealing functions are extremely sensitive due to high volatility of exchange rate movements as well as large volume of transactions. There is also risk of mistakes. All dealers are required to be on leave for two weeks during a year and this is mandatory. During this period, dealers are not expected to be in contact with their colleagues in the dealing room. Typically this period is continuous two weeks.

08.00 Job descriptions for the Dealing Officials, the Mid Office and the Back Office personnel :

08.01. Deputy General Manager :

- Overall responsibility of all dealing and treasury activities.
- Responsible for dealing room financial plan, strategy and operation of back office.
- Setting risk management strategy within internal and regulatory limits.
- Setting individual dealer's dealing limit with the approval of competent authority and compliance of dealings within the approved limit.

- Decide on particular positions during unfavorable situation.
- Responsible for maintaining open position within the stipulated limit.
- Continuous development of systems, processes, business, strategies, etc. with the approval of authority.
- Follow-up the flow of incoming and outgoing funds in relation to dealing activities.

08.02 In-charge (Mid Office) :

- To monitor compliance of all types of dealing room limits as well as dealer's individual limits.
- To monitor compliance of counter party limit.
- To check and sign all types of internal and regulatory reporting.
- To inform the Deputy General Manager of any limit violation.
- To review the counter party limit.
- To monitor profitability position of dealing room.

08.03 Chief Dealer :

- To monitor the daily foreign exchange rate circular.
- To form the market view through technical and fundamental analysis.
- To monitor the other dealers' activities.
- To maintain individual limits.
- To maintain individual position sheet.
- To guide other dealers in decision making.
- To monitor the exchange position.
- To monitor the daily profit and loss of the dealing room.
- To maintain the dealer's pads.
- To monitor the counter party limits.
- To make proposal for increasing or review of the counter party limits.
- To conduct BDT/USD/Corporate and other cross currency deal.
- To check and sign dealer's pad prepared by other dealers.

08.04 Other Dealers :

- To prepare the daily foreign exchange rate circular.
- To participate in forming market view.

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- To take cross currency position and square profitability.
 - To conduct BDT/USD/Corporate deal.
 - To maintain individual limits.
 - To maintain individual position sheet/blotter.
 - To prepare deal slip.
 - To seek help from the chief dealer in case of emergency or adverse situation.
 - To maintain the dealer's pad.
 - To help the back office people in case of any discrepancy.

08.05 In-charge (Back Office) :

- To monitor all activities of the settlement.
- To check and sign the payment instruction.
- To check the deal record.
- To check the position reconciliation sheet.
- To monitor the exchange position.
- To check and sign the deal confirmation.
- To claim/pay for good value in case of late settlement.

08.06 Back Office (Settlement) :

- To check the exchange position.
- To check the deal confirmations.
- To check the settlement instructions.
- To check the nostro account statements.
- To check the deal record.
- To check the position of reconciliation sheet.
- To find out late receipt or payment in the nostro accounts if any, and claim for settlement with good value.
- To check the counter party limits.
- To check various internal and regulatory limits.

08.07 Back Office (Process) :

- To prepare the exchange position.
- To prepare deal confirmations.

- To send and receive all deal confirmations.
- To maintain deal record.
- To prepare settlement instructions.
- To maintain position of reconciliation sheet.
- To check the nostro accounts statements to find out late settlement if any, and claim or pay for good value.
- To prepare, check and pass all the deal vouchers on day-to-day basis.

08.08 Mid Office (Report) :

- To prepare all regulatory reports as required.
- To respond to various queries regarding reports.
- To monitor all internal regulatory limits.
- Reporting of excess limit utilization.
- Determination of daily profit and loss.
- To generate various MIS.

08.09 Back Office (Reconciliation) :

- To monitor all foreign currency nostro accounts reconciliation on day-to-day basis.
- To monitor BDT/USD/Corporate transactions' reconciliation on day-to-day basis.
- To check the shadow ledger on day-to-day basis.
- To inform the dealers of any discrepancy or unmatched item.

08.10 Back Office (Foreign Currency Reconciliation) :

- To prepare of all deal vouchers.
- To reconcile all foreign currency nostro accounts on day-to-day basis.
- Reporting of any unmatched item to the In-charge.
- To inform the dealers of any discrepancy.
- To investigate and match unreconciled amount

08.11 Back Office (BDT/USD/Corporate Reconciliation) :

- Preparation and posting of all BDT/USD/Corporate transactions vouchers

- To reconcile all BDT/USD/Corporate transactions on day-to-day basis.
- Reporting of any unmatched amount.
- To inform the dealers of any discrepancy.
- To investigate and match unreconciled amount.
- To issue sale/purchase confirmation letter.

09.00 Treasury Back Office is restricted from doing the following Activities :

A. Dealing activities :

- (i) Decide on exchange rates/quoting prices.
- (ii) Striking deals with counter parties.
- (iii) Raising deal slips.
- (iv) Altering deal details.

B. Updating position blotters.

C. Approving counter party credit limits.

D. Approving market risk limits.

10.00 Conclusion :

The dealer's job is highly demanding and this job requires high level of skills and specialization in the respective arena. On the other hand, certain positions in the back office also require high level of skills and specialization. The dealers are responsible for the risk management. Therefore, it is the responsibility of the top management to appoint competent and deserving personnel in the dealing room and the back office. Dealers have to work hard and long hours as well as under extreme pressure and stress even in the public holiday. Hence, they may be given more financial benefit in the shape of dealing allowance, transport facility and accelerated promotion, etc.

CODE OF CONDUCT OF THE FOREIGN EXCHANGE DEALERS

GENERAL CODE

1. Purpose :

The aim of the code of conduct is to set out the manner and spirit in which business should be conducted in order to ensure that the foreign exchange market and its participants enjoy a reputation for high standards of professionalism, integrity and ethical conduct. This is addressed not only to dealers in foreign banks, but also to the management of such institutions together with relevant operational support staff, and should be well understood by each of them.

2. Responsibility of management for dealing activities :

Control of the activities of all personnel engaged in dealing (both dealers and support staffs) is the management's responsibility of such organizations. Management should, therefore, clearly set out, in writing, the authorities and responsibilities within which dealers and the support staff should operate. These might include :

- General dealing policy including reporting procedures;
- Persons authorized to deal;
- Instrument to be dealt in;
- Limits on open positions, mismatch positions, counterparts, stop-loss limits, etc.;
- Confirmation and settlement procedures;
- Relationship with other foreign exchange banks, brokers and customers; and
- Other relevant guidance as considered appropriate.

3. Responsibility of Staff for dealing activities :

All personnel engaged in dealing activities (both dealers and support staffs) must observe the following code as their fundamental behavior in the dealing activities:

- They must keep dealing activities within the responsibilities authorized by the management and observe the instruction given by the management for supervisors in each dealing section (dealing room and back office) concerned.
- Troubles, which arose during dealing activities and other issues which might cause serious troubles, must immediately be reported to the management or supervisors for their instructions.

4. Use market terminology and definitions :

The management of banks should see if its staff uses common expressions and have knowledge of their generally accepted meanings in their dealing activities in order to avoid misunderstandings.

5. Dealing unit and back office :

The organizational framework in an institution should clearly separate the dealing unit from the back office where all the administrative works (payments, global position-keeping) are done and from book-keeping department, which should, among others, be responsible for a timely and swift checking of all incoming confirmations. A bank should not start foreign exchange trading with less than two trained and authorized people in its room designated for dealing.

6. Recording a deal :

All the essential details of a deal must be written down in a dealing ticket which must be forwarded as soon as possible to the back-office for further processing. Alternatively, the information may be entered into the computer system.

7. Accounting :

The back-office must work with the bank's accounting department to ensure that all transactions and violation changes are accounted for promptly. Because of two-day settlements, the value date accounting is inadequate for the monitoring of risk positions and hence accounting must be established on a transaction basis.

CODE REGARDING DEALING PRACTICES

1. Opening hours in the foreign exchange market :

Openings hours should be defined.

2. Confirming procedures :

Dealer's must confirm verbally.

After dealers' confirmation, it is the back-office's responsibility to carry out reconfirmation independently from those who initiate deals. Recommendation must be sent out as quickly as possible after a deal has been done and should be addressed to the back office of the counterpart bank.

All reconfirmations should include the following information as a minimum requirement :

- date of transaction;
- By which means effected (Phone, Telex);
- Name and location of counterpart;
- Rate amount and currency;
- Type and side of deal (buying and selling)
- Value date, maturity date and all other relevant dates;
- Standard terms and conditions applicable; and
- All other important and relevant information.

Upon receipt, all reconfirmations must immediately be thoroughly checked and appropriate action be taken to rectify differences. If the counterpart's recommendation is considered incorrect, it must immediately be informed. A new reconfirmation (Or written agreement to a correction) must be requested from and provided by the bank whose original reconfirmation was incorrect.

3. Payment/Settlement instructions :

Payment/Settlement instructions should be passed as quickly as possible to facilitate prompt settlement. The use of standardized payment instructions between counterparties who regularly deal with each other is recommended as this use can make a significant contribution to reduce both the incidence and the amount of differences arising from the mistaken settlement of funds.

4. Confidentiality :

Confidentiality and anonymity is essential to the operation of a professional foreign exchange market. Participants in the market- commercial clients as well as banks can expect to have their interest and to ensure that its employees can readily identify information that is confidential or situations where anonymity is essential, and instruct their employees to handle such information accordingly. Whenever confidentiality is broken, management is to see that the instructions issued swiftly to correct the conditions that permitted such a situation to occur.

The use of confidential information by traders for their personal benefit, or in a manner that compromises with the institution in any way, should be strictly forbidden. Dealers operating in the market are responsible for maintaining confidentiality. Without disclosing or discussing any information relating to deals transacted, in the process of being arranged except to, or with the counterparty involved. A dealer should not be permitted to pass on information outside the institution, nor should he distribute information within his institution, except with explicit permission from the parties involved on a need-to-know basis.

ETHICAL RULES

1. Trading for personal account :

It is expected that any trader will give full attention to the employing institution's business activities and not be distracted by his own financial affairs. Any bank dealer should not be allowed to deal for their own account in any instruments since it is expected that any dealer will fulfill his institutional responsibilities objectively unbiased by his own financial position. Management has to be aware that, if traders are permitted to trade in instruments closely related to that deal for the institution, a conflict of interest might arise which could be detrimental or embarrassing for the institution, the trader, or both. Therefore, it is the management's responsibility to develop a clear institutional policy on these matters.

2. Protection against fraud :

All staffs should pay much vigilance in regard to attempted fraud particularly in the following cases :

- Deals which do not include pre-agreed standard settlement institutions;
- Deals whose payment is made in favour of a third party;
- Inability to make reconfirmation after concluding the deal; and
- Other deals which have different standards than the pre-agreed.

3. Entertainment, gifts and gambling :

Neither management nor employees should offer inducements to conduct business or solicit them from the personnel of other institutions.

Where inducements are recognized in the normal course of the business, management should formulate policies in this area, which include guidance on the provision and receipt of entertainment and gifts by staff. This should include what may or may not be offered or accepted, together with procedures for dealing with gifts judged to be excessive, but which cannot be declined without causing offence. Similar guidelines on gambling should be established with other market participants.