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SE Work Space

HD **Industry Insight Industry comment by James Wall Managing director Financial Institutions Group Commonwealth Bank**

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As their pool of investment funds grows, Australian pension and investment institutions are increasingly looking overseas in their search to match their long-term liabilities with comparable long-term assets.

At the same time, there is a growing desire among overseas investors to buy into large-scale Australian infrastructure opportunities, such as the privatisation of government utility assets in Queensland and New South Wales.

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Both these trends, and the increasing importance of cross-border trade, have brought the issue of managing foreign currency risk back into sharp relief.

While managing volatility is an important part of any strategy, the increasing requirement to transact in currencies such as the Chinese RMB adds new levels of complexity, and requires new platforms and solutions to satisfy this need.

Much of the fund management industry in Australia involves superannuation and retirement savings. The liability they are accumulating is a long-term liability, and institutions are looking for longer-dated assets to match these liabilities.

To achieve this, we see the desire among these institutions to invest offshore becoming more prominent. On top of that, many superannuation funds are becoming more directly involved in buying and managing these assets.Foreign currency exposure

According to Chris Loong, executive director of institutional FX at Commonwealth Bank: "Typically, the first thing superannuation funds are doing is making a choice about a particular offshore asset.

"They are selecting from a range of traditional assets like global bonds and equities, and increasingly from assets such as infrastructure and property. Of course, once they make that decision, they are also taking on foreign currency exposure.

"They need to be aware of that exposure, how they manage it, and what it means – not just for a specific portfolio – but also for the overall portfolio."

Increases in global trade are also an important consideration. Last year, global two-way trade between Australia and China topped $150 billion.

According to Mono Ganguli, Commonwealth Bank's executive director of client risk solutions, "There is an increasing use of RMB-denominated instruments in risk mitigation. When you extrapolate, just by the sheer size of China's economy and the wealth that is moving back and forth between China and other countries including Australia, it's an important consideration."

Investment in resources projects was obviously an important part of that, but increasingly, as those projects shift from development to production, investment is shifting into assets like utilities and social infrastructure. Investors buying into Australian assets bring different mindsets to their approach. Some are happy to take unhedged positions because they are looking for exposure to the Australian currency and economy.

Others, however, may wish to hedge the principal and choose to focus on hedging the flows when they repatriate profits or diversify their Australian investments. "Either way, they are becoming more sophisticated at recognising those exposures, aggregating them and then managing them," Mr Loong said.

"Some superannuation funds are also considering whether they should directly execute foreign exchange **transactions** themselves and manage these in-house. Large funds face a choice. Are they taking on too much operational risk? Do they have the legal and regulatory infrastructure? What is the cost of setting up the hardware, software and systems? And of course, do they have the right people?"Managing risk

Companies with currency exposures have to decide their best strategy and determine the risk for the whole portfolio. "It's one thing to say your global bond portfolio is always traditionally fully hedged back to the AUD, but what does that mean in combination firstly with the exposures from their other global assets, and then especially when combined with their domestic assets?" Mr Loong said.

For an organisation like CBA, it is important to empower our customers to manage these risks through the delivery of world-class platforms to help companies meet these challenges.

The bank's multicurrency program is doing just that. By enabling our entire core banking platform with the ability to transact in multiple currencies, we are providing customers with foreign currency requirements access to features previously reserved for Australian dollar **transactions**, according to Mr Nick Tsotras, managing director of global **transaction** services.

"Now, for the first time in Australia, we will have real time **transaction** data for customers with foreign currency accounts, which they will be able to open and maintain online."

"Our business customers will see the introduction of features, such as sweeping and pooling of their foreign currency accounts, creating an enhanced liquidity management solution, which is a unique capability. The end result is a much-improved customer experience that provides our customers with greater visibility and control over their foreign currency," Mr Tsotras said.

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