

Gaining currency



THE LAUNCH OF A SYNTHETIC BASKET CURRENCY COULD HELP CORPORATE TREASURERS TO INSULATE COSTS AND REVENUES FROM ECONOMIC AND POLITICAL VOLATILITY, AND FREE MULTINATIONALS FROM EXCHANGE RATE RISK. IAN HILLIER-BROOK AND KEN LILLIE PUT THE CASE FOR THE WOCU.



The wocu or World Currency Unit was launched in September. To quote Howard Flight, fund manager, politician and the author of "All You Need To Know About Exchange Rates", the definitive work on foreign exchange: "Corporate treasurers and ACT members will really like the wocu concept as it reduces volatility and exchange rate risk."

The wocu is a synthetic currency created from a basket of the currencies of the world's top 20 national economies (as measured by GDP) and weighted by means of a GDP-based algorithm. The wocu has been developed over a number of years, initially by a former Reuters senior manager who had the idea while looking at a standard Reuters FX/FX foreign exchange screen. He transferred the US dollar from the top of the screen into the body of the screen among the other currencies, and the wocu was born.

After some years of further research the WDX Organisation was formed and investment raised in 2009. The IT infrastructure has been built and wocu prices can now be

Executive summary

With an unsuccessful FX hedging strategy able to lose a multinational company large sums of money in a frighteningly short time, the time may have come for treasurers to push their banks to adopt the wocu, an apolitical, non-sovereign balanced global currency.

seen at the wocu website (see end of article for URL). Wocu pricing is currently available in a non-tradable form and a tradable wocu should be available by 1 January 2010.

The constituent countries, and the weighting factors will be updated by the independent WDX Institute, which will carry out further research into foreign exchange and international trade. It was set up and will initially be funded by the WDX Organisation. It is made up of experienced market professionals and leading academics, and will meet frequently but specifically every six months to confirm the membership of the top 20 countries by GDP and their weightings in the wocu algorithm.

The structure of the wocu makes it much less volatile than sovereign national currencies because it is a balanced basket of currencies. It is totally apolitical as the wocu weighting algorithm is managed by an independent institute, thus freeing it from any governmental interference, unlike sovereign national currencies whose exchange rate value is affected by political decisions.

The European Community created its own basket currency in 1979, the ecu. But while it was embraced by corporate treasurers, it was not very popular with foreign exchange traders. The ecu represented a basket of the sovereign national currencies of European Community members, but it was overtaken by the rise of the euro, which is effectively a sovereign currency for most EU states, and so heavily influenced by political decisions.

WHY WE NEED THE WOCU Recent FX currency market volatility and uncertainty has focused attention on the need for an apolitical, non-sovereign balanced currency. Stories abound of large multinational companies losing very large sums of money on unsuccessful hedging strategies. The wocu will, by reducing volatility, significantly reduce hedging risks and related hedging costs as less hedging will be required; by virtue of being less volatile, it will also be less expensive to



THE WOCU WILL, BY REDUCING VOLATILITY, SIGNIFICANTLY REDUCE HEDGING RISKS AND RELATED HEDGING COSTS AS LESS HEDGING WILL BE REQUIRED; BY VIRTUE OF BEING LESS VOLATILE, IT WILL ALSO BE LESS EXPENSIVE TO HEDGE.

hedge. A financial engineer recently stated that reducing volatility by a factor of two would reduce hedging costs by a factor of four.

Below are two possible uses of wocu by multinational companies:

Scenario 1: Company A has a global product but its sales costs, etc, are in a domestic currency. It therefore prices its product in wocu or sets a local price based against wocu (set weekly, monthly or whatever, based on unit price, market, etc). The sale is then effected in local currency or the company asks its bank to receive funds and FX into local currency based on a wocu amount (or to receive a local amount based on a wocu exchange value).

Scenario 2: Company B has buyers in different countries and sellers in different countries, so it make no sense to exchange the wocu into local currency only subsequently to convert it back to settle invoices. Better that a wocu account is maintained for taking and disbursing funds to satisfy the buying and selling of the commodity. The only transaction into local currency is for the "profit" element.

Charities and other not-for-profit organisations are faced with the same problems as companies as they also raise funds and make disbursements in many different – and often volatile – countries and currencies. The ability to conduct international activities in a more stable apolitical basket of currencies will reduce their risks and thus their costs.

Like the wocu, the International Monetary Fund's special drawing rights instrument is an international artificial basket currency, but one that is more political and less well balanced. It was created in 1969 to support the Bretton Woods fixed exchange rate system, but survived the collapse of Bretton Woods. It is used for such things as international postage, roaming charges for mobile phone companies and in some areas of international shipping and transport.

However, the IMF reweights its special drawing rights only every five years and uses only four currencies (dollar, sterling, yen and euro), so its ability to facilitate multinational trade through reduced volatility is limited. Special drawing rights could also be said to be open to political interference. Nor does the instrument reflect the world's rapidly emerging BRIC (Brazil, Russia, India, China) economies, nor the growth of any other emerging economies.

Figure 1: Distance from baseline: wocu and euro



Figure 2: Distance from baseline: wocu and sterling

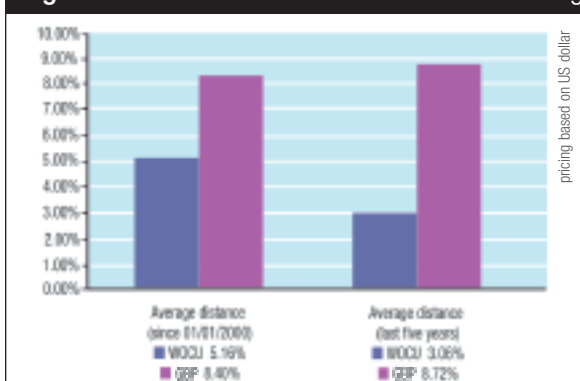


Figure 3: Volatility from baseline: wocu and euro



Figure 4: Volatility from baseline: wocu and sterling





cash management

FOREIGN EXCHANGE

By comparison, the wocu is reweighted and its constituents updated every six months by the WDX Institute. There is no political interference and its value simply reflects the GDP of the world's 20 biggest economies. It is therefore eminently suited to the conduct of international trade and the reduction of volatility and risk in the modern world.

A TRADED INSTRUMENT A number of major European banks are in discussion with the WDX Organisation and have expressed a willingness to settle both ends of a commodity trade conducted in wocu. They have indicated that over time they will support wocu-denominated accounts, so companies can hold wocu rather than simply settling trade in the currency. Multibank dealing system vendors have also indicated that as soon as the wocu is traded by major banks they will make it available on their systems.

The WDX Organisation is also in discussions with international exchanges and clearing houses to develop trade not only in wocu but also in futures, options and other derivative instruments.

The wocu is unaffected by specific regulatory issues. The consensus among members of the WDX Institute and risk and regulatory management within major consulting firms is that as the wocu is a basket of currencies it does not require specific regulatory approval.

A roundtable of invited corporate treasurers recently held to discuss the application of the wocu in the corporate, governmental and charity worlds greeted it with enthusiasm. More such discussions are planned for the very near future.

The next step is to work with corporate treasurers and banks to facilitate trade denominated in wocu, and with brokers, exchanges and clearing houses to ensure that the wocu rapidly becomes a tradable instrument. The official launch of the wocu will take place by 1 January 2010.

It is clear that the time is right for the wocu. There has been much publicity recently about the desire of many commodity producing nations to move away from the US

AN APOLITICAL AND LESS VOLATILE INSTRUMENT IS NEEDED AS THE GLOBAL ECONOMY CHANGES, FINANCIAL POWER MOVES EAST AND THE EMERGING BRIC ECONOMIES TAKE OVER FROM THE LEADING FINANCIAL POWERS OF THE LAST CENTURY.

dollar as the de facto global reserve currency. An apolitical and less volatile instrument is needed as the global economy changes, financial power moves east and the emerging BRIC economies take over from the leading financial powers of the last century.

As emerging economies grow, their currencies can become part of the wocu by virtue of GDP growth rather than political manoeuvring. Over time corporate treasurers will work with their banks not only to price trade in wocu, but also to hold assets and even price bonds in wocu. The wocu is an idea whose time has come.

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For wocu prices, go to: www.wocu.com

