Treasury and Trade Solutions | CitiFX®

Managing Risk in Turbulent Times

Judy Kamau
Head, FX Corporate Sales & Structuring
East Africa
Citi Markets

Contents

Executive Summary

Executive Summary

The findings presented in this report are based on a comprehensive review of survey results gathered from nearly 150 Citi Treasury Diagnostics participants. The respondents come from organizations representing a diverse range of sizes, industries, and geographies. Participant companies varied in turnover size—ranging from less than 1 billion USD to greater than 25 billion USD—and represented all sectors of the economy and all regions across the globe.

Citi Treasury Diagnostics is an award-winning benchmarking tool designed to help companies assess the effectiveness of their treasury, working capital, and risk management practices against industry peers and best-in-class companies. It equips treasury departments to identify opportunities to deliver more value to their firms.

Key findings include:

- FX risk management practices vary significantly by region, particularly around objectives, the emphasis placed on types of exposures, and the approaches used by corporates to hedge risks
- FX risk management policies are broadening in scope to include more strategic and tactical methodologies, such as assessing the impact of FX on performance indicators (e.g., Net Debt to EBITDA)
- While reducing earnings volatility remains a priority, the number of corporates actively taking measures to mitigate FX volatility in earnings is relatively low
- Over half of the companies surveyed do not differentiate between emerging market (EM) and developed market (DM) transactional hedging practices
- While many organizations have existing FX risk management programs in place, companies tend to leverage traditional strategies, practices, products, tools, and technology
- Some corporations have focused on leveraging cash management processes, such as pooling and cash flow forecasting, to improve the effectiveness of their risk management programs
- Corporations continue to deploy various constructs to achieve greater centralization and more effectively manage risk, however, natural risk management techniques, such as netting, appear to be a missed opportunity among a number of companies
- Despite the increasing recognition of technology as an important enabler to meeting risk management objectives, over half of survey participants reported that their treasury management system (TMS) does not support financial risk management processes

FX Risk Management

Regional Variations in FX Risk Management

Survey results show significant regional variations in FX risk management practices, perhaps driven by differences in regulatory environments and traditional market practices.

FX Risk Management Objectives

- Reduce risk to both cash flows and earnings:
  - 59% Americas
  - 31% EMEA
  - 68% APAC
- Reduce risk to transactional cash flows only:
  - 31% Americas
  - 62% EMEA
  - 30% APAC

Types of Exposures Hedged

- Net monetary FX-denominated assets and liabilities:
  - 42% Americas
  - 61% EMEA
  - 63% APAC
- Forecasted FX-denominated exposures:
  - 29% LATAM
  - 76% NAM
  - 85% EMEA
  - 58% APAC

Hedging Approach

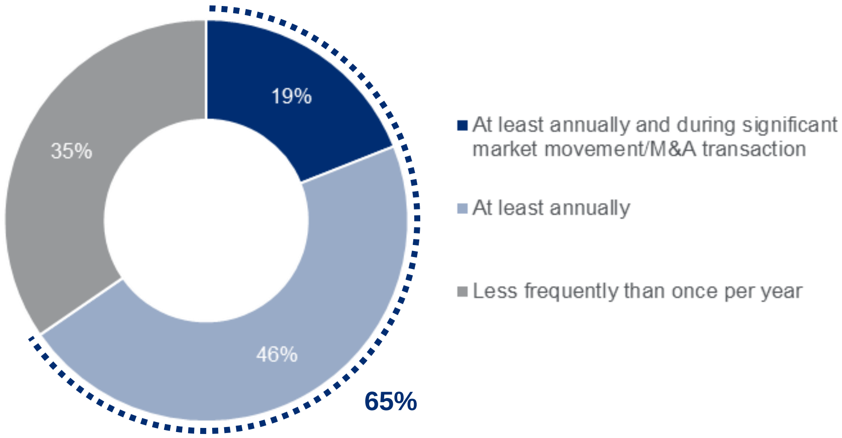
- Opportunistic hedging:
  - 24% LATAM
  - 13% NAM
  - 14% EMEA
  - 11% APAC
- Rolling hedging:
  - 12% LATAM
  - 26% NAM
  - 32% EMEA
  - 17% APAC

Note: Sum of percentages may be greater or less than 100 percent due to multiple-answer questions

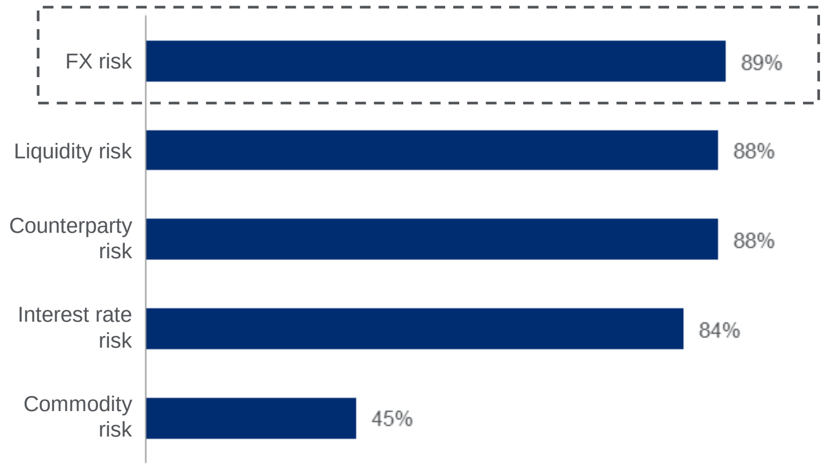
Treasury Policy

89% of companies surveyed reported having a formal written FX policy in place. 65% of respondents also indicated that policies are reviewed at least annually and/or during significant market movement or M&A transactions.

Frequency of Treasury Policy Reviews



Treasury Policy Coverage



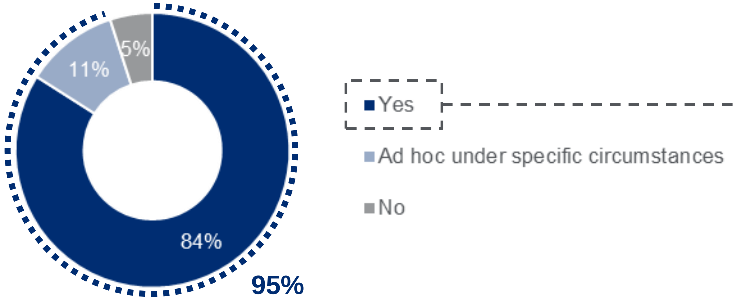
"We've identified the need for broader policy review, largely a result of unexpected FX volatility deriving from our intercompany portfolio."

– Americas multinational CTD participant

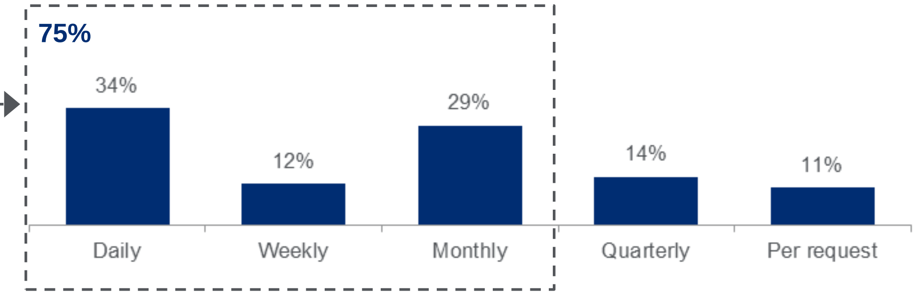
Note: Sum of percentages may be greater or less than 100 percent due to multiple-answer questions

FX Risk Assessment

Assessment of FX Risk



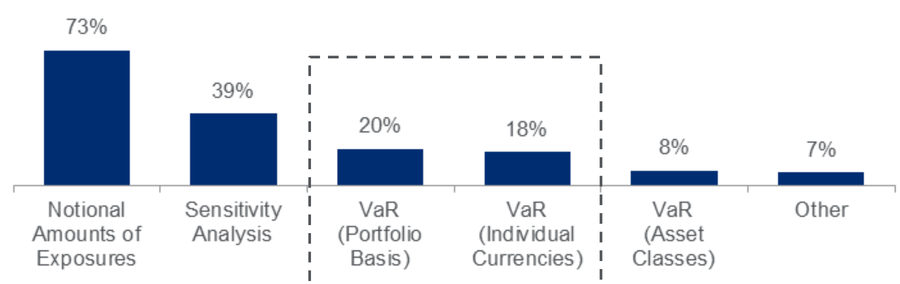
Frequency of FX Risk Assessment



95% of companies surveyed reported assessing FX risk, of which, 75% indicated doing so at least on a monthly basis. Over three-quarters (78%) of respondents indicated that FX risk decision making and execution is centralized. Often those with more complex exposures reported applying more advanced risk tools such as value-at-risk and portfolio analyses. While it remains true that statistics will never be a panacea for all FX risk management concerns, these quantitative modelling techniques and tools can be valuable to a corporate treasurer to apply when formulating a risk management strategy.

Level of FX Risk Management Centralization

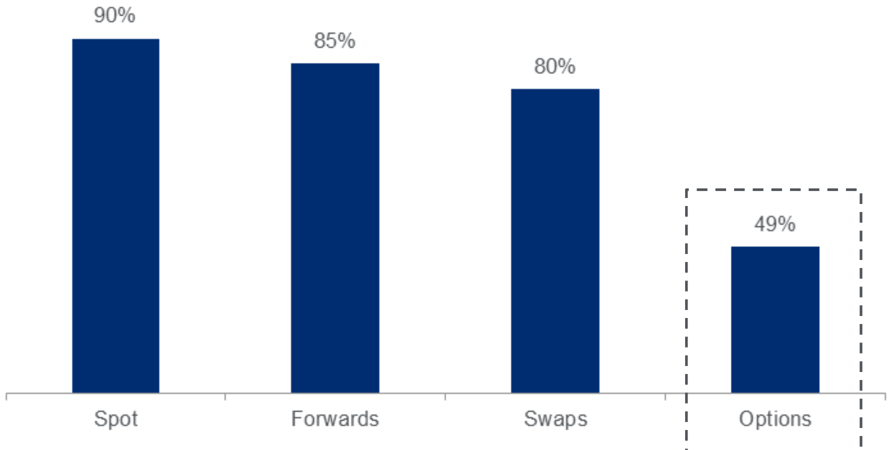
Methodology / Reporting



Note: Sum of percentages may be greater or less than 100 percent due to multiple-answer questions

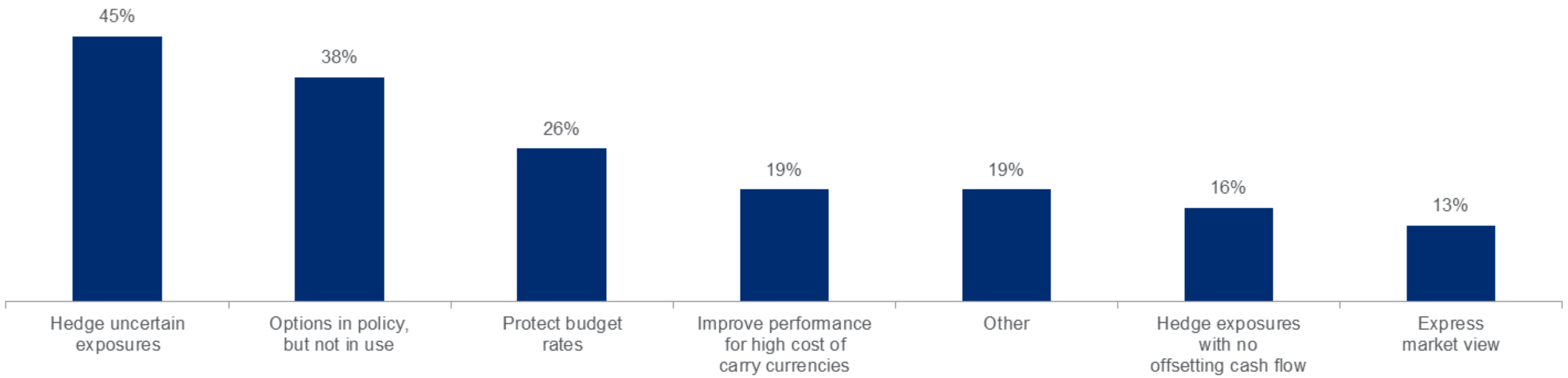
FX Instruments

Policy-Permitted Financial Instruments



Per corporate risk management policies, spot, forwards, and swaps remain the most commonly permitted financial instruments. Slightly less than half (49%) of survey participants reported option-based strategies as being permissible, and among those, another 38% reported that while options are in policy, they are not presently in use.

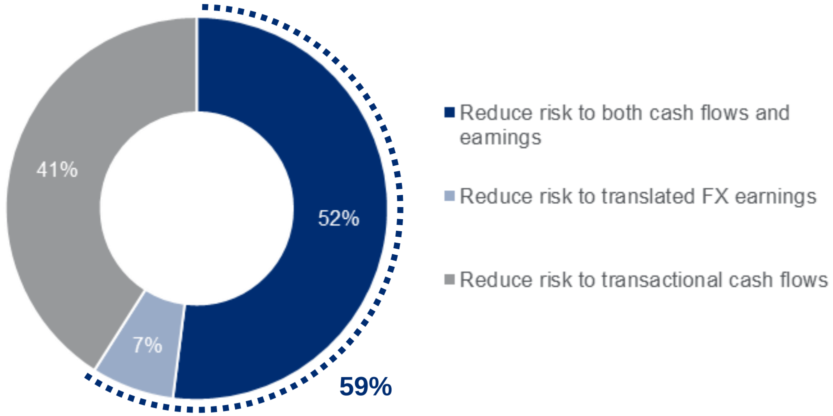
Reasons for Choosing FX Option Strategy



Note: Sum of percentages may be greater or less than 100 percent due to multiple-answer questions

Risk Management Objectives

Risk Management Objectives

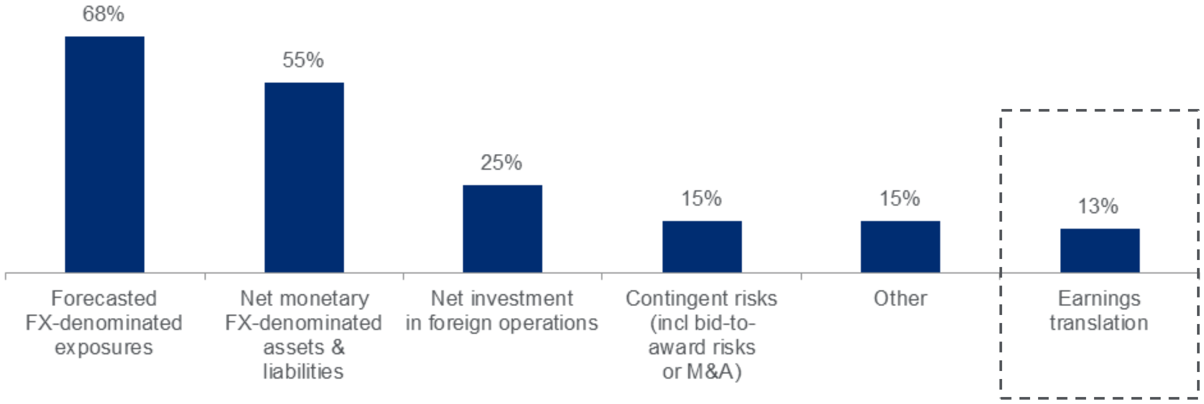


"Managing foreign earnings risk is increasingly becoming a major concern and challenge for us."

– Americas multinational CTD participant

While 59% of companies reported reducing earnings volatility as a key risk management objective, the number of corporates actually directly hedge earnings translation exposures is quite low (13%).

Types of Risks Hedged

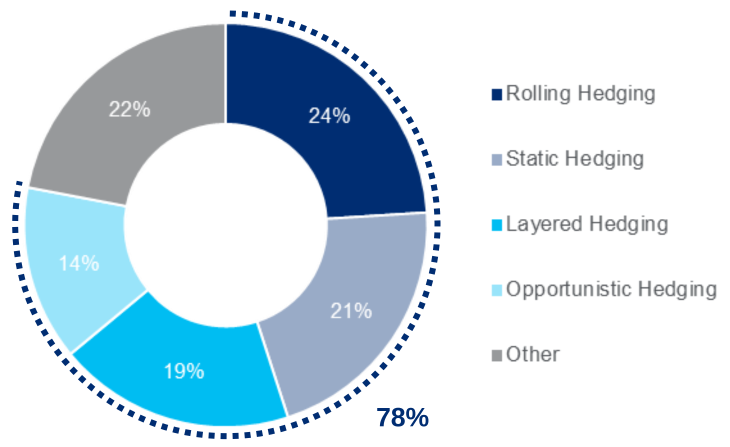


Note: Sum of percentages may be greater or less than 100 percent due to multiple-answer questions

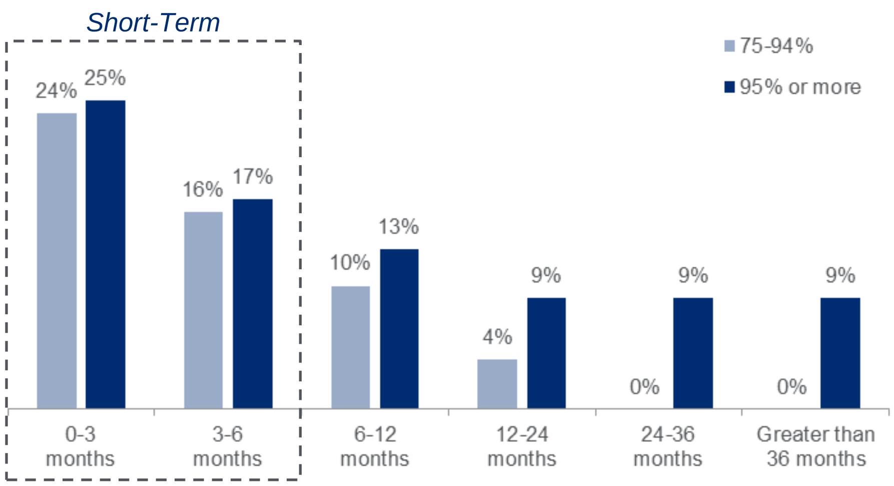
FX Transaction Risk

The majority of companies (78%) follow a rolling, static, layered, or opportunistic approach to hedging forecasted exposures. Additionally, many hedging programs continue to be short-term in nature. As a result, the number of companies realizing significant economic and risk reduction benefits has been limited. 58% of respondents companies reported analysing hedging performance at least on a monthly basis.

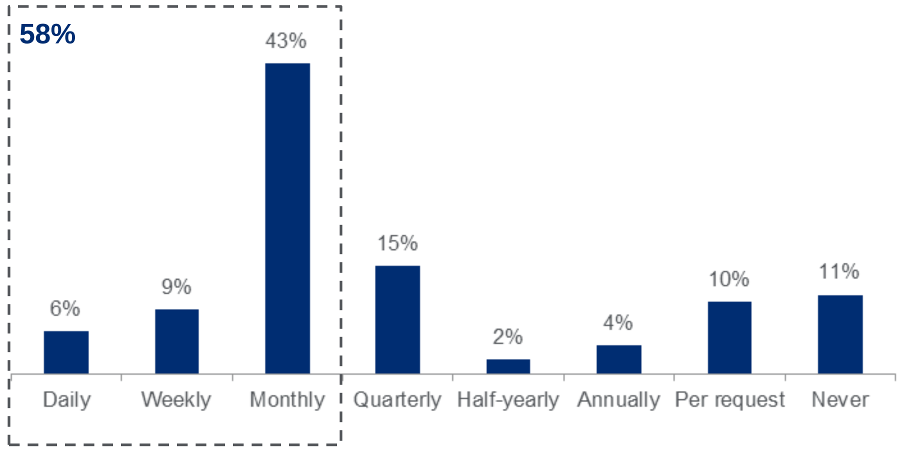
Approach to Hedging Forecasted Exposures



Proportion of Forecasted Exposures Hedged



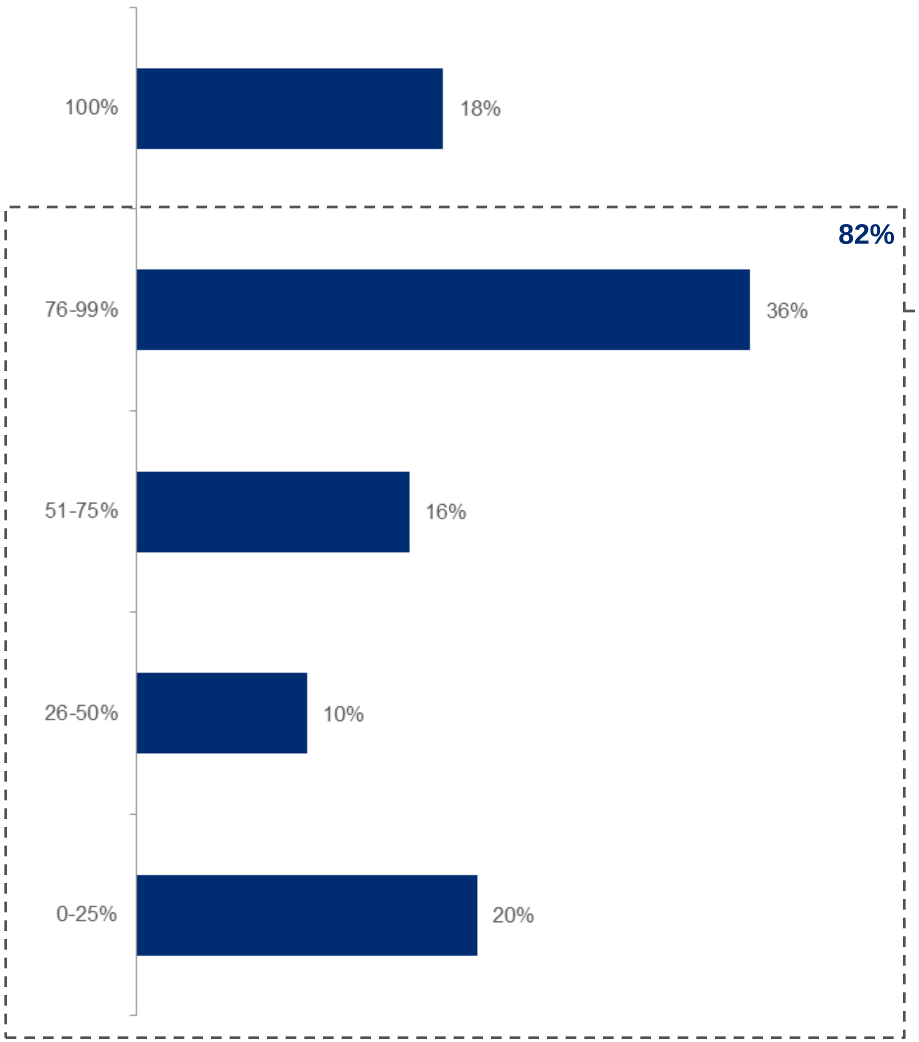
Frequency at which Hedging Performance is Analysed



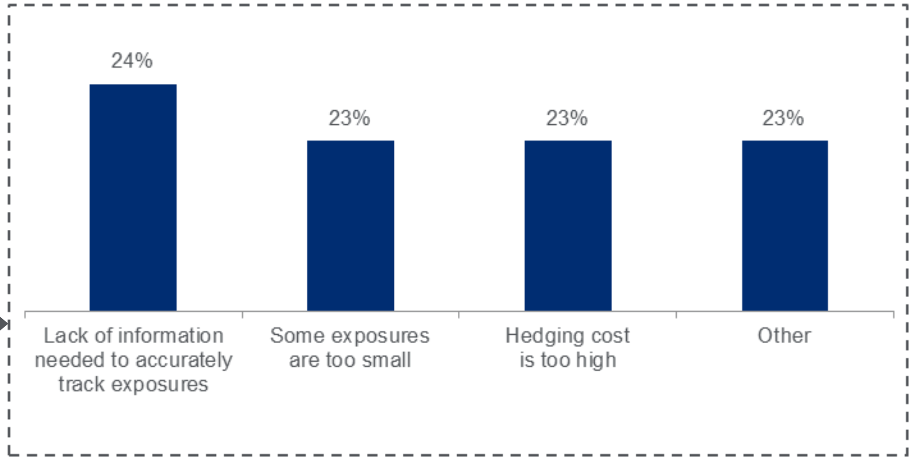
Note: Sum of percentages may be greater or less than 100 percent due to multiple-answer questions

FX Translation Risk

Percentage of Net Monetary FX-Denominated Assets and Liabilities Hedged



Reasons for Hedging Less Than 100% of Existing FX-Denominated Assets and Liabilities

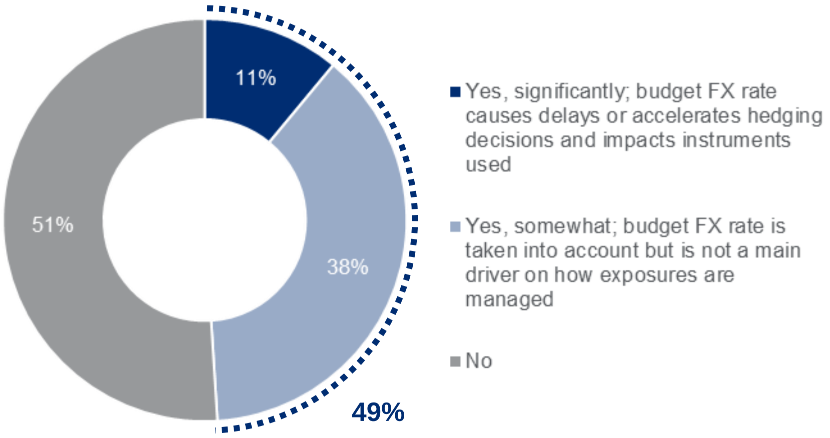


82% of companies reported hedging less than 100% of net monetary FX-denominated assets and liabilities. Apart from costs, another commonly cited reason for hedging less than 100% of existing FX-denominated assets and liabilities was the difficulty in accurately tracking exposures.

Note: Sum of percentages may be greater or less than 100 percent due to multiple-answer questions

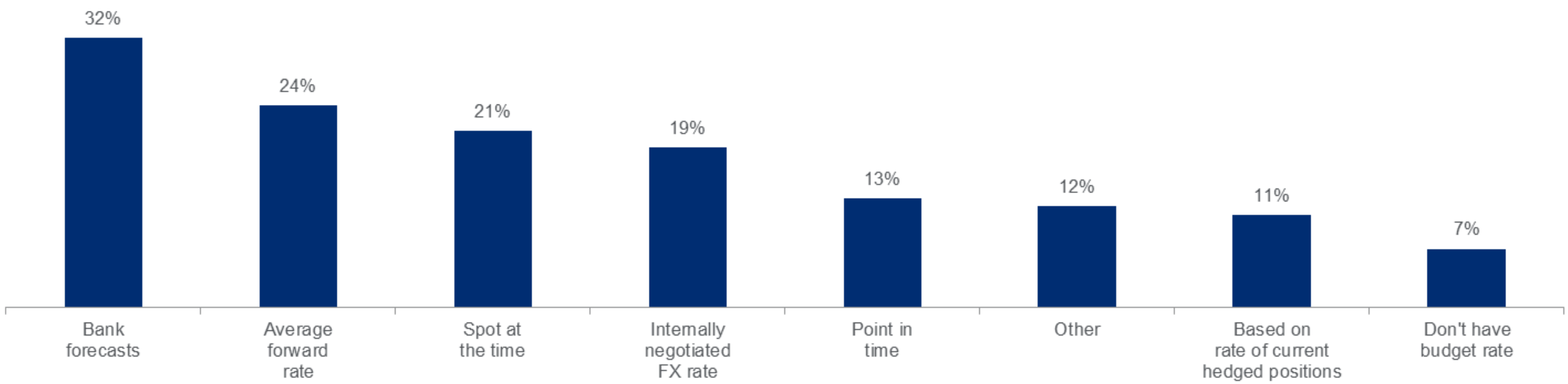
FX Budget Rates

Impact of FX Budget Rate on Hedging Decisions



Nearly half (49%) of corporates surveyed reported that FX budget rates impact corporates risk management decision making and hedging practices. In determining FX budget rates, multiple data points are utilized, with bank-provided rates being the most popular.

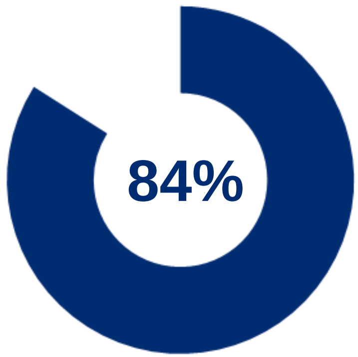
Approach to Determining FX Budget Rates



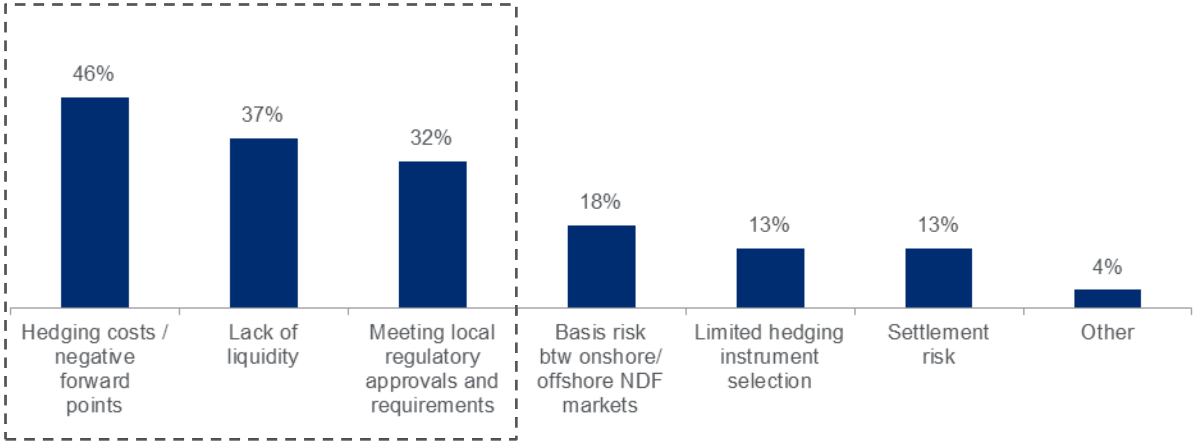
Note: Sum of percentages may be greater or less than 100 percent due to multiple-answer questions

Emerging Market Risk

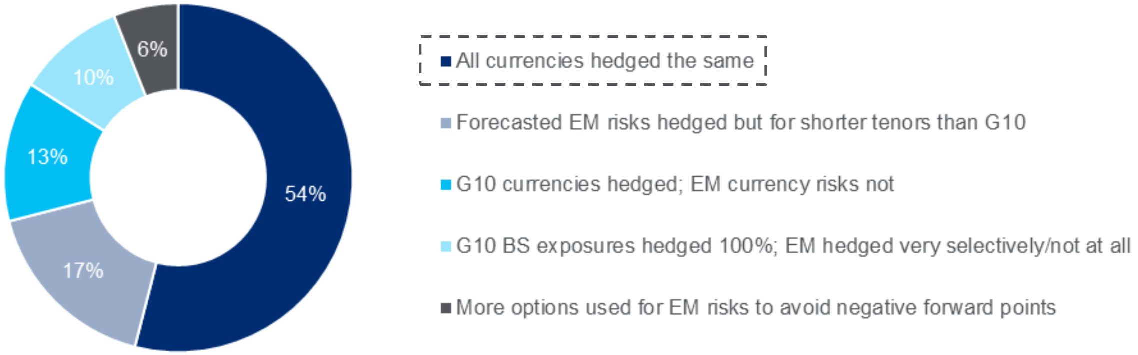
Percent of Respondents with Exposures to Currencies Outside the G-10 Currencies



Emerging Market Currency Risk Management Concerns



Hedging Approach to Managing Emerging Market Currencies

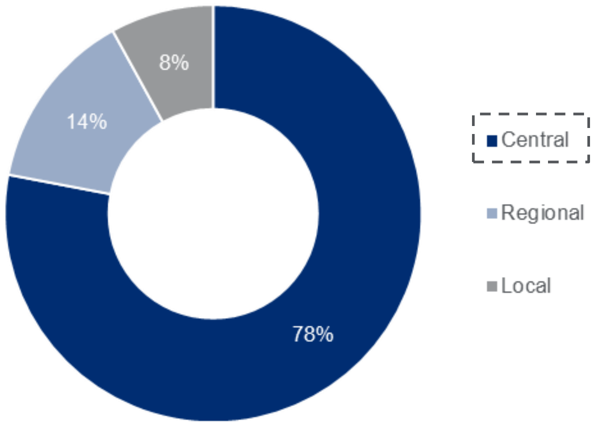


While 84% of respondents reported having exposures to currencies outside the G-10, over half (54%) of corporations reported using the same approach to managing EM and DM currencies. Costs, market liquidity, and local regulatory considerations were cited as the primary concerns when managing EM currency risk.

Note: Sum of percentages may be greater or less than 100 percent due to multiple-answer questions

Centralization of Risk Management

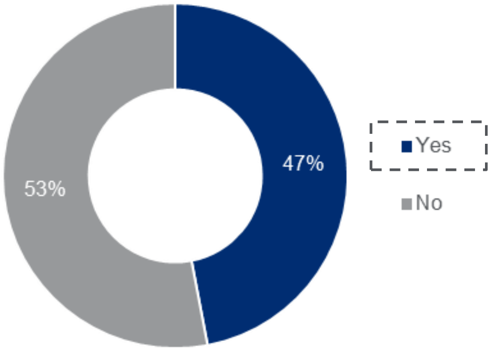
Level at Which Risk is Management



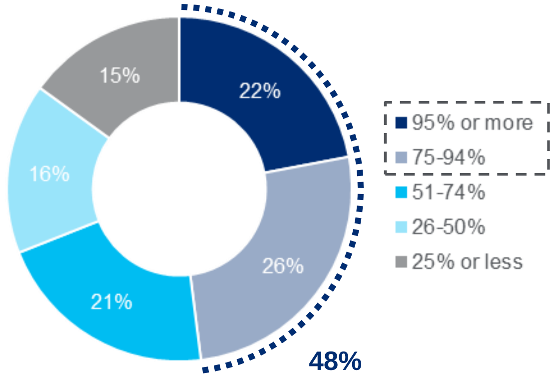
Most of the companies surveyed (78%) reported managing risk on a centralized basis and do so utilizing constructs such as netting, in-house banks, and shared service centres.

With less than half (47%) of respondents having reported implementing an intercompany netting process, netting exposures across entities as a natural risk management technique appears to be a missed opportunity among a number of corporates. Even among those that do, only 48% include more that 75% of intercompany flows in their netting system.

Implementation of Intercompany Netting Process

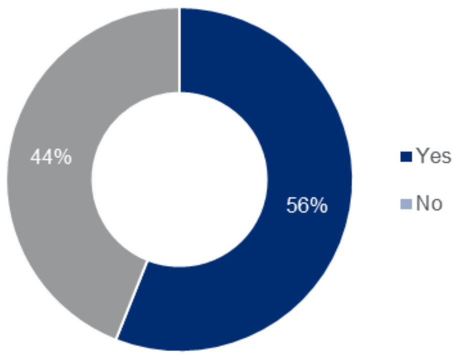


Percentage of Intercompany Flows Participating in Netting System

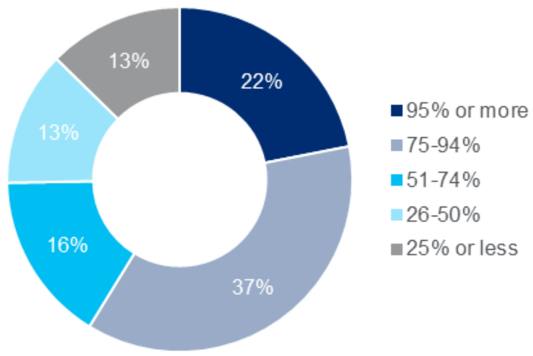


Centralization of Risk Management (cont.)

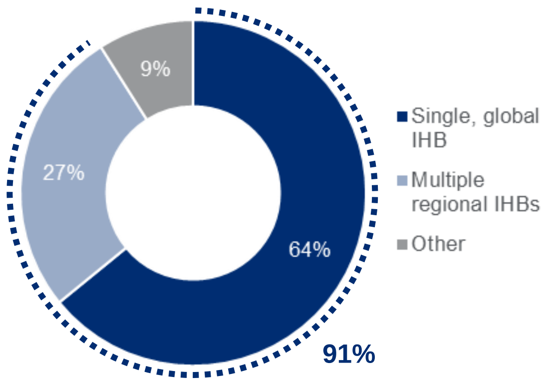
Use of In-House Bank



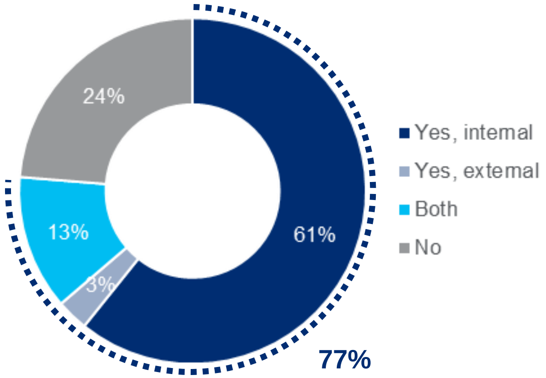
Percentage of Intercompany Flows Accounted for by In-House Bank



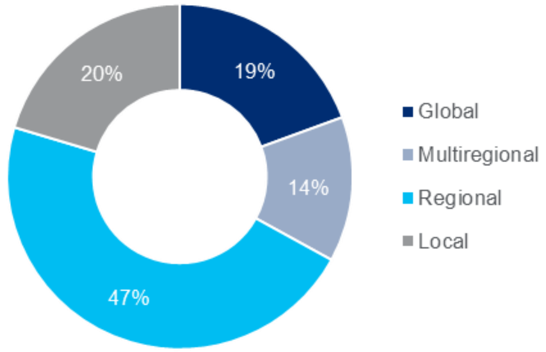
In-House Bank Construct



Use of Shared Service Center(s)



Scope of Shared Service Center(s)

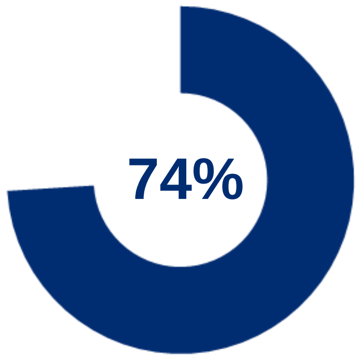


Corporations continue to deploy various constructs to achieve greater centralization and more effectively manage risks. Over half (56%) of companies reported using an in-house bank, 91% of which did so on a global or regional basis.

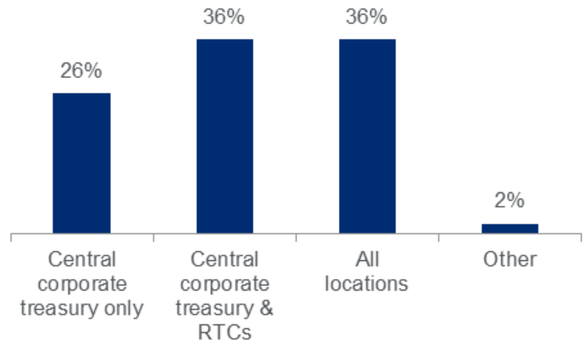
Technology

Technology

Companies Using Treasury Management System (TMS)) or Enterprise Resource Planning (ERP) Treasury Module

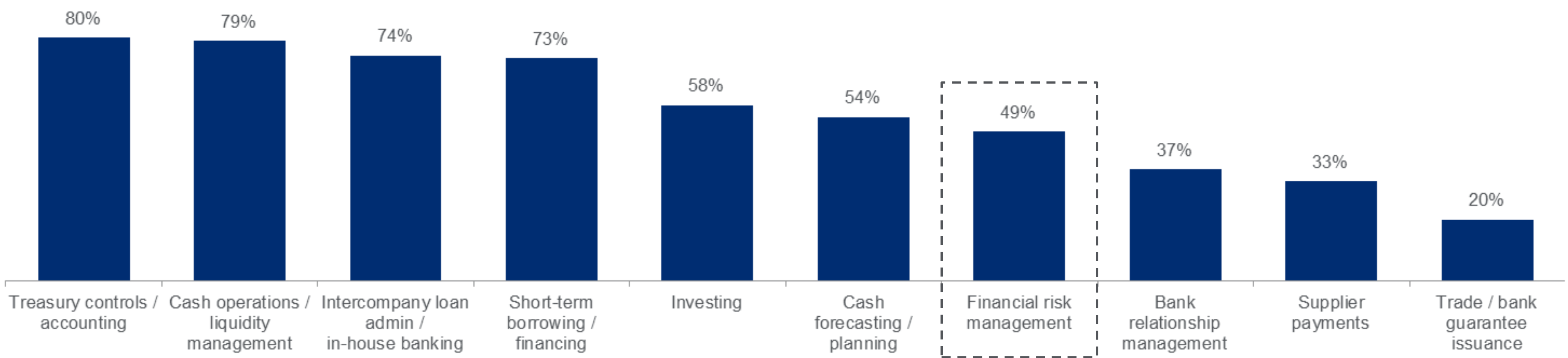


System Access



Despite nearly three-quarters (74%) of respondents reporting using a TMS/ERP treasury module as well as the increasing recognition of technology as an important enabler to meeting risk management objectives, over half (51%) of survey participants reported that their treasury management system (TMS) does not support financial risk management processes.

Processes Supported by TMS or ERP Treasury Module



Note: Sum of percentages may be greater or less than 100 percent due to multiple-answer questions

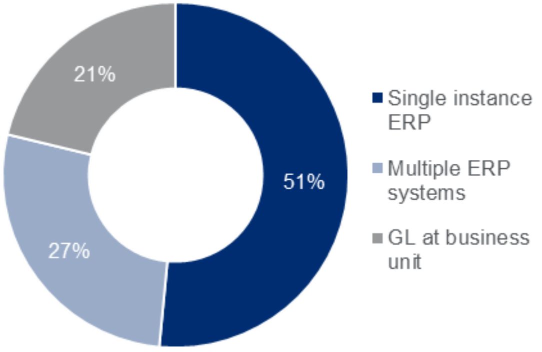
Technology (cont.)

An area where corporations have seen success has been in addressing shortcomings in connectivity. 86% of companies reported having a treasury system that interfaces with corporate and legal entity ERP and general ledger systems in some capacity. A further 78% reported that their systems (e.g., TMS, ERP, general ledger (G/L), etc.) integrate with bank systems for purposes of transaction processing and account uploads.

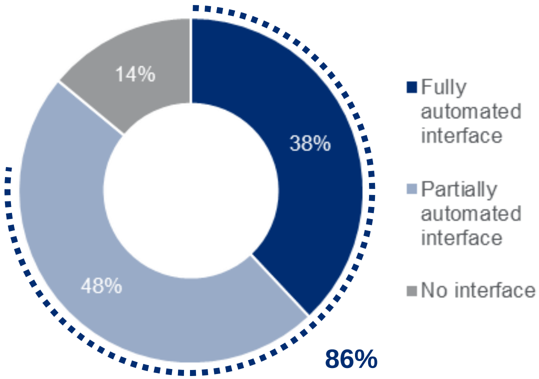
"Technology continues to be a core priority within treasury going forward."

– European multinational CTD participant

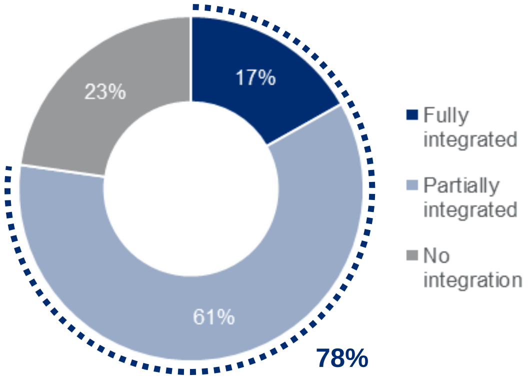
ERP Consolidation



Treasury System Interface with ERP/GL



Integration with Bank Systems



citi®