Case Study 2

2.3.1 Kingspan plc

Hedging Policy and Exotic Derivatives Exercise[1]

Unit:	Study Unit 3 – Strategic Treasury Solutions
Case:	Case 2 – Treasury evolution
Date:	1 September 2016
Summary:	Exam-style questions examining Kingspan's policies and procedures for managing FX risks, together with implementation issues.
Key words:	risk, foreign exchange, foreign exchange, option, hedging

Question 1

a) Comment on the FX exposures faced by the company at the 2016 year end, recording any assumptions you make.

Student notes

Consider:

- transaction (economic) and translation exposures
- use the risk management framework to identify, assess and evaluate Kingspan's FX exposures and current hedging

b) Based on your answer to question 1 a) above, **briefly** comment on Kingspan's hedging policy.

Student notes

Consider:

- rationale for hedging policy
- transaction (economic) and translation exposures
- any anomalies

[1] Post your responses to the various questions and discuss your thoughts and responses in the Case study 2 forum in light of the answers posted by fellow group members and the model answer released by the tutors. You are expected to post during the Case study 2 timeline – see course site U3/Case 2 for dates.

Question 2

Kingspan is open to option-based hedging, so long as instruments conform to policy (ie "reduce risk exposure positions") and are understood by the Board. Options are permitted instruments under Kingspan's policies, and average rate options ("ARO") are expressly referred to in the Foreign Exchange Translation Risk Management policy but only with regard to translation exposure.

Discuss the advantages and disadvantages of Kingspan using average rate options to protect the translation exposure to non euro earnings. Could they be useful in protecting transaction risk as well?

Student Notes

Consider:

- What an ARO is and the main differences to a vanilla option.
- How ARO strikes can be constructed.
- Brief comparison of AROs with Average Strike options (ASOs), vanilla option strips and outright FX for managing FX risk (NB A detailed discussion of option strips is included in Question 2).
- Typical applications for AROs.
- How Kingspan could use AROs to hedge income – advantages and disadvantages of AROs for doing so.