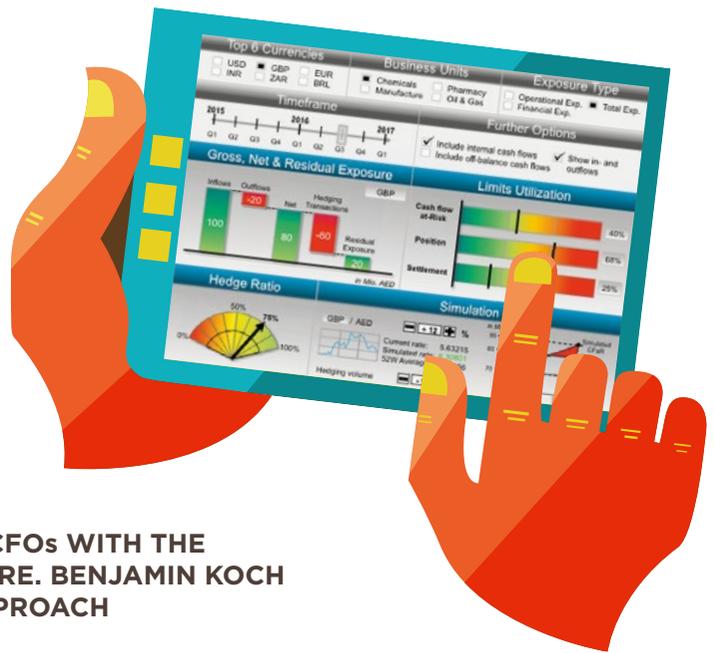


A watchful eye on currency risks



GOOD FX RISK MANAGEMENT MEANS PROVIDING CFOs WITH THE TREASURY REPORTING INFORMATION THEY REQUIRE. BENJAMIN KOCH AND ACHIM KREUZER SUGGEST A DASHBOARD APPROACH

Generating meaningful reports tailored to the standing management guidelines and decision-making needs of executives presents a much-debated challenge in any organisation. Treasurers in particular feel this challenge, with their roles increasingly shifting towards becoming advisers to their CFOs. One of the most pressing areas for treasurers lies in supplying their CFOs with substantial, yet concise, information on demand.

Evidence from recent years shows a clear trend in best practice, away from lengthy detailed reports towards purpose-built dashboards – making increasing use of real-time information based on new technologies. Clients confirm that, increasingly, they want to use their smartphones and tablets to keep a check on their organisation's financial status and its risk reports.

Currency risk management lends itself perfectly as an illustration of the information CFOs really require in their reports. Four recurring questions prove to be essential in practice.

What is the currency risk position from our operations – and also from our financing and investment activities?

Most CFOs are interested in both the net currency risk exposure from operations as well as its major components. The latter provides insights on the source and distribution of currency risks by business unit, currency, maturity and type of cash flow. The structure and the level of detail of the information should be designed according to their relevance to

management guidelines and individual recipients' preferences. For instance, limiting the report's overview to the five to seven most relevant currencies may be sufficient, depending on the underlying business environment.

Which measures in line with management guidelines have been taken and how did these influence the currency risk position?

Currency risks that are not eliminated through netting or a natural hedge are subject to measures in line with management guidelines that need to be consistent with the currency risk strategy in place. While hedging details, such as the specifics of the applied derivatives, appear to be of little interest to CFOs, two directly resulting KPIs are highly recommended for inclusion: the hedge ratio as well as the ultimately remaining currency risk position.

Are we within the predefined limits?

Currency risks from operating and financial cash flows and, in particular, from derivatives used for hedging constitute a significant risk of losses. Implementing an effective limits framework is paramount. Any breaches of those limits must be reported up to CFO level and should form part of exceptions reporting. Effective limits are best defined so as to be closely aligned to financial strategy and corporate risk orientation. In the case of portfolio-based risk steering, for instance, an effective CFaR limit can be of high relevance for CFOs in addition to the more standard position limits and settlement limits.

What effect would changing relevant parameters have on our most important KPIs?

Even though the predictability of currency exchange rates is seen as a controversial issue in academia, it is crucial to consider potential rate changes and anticipate their likely impacts. Simulations and sensitivity analyses support the CFO when it comes to estimating the effects on core KPIs, resulting from personal expectations as well as worst-case scenarios for rate changes. Consequently, significant value can be added to the CFO's FX dashboard by incorporating simulations. One frequently applied example is the simulation of CFaR under varying exchange rates.

In conclusion, CFO and treasury reporting can be significantly improved, taking into account newly emerging best practices. A company-specific design, based on individual requirements, however, should never be sacrificed.



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