



Simply Treasury

WHITE PAPER

FOCUS

**DYNAMIC FX MANAGEMENT
IN A FAST-MOVING ENVIRONMENT**

SPOTLIGHT

VOICES OF THE INDUSTRY

COMPLEXITY

"Foreign Exchange exposures management remains essential in an extremely volatile economic context to preserve our business margins."

Marc Pescarolo, FERRERO

MANUAL PROCESSING

"We notice that among our community, a lot of peers have still heavy manual processes around FX management."

Benoît Hamar, EUROFOIL

VOLATILITY

"Although we have always faced market fluctuations, the current health crisis has exacerbated the volatility, which can have deep P&L impacts if not properly hedged or monitored."

Fabrizio Dicembre, 3Ppark

REPORTING

"Effective reporting on FX management (i.e. financial and accounting/IFRS) requires ad hoc IT tools and often more than what TMS's are proposing."

François Masquelier, EACT



François
Masquelier

Chairman of Luxembourg Treasury Association,
ATEL and Vice-Chairman of EACT

INTRODUCTION



When we address the FX management, it is interesting to remind that FX risk has been identified by PwC in its EU survey as third priority risk in 2017 & 2019. It demonstrates that this risk remains high on treasurer's top challenges.

As rightly said by a former CFO of Microsoft, "the FX is the hardest job in finance". For corporate treasurers it is obviously also essential. Foreign Exchange (i.e. FX) is, above all, an operational risk.

FX calculation, accounting and management will depend on three main factors: (1) people, (2) processes and (3) IT systems and solutions.

These three important elements are often missing in finance teams. All Heads of Treasury complain about lack of human resources. FX processes are highly manual and too often EXCEL-based and even if they used sophisticated Treasury Management Systems or FX platforms, they do not have appropriate functionalities for automating processes and produce reports.

FX management is also complex because of the lack of visibility on how to identify and to report risks at subsidiary level, the automate reporting of such risks and allocate hedges to underlying to track net exposures, their quantification and (planned) timing of in/out-flows. In a post-COVID period, the relevance of forecasts is even more complicate given number of uncertainties around solvability of customers, delay in deliveries caused by lockdowns, etc...

Time is becoming a real issue in FX management. With current volatility and high intraday volatility, any delay can cause huge P&L impacts".

"Raison d'être" of treasury function reinforced by the health crisis. The COVID health crisis was a perfect example to illustrate the "raison d'être" of treasury. Treasurers should reposition treasury within finance department, as it is key. But a way to do so could be to revisit and revamp FX management strategy.

IN SHORT

FOREIGN EXCHANGE

Forex markets daily turnover

6,6
TRILLION USD

FX market is the only financial market in the world to operate

24
HOURS A DAY

It comprises
170
different
currencies

USD is on one side of
88%
of all forex trades

7 currencies pairs make up
68%
of the forex markets trading volume

Largest centers are



One pip worth's roughly
88\$
PER MILLION



“ Adopting a more dynamic and automated solution for FX management generates value. ”

(Source: CompareForexBrokers - Justin Grossbard)

Toni Rami (KANTOX):
Dynamic Hedging



INTERVIEW

Do you think that there are opportunities for partnership between banks and Fintech's, for example on improving FX management?

Yes. We are a living example of that with our BNP Paribas and SVB partnerships. Many banks understand the needs of the corporates they serve, by providing upgraded technology to support those corporates as well as themselves in the digitalization journey. In the area of FX management this is particularly relevant, since the only automation that has taken place here is

“ The benefits here lie in three dimensions: Cost, risk reduction and growth. ”

the possibility of serving customers through a SDP or MDP thus only supporting the strict trade execution part of the workflow. By having a different perspective, some banks have realized that the real need of the corporate is to streamline the entire end-to-end process. Banks have a massive client portfolio and are perceived as trustworthy enterprises with whom to do business with. However,

It is these factors which act as the main challenge to overcome for many fintech solutions. These partnerships make it much easier for the client to make decisions and embark on the digitalization journey.

How would you explain the concept of “dynamic hedging”?

Dynamic Hedging is the product Kantox has built and will continue to build on so corporates can fully automate the workflow of managing currencies. We have engineered a product that will ‘vacuum’ all the FX exposures that a corporate has as soon as they arise (e.g. forecasts, firm commitments, balance sheet items). We can do this from any system where this information might be located (ERP, TMS, sales order system...) and from as many entities/subsidi-

aries this can be generated from. Through this process, Dynamic Hedging sets up the necessary processes to maximize data quality on which the hedging will be executed. In short, it enables exhaustive, timely, granular, and validated exposure capturing. In parallel, to have all these exposures retrieved, Kantox's Dynamic Hedging will enable any corporate to construct their ideal hedging program through the configuration of a few simple rules. This ranges from the simplest rolling, layering or micro-hedging program, to the most elaborate such as dynamic layering, which help companies minimize negative carry combined with balance sheet programs. This enables companies to eliminate the risk of not adhering to the defined policy, as well as massive time savings, full traceability, and governance over the topic.

Do you think that a revisited FX management (i.e. more automated, centralized, and dynamic) can bring added value to the operating businesses?

Of course. The benefits here lie in three dimensions: Cost, risk reduction and growth. In general, we can see by automating these processes; companies can turn something that is usually perceived as a burden to be managed by the treasury team into an advantage. This result is increased sales, higher margins, and above all, a more robust company that will not suffer from currency volatility no matter how internationalized it is.



CHALLENGES

- The absence of technology is classic and usual problem faced by treasurers. Even with Treasury Management Systems, treasurers must often have recourse to additional tools, applications, or spread-sheet developments. Some IT vendors have bought solutions to complement their treasury suite. FX management remains, in general, too EXCEL dependent, not robust enough and error prone.
- Uncertainties around businesses and reliability of cash-flows in currencies
- The economic context is changing faster and faster.
- Political risks also increased last years. Therefore, the currencies fluctuation has also increased significantly over last months. It remains a "classic" but prime risk for corporates to manage.
- The impact of swap points (depending on your position) with certain currency pairs may affect the price, increase costs of hedging or simply be a stop.
- Difficulty to monitor open positions (if any) e.g. when differential of interest is too large or tenor too long.
- Absence of perfect coordination and gaps between exposure and hedging (lack of communication may appear with home-working).

WHAT ARE THE TOP PRIORITIES OF TREASURERS TODAY?

WE CAN IDENTIFY 4 MAJOR ONES:

1. Liquidity management and funding,
2. Working capital optimization,
3. Cash-flow forecasting accuracy and eventually,
4. FX exposure management.

They are all interconnected. The crisis crystalized the demand for a more dynamic and automated management of treasury and more specifically of FX hedging. Treasurers are there to ensure liquidities, to guarantee outflows execution and protect margins against FX fluctuations. By a proactive management, treasury can become a "revenue protector", to play a more strategic role as stakeholder, to be a partner of the operations, giving if possible, a competitive advantage to business operations.

HEDGING OR NOT HEDGING, THAT IS THE QUESTION?

We should accept that not hedging is not an option. Markets become more/too volatile since the COVID crisis (e.g. trade wars transformed into budget wars, liquidity issues, USD challenged as world reserve currency, low interest rates in all major currencies, uncertainties consequences of health crisis, etc...). Many reasons to think it will continue and accelerate in future with daily larger corridors of fluctuations. It requires a smarter approach to be successful and add value to dynamic and automated FX management. The good news is that there are solutions and if effectively use, treasurers can even add value to FX hedging if done properly.

TAKE AWAYS

HOW TO PROTECT BETTER MARGINS AND IMPROVE COMPETITIVENESS?

In low margin businesses to give competitive advantage to operations is fantastic. Margins are so low that FX movements can kill the whole operating margin. You can build on technologies and leverage to optimize your FX management. But you need solid forecasts and a robust solution, including automation to free up time of teams and reduce risks of errors, while reinforcing internal controls. The discipline and respect of strategy is critical. You have today an opportunity to revisit and revamp your FX management. Outsourcing is a solution to compensate absence of resources, processes, and systems. There are many factors to optimize FX management: Fluidity of data exchanged, good knowledge of processes and underlying businesses (often not understood by finance people), identification of natural hedges if any, process automation to simplify tasks and agile tools to refine hedges and to continuously adjust positions which will fluctuate. As you can see, it is a major risk (and it is bad news) but there are solutions (and that is the good news). It may be time to revamp your FX management and to implement IT solutions to automate all processes and adopt a dynamic management to generate added value to operations.



Simply Treasury

Francois Masquelier

Phone +352621278094

Email francois@simplytreasury.com

Address Résidence Soho NY (4A52)

1 rue de Chiny

L-1334 Luxembourg