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Continued evolution
2016 Global Foreign Exchange Survey

Contents

Executive summary

Deloitte Global Treasury Advisory is pleased to share its first Global Foreign Exchange survey

The survey was crafted in response to the high recent profile and impact of Foreign Exchange (FX) on businesses. In 2015 alone, the surge in the US Dollar wiped billions off earnings of US organisations; material currency shifts surprised financial markets (ranging from the Swiss Franc in one direction to emerging market currencies in the other); and the decision to include the Chinese Renminbi in the SDR bucket from October onwards also reflects further progression in the currency markets. Furthermore, FX rates impact corporate transactions with the strengthening of the US Dollar having fuelled increased cross-border M&A activity for the US corporate sector (Deloitte M&A Index, 2016: Opportunities amidst divergence).

2016 is expected to exhibit similar levels of uncertainties, with different expectations around interest rate policies, quantitative easing removals, potential depegging of some currencies and other actions by global economies all driving FX volatility. Increased currency risk can have a direct impact on reported profits and on cash through the taxation of unrealised FX, even on intra-group transactions, and more generally, the forthcoming changes to global tax rules under the OECD's Base Erosion and Profit Shifting ("BEPS") initiative could impact on the financial implications of centralised FX hedging activities.

Corporates' ability to manage currency risk effectively will therefore continue to be tested. Boards and CFOs need to be comfortable that currency related value erosion is avoided and where necessary challenge their treasury teams to address some of the identified hurdles.

The survey provides insight into the challenges corporates encounter when managing currency risk and possible causes (and solutions) for these challenges, as well as FX risk management structures, strategies and processes adopted by corporates across the globe. Key findings are summarised below.

Treasury challenges

Lack of visibility over FX exposures and of reliable forecasts, and the manual nature of exposure quantification is a challenge for nearly 60% of respondents. This challenge is pervasive throughout the survey, from the many sources of FX exposures in organisations, to the existence of largely manual forecasts and exposure collation processes, and the under-utilisation of treasury systems in the FX management processes.

Without accurate measurement, risks cannot be managed effectively and hence value erosion from negative currency rate movements cannot be minimised. Organisations should prioritise appropriate investment to improve and automate exposure capture and analysis processes.

The Board Agenda

The survey suggests that Boards do not always receive sufficient information in relation to FX risk. Executive management could challenge their treasurers more to better understand the impact of FX risk hedging strategies on profit margins and EPS; why only 11% of respondents manage year on year performance and predictability; and why opportunities to minimise exposures through the use of netting and natural hedging techniques are only explored by around half of the respondents.

Treasury structures

FX risk is predominantly managed via a central structure with 93% of respondents using a centralised treasury or in-house bank model, sometimes complemented by regional treasury centres. Organisations with centralised models report a higher number of benefits and fewer challenges than those with a decentralised model, although those benefits and challenges reported are similar, suggesting both can work.

Hedging strategies
Hedging strategy objectives are mainly focussed on protecting cash and minimising volatility in income statements. As a result, hedging strategies are primarily centred around monetary balance sheet FX items and FX cashflows, and much less on P&L translation or net asset hedging.

Use of technology
Technology is recognised as an important enabler to achieve efficient and effective processes, yet it appears to be a hindrance for many organisations who still deal with a multitude of source information systems with limited interconnectivity. More than 60% of respondents rely on manual forecasting processes.

A big thank you
Thank you to the companies around the world that responded to our survey online or by interview. Please contact your Deloitte advisory contact for a download about how your company responded or compared to your peer group.

Deloitte's Global Treasury Advisory Services team has emerged as the largest global professional services treasury practice. We offer services across all areas of treasury, covering FX hedging strategies, M&A, strategy, operating model and process transformation, treasury technology strategy, selection and implementation. If this survey resonates with the issues that your company faces, please contact us. Our international contact points are provided on page 18.

Sincerely,

Melissa Cameron
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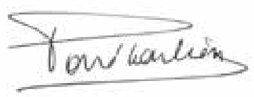
Global Treasury Advisory Services
Principal, Global Treasury Leader



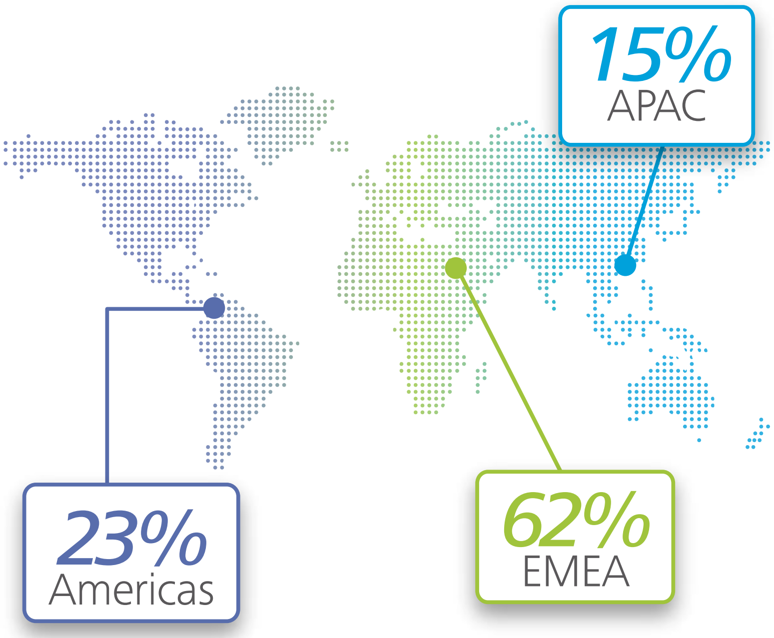
Karlien Porré
Deloitte LLP
Global Treasury Advisory Services
UK Treasury Partner

2016 is expected to exhibit similar levels of uncertainties, with different expectations around interest rate policies, quantitative easing removals, potential depegging of some currencies and other actions by global economies all driving FX volatility.

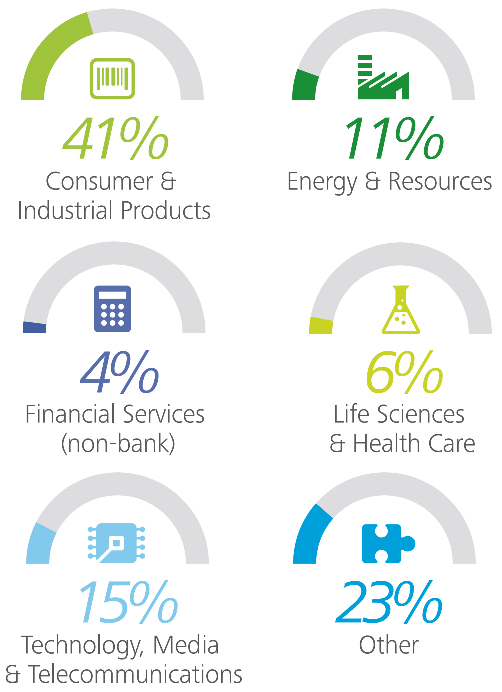
Survey demographics

We surveyed 133 corporations around the globe, representing a wide array of size, geographies and industries.

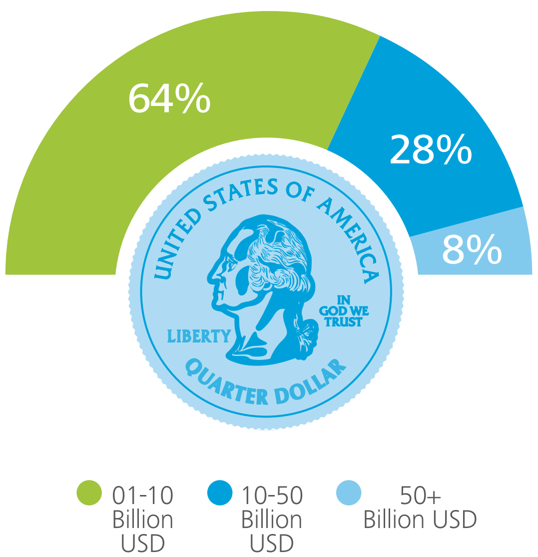
In which region are you based?



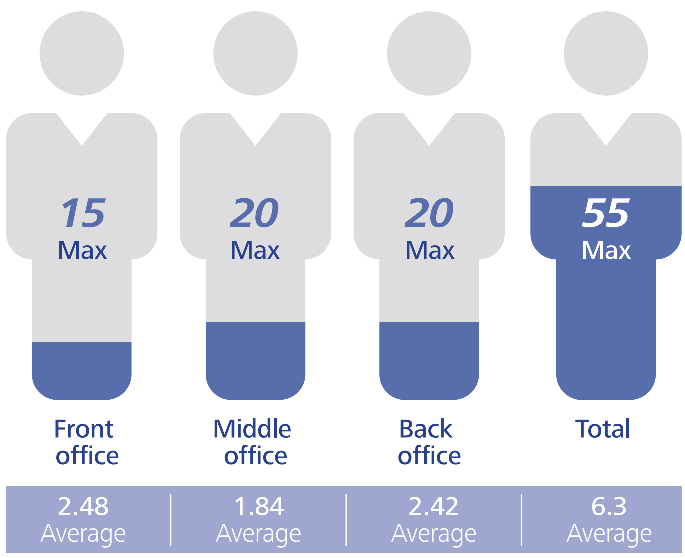
What industry are you in?



Annual revenue



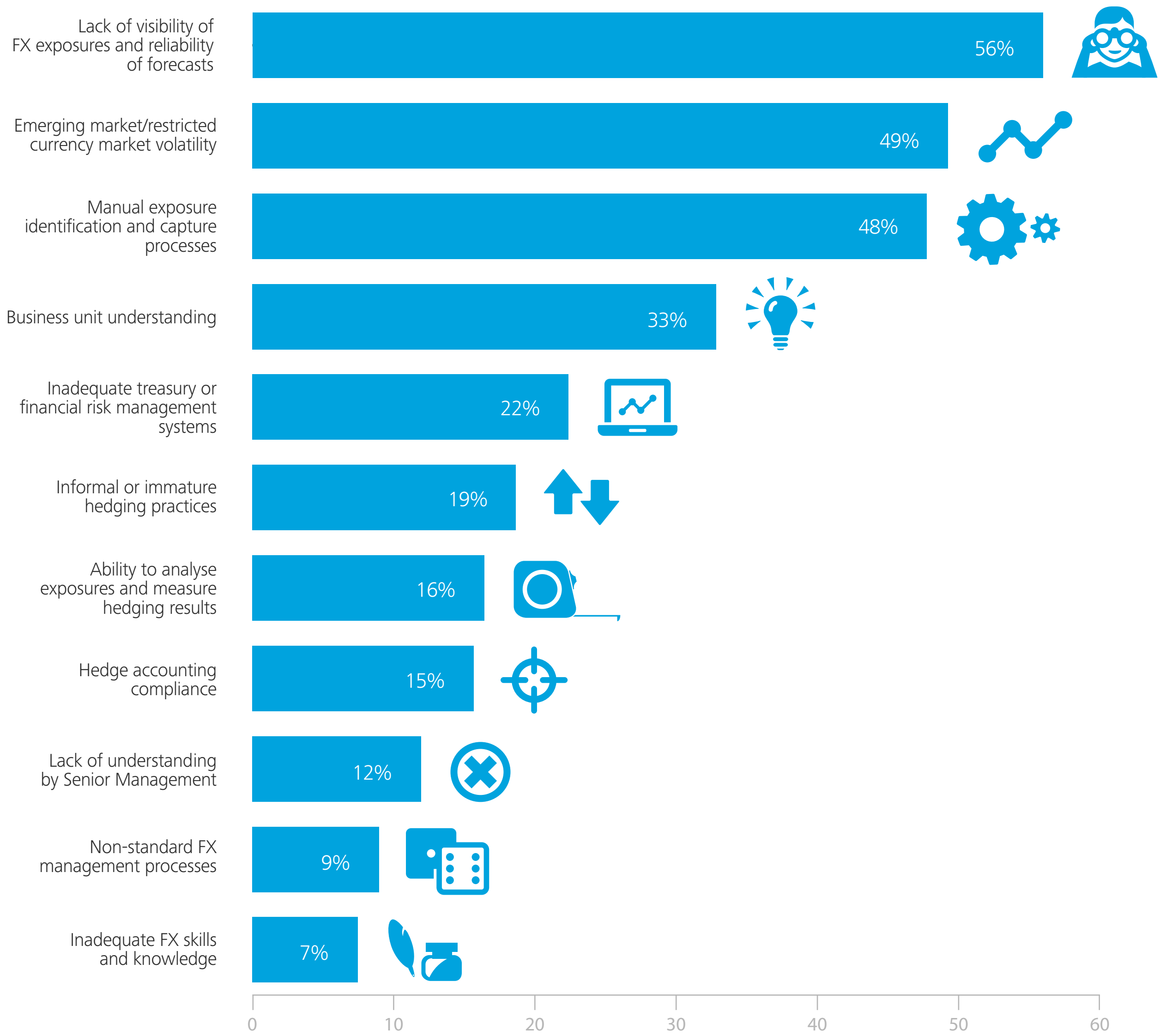
Number of people managing FX risk



Note: This analysis excludes people suporting FX management in the operating entities

Treasurers face various challenges in managing risk

Top three challenges treasurers face in managing FX risk



Lack of visibility of FX exposures and of reliable forecasts is a challenge for nearly 60% of respondents. Without accurate measurement, risks cannot be managed effectively and hence arguably, value erosion from negative currency rate movements cannot be prevented. Hedging ineffectiveness disproportionally increases with inaccurate exposure information and hence organisations who have successful FX hedging strategies are those who have invested in the right exposure identification processes and technologies.

Lack of visibility driven by complexity and inadequate investment in automation

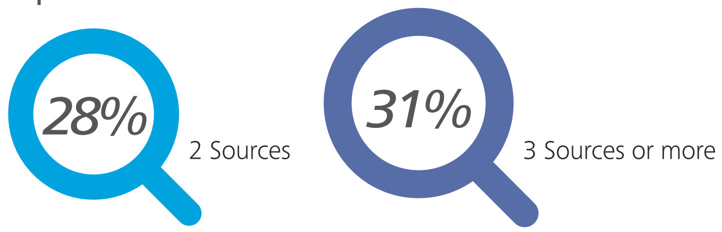
The lack of visibility reflects the complexity of the topic with 31% of corporates relying on three or more sources to identify exposures. Companies therefore need to focus on achieving real time integration of different systems, and data quality and consistency from the different sources, to drive visibility and reduce inaccuracy.

Complexity increases as companies become more global. 50% of respondents operate in more than 20 countries. Treasurers need to impress this complexity on senior management and global teams.

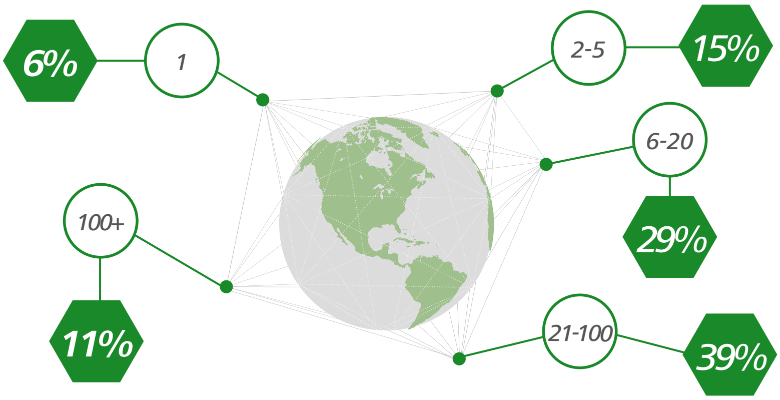
Lack of automation is a contributing factor to the challenges of identifying FX exposures, emphasised by 62% of participants using manual forecasts and 36% having fully or largely manual processes. Manual information and processes cause late and unreliable forecasts, and one could challenge whether the operating entities understand what they need to gather. Unsurprisingly therefore, the survey findings show a direct correlation between levels of automation and confidence in forecasts, demonstrating that investment in tools and technology helps to address the visibility challenge.

Inaccurate forecasts, poor communication on changes in forecasts, and non-transparent exposures constitute the top three sources of ineffectiveness in managing FX risk. FX risk cannot be managed effectively if they cannot be quantified in the first place. Treasurers need to be core members of corporate projects on IT and cashflow forecasting, to ensure their requirements are fully factored in.

Number of sources used to identify and quantify FX exposures



Number of countries the participating companies operate in



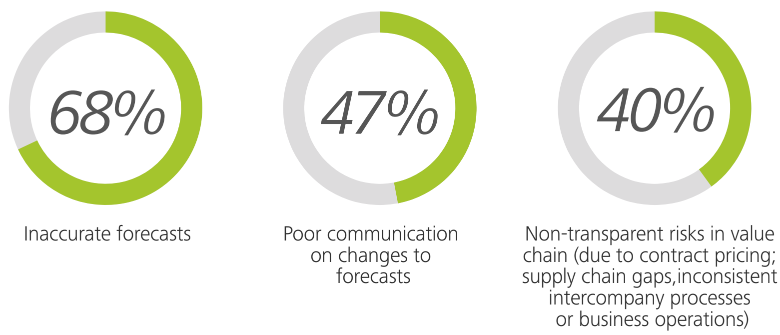
Sources of exposure

Manual FX forecasts received from business units

Exposure identification process

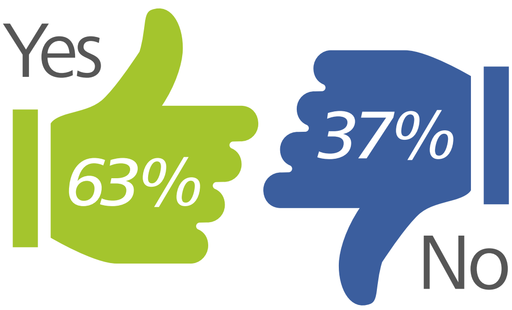
Fully or largely manual processes, based around excel spreadsheets

Sources of ineffectiveness



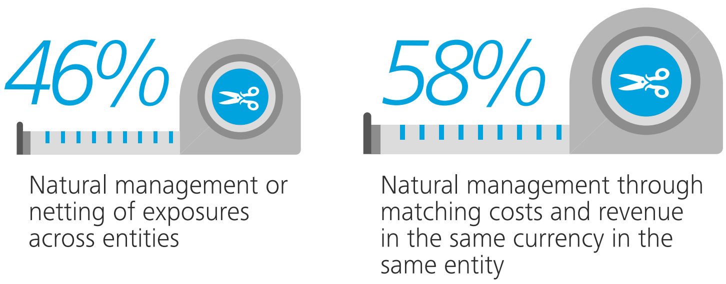
The Board's visibility of FX exposures and therefore their ability to challenge is limited

Are FX exposures and FX risk management performance quantified and reported in a clear manner to senior management and the Board of Directors?



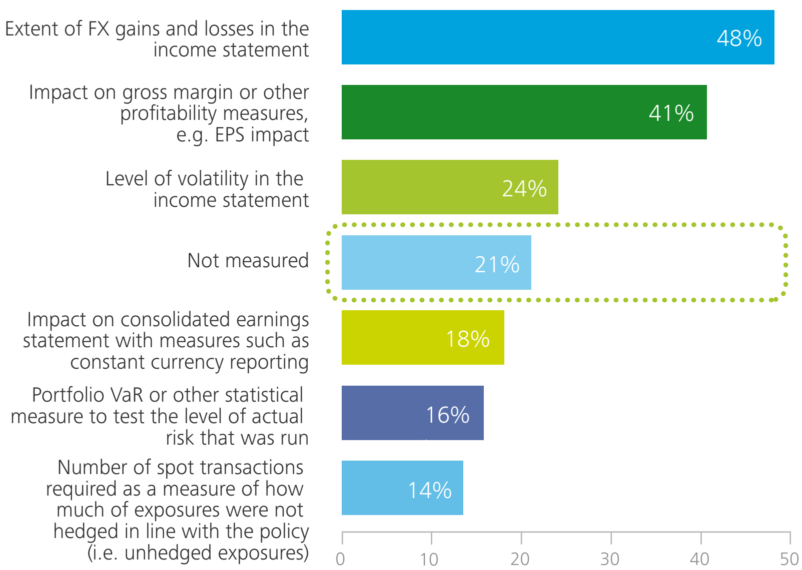
Board visibility is impaired with 37% of corporates reporting that the Board does not receive sufficient information in relation to FX exposure and risk management. This limits the Board's ability to challenge and guide. Treasurers should review their reports and communicate key FX risk metrics aligned to wider financial and strategic measures.

Natural Risk reduction



Boards should challenge their treasury teams over the limited use of natural hedging and netting within their organisations. Currently, only 58% of corporates minimise exposures and hedging cost through natural hedging and an even lower 46% through netting. The question of course arises whether Boards have the visibility to challenge this, and ask key questions such as why gross rather than net exposures are hedged with derivatives, and why commercial teams do not maximise the opportunities to match currencies of revenue and costs; and by how much, as a result, FX hedging costs are higher than they should be.

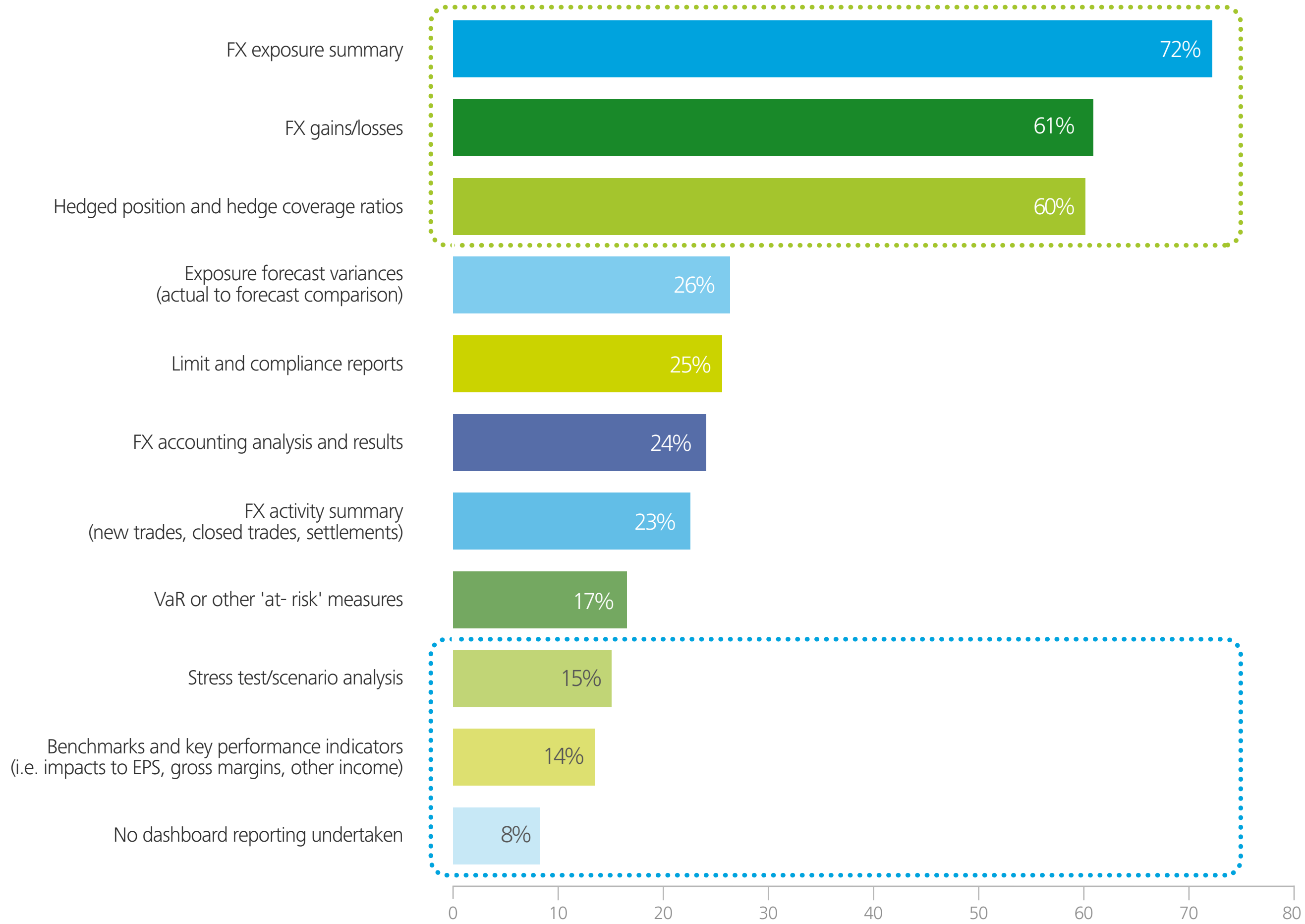
Measurement of commercial effectiveness of FX risk management activities



Boards should also challenge their teams on improved measurement of the effectiveness of FX hedging activities. Crucial measures such as impact on profitability are tracked by less than half of the respondents and 21% do not measure performance at all.

Opportunity to improve reporting to the Board

Key risk management dashboard reports used for the Board of Directors, Risk Committee and/or Senior Management



When reporting to senior management, more than 70% of respondents only report fairly basic metrics such as quantum of foreign exchange exposures, hedged positions and foreign exchange gains/losses.

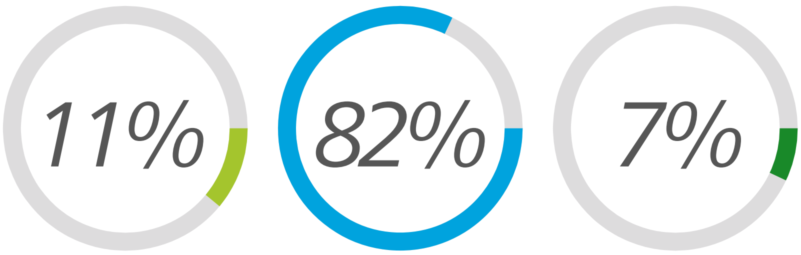
Less than 25% generate more sophisticated information such as performance against key benchmarks, variance analysis, VaR or other at-risk measures, stress tests or scenario analysis.

Treasurers have an opportunity to improve the reporting provided to Boards and senior management by incorporating the more complex underused analysis, as well as improved staple reporting.

Both centralised and decentralised models work

Perceived benefits of operating model

What is your current operating model for managing FX risks?



Central function with regional centres hedging on behalf of other subsidiaries

Central model as part of an in-house bank

Decentralised management by individual units/divisions

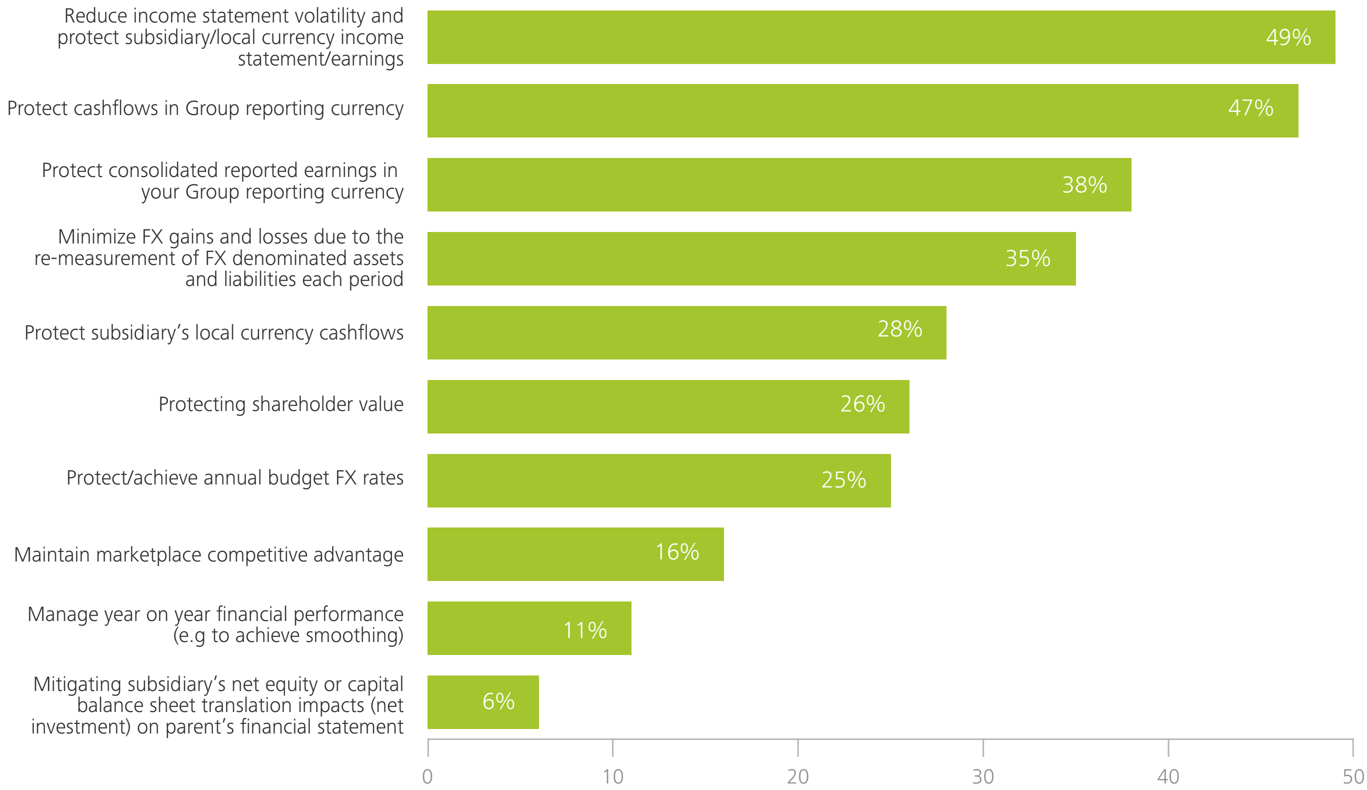
Both centralised and decentralised models appear to deliver increased oversight of FX exposures and clear responsibility as a key benefit of their structure.

Centralised models achieve more benefits overall, but it is noticeable that decentralised models outperform in fostering improved risk management decisions and responsiveness to FX management actions. We expect this results from the increased responsibility placed on operating units, thus generating greater awareness.

Neither model is deemed to be effective in maximising the value delivered to the business, which less than 40% of respondents felt they had achieved. This is somewhat disappointing given the finding in our 2015 Global Corporate Treasury Survey that delivering value to the business was one of the top mandates Treasurers felt they were given by their CFOs. Treasurers therefore continue to try and find the right structure and approach to value creation and optimisation. They need to balance the trade off between having efficiency from centralised operations versus having deep local market knowledge and driving value for the business.

Hedging objectives focus on reducing income statement volatility

Primary hedging objectives



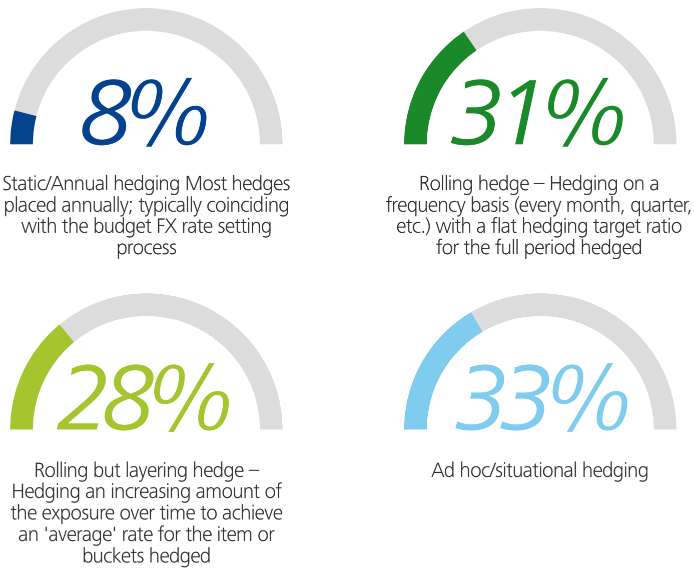
Protecting the income statement (either in subsidiary local currency or Group reporting currency) and consolidated cash flows are key hedging objectives. Low on treasurers' objectives list appear to be protecting balance sheet or net equity translation impacts.

Most hedging objectives focus on protecting discrete periods. Only 11% manage year on year financial performance, which seems to contradict the fact that the majority of companies use rolling hedging programmes. Hedging objectives should arguably not just focus on covering the nearest accounting period, but provide resilience to FX risk in the longer term and thus protect business growth.

Less than a third of respondents claim to focus on protecting shareholder value and maintaining marketplace competitive advantage. However, we know that many organisations are aligning hedging with their commercial strategies, and hence we expect that these low scores reflect the fact that whilst this is not a primary hedging objective, it nevertheless is one factor considered when developing hedging strategies.

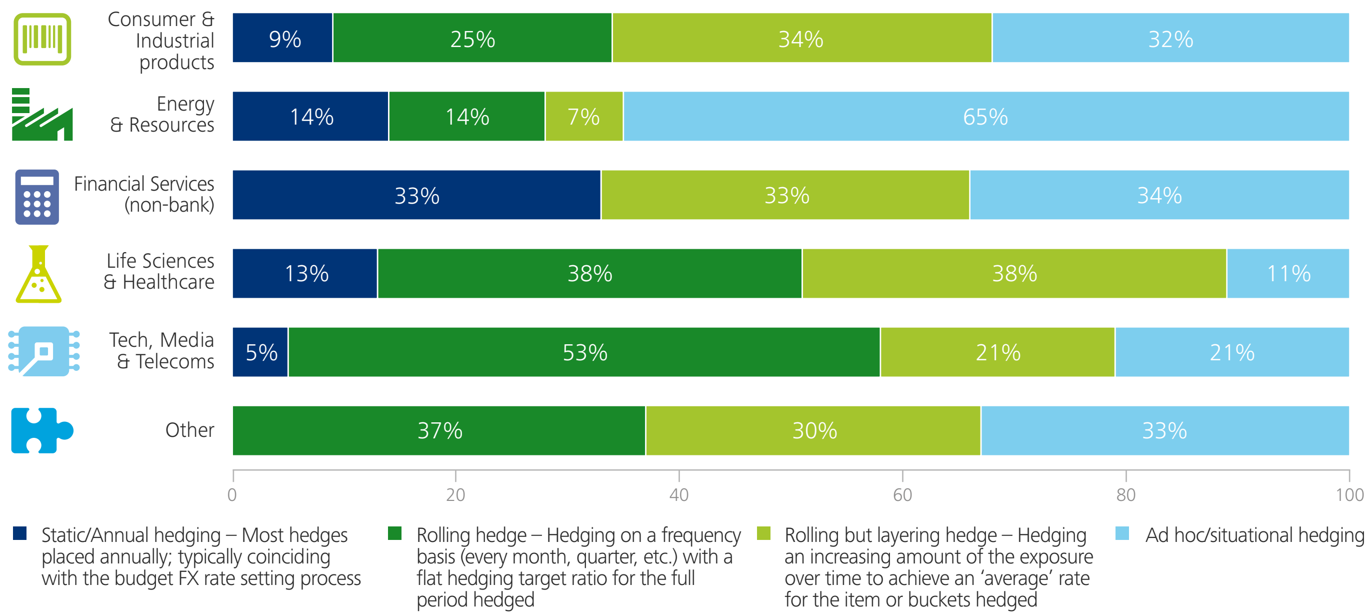
Primary hedging strategies vary by industry

Primary derivative hedging strategy



59% of corporates primarily use a rolling hedging strategy with roughly half incorporating some form of layering (28%) and the balance (31%) using a flat hedge ratio. This majority approach is not a surprise given the benefits provided by a rolling approach including reduced volatility between periods and the continued, rolling visibility of future FX rate achieved.

Primary derivative hedging strategy

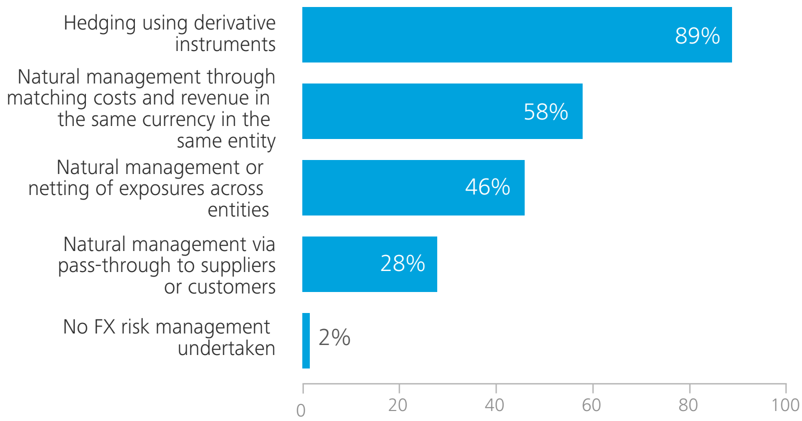


33% follow an ad hoc or situational approach hedging. The ad hoc approach is largely driven by the Energy and Resources industry and the Automotive and Process and Industrial Products (within the Consumer and Industrial Products) where respectively 65% and 32% adopt an ad-hoc hedging strategy. Different approaches clearly reflect the different nature of the business and hence profile of exposures.

Missed opportunities in natural hedges

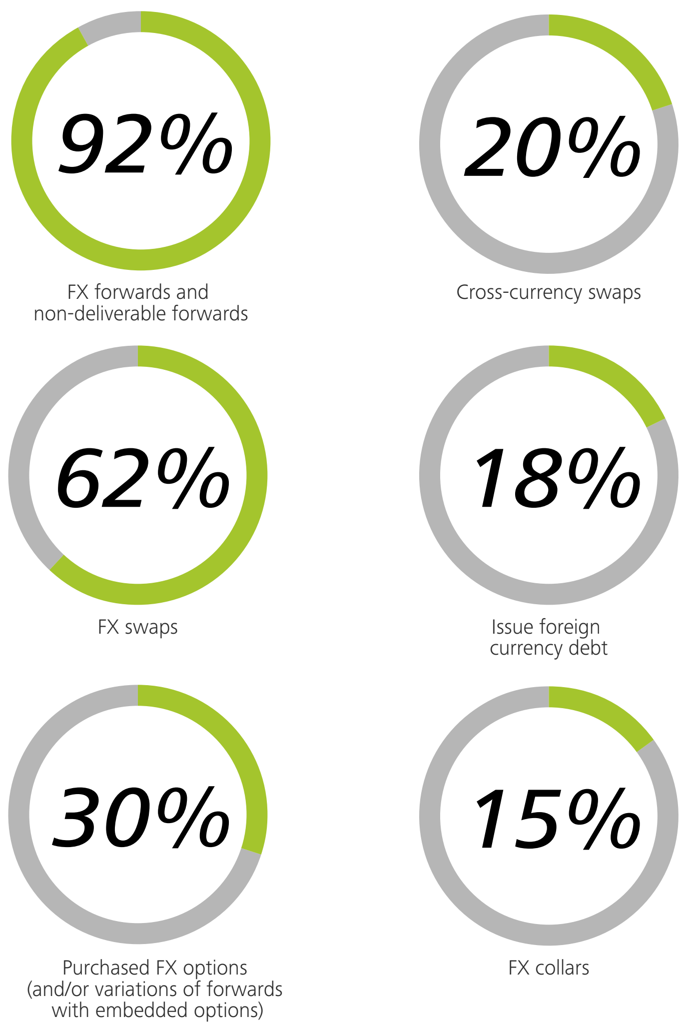
Surprisingly, only around half of respondents use natural risk management techniques such as cash flow netting and exposure matching. As nearly 90% of respondents use derivatives, opportunities seem to exist to increase usage of natural hedging to reduce derivatives related costs.

Risk management approaches used



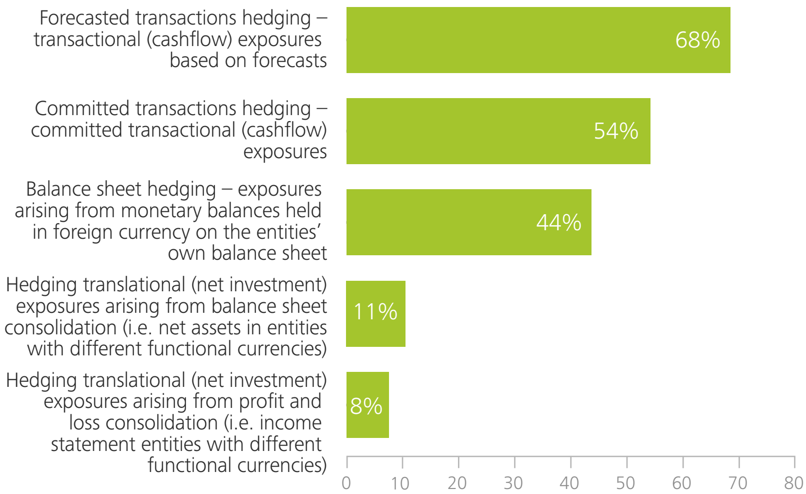
Of those using derivatives, the vast majority use FX forwards and FX swaps. Products such as options and collars are used by only a third of respondents. This is low, perhaps driven by the reluctance to pay premiums or due to the perceived lack of benefits and in-house skills to manage these instruments.

FX instruments used in hedging programmes



The majority of derivatives hedge transaction exposures

Derivative hedging programs currently employed

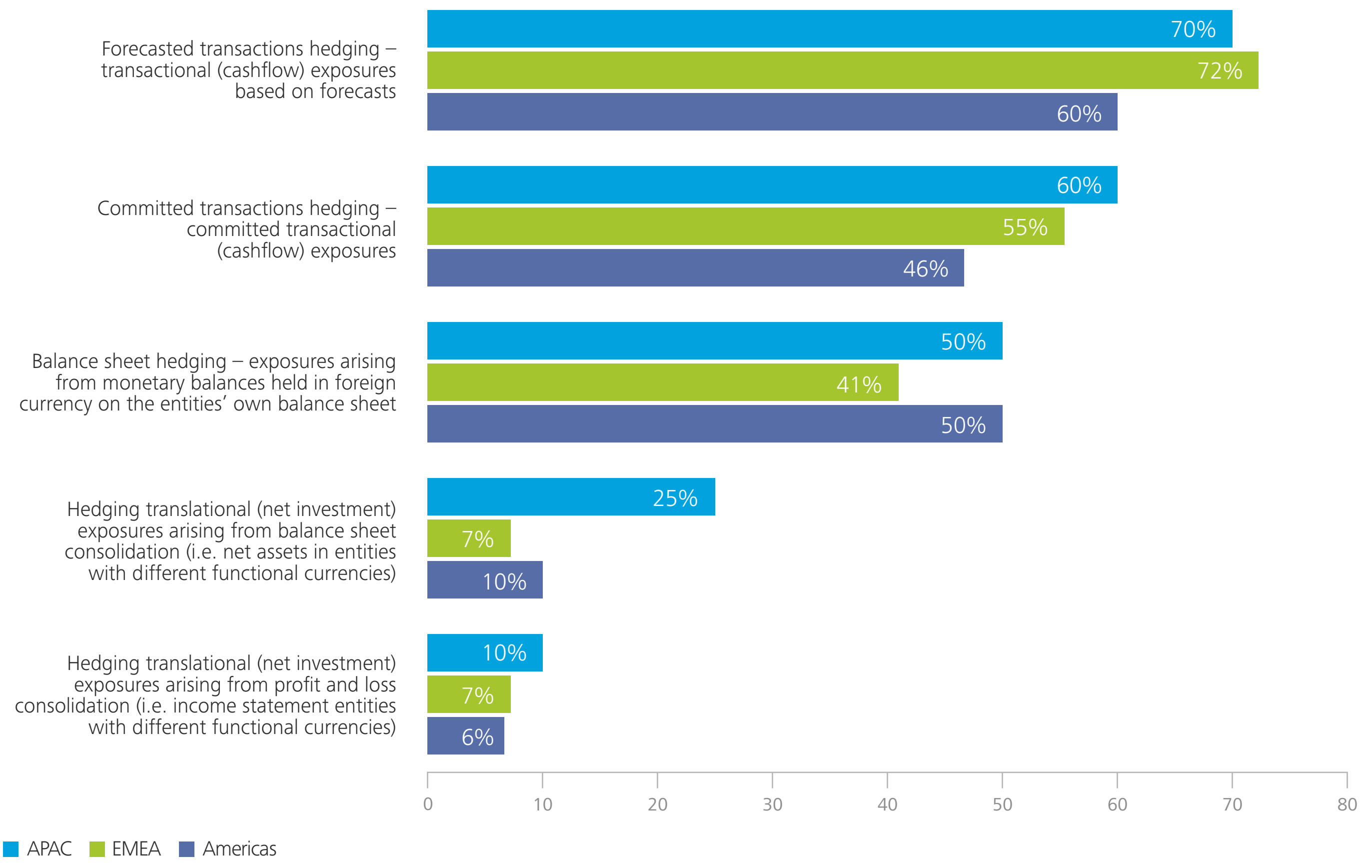


As expected, corporates surveyed focus largely on hedging cashflows, both committed and forecast, and monetary balance sheet exposures.

There is limited hedging of translation exposures (i.e. income statement and balance sheet consolidation risk). This is likely to reflect the complexities of hedging pure translation exposures with derivatives, but also that most corporates are comfortable that shareholders are aware and are managing those risks themselves.

There are some noticeable geographical differences. In EMEA, there is a greater difference in the proportion of companies hedging forecasted exposures (72%), versus hedging balance sheet exposures (41%); in the US, there is a more even split (60% versus 50%). In addition, net investment hedging is around three times more common in APAC than the rest of the world.

Derivative hedging programmes currently employed – by geography



Hedging transaction exposures

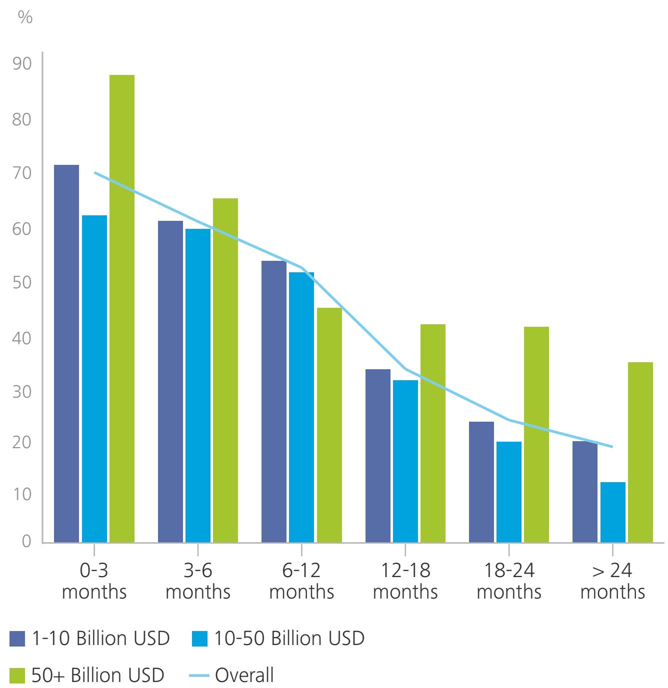
The percentages of transaction exposures hedged (either forecast or on the balance sheet) decline as the tenor increases. Exposures in the first three months are hedged on average for 68% in 83% of corporates, with the hedge ratio declining to 18% on average for exposures beyond 24 months in organisations that hedge that long (only 29% of those surveyed).

For larger corporates the percentages are higher, perhaps driven by increased confidence in forecasts and visibility of exposures due to the higher percentage of decentralised treasuries.

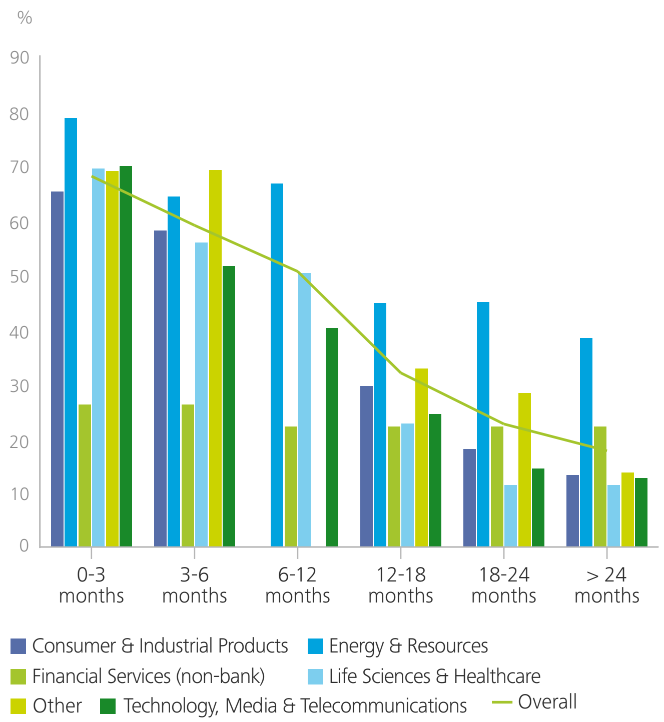
Across industries the level of hedging is fairly consistent, with the exception of Financial Services, where FX hedging practices focus primarily on balance sheet exposures rather than forecast transactions. This is expected, given the different nature of FX exposures in the FS sector versus commercial organisations.

Exposure type	Firms that hedge (%)	Avg. hedge ratio
Transaction exposures		
Balance sheet	80%	–
Forecast transactions		
0-3 Months	83%	68%
3-6 Months	83%	59%
6-12 Months	77%	50%
12-18 Months	50%	32%
18-24 Months	37%	22%
Beyond 24 Months	29%	18%
Translation consolidation exposures		
Net Investment	11%	–
Foreign Earnings	8%	–

Transactional hedging per period, Size

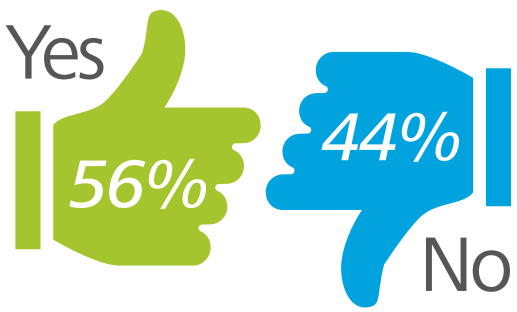


Transactional hedging per period, Industry



Use of technology to manage FX risks

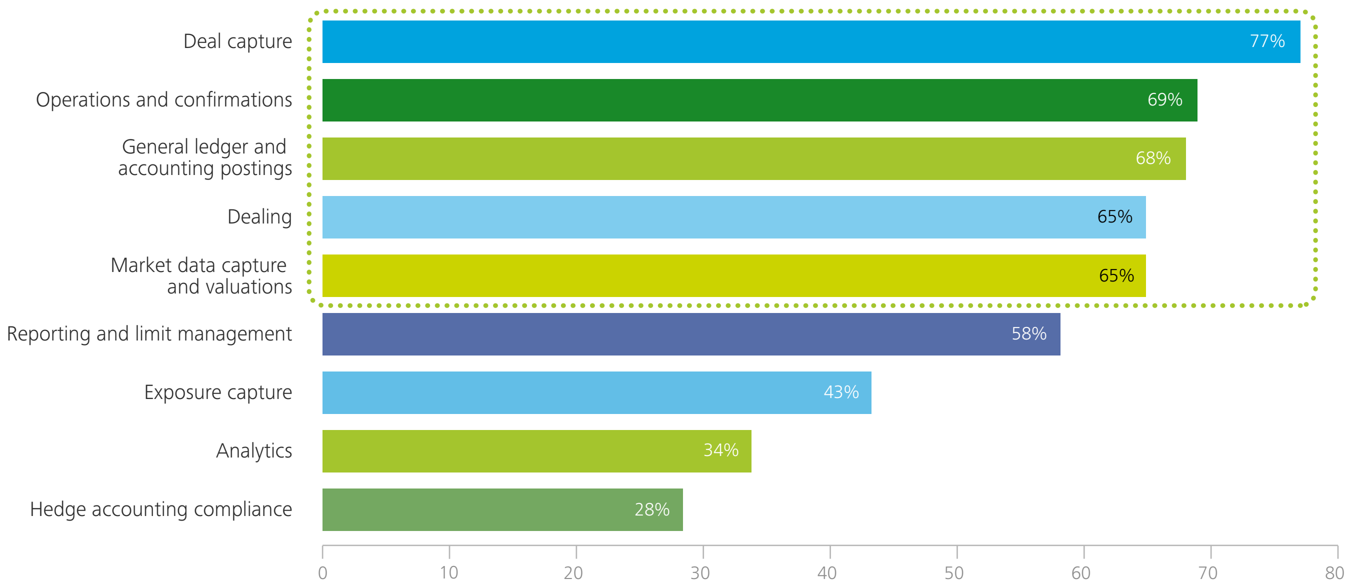
Do you use a Treasury management system and/or financial risk system today for FX risk management?



44% of respondents do not use a Treasury Management System ("TMS") for managing their FX exposures and for those who do, their main usage is process driven, covering deal capture and operations. Other tasks such as exposure capture and analytics are often done outside the TMS environment.

We believe there is scope for Treasurers to extend the usage of their TMS from its current form to support all tasks. With respect to exposure identification and capture, interfaces with other financial systems may be required to resolve the current key challenges of inaccurate forecasts and the visibility of exposures.

To what extent is FX risk management automated within your Treasury Management System and/or financial risk system(s)?

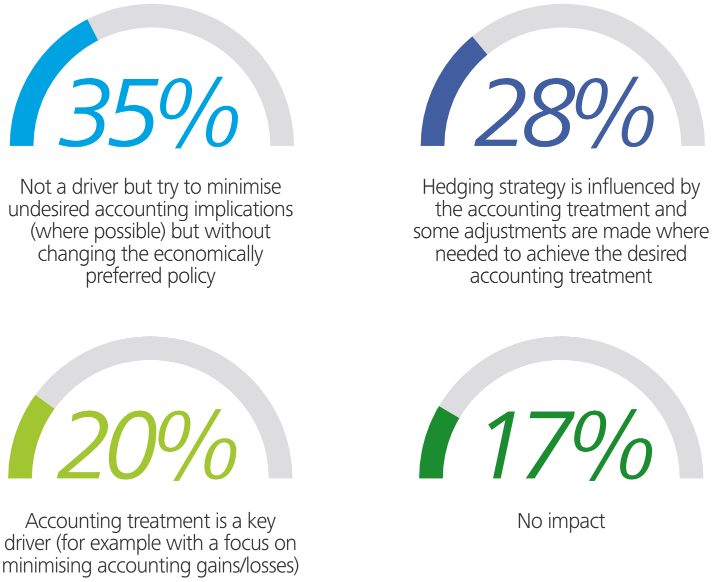


Accounting treatment influencing hedging strategies

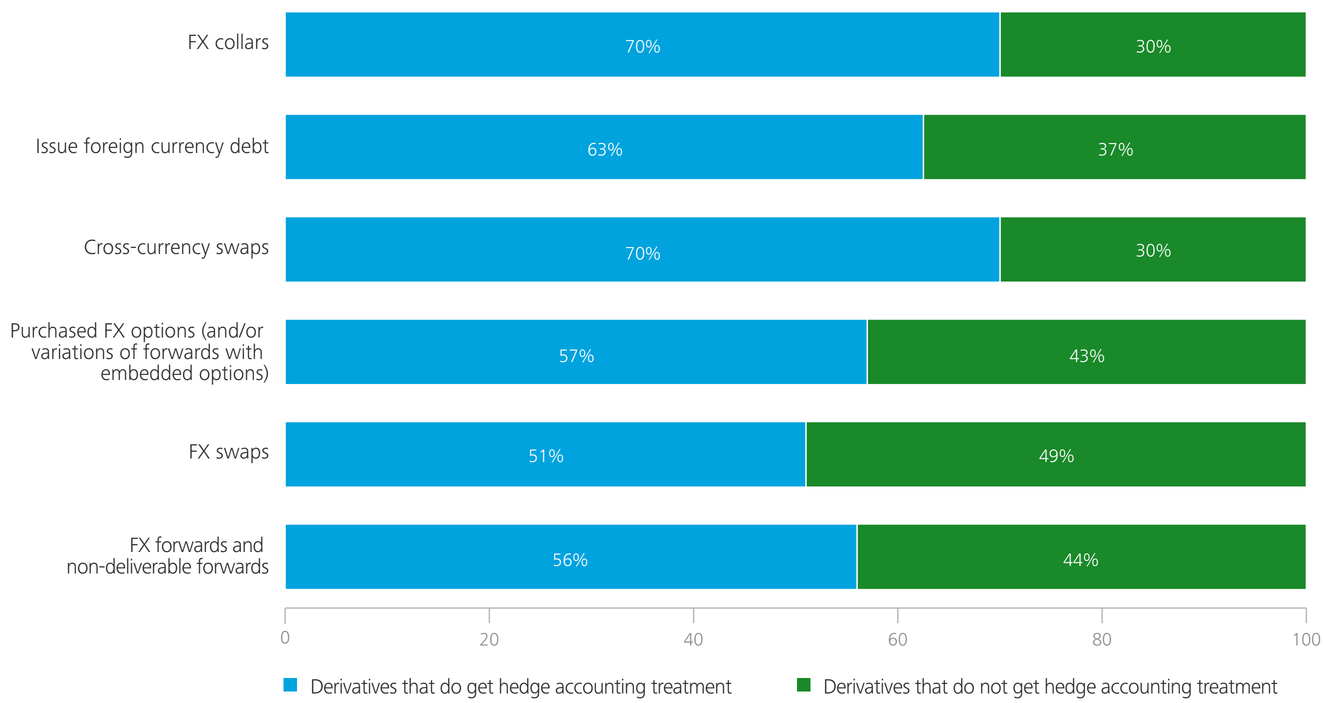
Accounting policies do not routinely drive hedging policies (only for 20% of organisations), but they are equally not routinely ignored (only 17% of respondents quoted that they have no impact). The more common impact of the accounting treatment is that it is one of the several influencers and/or policies are tweaked where possible, to avoid undesired accounting results.

This demonstrates the need for treasurers to balance the economically optimal hedging strategy with managing wider stakeholders' expectations.

The extent to which accounting treatments impact or drive hedging strategies



Adoption of hedge accounting treatment for FX derivatives



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