

The Deloitte logo, consisting of the word "Deloitte" in a bold, dark blue sans-serif font, followed by a small green dot.

Continued evolution
2016 Global Foreign
Exchange survey



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Executive summary

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

The survey was crafted in response to the recent high profile and impact of Foreign Exchange (FX) on businesses. In 2015 alone, the surge in the US dollar wiped billions off earnings of US organizations; 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 fueled increased cross-border M&A activity for the US corporate sector (Deloitte M&A Index, 2016: Opportunities amidst divergence).

Similar levels of uncertainties are anticipated in 2016, 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 unrealized FX, even on intra-group transactions. More generally, the forthcoming changes to global tax rules under the OECD's Base Erosion and Profit Shifting (BEPS) initiative could impact the financial implications of centralized FX hedging activities.

The ability of corporations 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 corporations 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 companies across the globe. Key findings are summarized below.

Treasury challenges

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

Without accurate measurement, risks cannot be managed effectively. Hence, value erosion from negative currency rate movements cannot be minimized. Organizations should prioritize 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 its treasurers more in order to better understand the impact of FX risk hedging strategies on profit margins and EPS; why only 11 percent of respondents manage year-on-year performance and predictability; and why opportunities to minimize 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 percent of respondents using a centralized treasury or in-house bank model, sometimes complemented by regional treasury centers. Organizations with centralized models report a higher number of benefits and fewer challenges than those with a decentralized model, although the benefits and challenges reported are similar, suggesting both can work.

Hedging strategies

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

Use of technology

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

A big thank you

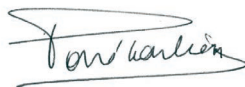
Thank you to the companies around the world that responded to our survey online or by interview. Please contact your Deloitte Advisory contact for more information about how your company responded or compared to your peer group.

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. International contact information is provided on page 18.

Sincerely,



Melissa Cameron
Principal | Deloitte Advisory
Global Treasury Leader
Global Treasury Advisory Services
Deloitte & Touche LLP



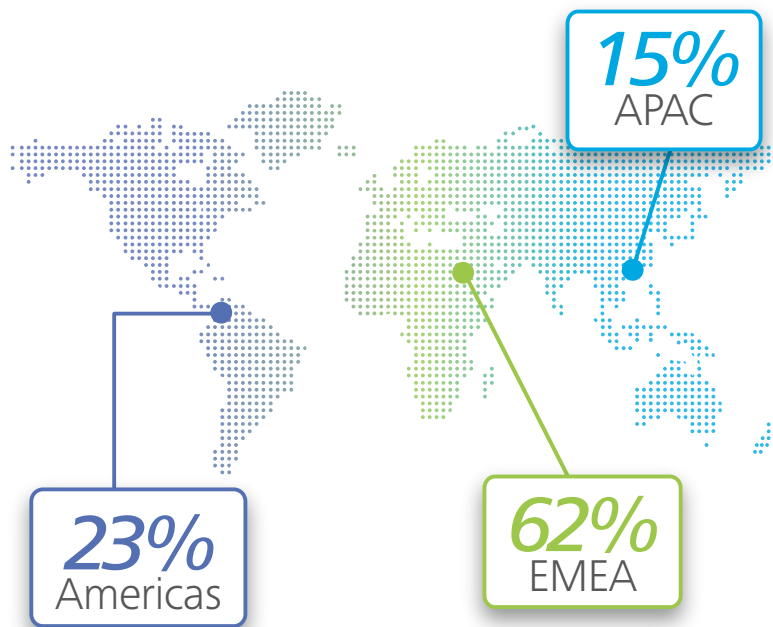
Karlien Porré
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Levels of uncertainties in 2016 are anticipated to be similar to what was seen in 2015, with different expectations around interest rate policies, quantitative easing removals, potential depegging of some currencies, and other actions by global economies all driving FX volatility.

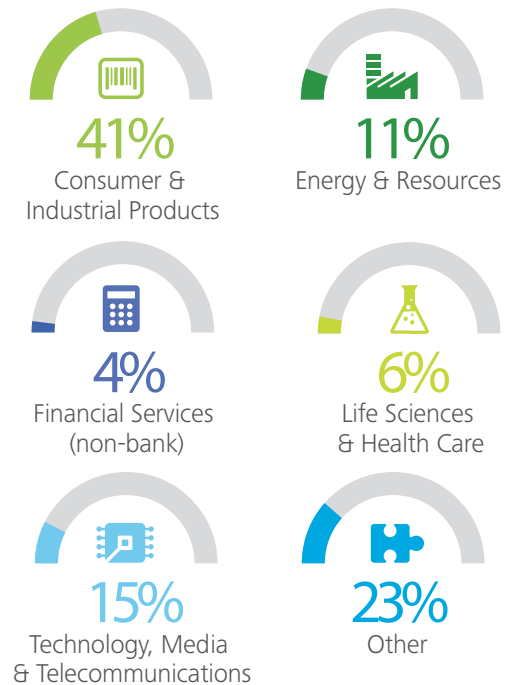
Survey demographics

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

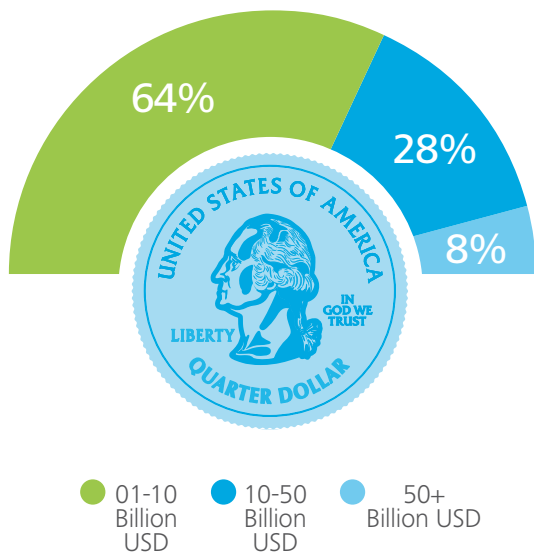
In which region are you based?



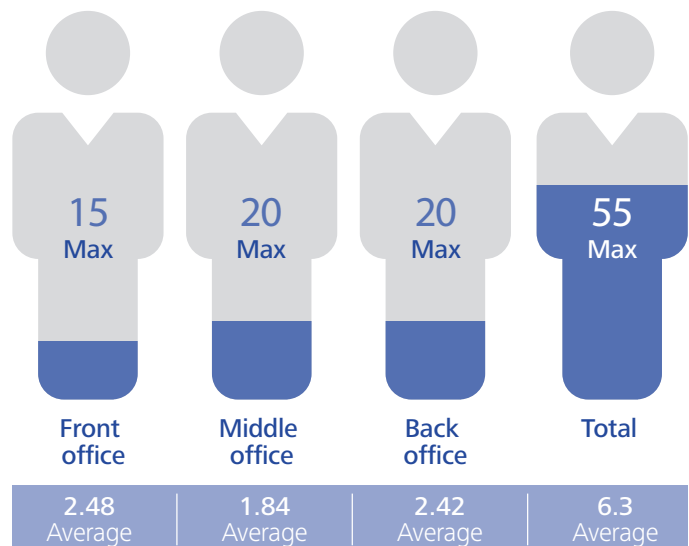
What industry are you in?



Annual revenue



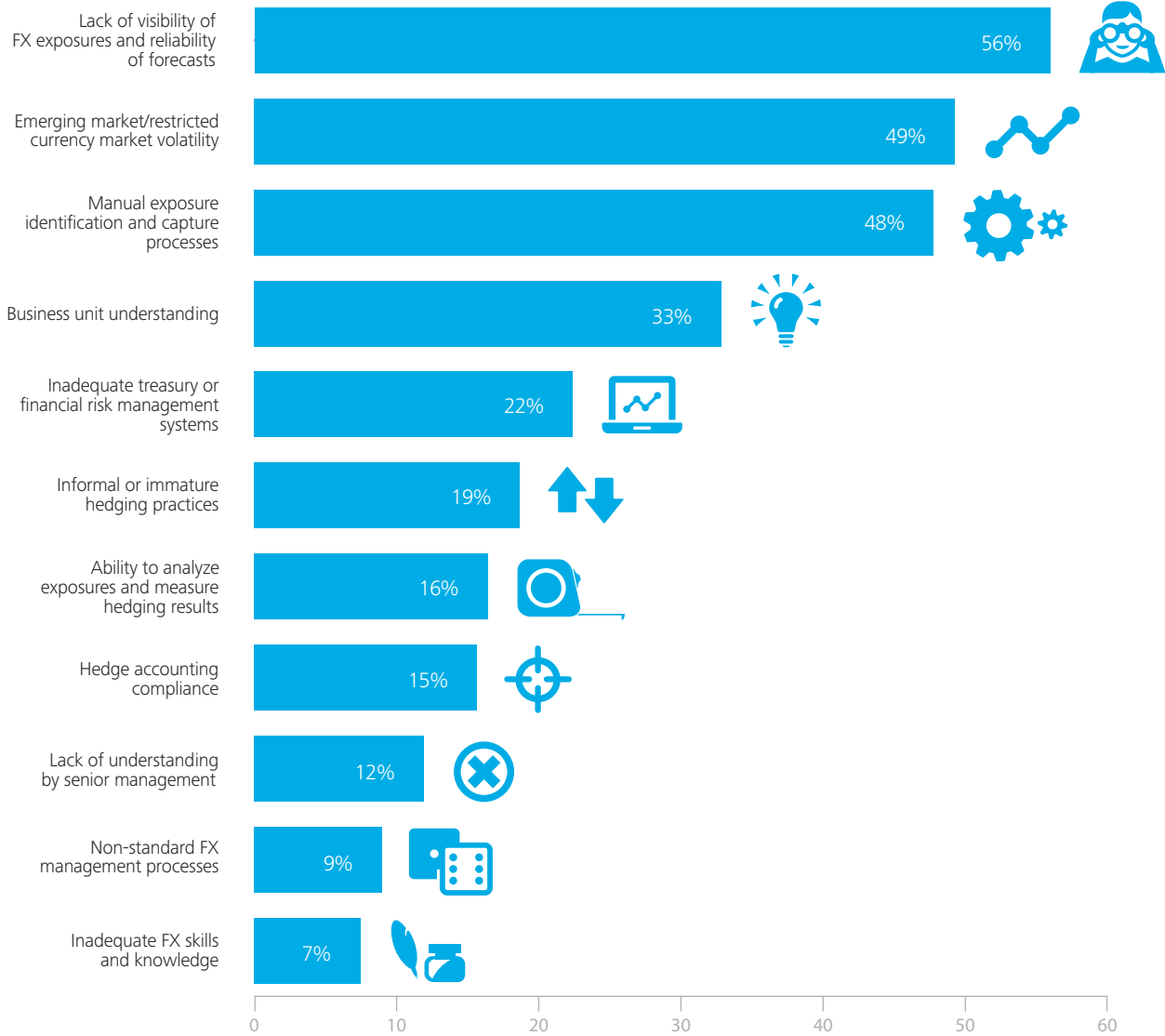
Number of people managing FX risk



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

Treasurers face various challenges in managing FX risk

Challenges faced by corporations

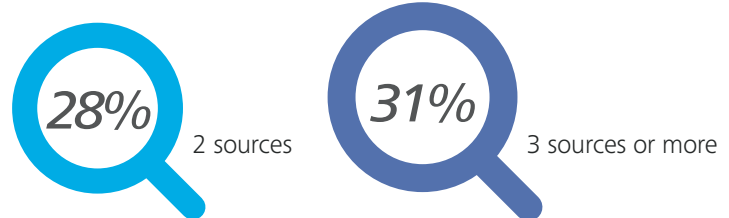


Lack of visibility related to FX exposures and reliable forecasts is a challenge for nearly 60 percent of respondents. Without accurate measurement, risks cannot be managed effectively and, arguably, value erosion from negative currency rate movements cannot be prevented. Hedging ineffectiveness disproportionately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

Lack of visibility driven by complexity and inadequate investment in automation

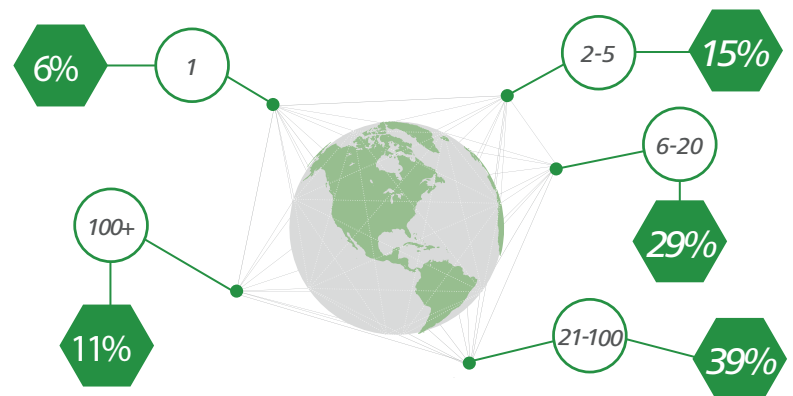
The lack of visibility reflects the complexity of the topic, with 31 percent of corporations relying on three or more sources to identify exposures. Companies therefore need to focus on achieving real-time integration of different systems, and data quality and consistency from the various sources, to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

Number of sources used to identify and quantify FX exposures



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

Number of countries the participating companies operate in



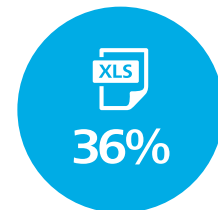
Lack of automation is a contributing factor to the challenges of identifying FX exposures, emphasized by 62 percent of participants using manual forecasts and 36 percent having fully or largely manual processes. Manual information and processes cause late and unreliable forecasts, and one could challenge whether the operating entities fully understand what they need to gather. Unsurprisingly, 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.

Sources of exposure



Manual FX forecasts received from business units

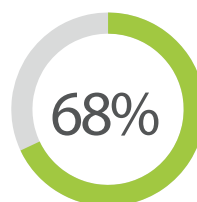
Exposure identification process



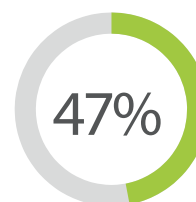
Fully or largely manual processes, based around excel spreadsheets

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 it cannot be quantified in the first place. Treasurers need to be core members of corporate projects on IT and cash-flow forecasting to ensure their requirements are fully factored in.

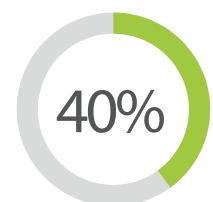
Sources of ineffectiveness



Inaccurate forecasts



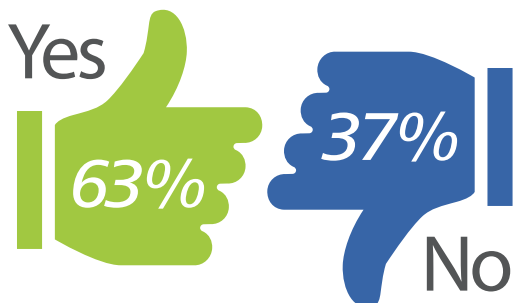
Poor communication on changes to forecasts



Non-transparent risks in value chain (due to contract pricing; supply chain gaps, inconsistent intercompany processes, or business operations)

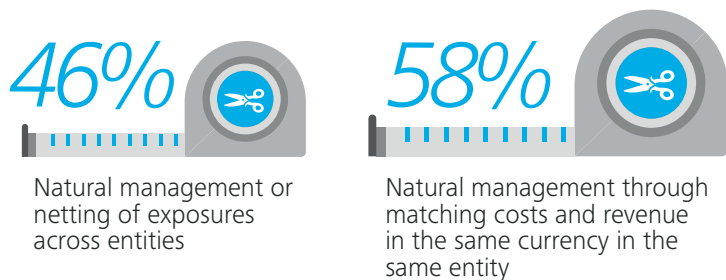
Board visibility of FX exposures

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 percent of respondents 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.

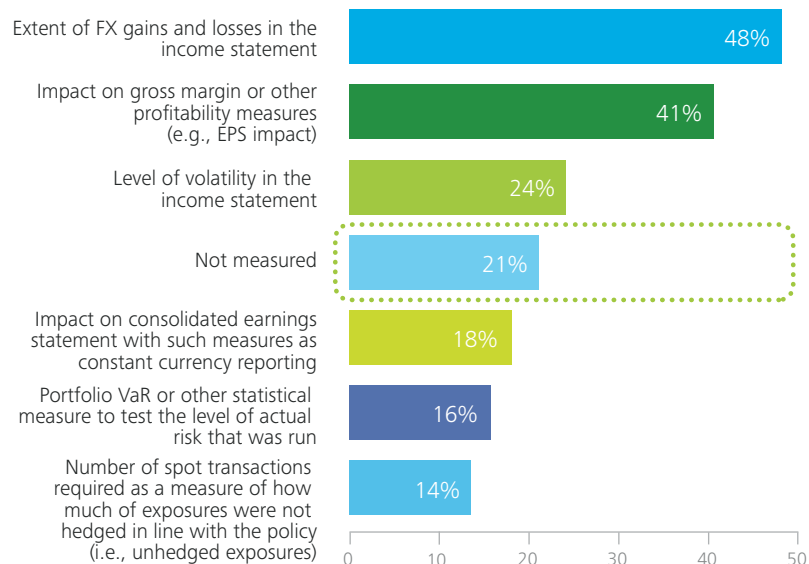
Natural risk reduction



Boards should challenge their treasury teams over the limited use of natural hedging and netting within their organizations. Currently, only 58 percent of corporations minimize exposures and hedging cost through natural hedging and an even lower 46 percent through netting.

The question of course arises as to whether boards have the visibility to challenge this and ask key questions, such as why gross rather than net exposures are hedged with derivatives. Or why commercial teams do not maximize opportunities to match currencies of revenue and costs, and whether FX hedging costs are higher than they should be as a result.

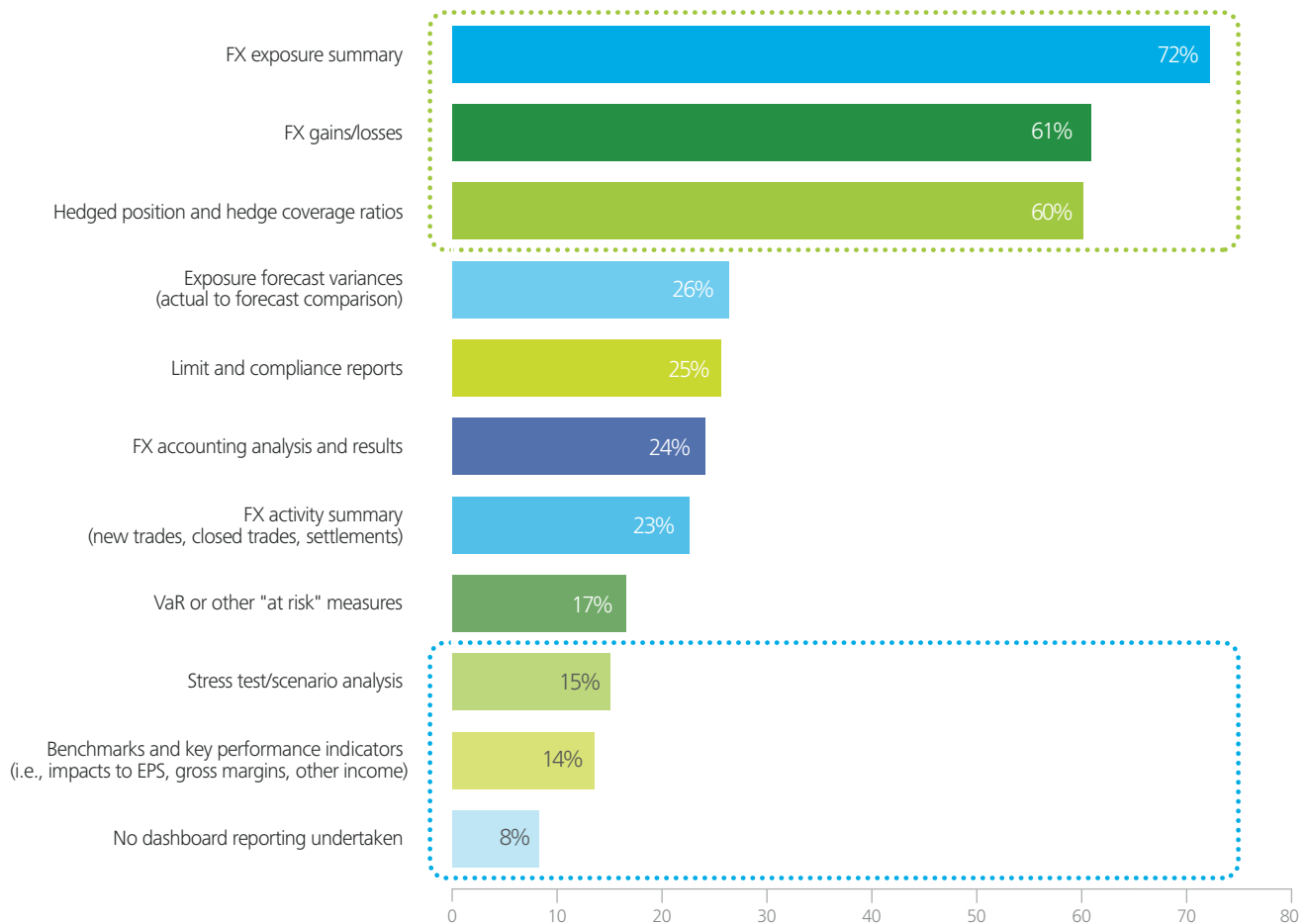
Measurement of commercial effectiveness of FX risk management activities



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 percent 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



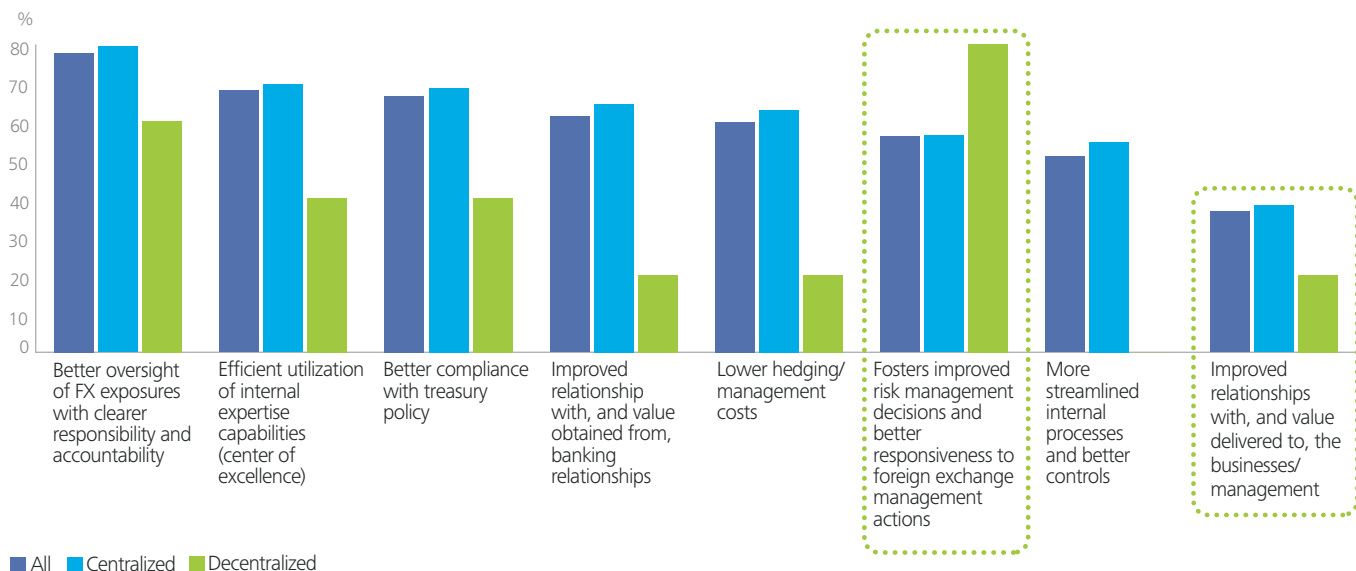
When reporting to senior management, more than 70 percent of respondents report only fairly basic metrics such as quantum of foreign exchange exposures, hedged positions, and foreign exchange gains/losses.

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

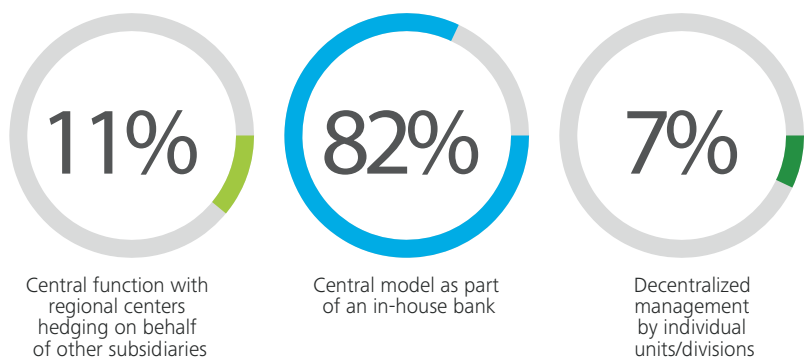
Treasurers have an opportunity to improve the reporting provided to boards and senior management by incorporating the more complex underused analysis, as well as improved staple reporting.

Both centralized and decentralized models work

Perceived benefits of operating model



What is your current operating model for managing FX risks?



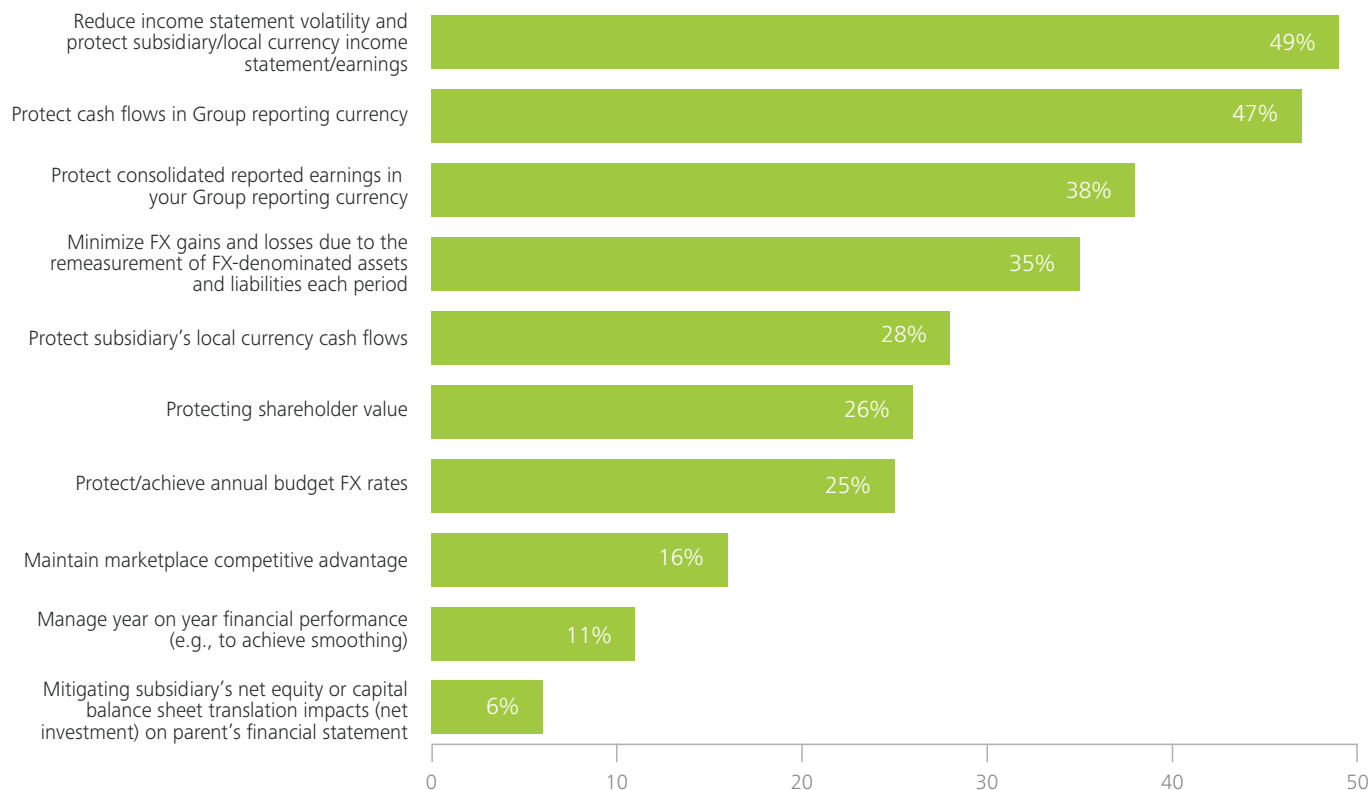
Both centralized and decentralized models appear to deliver increased oversight of FX exposures and clear responsibility as a key benefit of their structure.

Centralized models achieve more benefits overall, but it is noticeable that decentralized 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 maximizing the value delivered to the business, which less than 40 percent 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 to find the right structure and approach to value creation and optimization. They need to balance the trade-off between having efficiency from centralized 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 appears to be protecting balance sheet or net equity translation impacts.

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

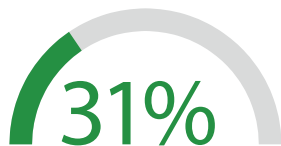
Less than a third of respondents claim to focus on protecting shareholder value and maintaining marketplace competitive advantage. However, we know that many organizations are aligning hedging with their commercial strategies. Hence, we expect that these low scores reflect the fact that while this is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

Primary hedging strategies vary by industry

Primary derivative hedging strategy



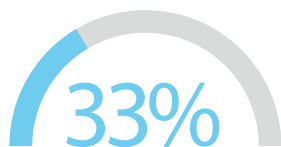
Static/annual hedging – Most hedges placed annually; typically coinciding with the budget FX rate setting process



Rolling hedge – Hedging on a frequency basis (every month, quarter, etc.) with a flat hedging target ratio for the full period hedged



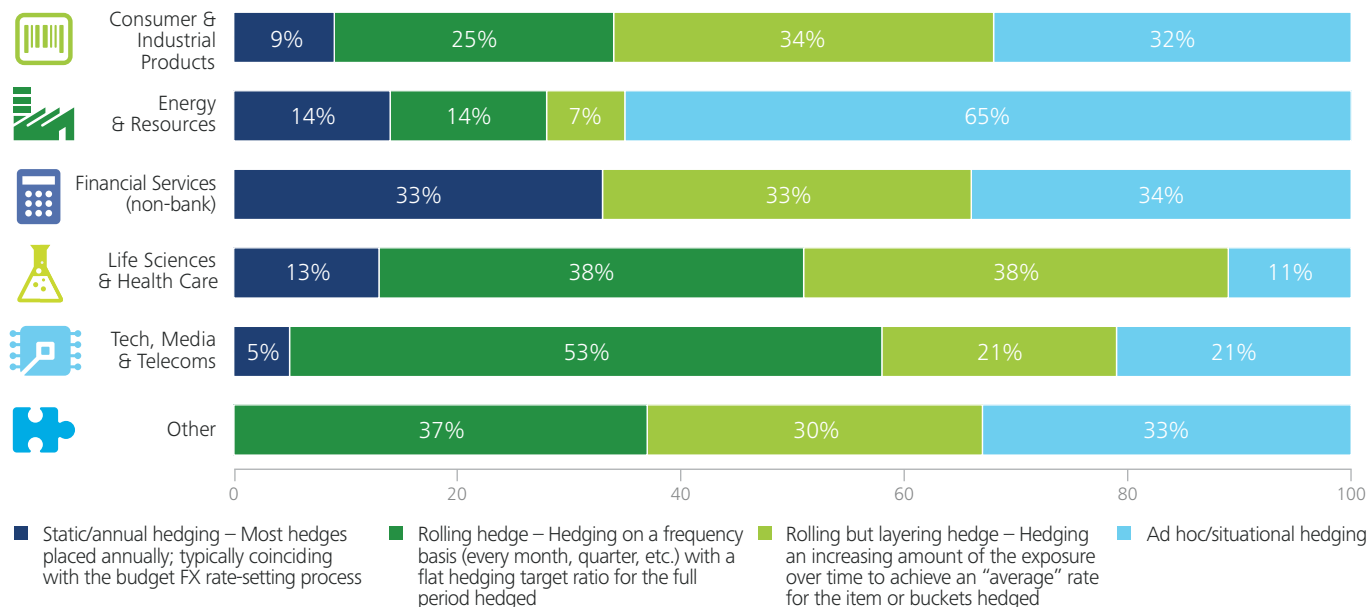
Rolling but layering hedge – Hedging an increasing amount of the exposure over time to achieve an “average” rate for the item or buckets hedged



Ad hoc/situational hedging

Fifty-nine percent of corporations primarily use a rolling hedging strategy, with roughly half incorporating some form of layering (28 percent) and the balance (31 percent) 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 continued, rolling visibility of future FX rate achieved.

Primary derivative hedging strategy

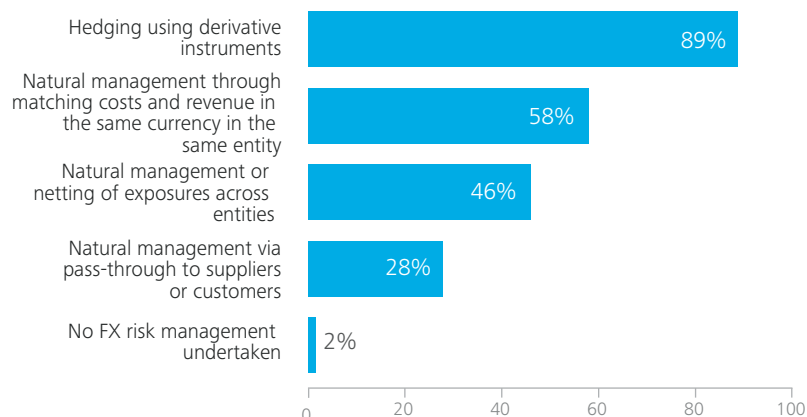


Thirty-three percent follow an ad hoc or situational approach to hedging. The ad hoc approach is largely driven by the Energy and Resources industry and the Automotive and Process and Industrial Products sector (within Consumer and Industrial Products) where respectively 65 percent and 32 percent adopt 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

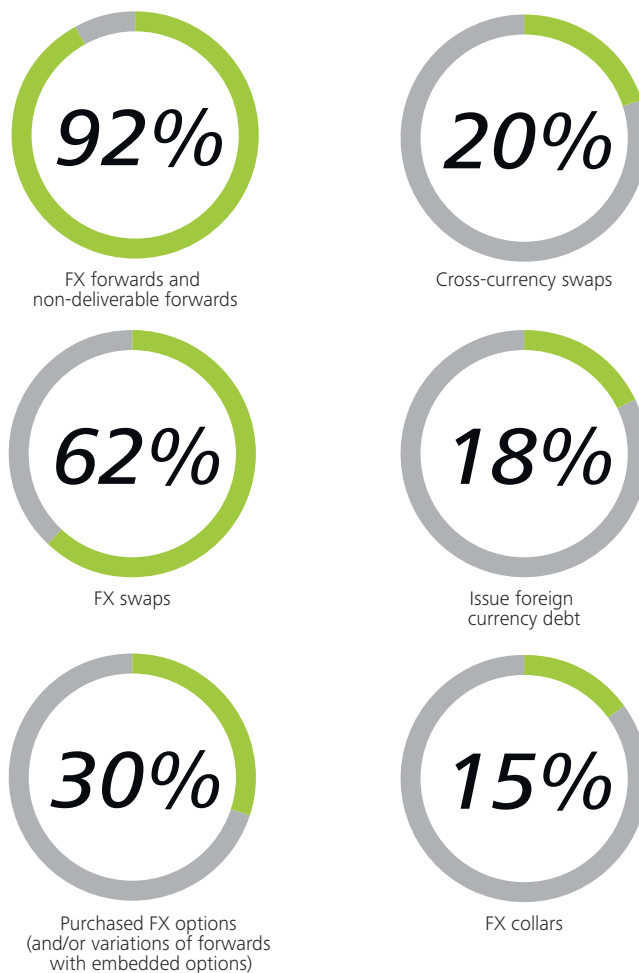
Surprisingly, only around half of respondents use natural risk management techniques such as cash-flow netting and exposure matching. As nearly 90 percent of respondents use derivatives, opportunities seem to exist to increase usage of natural hedging to reduce derivatives-related costs.

Risk management approaches used



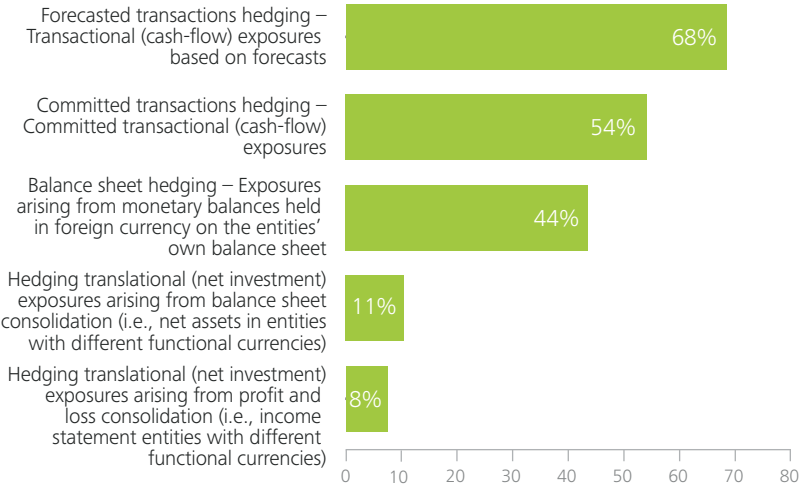
Of those using derivatives, the vast majority use FX forwards and FX swaps. Products such as options and collars are used by only a third of respondents. This is low, perhaps driven by the reluctance to pay premiums or due to the perceived lack of benefits and in-house skills to manage these instruments.

FX instruments used in hedging programs



The majority of derivatives hedge transaction exposures

Derivative hedging programs currently employed

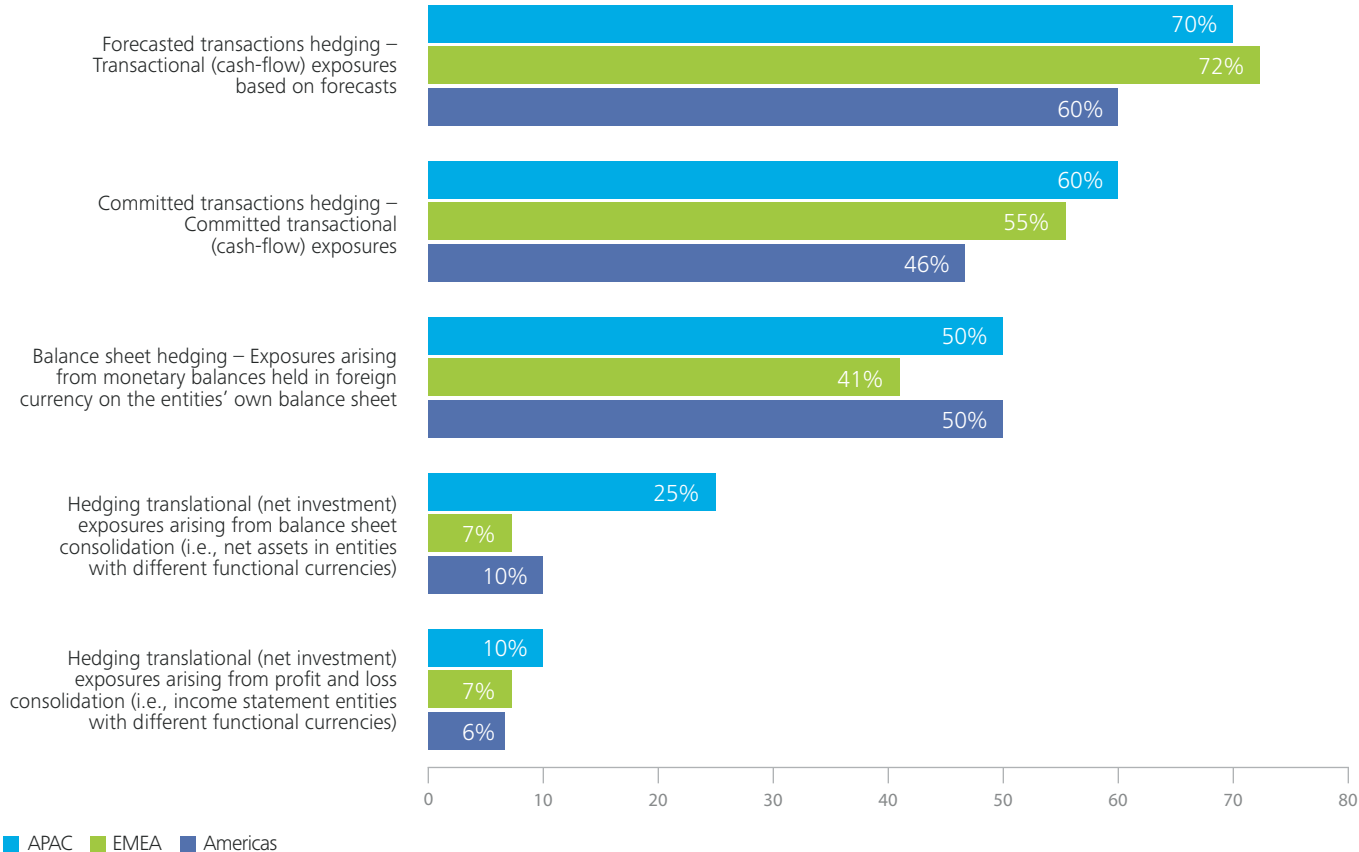


As expected, corporations surveyed focus largely on hedging cash flows, both committed and forecast, and monetary balance sheet exposures.

There is limited hedging of translation exposures (income statement and balance sheet). This is likely to reflect the complexities of hedging pure translation exposures with derivatives, but also that most corporations 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 percent), versus hedging balance sheet exposures (41 percent); in the US, there is a more even split (60 percent versus 50 percent). In addition, net investment hedging is approximately three or four times more common in APAC than the rest of the world.

Derivative hedging programs currently employed – by geography



Hedging transaction exposures

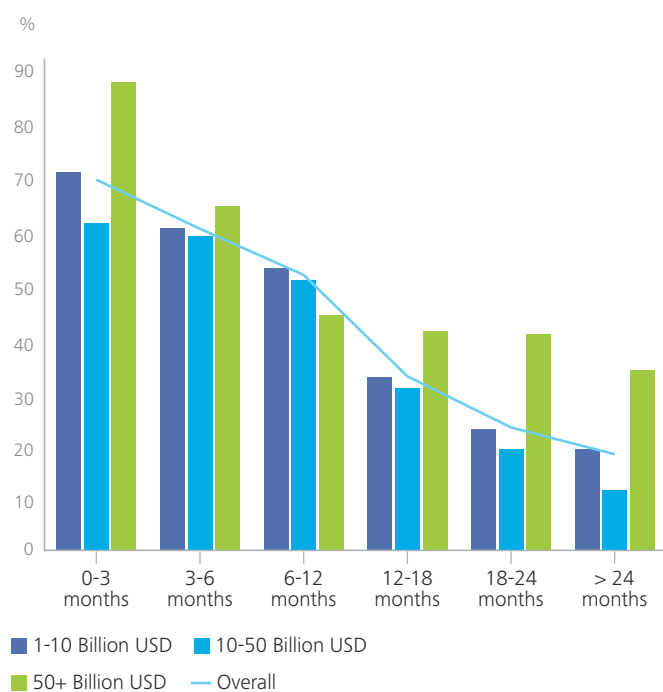
As expected, transactional hedging percentages decline as the tenor increased. Exposures in the first three months are hedged on average for 68 percent in 83 percent of corporations, with the hedge ratio declining to 18 percent on average for exposures beyond 24 months in organizations that hedge that long (only 29 percent of those surveyed).

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

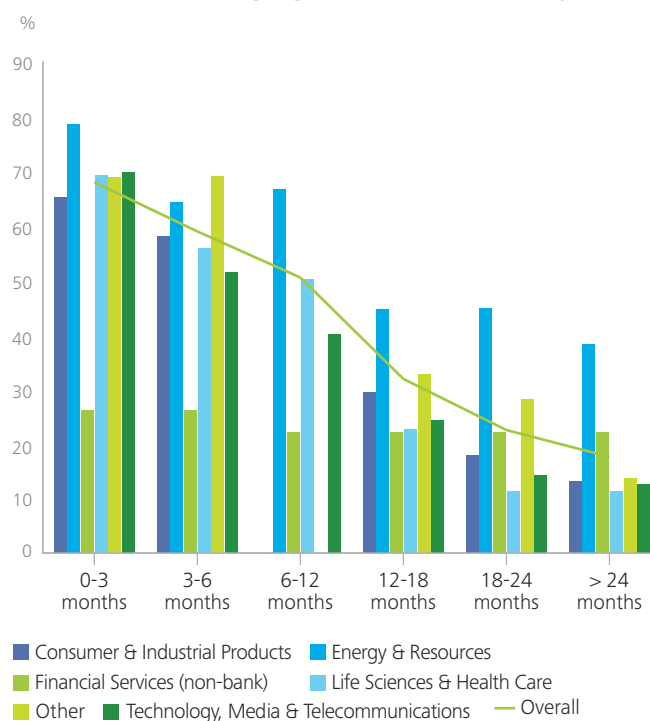
Across industries the level of hedging is fairly consistent, with the exception of Financial Services (FS), where foreign exchange hedging practices focus primarily on balance sheet exposures rather than forecast transactions. This is expected, given the different nature of FX exposures in the FS sector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

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

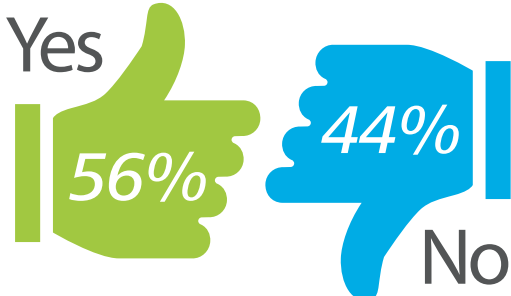


Transactional hedging per period, industry



Use of technology to manage FX risks

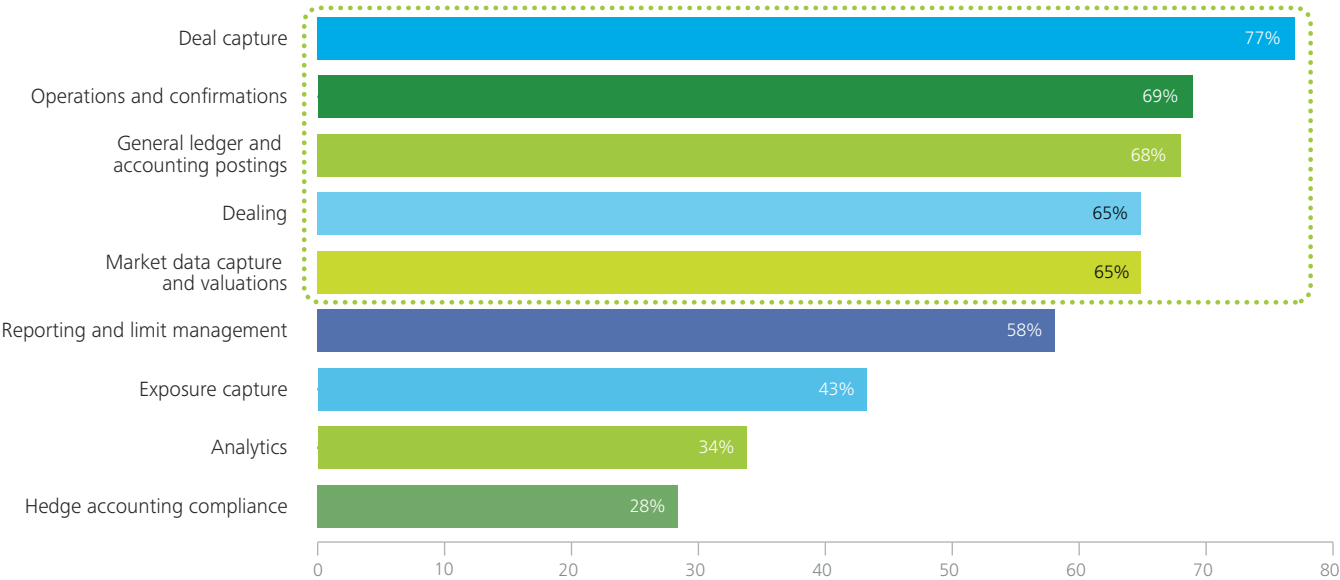
Do you use a treasury management system and/or financial risk system today for FX risk management?



Forty-four percent of respondents do not use a treasury management system (TMS) for managing their FX exposures. 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)?

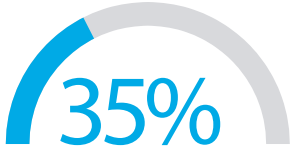


Accounting treatment influencing hedging strategies

Accounting policies do not routinely drive hedging policies (only for 20 percent of organizations), but they are equally not routinely ignored (only 17 percent 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 that is 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



Not a driver but try to minimize undesired accounting implications (where possible) but without changing the economically preferred policy



Hedging strategy is influenced by the accounting treatment and some adjustments are made where needed to achieve the desired accounting treatment

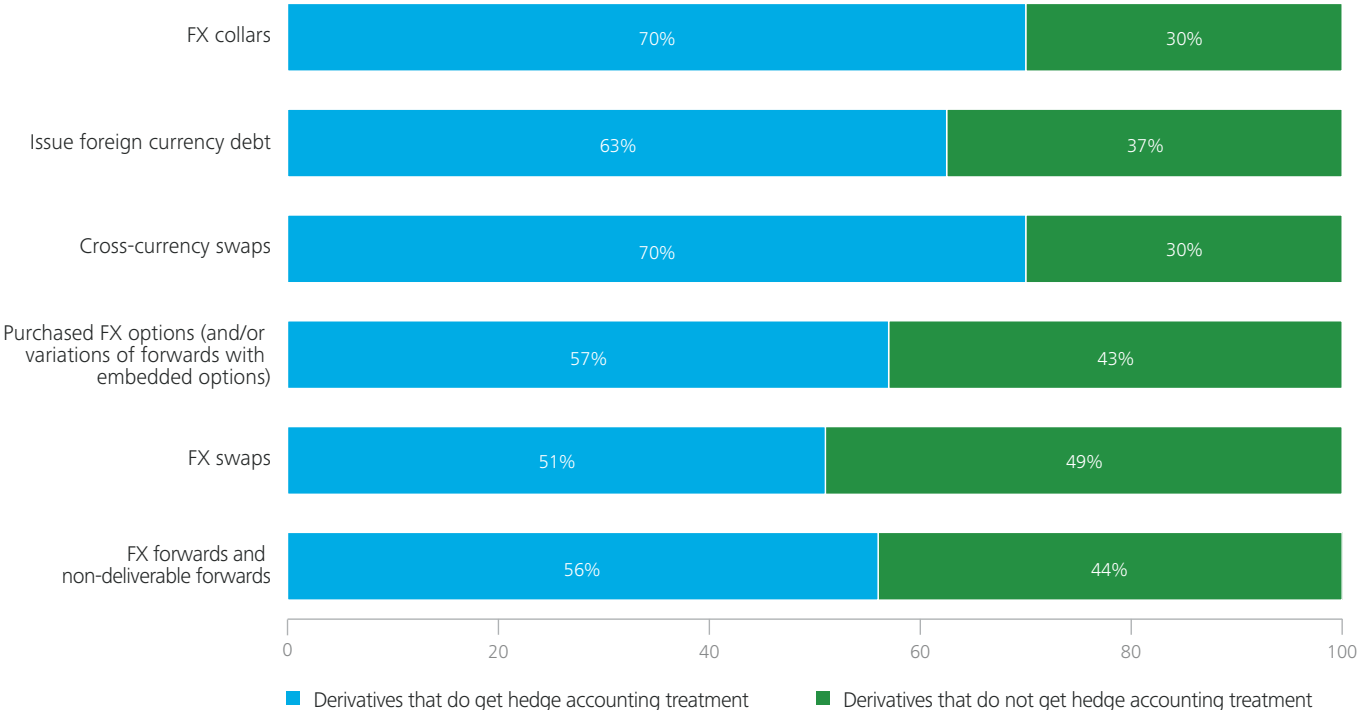


Accounting treatment is a key driver (for example with a focus on minimizing accounting gains/losses)



No impact

Adoption of hedge accounting treatment for FX derivatives



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