CURRENCY MANAGEMENT PLAN DEVELOPMENT

The Currency Management Plan (CMP) is composed on different sections, corporate, fiscal framework, hedging operations, and risk management. The fiscal framework will require updating to keep current.

Corporate

Policy Objectives

Determine the objective of the Policy; eliminating risk, protecting catastrophic losses, achieving annual budgets, minimizing hedge costs, maintain/gain competitive advantage, reduce volatility. Existing policies should be reviewed.

Countries of Operation/Risk

Identify existing and potential countries the company does business with and which currencies it has exposure to.

Inter-related Risks

Determine if there are correlations in currency movements to other inputs or sales. Correlations can either be offsetting or amplifying. Their effects should be considered when determining hedging policies and strategies.

Management of Foreign Acquisitions

Each partnership or acquisition entered into has basis on financial outcomes and has a price at which it becomes unfeasible. Determine how currency movements affect these foreign deals and explore if there is a suitable way to manage this risk.

Risk is also present during the due diligence phase. In some situations it may be prudent to manage this risk.

Governance

The Currency Management Plan will become an integral part of the company's financial outcomes. Providing management a range of potential outcomes will assist in company planning and operations. It is imperative that upper management understands and signs off on the CMP.

Fiscal Framework

Identify Business Segments

Analyze business segments separately to develop better planning and management. Review, fixed contract business, volume commitments, recurring sales/revenue, and irregular sales/revenue. Also it may be beneficial to look at geographic operations separately.

How Currency Rates Affect Core Business

Determine what affect rates movements have on sales volume, revenues, competition, input costs, and affect your clients or suppliers. This will help in formulating a more effective plan.

Timing of Risk

Determine when currency risk begins; at submission of proposal, upon acceptance of a contract, once a sale/purchase is made, or upon billing/payment?

Drivers

Determine what is to drive the currency strategies for each business segment. Key drivers include budgets, profit margins, and price levels.

Pricing/Costing

What flexibility does your company have in changing its pricing to reflect currency movements. What drives the changes?

Competition

Analyze how the competition will be effected by the currency movements. Consider local competitors, foreign competitors, and the barrier of entry of competitors into your market. How can you make it more difficult to have a competitor steal away your customers.

Sensitivity Analysis/Stress Testing

Once the risk to your business is defined, a sensitivity analysis to currency movements should be run. This can be used to help determine the worst and best case scenarios and what can be done to best plan for such potential occurrences.

Contingencies

Operating in an unfavourable currency environment? At what point does the company implement measures? Have a contingency plan to look at alternative sources for revenue or inputs (different countries, clients that might be flourishing or suppliers that can reduce prices from a currency move adverse to your company). Visit with suppliers and clients to determine possibility of assistance by price adjustments. Understand what currency changes mean to the companies you deal with.

Hedging Operations

Trading and Hedging Responsibility

Define responsibility of risk managers, treasury and senior management.

Allowable FX Strategies

Determine the types of strategies acceptable, active, passive, dynamic, or situational.

Types of Instruments

Define the allowable instruments; spot, forwards, options, futures, or swaps.

Margin Requirements

Determine the financial implications of margin requirements.

Competitive Rates

Significant costs can occur by receiving less competitive rates. Many companies do not have methods of determining the best rates, or their methods may be flawed. Currencies move constantly, sometimes very swiftly. During volatile markets some providers increase their margins to cover their risk and this cost gets passed on. Methods should be put in place to determine the true cost of transactions and FX strategies.

Proper FX Accounting Procedures

Require uniform FX accounting procedures, booking procedures, and multicurrency general ledgers for all FX transactions. Reconcile the realized FX hedges in the appropriate accounting periods and ensure all outstanding hedges follow the selected method of accounting.

Hedge Accounting Rules

Consider the implications and benefits of implementing hedge accounting rules.

Risk Management

The Amount at Risk

It is important that the exposure managed is the correct amount. You can't manage what you don't measure. This should be periodically reviewed to ensure the proper amount, neither too much, nor too little is being managed. This will prevent adding undesirable risk.

Types of Exposures to be Managed

Determine which type of exposure the company wants to manage. Each are likely to be treated separately.

- Transactional – Cash flow items
- Contractual – Secured contract amounts
- Anticipated – Forecasted Sales/Expenses
- Assets/Liabilities – Balance sheet foreign holdings/debts

Time Horizons

The time horizon needs to be identified for various exposures as long or short term. Decisions on how far out to hedge need to be addressed.

Management Controls

Daily/Weekly FX reconciliation and review to ensure accuracy and compliance.

Risk Sharing/Transfer

Explore situations with existing customers/suppliers that may be willing to share or accept currency risk.

Pre-commitment Risks

Risk can exist prior to final contracts or order agreements. Explore if it is beneficial to manage risks during these periods. Consider your company can potentially gain competitive advantages if it offers to hold its bid pricing even should a significant currency move occur prior to award.

Type of Benchmark

A benchmark or means to measure the performance needs to be determined. Many companies will implement some type of FX strategy without having any means to determine its effectiveness. This can be dangerous as it may look successful at times, but there may be significant underperformance, excess costs, added risks, or missed opportunities. The most appropriate benchmark would be determined based on the companies many risk factors and objectives. Some options are; spot rate, forward rate, budget value, volatility, profit margins, compare to booking rate, model portfolio, sales revenues.

Measurement FX Risk and Management Performance

FX risk management aims first at identifying corporate FX risk exposure and then setting out the appropriate rules and procedures to manage that risk in a way that is consistent with the corporate risk appetite and culture. One foundation of FX risk management is to develop a system that provides reasonable expectations, reducing “surprises” or unforeseen implications to the bottom line.