GOALS OF RISK MANAGEMENT

- Determine FX Management Objective
- Accurate and timely information on performance versus objectives
- Minimize transaction costs
- Ensure compliance to stated goals

Determine the benefits of balancing the time and costs of implementing a risk management policy against the intangible downside of doing nothing. Downside risks only become tangible after they occur. Use a sensitivity analysis to determine the risks that face your business to fluctuating exchange rates.

CORE PRINCIPLES

<u>Sound FX Policy</u>

A Currency Risk Management Plan should be developed and approved by senior management. Though treasury will be involved, it is senior management's responsibility to define the guidelines which will dictate the CRMP.

The following should be addressed:

1. **FX Policy Objectives**
   Determine the objective of the FX Policy; eliminating FX risk, minimizing hedge costs, maintain/gain competitive advantage, reduce volatility.

2. **Trading and Hedging Responsibility**
   Define responsibility of risk managers, treasury and senior management.

3. **Types of Exposures to be Managed**
   - Transactional – Cash flow items
   - Contractual – Secured contract amounts
   - Anticipated – Forecasted Sales/Expenses
   - Assets/Liabilities – Balance sheet foreign holdings/debts

4. **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. If error is large, reducing the timeline should be considered.

5. **Time Horizons**
   The time horizon needs to be identified for various exposures as long or short term.

6. **Allowable FX Strategies**
   - Active management
   - Passive management
   - Opinion trading
   - As Needed

7. Types of Instruments

- Spot
- Forwards
- Options
- Futures

8. 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.

- Spot rate
- Forward rate
- Budget value
- Volatility
- Profit Margins
- Compare to Booking Rate
- Model Portfolio

9. Management Controls

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

10. 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.

11. 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.

12. 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.