




NO. Surprises

FX results remain
a mystery for
most multinational
companies

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It is likely that corporate treasurers and FX managers have seen more wild swings in the market in the past 18 months than they have seen for the bulk of their career. Yet, a recent global survey of FX best practices suggests that, despite their best efforts to neutralize currency volatility impacts to the value of their organizations, a majority of treasurers have seen volatility in currency markets translate into material FX gain/loss results. With little variation in survey results based on the industry, size or country of origin, what stood out most in the survey was an over-riding concern about the ability to access reliable FX data, quantify FX exposures, and achieve a timely understanding of their risks. How companies address these challenges as market volatility continues will determine their success in protecting corporate value at a time when “doing more with less” is the call of the day.



A recent survey reveals that companies lacking an understanding of their FX exposure cannot consistently manage FX

World economies on a tight rope

Echoes of the global financial crisis that erupted in September 2008 continue to reverberate beyond the United States and Europe, causing unprecedented levels of global currency volatility. Recent business headlines have largely focused on the Greek debt crisis and its impact on the euro, but with Greece representing just 2.5 percent of the European economy it is just one of the beginning chapters in an ongoing drama that will continue to breed uncertainty and unpredictable outcomes.

The Greek crisis caused the euro to drop 6 percent against the dollar in one month and 11 percent since January. The recent \$1 trillion bailout plan may put a halt to this downward trend in the short term, but growing deficits across Europe have forced every country in the Eurozone to walk along the same crowded tightrope. While everyone assumes that the PIGS (Portugal, Italy, Greece and Spain) is the main suspects in the euro crisis, the same debt problems apply to France, Germany and the rest of the EU.

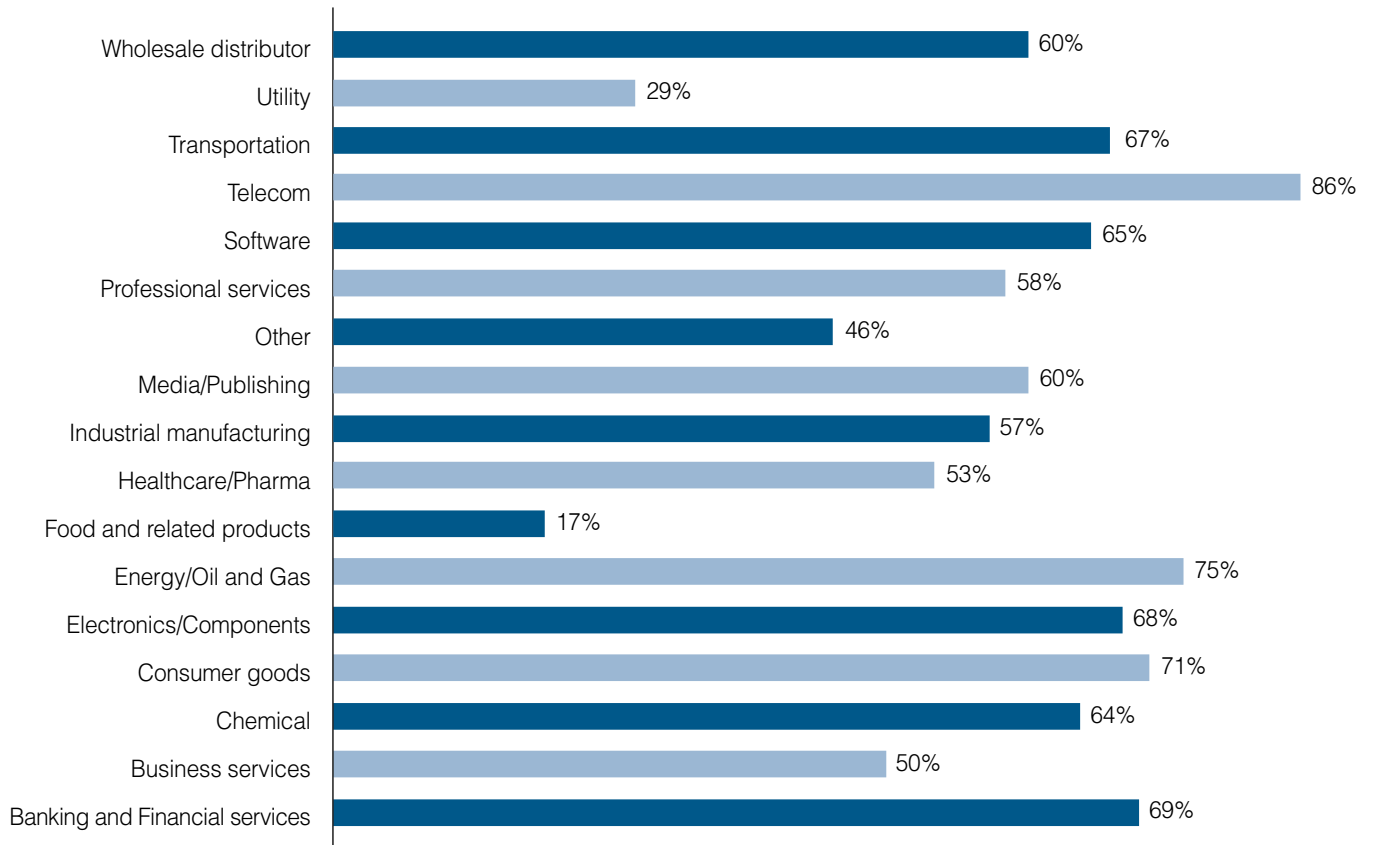
An April 2010 study from the European Central Bank projects that government deficits in the euro area will climb to almost 7 percent of GDP in 2010 and that all euro area countries will exceed the 3 percent of GDP limit. In the next year, the study suggests, euro-area government debt-to-GDP

ratio could increase to 100 percent, with many countries well above that. With so many economies in the Eurozone out of balance, the increasing uncertainty of individual countries could have a domino effect, sustaining current levels of volatility or possibly pushing even higher.

Economic uncertainties are exacerbated by political uncertainty as witnessed by the recent events in the United Kingdom and their impact on the GBP. The election of David Cameron as prime minister, combined with the announcement the next day that the U.K. government would shave \$9 billion off of the nation's budget deficit and encouraging manufacturing and production figures, suggests a brighter outlook for the sterling than the euro. But a shaky British coalition government will have to demonstrate its resolve and produce significant enough results to keep an already nervous marketplace from overreacting.

Beyond Europe, China's decision to peg their currency to the U.S. dollar is under greater scrutiny. The general consensus is that a revaluation of the Chinese yuan, or RMB, is imminent. Technically, the RMB rose steadily through Q2 of 2010 by about 0.3 percent—not nearly enough to placate critics whom insist that it is undervalued by 25 to 40 percent. Current speculation suggests a 2 percent to 5 percent appreciation of the RMB against the

Figure 1: Material FX gain/loss results by industry (Average 58 percent experienced a material FX gain/loss)



dollar. One potential impact of an RMB appreciation is a decline in the euro, since China's currency peg also has necessitated tangential purchases of euros.

With so much uncertainty among the world's largest economies, multinational corporations have seen the historically valid systems and processes they use to monitor and manage FX volatility stressed to the breaking point. The result has seen ongoing surprises that manifest as impacts to corporate revenues, COGs, OPEX and net income. Companies that fail to achieve more complete and timely transparency to the sources of FX risk will continue to receive unpleasant surprises in the form of negative impact earnings. Even when they show up as negative impacts to earnings, companies will be punished by the market, disproportionate to the rewards of unexpected FX related gains.

FX gain/loss impacts on the rise

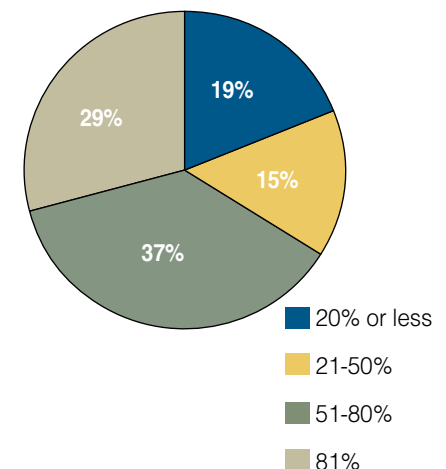
In April 2010, an FX benchmark survey conducted jointly by SunGard and FiREapps asked more than 250 FX practitioners across a range of industries, revenue categories, and regions about their balance sheet FX gain/loss results and about the policies and practices that guide their FX risk management operations. Fully 59 percent of respondents reported experiencing FX gain/loss results that had material impact over the last 12 months—a 45 percent increase over results from a similar survey conducted a year prior. That outcome was consistent across a wide range of factors, from company demographics to specific FX practices, suggesting deeper issues at work.

The bottom line: No company doing business internationally was immune to foreign currency volatility impacts.

Hedging results don't measure up

While similar FX outcomes for different companies may not seem too surprising, the fact that different hedging strategies and practices failed to produce different results for FX risk management practitioners raises some red flags. Seventy-

Figure 2: What percent of your exposure is hedged?



one percent of the survey indicated that they hedged 80 percent or less of their exposure, while 34 percent reported that they hedge less than half. Digging into the FX gain/loss results for these companies demonstrated that more aggressive hedging did not translate into fewer cases of material FX gain/loss results.

One added surprise here was how few companies hedged more aggressively than 80 percent of their exposures. Often, sub-optimized hedging can be a sign of a lack of confidence in a company's FX exposure calculation. FX managers occasionally make a conscious decision to under-hedge, and essentially "hedge their hedges" to prevent over-hedging an exposure whose magnitude they have over-estimated. At the same time, de facto under-hedging often occurs simply because a company has under-estimated its exposure.

Beyond the percent of exposure hedged, the survey looked at hedging policies, and how companies defined when to hedge. The majority of respondents choose to hedge based on a specified unit amount of their entire exposure, versus using a specified percentage of the total exposure, or a specified number of currencies reflecting the "Top X" exposures. Once again, no policy decision resulted in significantly different FX gain/loss results.

Figure 3: Hedging practice

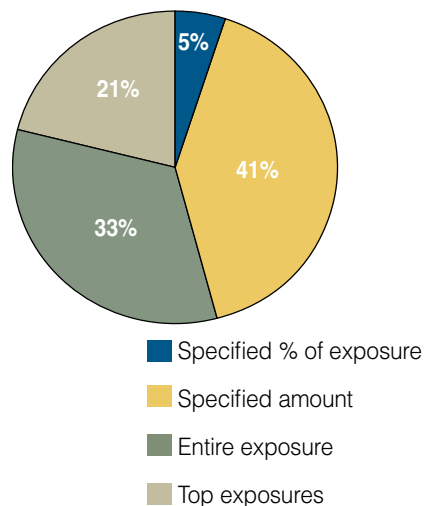
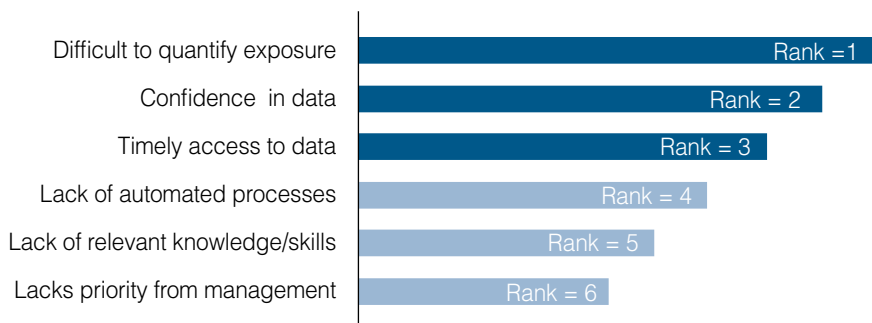


Figure 4: FX management top challenges



Confidence in FX Data is the wild card

While digging into company demographics and a variety of FX policy/practice details produced few correlations to FX results, asking respondents about the challenges they faced when trying to manage FX results finally hit pay dirt. Here, one prevailing issue emerged that defined the dilemma FX managers face every day, one that further explains why FX gain/loss results seemed indifferent to specific company business environments and immune to specific actions to mitigate currency volatility impacts.

When asked to rank their top FX management challenges, survey respondents overwhelmingly cited access to FX data, confidence in FX exposure calculations based on that data, and the timeliness of FX analysis as the biggest issues they faced. A lack of automated processes, lack of requisite knowledge/skills, and lack of management priority trailed behind these top concerns.

With a lack of transparency to the data that drives their FX exposure calculation and, hence, their risk mitigation decisions, FX managers have their hands tied. It stands to reason that no matter how aggressively you decide to mitigate FX risk, or how you decide to define your risk appetite in terms of currency exposure, you are not going to make

good decisions or get good results if you do not have confidence in your data.

Transparency is key

The real problem highlighted by these results is that, essentially, treasurers and controllers alike do not know what they do not know about their foreign currency exposure data. All too often, the problem only shows up after the fact, as a material misstatement of FX gain/loss with serious consequences.

To overcome the challenges identified in this survey and improve FX gain/loss results, corporate treasurers need to start by achieving greater awareness of the problem within their organization. Automated approaches to FX exposure management can help treasurers achieve broader and deeper visibility to the foreign currency exposure data they receive from accounting. With greater transparency, corporate treasurers are equipped to identify potential sources of error or inconsistency, increasing their confidence in their FX management decisions and outcomes.

Transparency to account-level foreign currency exposure details for all currencies gives corporate treasurers the evidence and insight needed to root out fundamental problems and achieve a complete and accurate FX exposure calculation.

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