J.C. Rathbone Associates Limited

FOREIGN EXCHANGE RISK MANAGEMENT

JCRA was formed in 1989 to provide independent advice to its clients on the management of foreign exchange and interest rate risk. Since then the company has expanded and is now the largest independent consultant in the UK working in this area. Based in London, it also has offices in Birmingham, Edinburgh, Leeds and Manchester, to ensure that it provides a timely and personal service. The company's principals are all experienced professionals, having worked at a senior level in the Capital Markets, Corporate Lending or Treasury Divisions of major banks.

FOREIGN EXCHANGE RISK

JCRA works with its clients to ensure that they manage their foreign exchange exposure in an efficient and cost-effective manner.

Specifically, a client may have one or more of the following types of foreign exchange risk:

i **Transaction Risk** – typically encountered by exporters and importers, where delivery takes place on a forward basis - the risk that the local currency value of foreign currency receipts will fall or that the local value of foreign currency payments will rise between the fixing of a contract and the date of payment or receipt.

This risk is encountered across many sectors: from manufacturers, through the travel industry to universities with foreign students. It is at its most significant in the case of cross-border acquisitions.

ii **Translation Risk** – encountered by businesses with overseas assets, liabilities or income streams: the requirement to translate the value of overseas assets and liabilities into the accounting currency at the end of an accounting period creates the risk that the balance sheet value of assets denominated in foreign currency will fall or that the value of liabilities will rise from one year to the next.

Unless this risk is correctly managed, it has the potential to deflate assets and/or inflate liabilities, adversely affecting banking covenants and restricting growth.

iii **Economic Risk** – the risk that the customer's core business, rather than an individual transaction, will be affected by adverse currency movements.

With increasing globalisation, capital moves quickly to take advantage of changes in exchange rates. Devaluations of foreign currencies can lead to increased competition in both overseas and domestic markets. Economic risk is the most crucial to hedge but is rarely addressed. For example, after sterling's expulsion from the ERM in September 1992, the pound's relative weakness dramatically improved trading conditions for British exporters. Unfortunately, if something is too good to be true, it usually is, and the advantage was short-lived. By April 1997, sterling had regained 2.7780 against the German Mark - the bottom of the old ERM band. Clearly, substantial advantage could have been gained by an appropriate hedging strategy.

Many situations typically involve more than one of the above risks. For example, a UK-based manufacturer with a US subsidiary may face transaction risk on its exports to Europe; translation risk on the sterling value of its US plant and the associated profit remittances; and the economic risk of a weaker Euro enabling foreign competition to enter its US and UK markets.

SERVICES PROVIDED BY JCRA

JCRA's foreign exchange services are split into two separate areas.

Recommendations on hedging strategies and structures

We undertake an in-depth analysis of our clients' business activities to ensure that actual and potential foreign exchange exposures are fully identified. This analysis may include not only clients' direct transactional or translational exposures, but also their indirect risk. These indirect risks might include, for instance, the differing impact that a movement in foreign exchange parities could have on an overseas-based competitor in becoming more competitive than our client.

Having completed the analysis of a client's exposure to foreign exchange rate movements we produce a written report, outlining the alternative hedging strategies that might be considered. Wherever possible, we look to incorporate a degree of flexibility so that a client need not 'lock in' to a particular rate but can maintain an ability to benefit from advantageous price movements. We always recommend a specific structure and provide a rationale for that choice in order to ensure that the hedging strategy is tailor-made to complement the client's business plan.

Pricing

Once a strategy and/or structure have been decided upon, with or without our input, JCRA can assist in achieving best pricing from the relevant bank or other provider, ensuring that the customer pays no more in terms of either premium or 'spread' than is absolutely necessary. We achieve this by benchmarking all hedging structures against the interbank market, to identify any spread that the bank may be charging. The value of this service is such that many customers instruct us to benchmark prices on a retained basis.

While we do not look to interfere in the relationship between our client and their bank, if our client is consistently overcharged we will work with them to set up alternative counterparty lines so that they can achieve best value pricing. Apart from producing lower credit charges, this also has the benefit of freeing-up utilisation of existing working capital facilities.

Different customers will attach differing levels of importance to strategy and structure in comparison to achieving best pricing. It is, therefore, important to note that the two services can be, and often are, taken completely separately. Any customer may choose either service, or both, according to their preference.

FRS13 and IAS39 Valuation

An extension of our pricing service relates to the FRS13 and, more importantly, IAS 39 accounting standards. These require companies to focus to a greater extent on the impact of their foreign exchange hedging policies and the structures used to protect their risk positions. The valuation process often draws attention to opportunities to restructure the hedging in a manner that better reflects evolving corporate development and changing market conditions.

FOREIGN EXCHANGE PERSONNEL

James Stretton is responsible for JCRA's activities in foreign exchange risk management and operates out of Leeds and London. Formerly with Citibank, he traded spot, forwards, futures and options as well as hedging most of Citibank's European capital. He ran his own consultancy before joining JCRA in 2002.

John Walker has specific responsibility for advising on the impact of changes in accounting and regulatory requirements, and specialises in valuation work. A Founder Director of JCRA, John is a Chartered Accountant and a member of the Association of Corporate Treasurers.

Ian MacFarlane is based in the London office and is involved in structuring long term hedging solutions on major transactions. Prior to joining JCRA in 1999 he was Head of Treasury at Daiwa Bank (Capital Management) Ltd, which included the foreign exchange risk management of the bank's capital.

Margaret Moss has specific responsibility for providing market related analysis and pro-active dealing advice, both internally and to clients. Margaret is a Founder Director of JCRA.

Miki Fairfax joined JCRA in 2001 having previously been with NatWest, providing treasury services to corporate clients. Based in Edinburgh, Miki has responsibility for the company's clients in Scotland and the North East.

Jonathan Dwyer is based in Birmingham and looks after the company's Midlands clients. He has experience of foreign exchange risk management from a corporate perspective, having previously worked for Royal Insurance and Acordis Ltd, before joining JCRA in 2001.

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