

# JCRA

## Financial Risk Consultants

Foreign Exchange Risk

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J.C. Rathbone Associates Limited  
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# Foreign Exchange Risk

Foreign exchange markets are over three times more volatile now than in 2007.

Many companies underestimate this tripling of risk to their earnings and balance sheets.

J.C. Rathbone Associates Ltd (JCRA) is an independent financial risk management consultancy which provides advice on appropriate means and fair pricing to manage foreign exchange risk. Our services cover transaction and translation risks in all their varieties.

Our clients range from importing and exporting companies, private equity investors, and fund managers to real estate investors & developers and contractors to major infrastructure projects. They are located in the UK, Europe, America, the Middle East and Asia, but their foreign exchange exposures reach many more countries.

## Transaction Risk

- The rates at which future foreign currencies are actually received or paid can move adversely in the meantime
- Based on not only the headline (or “spot”) rate, but also forward interest rate adjustments for future dates and the cost of options
- Affects the import and export of goods, services and commodities, payments and receipts of interest payments and earnings, private equity acquisitions and disposals, fund portfolio adjustments and rollovers
- Affected by changes in liquidity, available tenors and even capital controls
- Can be hedged effectively, efficiently, transparently, flexibly and cheaply
- Often hedged ineffectively, inefficiently, opaquely, inflexibly and expensively, where only the bank fully understands the contract
- Often misinterpreted and mismanaged (including the existence of the risk itself and even the correct currency)

## Translation Risk

- Volatility in rates at which overseas assets and liabilities are revalued risks substantial losses
- Exposures are long-term, even infinite in tenor, so awkward to manage
- Must be managed carefully to reduce the risk of unwelcome cash calls by banks, if the hedge itself incurs losses
- Sufficient long-term foreign exchange lines may not always be available
- More credit-efficient strategies are often required, even with zero premium





## Risk Management from Banks

- Banks sell products
- Bank salespeople can lack the time or even expertise to analyse the nature of the risk in detail
- Bank advice can be skewed towards requiring a hedge to be transacted
- Bank strategies can include additional clauses affecting the hedge protection in conditions of extreme volatility; these help to improve the initial price if margins are wide, but the core hedge benefit can be lost entirely
- Pricing of derivatives is opaque to those without specialist software or experience in derivative pricing

## Independent Risk Management

- Bank disclaimers recommend seeking independent advice
- Important to examine cashflow and balance sheet exposures in detail
- Thorough examination of worst-case exchange rates, the relative need to retain competitiveness in the relevant business sector and attitude to risk
- Assessment of liquidity, depth and tenor of markets and pricing constraints
- Review of both the suitability and price of hedge strategies suggested by banks
- If necessary produce alternative solutions better suited to the specific profile of each client and their exposure
- Benchmark pricing on all trades executed with a counterparty, no matter how complex

## Why JCRA?

- We provide independent advice in the best interests of our clients
- We take the time to understand the true as opposed to apparent exposures
- We consider the exposure in terms of each client's specific business needs, rather than a template
- Our experience in capital markets gives insight into the most complex hedge strategies proposed by banks
- We aim to simplify unnecessary or dangerous hedge proposals, so that the benefits and weaknesses are clear to our clients
- We advise where practical on achieving natural hedges to minimise rather than to increase ongoing hedge transactions
- We benchmark all pricing through our sophisticated pricing models, verify the ensuing documentation and offer independent revaluation of existing positions



It makes sense to be prepared [www.jcra.co.uk](http://www.jcra.co.uk)

# JCRA

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