Top tips for currency hedging

by Farah Khalique

Hedging experts share their advice on how to find the most suitable product and negotiate the best possible price, and what to do if your hedges go pear-shaped.

Volatility in currency markets remains elevated and has reinvigorated demand for products such as currency forwards and options, which can protect the buyer from moving exchange rates.

These products are typically sold by banks, and require a greater degree of consideration than buying simple spot foreign exchange. Corporates treasurers still commonly buy options, particularly more complex structures, over the phone as opposed to on electronic portals.

Have someone on a call with you when pricing a transaction live with the bank

Abhishek Sachdev, Vedanta Hedging

Fail to prepare, prepare to fail

The Association of Corporate Treasurers (ACT) supports and educates its members on the importance of hedging against currency risk.

Will Spinney, associate director of education at the ACT, advises treasurers to "get it right from the start" by selecting the most appropriate product and comparing prices before picking up the phone to the bank.

"Before [any corporate] even starts to talk to their bank, they should make sure of what they're buying," says Spinney. "The danger is that they get sold something which is inappropriate.

"I'm a firm advocate for keeping things simple by using vanilla options and forwards."

Corporates can use real-time pricing and analytics software to indicatively price an option, offered by the likes of Bloomberg and SuperDerivatives, before committing to buy.

However, a Bloomberg terminal costs upwards of $20,000 a year, which is prohibitive for some companies, and they can be a minefield to navigate.

Negotiate hard

Vedanta Hedging is an independent derivatives consultant that works with businesses to ensure they get the most competitive pricing on their derivatives pricing.

Founder Abhishek Sachdev says some companies, even those that have a dedicated treasurer and finance director, prefer to use the services of a firm such as Vedanta to act as a middle-man and negotiate on their behalf.

"My advice is have someone on a call with you when pricing a transaction live with the bank, to make sure the price is as low as possible and not generating any additional profit for the bank," he says.

"We use Reuters and Bloomberg to price these services on a live, real-time basis. Often on a call with a client the bank might say the cost [to buy an option] is £150,000 for the next six months and we say the actual cost might be £90,000, so we think a fair cost should be £120,000."

The negotiation process is the time to secure the best deal.

Jackie Bowie, CEO,
JC Rathbone Associates

Jackie Bowie, chief executive officer at consultancy firm JC Rathbone Associates, says it is all too common for corporates to relinquish their rights when structuring a derivative, such as the right to extend the option.

If markets move in the customer's favour, they might want to extend their option and pocket a gain, but often the customer has unwittingly handed over this right to the bank in return for a better headline exchange rate on their derivative.

"Why give that control to the bank?" she asks. "Keep that to yourself. An extension should be the customer's right and not the banks. Any flexibility should always be in the customer's favour, but unfortunately with structured FX products it is usually the other way around.

"Pay a slightly worse rate, but in return ensure you retain control of your own hedging. You can easily put this in to suit you."

The advice Bowie gives to finance directors is: "If you get your FX right, your shareholders and board will say you got lucky, but if you get it wrong, you lose your job."

Fix a pear-shaped hedge

Nevertheless, hedges can move in unexpected directions. When volatility surges and markets move in unexpected ways, such as when **the Swiss National Bank scrapped its EUR/CHF 1.20 cap**, a corporate can be triggered out of their option and left completely unhedged.

They can go back into the market and re-hedge, but at a worse rate than the original hedge.

It is important to quickly take steps to rectify the hedge, such as seeking independent advice on how best to restructure it. Corporates should beware a salesperson who says they can sell "another great product" to hit the company's budget rates, say by selling a forward rate that is not even available in the market.

Bowie says: "There is no free lunch in derivatives. I often see people try to engineer something to protect their budget rate, which can be a mistake.

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