

Don't just take the risk, understand it

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Bank of Ireland 

Global Markets

Key contacts



Barra Cryan



Barra.cryan@boi.com



www.linkedin.com/in/barracryan



Conor Haugh



Conor.haugh@boi.com



www.linkedin.com/in/conorhaugh



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- Bank of Ireland's international treasury colleagues in US and UK, and
- A team of regional treasury managers across the Country



268
branches

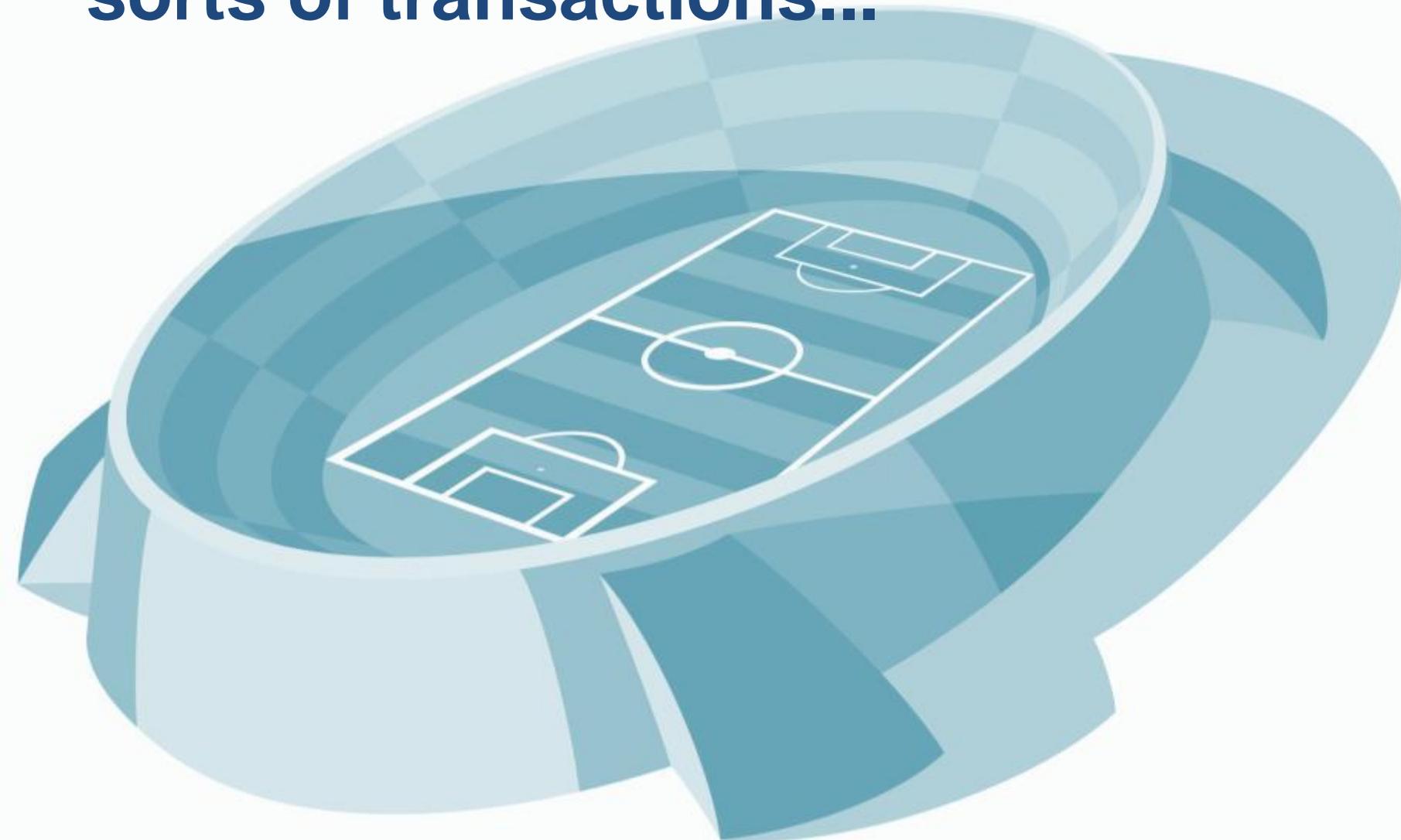


Workbench
network

There's potential currency risk in all sorts of transactions...

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Currency risk – the basics

FX Foundations 1



FX Solutions 2



Managing currency risk

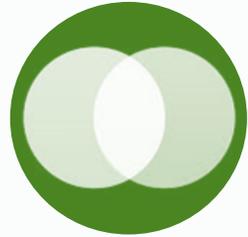
	Removes currency fluctuations	No upfront cost	Known worst case	Known best case	Flexibility
Spot	x	✓	x	x	x
Forward	✓	✓	✓	✓	x
Option	✓	x	✓	x	✓

- What level of currency volatility can your business tolerate?
- Do you favour flexibility or control?
- Do you need a range of solutions for different situations?

Forwards - *Today's rate in the future*



Spot rate



The interest rate differential between the two currencies

A company wants to lock in the value of **£1 million** versus **€** today for value in three months:

$$\begin{aligned} \text{Current EUR/GBP Exchange (Spot rate)} & \mathbf{0.8950} \\ + \\ \text{3 Month Interest Rate Difference*} & \mathbf{+0.0016} \\ = \\ \text{Forward Contract Rate} & \mathbf{= 0.8966} \end{aligned}$$

**As GBP interest rates are higher than EUR interest rates the customer is compensated by the bank.*



Currency account – a “natural” hedge



A separate account that you can use to pay and receive in the same foreign currency

Use to “net off” payments in and payments out in the same currencies

Interest rate risk

Fix
Float
Blend
But do it
on purpose



Don't just take the risk: understand it

Creating a treasury policy

Identify, understand & document risks

- What level of currency / interest rate risk can your business safely tolerate?
- Should you 'fix' or 'float'?
- Is exchange rate risk priced into your products/services?



Define roles and responsibilities

- Who needs to be involved?
- What needs to be done?
- Who needs to know about the policy?



Agree the strategy



Document the policy and agree with stakeholders, so it becomes the policy of the company, not one person.

Execute, monitor, review

This is when the work really begins!



Case study: Irish Artisan Dairies (IAD)



1st June 2016, IAD agree a 12 month contract to supply a UK multiple with **1 million units of product @ £0.85 = £850,000** (monthly income of £70,833).

EUR value of this contract at prevailing exchange rate of 0.7736 in June 2016 = **€1,098,759** (€91,563 per month).

IAD's production costs = €1.00 per unit. IAD are being paid / receiving £0.85 per unit @ EUR/GBP exchange rate of 0.7736 = €1.099 per unit, producing a profit **margin of c.9.9%**.

IAD now have a **EUR v GBP** foreign exchange exposure to manage for the term of this contract.



2016 - A year of surprises

EUR/GBP rate

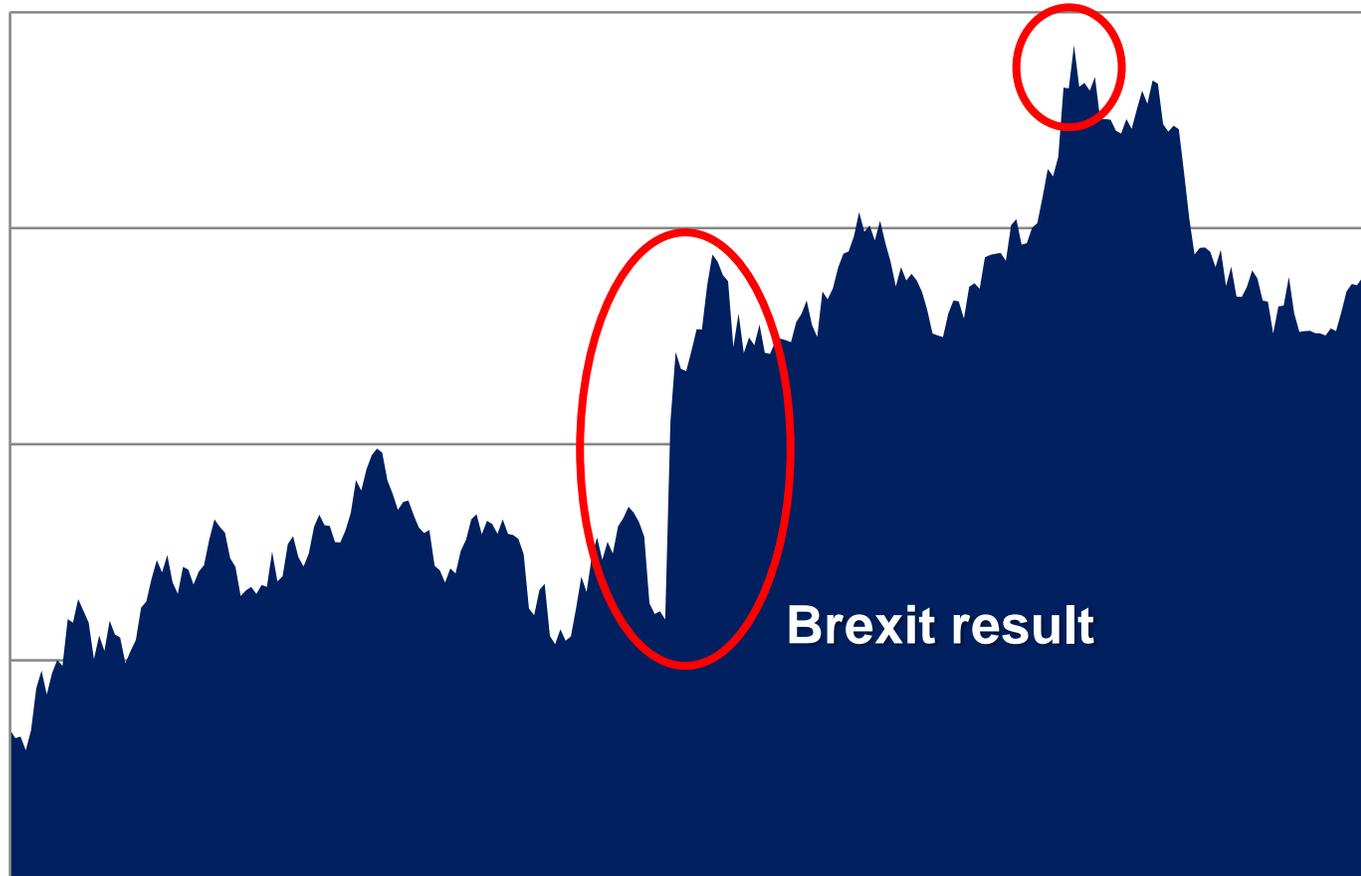
€1 / £0.90

€1 / £0.85

€1 / £0.80

€1 / £0.75

€1 / £0.70



Brexit result

Source: Reuters

- The range was only 5% in the whole of H1
- 8% move on “Brexit Night”
- Substantial increase in H2 volatility

Case study: Irish Artisan Dairies

Identify & Understand the risk: e.g. 1% move in GBP impact on profit

Define Roles & Responsibilities: Finance, senior management

Agree The Strategy: Cover forward or leave unhedged?

Execute, Monitor, Review: Is this approach working?
Are your profits adequately protected ?

What did IAD do?

In this case IAD chose to lock in the exchange rate using a Forward Contract, at an average EUR/GBP exchange rate of **0.7788**.

At this hedged rate, the contract provided IAD with guaranteed income of **€1,091,423** and protected their estimated margin of c. **10%**

What would have happened had IAD not hedged transacted at Spot Rates each month:

IAD would have achieved an average EUR/GBP exchange rate of **0.8605** over the 12 month term of the contract.

Total income under the contract would have been reduced to **€987,798**, resulting in a significantly different outcome for IAD - a **loss** of **1.2%**

Let us help

- In branch
- Your business banking manager
- Regional treasury specialists

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Barra Cryan



Barra.cryan@boi.com



www.linkedin.com/in/barracryan



Conor Haugh



Conor.haugh@boi.com



www.linkedin.com/in/conorhaugh

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