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FX Hedging Policy Template

Introduction

If your business operates internationally, you're likely dealing with foreign exchange (FX) risk. Financial derivatives are a great way to manage this, helping reduce the impact of currency fluctuations on your financials. A robust FX hedging policy is essential—it should clearly define risks, strategies, and goals, making sure everyone's on the same page. It needs to be detailed enough to provide clear guidance but flexible enough to adapt as your business grows, enters new markets, or undergoes mergers.

FX Hedging Policy Components

1. Objectives

First, lay out your risk management goals. These should align with your company's overall objectives and be clearly defined for all stakeholders. The policy should cover all relevant entities and use measurable metrics like EPS, EBITDA, or FX gain/loss. Different hedging programs (cash flow, balance sheet, etc.) may have distinct objectives, and your policy should reflect that. Make sure risk tolerances are clearly defined and quantified.

2. Definitions

It's important to clearly define key terms. This helps keep everyone on the same page and ensures consistency in how risks are managed. Terms to define include different types of FX risk, derivative products, sources of risk, and what your hedging priorities are. Defining what should and shouldn't be hedged is also crucial.

3. Strategies

This section should specify what will be hedged, what won't, the length of your hedging programs, and the products you'll use. Be clear about which entities are covered and whether you'll allow flexibility or stick to specific ratios and durations. All hedging strategies will be implemented using the Bound platform, where you can access the necessary products and programs.

4. Responsibilities

It's essential to define who in the company has the authority to make hedging decisions. There should be a clear separation of duties, and responsibilities must be well-defined. Many companies now favour a centralised approach to risk management, which can provide consistency and a holistic view. Management approvals should be based on the size and duration of trades, and any relevant committees or decision-makers should be identified.

5. Controls & Monitoring

This section focuses on how the hedging program will be operationally managed. It should cover reporting responsibilities, trade confirmation processes, how you'll monitor hedging effectiveness, and how mark-to-market valuations will be handled. Additionally, ensure your FX manager sticks to counterparty credit limits and reference any separate counterparty policy that may apply.

6. Regulatory Considerations

Ensure your policy addresses relevant regulatory requirements, such as EMIR reporting, if needed. It's a good idea to design your policy to be adaptable to any future regulatory changes as well.

7. Accounting Considerations

While detailed accounting information is usually kept in a separate policy, it's important to ensure alignment between your FX hedging and accounting policies, especially when it comes to hedge accounting and the supporting documentation required for your hedging programs.

The draft FX hedging policy provided here is a flexible framework you can tailor to your company's specific needs. Policies vary depending on business models, risk exposure, and how much flexibility or detail is required. This example is for illustrative purposes only—it's not a specific recommendation for products, strategies, or accounting treatments.

Text that is both coloured in purple and put in square brackets []are expected to be replaced by what is relevant to you. Every FX policy should be customised to fit your unique goals and situation.

FX Hedging Policy Template

Statement of Purpose

The purpose of this policy is to outline the objectives, policies, procedures, and practices for [Company name]'s management of foreign currency exposures. This includes identifying, measuring, and mitigating these risks. Managing FX risk means using tools like cash flow management or hedging to limit the impact of currency swings on our [Functional currency] cash flows.

The Board of Directors, [Appropriate Committee], and senior management are responsible for establishing a comprehensive set of policies regarding the use of derivatives (or "hedges"). These policies should align with the company's overall strategy, commercial objectives, risk tolerance, and financial capacity and flexibility.

Scope

This policy applies to [Company name] and all its subsidiaries (referred to as "the Company").

Objectives

The main objective of FX risk management is to minimise the impact of foreign exchange rate fluctuations on the Company's earnings and the fair value of its assets and liabilities, while avoiding unnecessary risk. The Company will generally implement currency risk mitigation strategies that minimise reported earnings volatility under Generally Accepted Accounting Principles (GAAP) or International Financial Reporting Standards (IFRS), while also supporting its strategic economic goals and ensuring enough liquidity and flexibility.

Definitions

Authorised Representatives: Designated employees, officers, or directors of the Company (e.g., CFO, Treasurer, Assistant Treasurer) who are responsible for evaluating and executing swap trades. These individuals are approved by the Board based on their education, experience, and industry knowledge.

Cash Flow Hedge: A derivative used to hedge the risk of variability in cash flows

associated with a recognized asset, liability, or forecasted transaction.

Dealing Mandates/Board Resolution: An official document signed by an authorised representative listing individuals authorised to enter foreign exchange contracts on behalf of the Company. This includes timely notification of any changes in the status of such individuals.

Derivatives: Financial instruments whose value is dependent on underlying variables or assets (e.g., interest rates and exchange rates). The Company may utilise certain derivatives for hedging FX exposures, tailored to its risk tolerance and understanding of these instruments.

- ➔ **Currency Swap**: A transaction combining a spot or forward FX deal with a forward contract in the opposite direction executed simultaneously. Swaps are typically used to manage balance sheet risk or adjust the maturity of an existing forward contract.

- ➔ **FX Forward Contracts**: Contracts to buy and sell currencies at predetermined amounts, settlement dates, and exchange rates. These are used to lock in rates for future transactions and mitigate the impact of adverse currency movements. The forward rate is calculated by taking the spot rate and adding or subtracting forward points, which are determined by interest rate differentials between the two currencies being exchanged.

- ➔ **Vanilla FX Options**: Options provide the right (but not an obligation) to buy and sell currencies at predetermined amounts, settlement dates and a specific rate (strike rate).The options holder does not need to wait until the settlement date to close out an options trade, nor do they need to exercise the option.

Foreign Currency: For [Company name], a [Location] based entity, "foreign currency" refers to any currency other than the [Functional currency].

Functional Currency: The currency of the primary economic environment in which a Company or subsidiary operates.

Margin Risk: The risk arising from the mismatch between the currency of revenues and expenses, which impacts operating margins and cash flows. Margin Risk can arise due to Transactional Exposures and Translational Exposures.

Mark-to-Market (MTM) Hedge: A derivative not designated for hedge accounting,

marked to market through profit and loss as its value changes. Typically used for managing Re-Measurement Risk.

Re-Measurement Risk: The risk associated with recalculating the value of booked but unpaid revenues and expenses in functional currency terms. Re-measurement of these line items is booked in the Other Income/Expense line item under FX Gain/Loss, and can contribute to volatility in Net Income.

Functional currency: The currency in which the entity prepares its financial statements.

Transactional Exposure: Exposures arising from trade-related activities that generate non-functional currency revenues and expenses, as well as from settlement-related activities that create non-functional currency receivables and payables.

Translation Exposure: The risk related to translating a foreign subsidiary's income statement and balance sheet into the [Functional currency] for consolidated financial reporting.

Accessible FX Products

The company will stick to simple, plain vanilla derivatives—just like those used by other companies—to manage FX risk. We don't use derivatives for speculation, and leveraged instruments or anything that's hard to value for Mark-to-Market purposes. Approved products include:

- FX Spot
- FX Forward Contracts
- Currency Swaps
- Vanilla FX Options

Available Hedging Programs

Forwarding

Forwarding program that locks in exchange rates with an FX Forward Contract, resulting in a known, fixed rate. Drawdowns are performed using the 'split' feature, which books a Currency Swap for the drawdown amount at an earlier settlement date. Amendments of trade amounts and settlement dates can be made at any point during the period via Currency Swaps.

Averaging
Averaging program that splits the exposure into smaller forward trades booked each day for the specified duration of the averaging program. The result is a trailing average of the market rate, which has a reduced volatility. Amendments of trade amounts and settlement dates can be made at any point during the period via Currency Swaps.

Ranging
Ranging program that simultaneously sets a Stop, Limit and Market Orders in order to keep exchange rates contained within a desired range. The result is a limitation of potential loss while allowing for some positive movement. Should any one of three Order types trigger, the remaining two orders will simultaneously cancel. Amendments of trade amounts and settlement dates can be made at any point during the period via Currency Swaps.

Strategy

[Company name] deals with foreign currency risk as part of its daily operations, with a portion of revenue, expenses, and capital activities in foreign currencies. The [Treasury/Finance team] will prioritise natural hedges to offset FX exposures where possible. If there's still material risk, we'll look to hedging within set limits.

We break FX risks into two categories:

1. **Margin Risk**: This is driven by projected revenues and expenses, impacting operating margins and cash flows. We can hedge up to [100]% of net exposure, with a tenor of up to [12] months.

2. **Re-Measurement Risk**: This comes from recalculating [Functional currency] values of booked revenues and expenses, impacting net income. We aim to hedge [100]% of this risk per reporting period, with any remaining converted at the spot rate.

Chosen Hedging strategy

E.g.
[Company name] has decided to lock in the exchange rate to achieve the desired budget rate of [x.xx]. This will be achieved via a 'Forwarding' program.

[Company name] has decided to build into and maintain a trailing average of [6 months]. This will be achieved via an 'Averaging' program with [6 month] cruise control settings.

[Company name] has decided to put a protection level in at a rate of [x.xx] and target level at a rate of [x.xx]. FX Transactions at rates within this range are allowed. This will be achieved via a 'Ranging' program.

Hedging Entities

Hedges will usually be placed at the entity with the underlying exposure, but we'll also consider credit strength, accounting, and tax implications to make sure the right entity in the Company's structure is used.

Cost Considerations

We'll execute hedging transactions as efficiently as possible, considering factors such as:

- ➔ Fees
- ➔ Market pricing, including interest rate and credit considerations
- ➔ Transaction sizing for maximum liquidity and pricing efficiency
- ➔ Counterparty relationship considerations

Controls and Monitoring

Performance Monitoring: We check in on how our FX risk management program is doing every quarter. That means looking at how the risk profile has shifted, how effective the strategy is, how the accounting is holding up, and ensuring we're in line with regulations.

Policy and Program Review: This policy will undergo an annual review and approval by the [Treasury/Finance team]. A significant change in our capital structure or hedging program may need us to revise it sooner.

Counterparty Risk Management: Approved counterparties will be selected based on;

- ➔ Strong credit or cash management relationships
- ➔ Minimum long-term debt ratings from top credit agencies
- ➔ An established trading relationship under an ISDA Master Agreement (or similar)

Controls: Only certain people—the [Chief Financial Officer, Treasurer, Assistant Treasurer, and Treasury/Finance Manager] are authorised to enter into foreign exchange contracts on behalf of the Company. The [Treasurer] may delegate this if needed, but if there's any deviation from the policy, the [Chief Financial Officer] has to give written approval. A signed dealing mandate will be shared with all financial institutions.

Our policy is a guide for managing FX hedging. Sometimes, a foreign exchange deal might align with the Company's best interests and this policy's objectives, even if it doesn't fit the guidelines outlined. In these cases, the [Treasury Manager] may go ahead with it, provided the following;

- ➔ The [Chief Financial Officer] approves the deal in writing before it's done.
- ➔ These exceptions will be reported to the [Chief Executive Officer and the Board of Directors] in the [monthly/quarterly] Foreign Exchange Report.
- ➔ In the event of a policy breach, the [CFO] must notify the [Board of Directors] right away or in the next [monthly/quarterly] Foreign Exchange Report.

Internal Accounting Controls: The [Treasurer] will recommend foreign exchange transactions, and the [Chief Financial Officer] will approve all hedging strategies. Only the [Chief Financial Officer, Treasurer, Assistant Treasurer, and Treasury/Finance] [Manager] can execute these transactions. The [Financial Controller] will make sure the internal control procedures are compliant, and record accounting entries.

Once a hedging strategy is approved by the [Chief Financial Officer], the [Treasurer] will execute the contracts with the following procedures;

- ➔ All transactions must be recorded right away, including the methods of execution (E.g.,through an online platform for the best pricing or over the phone)

- ➔ The [Treasurer or finance staff] will share the contract details with the [Financial Controller]— like the currency, amount, contract rate, and reason for the hedge. These details are cross-checked against our internal system.

- ➔ FX transaction confirmations will be sent to the [Financial Controller], who will log them. If we don't get a confirmation within three days, the [Financial Controller] will follow up with the counterparty to verify the trade.

- ➔ The [Financial Controller] will also compare the counterparty's record of the transaction with the Company's confirmation ensuring a match. Investigating any

discrepancies and flagging them to the [Chief Financial Officer].

At the end of each month, the [Financial Controller] will go over all FX-related cash transfers, making sure everything is as expected. These transfers will also be reviewed quarterly against the FX Contract Summary to support entries for unrealized gains or losses on open FX contracts.

Reporting: A [monthly/quarterly] Foreign Exchange Report will be prepared by the [Treasury/Finance team] and reviewed by the [CFO], covering;

- ➔ Net transaction exposure by currency and recommended hedging actions
- ➔ A summary of open FX contracts
- ➔ Results of closed positions
- ➔ Any policy violations or exceptions

The report will be shared with the [CFO and Treasury/Finance Manager], with a quarterly review by the Board of Directors.

Roles and Responsibilities: The [Board of Directors] approves:

- ➔ Types of derivative contracts for hedging FX risk
- ➔ Use of derivatives for non-FX risk purposes
- ➔ Rules around uncleared derivatives

The [Senior Management/Treasury/Finance team] are responsible for:

- ➔ Identifying risks and setting hedging objectives
- ➔ Setting trading limits and segregating duties
- ➔ Executing hedging transactions
- ➔ Monitoring hedge portfolio fair values and their effectiveness
- ➔ Monitoring the Company's FX risk exposure

The [Treasury/Finance team] will:

- ➔ Report FX activity results to the [CFO] quarterly and provide regular MTM and realised gains/losses updates.
- ➔ Send all trade confirmations and provide all contract-related information

Application of Hedge Accounting (Optional)

The Company follows the rules when it comes to accounting for derivatives, with proper procedures documented separately. All derivatives are recorded on the balance sheet at their current Mark-to-Market value, unless hedge accounting is applied. Designated hedges are managed according to regulations, with the impact reflected in stockholders' equity and earnings.

Detailed procedures for hedge accounting are outlined below:

The Company hedges exposures to fluctuations in the [Functional currency] value of anticipated foreign exchange cash flows. These exposures arise from forecasted revenue and expenses denominated in non-[Functional currency]. For derivative instruments designated as cash flow hedges, the after-tax gains or losses from are recorded as a component of "Accumulated Other Comprehensive Income (Loss)" in stockholders' equity and is moved into earnings when the hedged item affects earnings.

We may also hedge net investments in certain foreign subsidiaries whose functional currency is not the [Functional currency]. For derivative instruments designated as net investment hedges, with effective gains or losses recorded in "Cumulative Translation Adjustment" within stockholders' equity, alongside changes in the hedged items.

Disclaimer

This template foreign exchange policy has been developed by Bound Rates Limited based on the experiences and insights of its employees. The policies and provisions included are suggested language reflecting these observations. This document is intended to serve as a guide to help companies draft their own policies that align with their specific needs, risk tolerance, foreign exchange activities, risk management strategies, and reporting procedures, as determined by their management, board of directors, and advisors (including tax, accounting, and legal experts). It is strongly recommended that any foreign exchange policy, whether based on this template or not, be reviewed and adjusted as per the company's specific requirements by the company's advisors, legal counsel, consultants, management, and board of directors.

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