

Risk Events: Strategies to Mitigate Foreign Currency Exposure

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Presenters



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John is a Managing Director in the Foreign Exchange Division at First Republic Bank. As a currency advisor John is responsible for providing risk management solutions and hedging solutions to throughout the banks' footprint with an emphasis on alternative asset firms. John joined First Republic Bank in 2011.

Prior to joining First Republic Bank, Mr. Frey worked at Morgan Stanley as a client service associate, where he managed business development and day-to-day client needs.

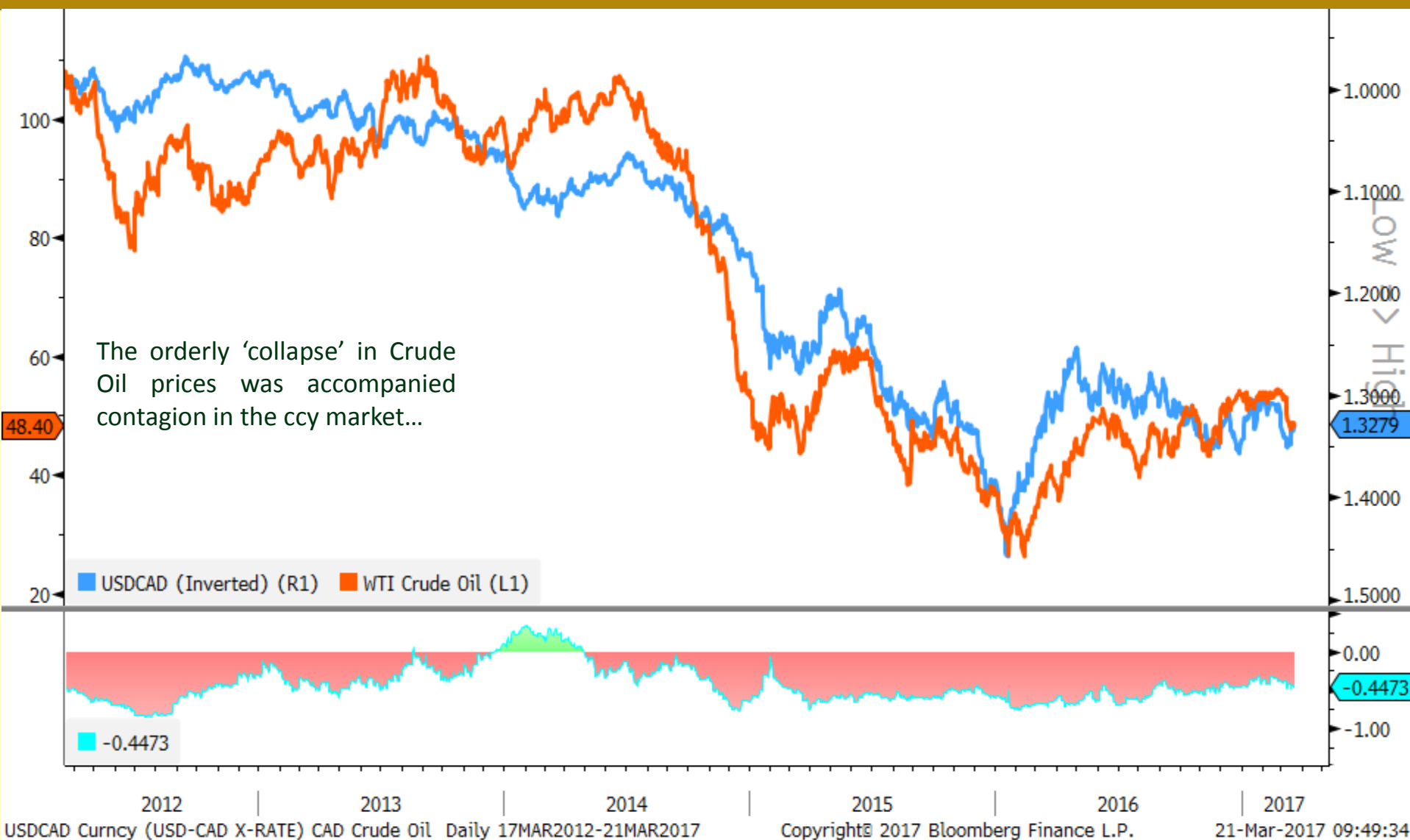
Mr. Frey earned his Bachelor of Science degree in Business Administration & Small Business Management from Southern New Hampshire University

Overview

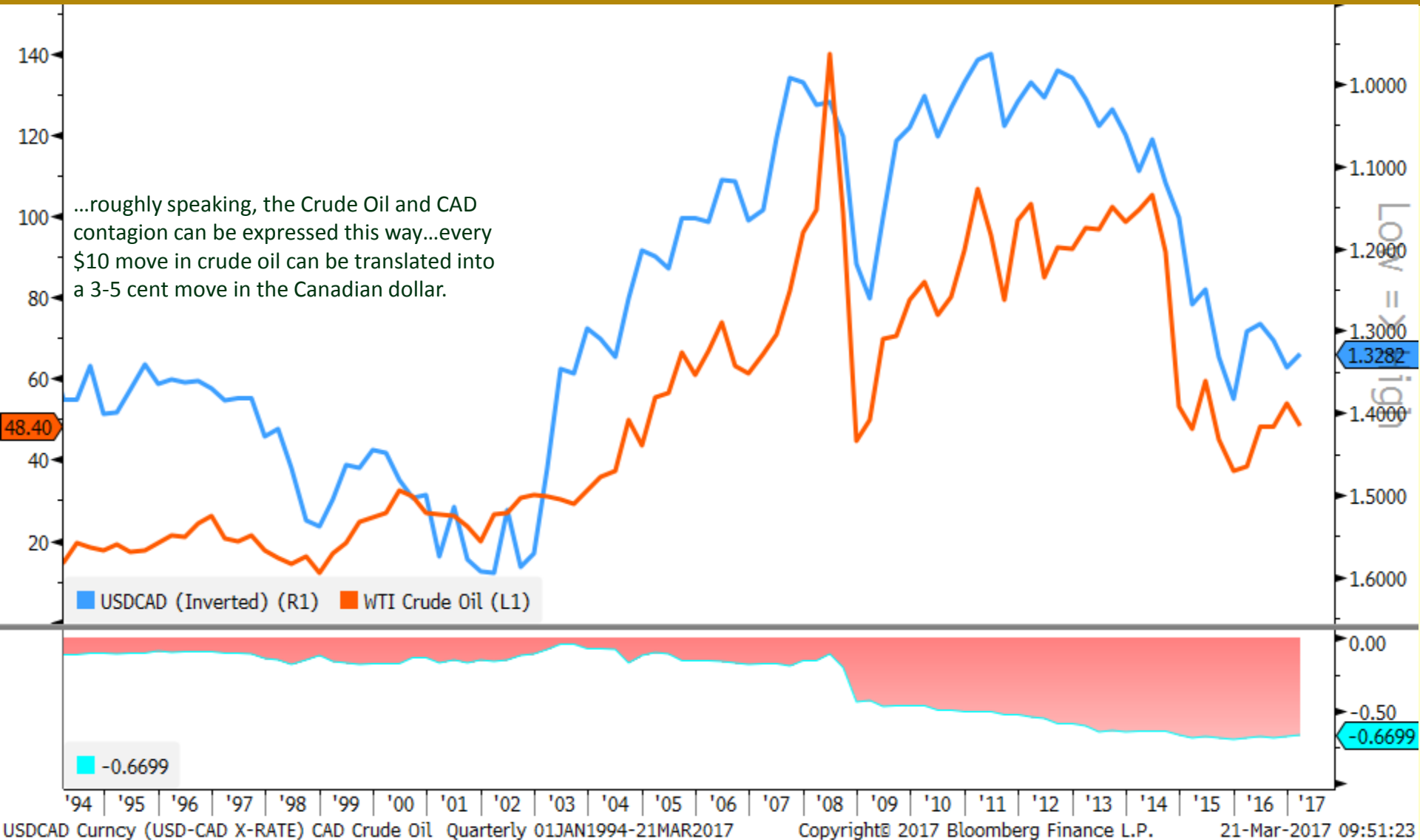
- 1. Event Risk Past & Present**
- 2. FX Hedging Product Review**
- 3. Brexit Effect on an Investment**
- 4. Risk Events on the Horizon**

Event Risk Past & Present

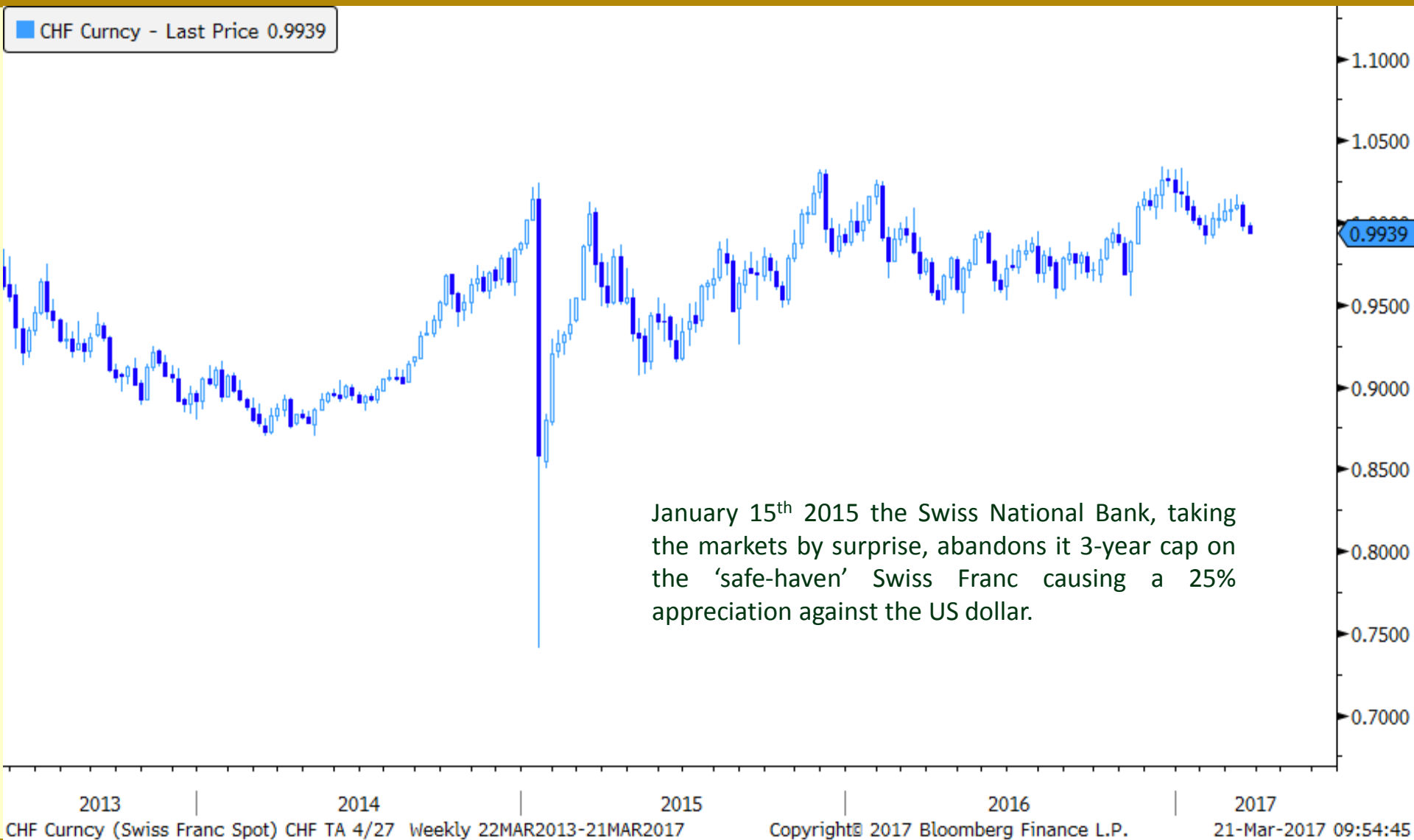
Crude Oil and the Impact Currencies



USD/CAD and Crude Oil



USD/CHF and the SNB



GBP/USD



The 'Brexit' Referendum was expected to result in the UK remaining in the EU. Polls showed that the Remain campaign held a slight lead going into the actual voting day. Early in the day price action even mirrored a 'remain' outcome with the GBP/USD initially rallying to the 1.50 level before a historic collapse.

EUR/USD



...not often mentioned as much, but not forgotten was the other side of the Brexit vote which has weighed heavily on EUR/USD.

FX Hedging Product Review

Hedging FX Risk with Forwards

Forwards lock in an exchange rate today to sell a foreign currency against USD on a specific future date or dates

Outright Forward Contracts

- Exchange rate, amount, and date(s) are set
- Complete protection from currency downside /no benefit from currency upside
- Binding commitment to transact

Non-Deliverable Forward Contracts

- Non-delivery forwards are used for restricted currencies, such as China or Brazil:
- No foreign currency exchange at maturity
- Instead, the trade unwinds for spot value, 1 or 2 days before maturity
- Achieves the same USD cash flow protection as a delivery forward



Hedging FX Risk with Options - Vanilla

A vanilla call / put option is the **right but not the obligation** to buy / sell a specified amount of a foreign currency against USD at a specified rate on a specified date.

Protection from adverse moves but benefit from favorable moves

Requires upfront premium, which varies according to strike rate

- Higher premium = higher strike rate = greater protection
- Cheapen premium by setting strike “out of the money” from current market
- Useful for budget rate protection and uncertain exposures

Flexible

- You set the currency, date, and strike rate
- Ability to sell back the option at any time



Hedging FX Risk with Cashless Options

Participating Forwards

- Purchase a put option on 100% of notional exposure and sell a call on a percentage of notional exposure* (e.g., 50%, 70%, etc.)
- 100% protection at strike rate
- Unlimited benefit from favorable movement via the call for, e.g., applies to 50% or 30% of notional



Hedging Product Decision Matrix

	Up Front Premium	Binding Obligation	Provides Protection	Allows for Participation	Credit Profile	Flexibility
Forward Outright	No	Yes	100%	0%	Fully Collateralized	Yes Rolling Hedge
Vanilla Option	Yes	No	100%	100%	0 Collateral Required	Yes Product can be customized to fit needs
Participating Forward	Not required	Partial	100%	Unlimited on floating piece of the structure	50% Collateralized	Yes Product can be customized to fit needs

Foreign Currency Accounts

A foreign currency account can increase the efficiency and ease of making transactions in other countries as well as provide a way to diversify your currency holdings.

Benefits

- With several major currencies (EUR, JPY, CHF) having negative deposit rates having a non interest bearing Foreign Currency Account can have an immediate cost savings
- Service focused on flexibility, planning and customization to suit the specific needs of your business
- Helps to avoid unnecessary foreign exchange conversions
- Holding place for currency received overseas to use for future outgoing payments
- Allows for local currency purchases when rates are most attractive

Product Details

Account domiciled in the U.S. and maintained during regular U.S. business hours

Brexit Effect on an Investment

Brexit Effect on an Investment

A PE firm purchased a UK based company 5 years ago for GBP 15MM. The company has been successful and on January 1, 2016 the PE firm made the decision to sell the asset for GBP 40MM in the next 6 months. The fund will receive GBP proceeds from the sale which will then be converted to USD.

Hedging Decision	USD Value at Expiry
Forward Outright	\$ 58,736,000
Vanilla Put Option	\$ 57,106,000
Participating Forward	\$ 57,560,000
Unhedged	\$ 53,244,000

Strategy Selection and Risk Tolerance

Other factors to consider when analyzing how to hedge an international investment or asset:

Hedge all or a percentage of total exposure?

- Managing a percentage of total currency exposure allows for forecasting error and reduces the risks associated with over-hedging.
- Hedging 50% of a currency exposure is a market neutral view.

Determining a hedge horizon

- Selecting a value date based on the ability to forecast the currency exposure (tiered hedging program).

Evaluating costs

- Should the firm utilize strategies with an cost upfront? Or zero cost strategies which limit opportunity?

Risk Events on the Horizon

Plenty of Dry Powder

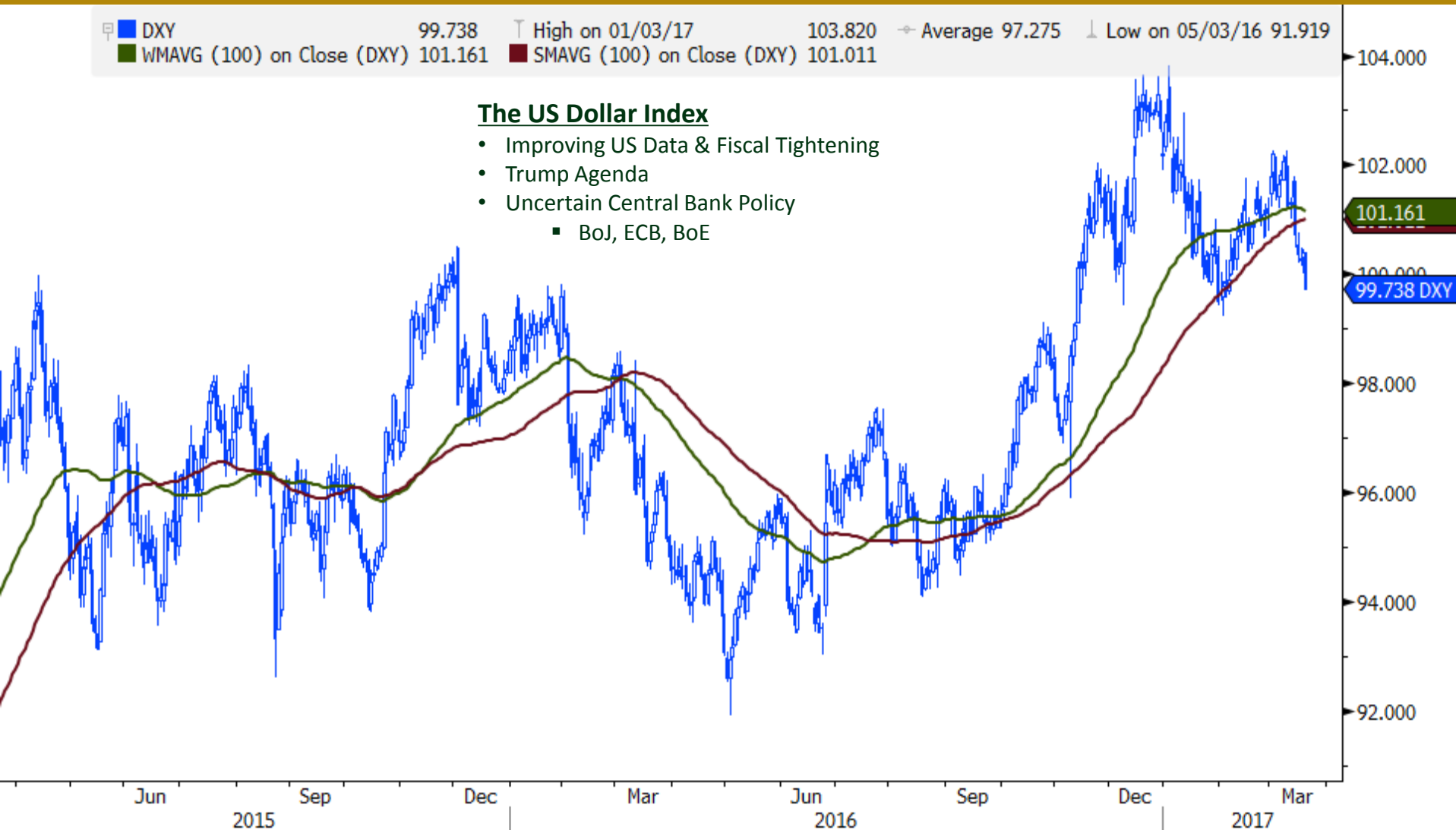
- **Continuation of Uncertain / Divergent Central Bank Policy**
 - FOMC, ECB, BoE, BoJ
- **Brexit Negotiations**
 - May set to trigger Article 50 on March 29, 2017
- **NAFTA Negotiations**
 - Trump vocal about rewriting NAFTA to be more “Pro-America”
- **French Elections**
 - Fear of “Frexit”
- **CNY Becoming More Freely Traded**
 - PBoC actively managing central bank policy to increase global interest in CNY

A very broad USD outlook w/ the DXY

■ DXY 99.738 ■ WMAVG (100) on Close (DXY) 101.161 ■ SMAVG (100) on Close (DXY) 101.011
↑ High on 01/03/17 103.820 ↔ Average 97.275 ↓ Low on 05/03/16 91.919

The US Dollar Index

- Improving US Data & Fiscal Tightening
- Trump Agenda
- Uncertain Central Bank Policy
 - BoJ, ECB, BoE



DXY Curncy (DOLLAR INDEX SPOT) DXY Daily 21MAR2015-21MAR2017

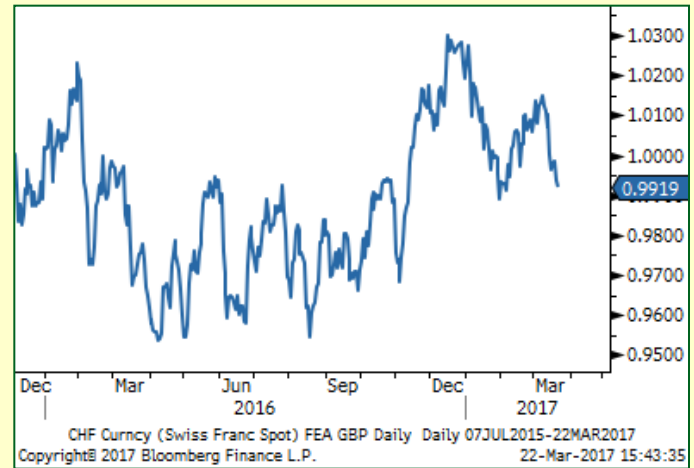
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GBP / USD Daily



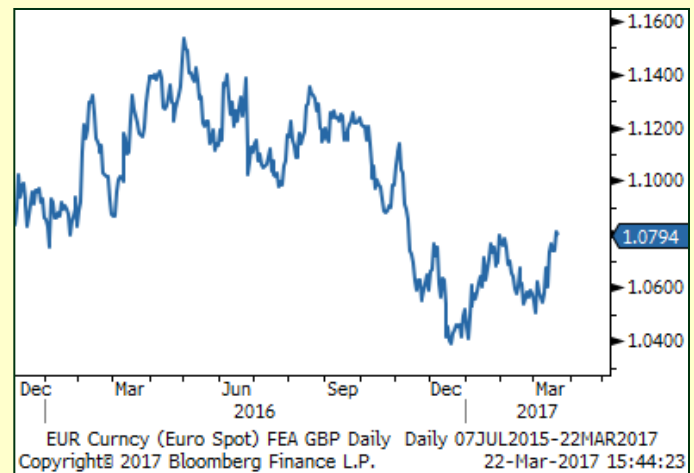
USD / CHF Daily



USD / JPY Daily



EUR / USD Daily



For more information

Please feel free to ask questions of the panel at this time or follow up with us in the future as we will be more than happy to discuss your firm's unique needs and situations.

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