NAVIGATING CURRENCIES INTELLIGENTLY.

With tailored solutions for institutional investors, 7orca manages currency risks holistically and cost-efficiently, particularly in the context of investments in Private Markets.

Case study – 7orca FX Structuring.
Example involving an institutional real estate manager.

The client's challenge.

The client, an institutional real estate manager, holds a global real estate portfolio with a significant investment focus on the United Kingdom and was therefore particularly exposed to ongoing GBP/EUR currency risk.

The currency risk was initially managed in-house. In the first phase, the client used a static hedge based on conventional FX forwards. The approach was subsequently changed to GBP put options in order to retain participation in a potential appreciation of the sterling.

Both approaches proved insufficiently viable in the specific mandate's context. The forward hedge created an ongoing drag on performance due to the negative interest rate differential between GBP and EUR and required significant liquidity when the sterling appreciated. The put option strategy was also costly because of the recurring premiums payments.

Against this background, investors expected the FX Overlay to be entrusted to a specialised, professional manager going forward.

7orca's solution.

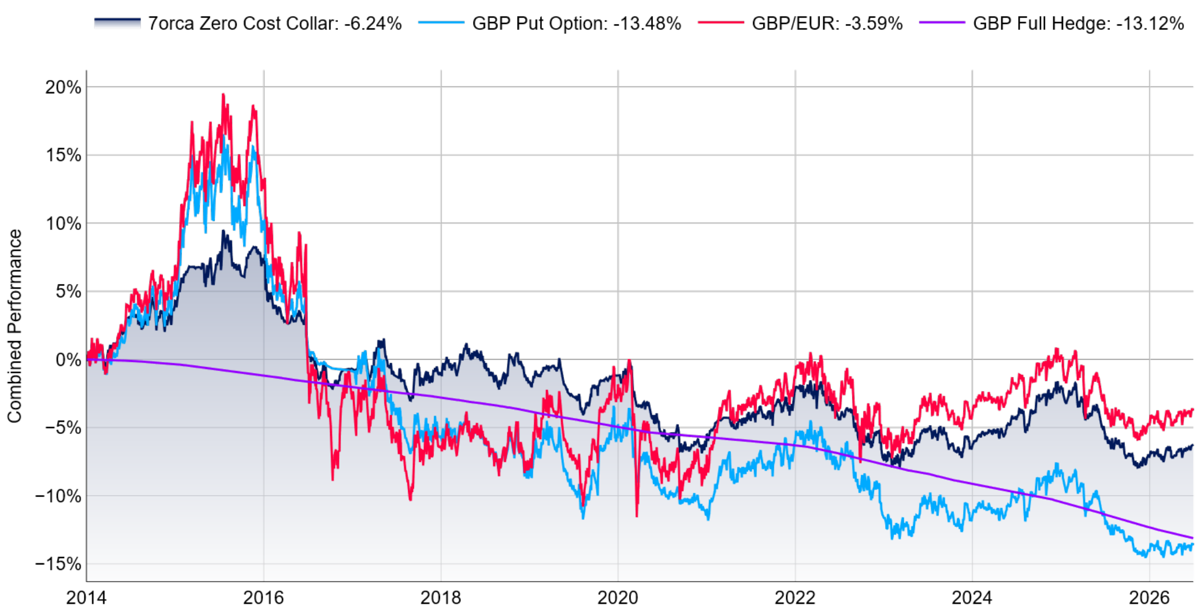
As part of 7orca's FX Structuring offering, 7orca conducted a structured comparative analysis of the hedging strategies used to date and added a further alternative: a zero-cost collar. This combines the purchase of a GBP put option with the sale of a GBP call option, with the premium received from the call largely or fully offsetting the cost of the put option.

Based on historical data, four alternatives were compared in terms of their impact, advantages and disadvantages and liquidity requirements. Liquidity requirements were also assessed using the GBP stress period of 2014/2015, during which the sterling appreciated by around 15% against the euro.

Strategy (Performance)	Advantages (+) / disadvantages (–)	Liquidity requirement
Unhedged (−3.6%)	+ No hedging effort required, full participation in appreciation – Full exposure to depreciation – Currency risk unmanaged	Not applicable
Forward (−13,1%)	+ Full protection against depreciation, exchange rate fixed, efficient – No participation in appreciation – Negative interest rate differential creates an ongoing drag	Potentially very high if GBP appreciates (stress test: up to around 20%)
Put-option (−13,5 %)	+ Protection below the strike, full participation in appreciation – Premium potentially expansive when volatility is high	One-off premium at inception (stress test: lowest requirement totalling the option premium amount)
Zero cost collar (−6,2%)	+ Defined hedging level + Close to zero net premium + Participation in appreciation up to the call strike – Residual risk down to the put strike – Appreciation capped, operationally more complex	Potential margin requirement from the short call (stress test: around 10%)

On this basis, 7orca developed a hedging strategy for the client based on a zero-cost collar that provides a balanced trade-off between hedging effectiveness, costs and liquidity requirements. 7orca provides ongoing support for the strategy across advisory and structuring, implementation and execution as well as monitoring and reporting.

Figure: Combined performance



Source: 7orca – own illustrations and calculations

The client's benefit.

The benefit to the client extended beyond the selection of an individual hedging structure. The key was to translate the different hedging approaches into a transparent basis for decision-making that systematically brought together hedging effectiveness, costs, liquidity requirements and operational feasibility.

- Significantly more limited and more controllable currency outcomes compared with the approaches previously managed in-house
- Significantly lower liquidity requirements during stress periods than under the previous static hedge
- A transparent, historically grounded basis for decision-making instead of a predominantly subjective strategy decision
- Joint development of a currency hedging strategy tailored to the client in close consultation with a specialised manager
- Meeting investors' requirement for professional and independent management of currency risk

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