FX and Interest Rate Risk Considerations for Fund Managers[1]

By Todd Cubbage and Dylan Glazier

This panel focused on hedging from the perspective of sponsors, hedge providers and hedge advisors. The discussion focused on certain considerations and market developments over the past year. Key takeaways from the panel are as follows:

1. The market has seen a steady increase in hedging activity considering political and economic uncertainty (emphasized in an election year in the US), as fund managers seek to maintain liquidity in potentially unstable times.

2. Sponsors are holistically revisiting their risk management strategies, focusing more on currency considerations, exploration of new hedging strategies such as direct lending swaps, and shifting towards longer tenors in FX hedging and facilities generally. Sponsors have also continued to diversity their hedging strategies, both in variety of hedging arrangements and counterparties to help offset risk.

3. Basel III “Endgame” regulations on banks and end users are continuing to be adopted across more and more countries, and the effects are noticeable. While not all jurisdictions have adopted Basel III yet, certain countries such as Canada and Australia have, and the standardized models for calculating regulatory capital requirements are working well and we are seeing a greater number of larger banks being required to hold additional capital. While the US aims to implement Basel III by July 2025, many are skeptical this will be attainable, and a pushback of the adoption date seems likely. Overall, there appears to be a consensus that market standardization in this space will be a positive influence and will help smaller market players close the gap against G-SIB institutions.

4. A wide variety of centralized and decentralized hedging programs within entities continues to exist. While both centralized and decentralized models have their advantages, in today’s market having a centralized hedging platform is seemingly beneficial as hedging activity becomes more frequent and more personalized – having existing relationships and expertise (particularly in-house) that can be leveraged in the hedging space is proving helpful to many.

5. As hedging activity continues to increase, sponsors must monitor their portfolio and liquidity management techniques more closely. More and more funds are also requesting not to post collateral for hedges or to include a higher credit support threshold, resulting in higher costs for the funds and riskier positions for the banks.

[1] The panelists were Thomas Childs, Co-Head of CIB Corporate FX Sales at Santander CIB; Kunal Dusad, Senior Vice President at Brookfield Asset Management; Sharif Saba, Global Head of Corporate Rates and FX Solutions at Wells Fargo; Scott Sinawi, Managing Director at BNP Paribas; Ciccy Yang, Managing Director at Derivative Path; and Philip Yates, Director at National Australia Bank.

6. The trend toward active hedging is expected to continue in the years to come, with a greater focus on the development of Basel III and the US economy in this election year. Certain hedging arrangements, such as currency hedging, deal capacity hedging and direct lending swaps, are likely to continue at significant rates.

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