12.6.1 FOREIGN CURRENCY HEDGING

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This Guide Memo describes the requirements and considerations associated with entering into foreign currency hedging contracts to hedge operational exposures. This Guide Memo is not applicable to the Stanford Management Company.

Authority:
Approved by the Vice President for Business Affairs & Chief Financial Officer.

1. Fundamentals of Currency Hedging

As a global University, Stanford faces foreign currency risk from its international business activities. Fluctuations in foreign currencies impact departmental budgets and the cash flows of its overseas operations. The University hedges currency risk exclusively for the purpose of reducing or eliminating volatility in departmental budgets and related cash flows. Currency hedges must be related to business transactions with a high level of certainty where the foreign currency amounts and payment dates are known. Projected receipts and disbursements related to transactions may be hedged by two types of instruments: Spot Contracts and Forward Contracts.

" **Foreign Currency Spot Contract**: An agreement with a financial institution to buy one currency and sell another at the current market exchange rate. Spot transactions require an upfront cash payment and settle within two business days.

" **Foreign Currency Forward Contract**: An agreement with a financial institution to buy or sell a currency at a set exchange rate at a specific date in the future. The forward rate is equivalent to the spot rate plus a premium or discount equal to the net present value of the interest rate differential between the two currencies. Cash payment is required when the contract matures.

" The University does not use Option Contracts for currency hedging at this time.

The objectives of currency hedging at the University are to:

- Reduce or eliminate volatility in the U.S. Dollar value of University's cash and cash flows, and
- Support business activities that are denominated in foreign currencies.

Currency hedges may be used to protect the U.S. Dollar (USD) value of both foreign currency denominated receipts and payments. Spot transactions, such as routine foreign currency vendor payments that are currently due, are processed through Disbursements. The Treasurer's Office is responsible for foreign currency when it needs to be held for an extended period, a foreign currency denominated receipt in excess of $25,000 is expected, or when a future transaction denominated in foreign currency needs to be hedged.
2. Hedging Considerations

Before requesting a currency hedge, one must evaluate the stability of the business transaction associated with the hedge and the potential impact of currency fluctuations on the budget. The department requiring the hedge bears the currency fluctuation risk if a contract is entered into to lock in an exchange rate for a vendor payment, and that payment is cancelled. Thus, the underlying transaction must be committed before requesting a hedge. If future cash flows, or timing of cash flows are uncertain, the risk can be mitigated by hedging a fraction of the exposure or by spreading contract maturities over multiple time periods. The currency hedging department is responsible for gains and losses associated with adjustments made to currency hedges. Departments are advised to include loss offset provisions in contracts priced in foreign currency, to pass through the financial risk associated with adjustments or cancellations.

Accounting treatment for the currency hedge should also be taken into consideration. The U.S. Dollar value of the currency held in a spot contract is subject to revaluation before the payment is completed. Individual departments’ income statements will reflect the change in value of foreign currency held at fiscal year end and, the University will revalue its overall exposure at each month end.

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3. Setting the Maturity Date of a Currency Hedge

If foreign currency is needed on a specific date, the currency hedge is set to mature on this exact date and instructions can be provided in advance to the financial institution to deliver the foreign currency payment to the vendor on the maturity date. If the payment date is not defined, such as a payment date linked to a milestone, the currency hedge maturity is set on the earliest possible date that the funds will be needed. In that instance, foreign currency is held in a multi-currency account after the hedge matures until the vendor payment is completed. The Treasurer’s Office must receive instructions to transfer payment at least five business days before payment is due. Departments requesting a spot currency purchase are required to fund the transaction when the purchase is completed.

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4. Approval Process

The Treasurer’s Office can provide market quotes, modeling, and help clarify the hedging process. A request to enter into a currency hedge must be submitted to the Treasurer’s Office and executed by a party with the appropriate spending authority. The currency hedge request form includes:

- Amount of foreign currency to be hedged
- Currency to be hedged
- Direction of the hedge (sending or receiving currency)
- Date that the foreign currency is needed
- Business purpose of the currency hedge
- Parties in the underlying business transaction (department and external party)
- Departmental contact making request
- PTA to which the currency hedge should be booked
Copies of executed contracts for the related business transaction, if applicable, and proof of spending authority or a delegation of authority for the requester should be included with the request. Foreign currency hedging requests are approved after a review of the related business transaction and receipt of all completed documentation. The Office of the Treasurer should be consulted for proposed hedges related to government-sponsored research as complex rules apply. Contact the Treasurer's Office at fx@lists.stanford.edu [1] or visit the Office of the Treasurer [2]'s website for more information.

5. Responsibilities of Departments and Treasurer's Office

a. Any material changes to the underlying business activity being hedged should be reported to the Treasurer's Office promptly.

b. Requests to modify or cancel a hedge should be submitted in writing to the Treasurer's Office as soon as the change in the related business transaction is confirmed. The financial impact (loss or gain) of modifying or canceling a currency hedge will be the responsibility of the department requesting the hedge.

c. All requests to create or change currency hedges are subject to approval from the Office of the Vice President for Business Affairs & Chief Financial Officer.

d. Departments are responsible for tracking their hedges, maturity dates and foreign currency transfers.

e. The Treasurer's Office:
   
   " Is responsible for initiating and modifying currency hedges, tracking and revaluing hedges at the consolidated level in compliance with accounting rules.
   " Will facilitate funds transfers related to currency hedges and their related accounting.