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30-year hedge for Indian companies to insulate from volatile exchange rates

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In a first of its kind for India, an international fund is launching currency hedging instruments of up to 30 years to help companies insulate themselves from volatile exchange rates.

Hedges up to 10 years are available in India, but are difficult to acquire. Generally, large corporates or public sector enterprises are the buyers. Even the 15-year hedging instrument is not unheard of, but such agreements are signed rarely and banks enjoy a huge margin.

The new hedges, to be offered by The Currency Exchange Fund (TCX), floated by a group of development finance institutions (DFIs), will offer currency protection for a minimum of seven to eight years and going up to 30 years. TCX, based in Amsterdam, was floated under an initiative by the Netherlands Development Finance Company (FMO) in 2017. Apart from DFIs, the government of the Netherlands and Germany are shareholders in the company that controls the fund.

The facility for India will be essentially an extension of what TCX does for companies in frontier countries such as Mozambique and Cambodia, as well as other developing countries. It is an offshore provider of hedges and offers hedges in 70 currencies. For a large company, the hedge can be availed of directly through TCX.

Small and medium enterprises (SME) can get the benefit from the hedge when they borrow from a DFI. As of now, TCX offers hedges worth $150-300 million in India due to prudential exposure limitations.

“TCX plans to increase its risk carrying capacities in single currencies to $500 million or equivalent in the coming years,” said Harald Hirschhofer, senior advisor of TCX.

Hirschhofer added the move was not aimed at profit maximisation and TCX wants to create a benchmark for the market and simulate other market participants to offer products with a longer term.

The hedge is available for all industries, except for restricted ones such as narcotics, armaments and other activities banned by international law.

HEDGING IT RIGHT

TCX will offer currency hedges for up to 30 years

This will give companies access to cheaper overseas funds

TCX hedges likely to be cheaper than those provided by banks

High cost of hedging prevents companies from accessing cheaper funds

Even as funds abroad can be raised at 3-4%, hedging adds another 6-7%

Renewable energy projects and green finance initiatives will be the major beneficiaries of the fund. Funds from developed countries, particularly DFIs, are eager to disburse loans to green projects. Additionally, many global funds have binding commitments to lend money to green projects in developing nations. Receiving meaningful financing from developed nations has become difficult for companies whose projects are not at least partly linked to green, sustainable or renewable energy projects. “The offering from TCX, with respect to India, is likely to be an immense enabler for Indian green assets to access long-term money in the dollar or euro markets, where pension funds have good appetite for long-term money,” said Sandeep Bhattacharya, India project manager for the Climate Bonds Initiative.

The hedges offered will not be concessional, but could likely be cheaper than those available in the market, given the background of TCX. Due to the high cost of hedging, small and medium enterprises, in particular, are infamous for keeping their currency exposure unhedged. Most do not have the confidence of tapping cheap overseas funds, fearing repayment in foreign currency at a time when the rupee depreciates significantly. One hindrance in effective hedging is banks not willing to extend market rates to smaller companies.

“Long-term over-the-counter currency hedges are expensive, especially for small- and medium-sized companies, as banks need to keep substantial capital against such derivatives (even if these are hedges that reduce the company’s risk). Pricing can be improved if the companies offer collateral, but that comes at a cost as well,” said Ananth Narayan, associate professor, S P Jain Institute of Management and Research.

Even when smaller companies hedge, the standard practice is to take hedges for one to three years and roll them over, as long-term hedging is prohibitively costly. Many do not follow this, exposing themselves to risks of currency volatility. In many instances, this lack of discipline is visible in large companies as well. According to currency dealers, many importers have stopped hedging, expecting the rupee to remain stable against the dollar. Most hedges have a tenure of two to three months. But consultants have started warning that the dollar may rebound from its multi-year low, which may lead the rupee to slide close to its record low of 68 to a dollar. If that happens, it could create panic among importers that have kept their exposure unhedged.