2021 EDITION

INGO FX Insights Report

Contents

Foreword

Global markets

In 2020 the FX market reacted severely to the pandemic with increased volatility across all currencies, creating funding uncertainty for International Non-Governmental Organisations ('INGOs'). For those based in the UK, this uncertainty was exacerbated by Brexit which resulted in changes to government policy, general uncertainty, and reductions in certain funding pools.

Financial markets are likely to continue to be volatile over the next 12 months, with currencies particularly sensitive to the relative success of vaccination programmes and attempts to keep infection rates under control. While it is difficult to anticipate how the virus crisis will evolve over the coming months, many predict a new wave during the summer/autumn and that new variants could undermine vaccine effectiveness, driving FX volatility up in the foreseeable future.

In terms of the major currencies, current consensus is that central banks will not start normalising monetary policy this year, however forward guidance of possible rate hikes may well provide support for some G10 currencies. We have already seen US 10-year yield increasing sharply in recent months. During the rest of 2021 and into 2022, we expect the FX market to be increasingly driven by economic data releases, focusing on expectations of rising inflation and GDP recovery around the world.

INGOs stretched

Many INGOs face a tightening of financial resources with falls in fundraising income as well as facing substantial cuts from FCDO. Managing cash reserves is a challenge for many INGOs, some of whom have to pre-finance operations or wait for the final tranche of grant monies for several months or years. As a result, many struggle to manage currency risk and will continue to be more exposed to volatility and adverse currency movements.

A robust treasury function is key to addressing some of these challenges. The INGO FX Insights Report 2021 was launched to provide insights into some of these challenges and identify possible areas for improvement, and to help find solutions for organisations with international operations.

Little has changed

Over ten years ago, the 'Better FX' guide published by Charity Finance Group attempted to tackle the common pitfalls INGOs faced when managing their FX exposures. Key insights such as the importance of using more than one provider, and agreeing clear and transparent transaction margins upfront, have not yet been widely adopted.

Many organisations have difficulty making long term decisions about their international operations. INGOs often lack the resources, technology and/or time needed to make these decisions with confidence.

This survey highlights the issues INGOs face in their FX operations. And while there is work to do, it is in many ways encouraging that most organisations recognise the risks they face, even if they sometimes lack the expertise or resources to manage them. We hope that, over the years, this survey will show a steady improvement as INGOs improve their FX function driven by better awareness of the solutions and the confidence to challenge their liquidity providers, whether broker or bank.

We thank all those INGOs that took the time to respond to this survey.

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“In forty years of working with INGOs I have seldom seen organisations face as many financial challenges as they do now. Over the decades there has been an added professionalisation in the way we work on so many fronts, but I do not think we have given enough attention to the way we manage the foreign exchange dealings, which are so fundamental to our work. This means we simply do not deliver all that we could to the people we exist to support and often our organisation or our beneficiaries take a hit that neither can afford. What this Insights report shows me is that there is plenty that we can do to improve this situation.”

Mark Goldring
Charitytransfers.org

Survey demographics

We surveyed a representative sample of 114 INGOs with a variety of missions and sizes

Figure A - What type of work does your charity get involved in?

Figure B - What areas were funds sent to (other than UK)?
Percentage funding by location

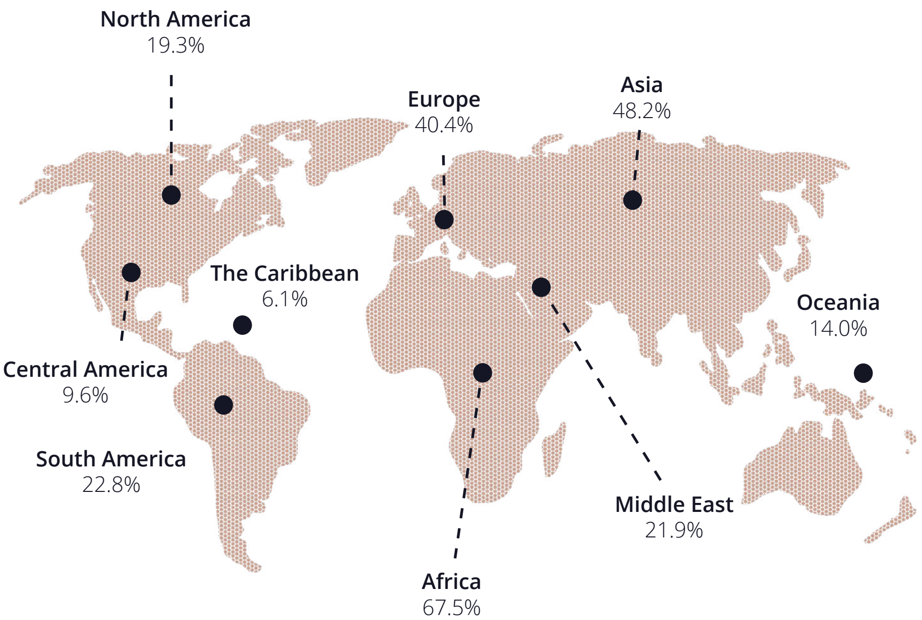
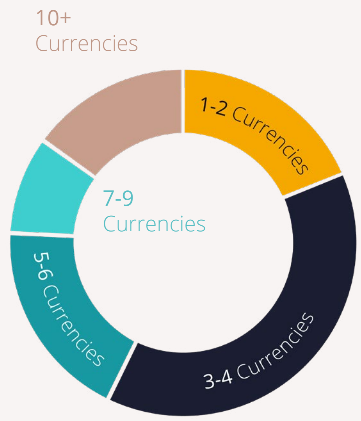
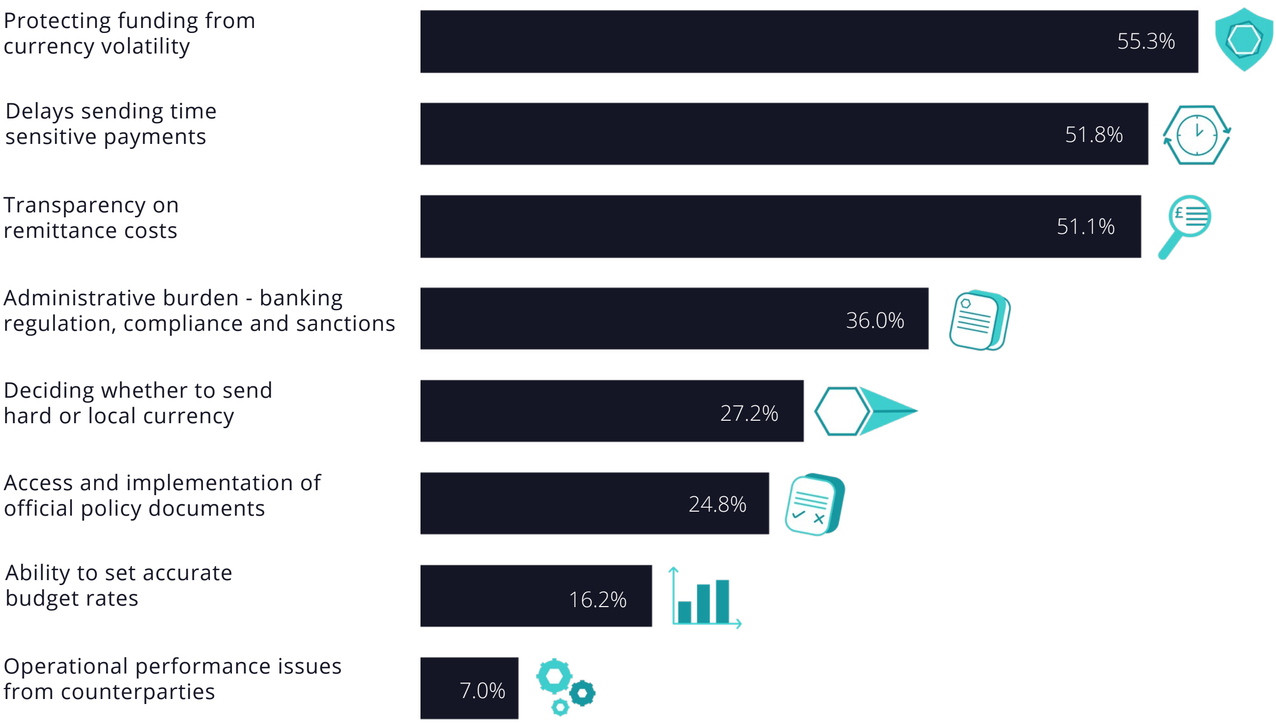


Figure C -
Percentage of INGOs that remitted funds in different currencies



Charity challenges

Figure 1 - Main challenges in funding overseas operations



The following challenges were identified by respondents:

FX volatility concerns – over half of the respondents, 55% have concerns over currency volatility, with 51% stating that a 1% - 5% FX movement would cause their charity financial difficulty. Unfortunately, volatility is a current reality and especially common for exotic currencies which rarely experience long periods of stability. For smaller charities, hedging is unlikely to be appropriate given the operational set-up involved and experience required. A simplified FX policy could include careful cashflow forecasting, conservative cash management, and staggering currency transactions to smooth the FX risk exposure. Charities should also consider natural hedging where foreign currency is held in foreign currency bank accounts (often in the main hard currencies) to create a natural hedge against fluctuations. Some charities are also moving away from sending funds to their overseas branches or partners annually or six-monthly to monthly transfers based on actual expected expenditure. This thereby reduces foreign exchange differences that might arise. Indeed 27% of respondents cited the challenge of deciding whether to remit funds in hard or local currencies. Larger or more experienced charities can benefit from a more formalised hedging strategy such as fixed or forward contracts, so long as it is well designed and managed on an ongoing basis. The challenges with currency volatility also hamper efforts to set an accurate budget rate as identified by 16% of respondents. This is particularly significant for those grants where FX losses are borne by the charity.

Delays in sending time sensitive payments – 52% of respondents report payment delays. Sometimes payment delays are unavoidable as sending money in certain jurisdictions may require additional compliance and paperwork to be signed. However, they can also be caused when an ill-matched liquidity provider is used. However more often, it is a result of onerous legal and regulatory requirements of either the banks or their counter parties and this was identified by 24% of the respondents. Some FX brokers and banks have excellent in-country relationships and a choice of counterparties, others do not.

Transparency on remittance costs – For 51% of respondents, one of the main issues for INGOs is understanding the transaction costs. The terminology itself can be confusing, whilst fees and margin (commission) may be hidden within the FX rate. Eighty-one percent of respondents said that access to software that analyses, and monitors transaction costs would be useful.

Access and implementation of policy documents – a number of issues raised by this survey could be helped - if not solved – if charities had an FX risk management policy. Only 25% of respondents have a policy, yet many struggle with budget rate setting, deciding whether to send hard or local currency, whether to use a retail bank or broker, and whether to have one provider or more. These issues can be addressed to some extent with an FX risk policy which doesn't need to be complicated or difficult to understand.

Protecting funding from foreign exchange volatility

55% of survey respondents name FX volatility as a major challenge and 63% believe a FX market movement (between 0% and 10%) in their respective exposures would cause them financial difficulty. This reflects the fact that 78% of respondents raise over 50% of their restricted funds from the UK, while every charity surveyed remits money to fund work overseas.

Clearly fluctuations in exchange rates can have a material impact on a charity's ability to deliver its planned funding of programmes in overseas jurisdictions. FX fluctuations are primarily determined by economic and geopolitical events, as well as exogenous factors such as COVID-19. Liquidity in the currency markets (especially for exotic currencies) and time horizon also influence the size of currency fluctuations.

Figure 2 - What percentage movement in the FX market would cause you financial difficulty?

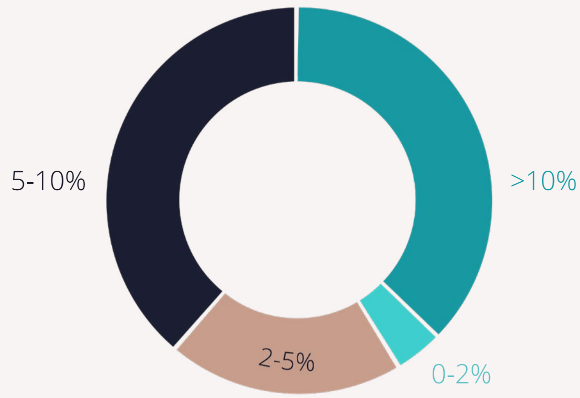
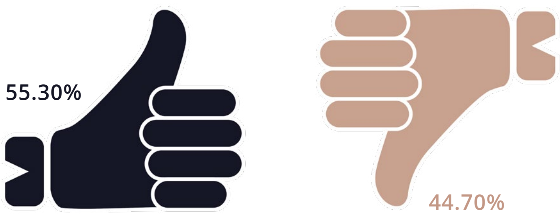


Figure 3 - Has foreign exchange volatility been a challenge?



Reasons for respondents' concern over FX volatility include low levels of hedge adoption (at 11%), which in some cases is due to a lack of expertise in implementing hedges, and because many participants operate in low-income countries where FX volatility levels are often greater. The majority of respondents counter the effects of negative currency movements by absorbing the cost using unrestricted funding or re-negotiating restricted funding terms, if possible.

Figure 4 - Which strategies do you engage in to counter currency volatility?

Only 11% of respondents try limiting the effects of negative currency movements through forward contracts or non-deliverable forwards (NDFs – used for most exotic currencies). These low numbers most likely reflect the fact that many INGOs either prefer the simplicity of spot transactions, or do not have the expertise or confidence or bandwidth or risk appetite to engage in more sophisticated approaches such as hedging and therefore avoid it altogether.

Protecting funding from foreign exchange volatility

Of the INGOs that adopt risk-management strategies, half of respondents use opportunist hedging, depending on the prevailing exchange rates or time their FX execution in line with near term funding. Around a quarter implement netting between inflows and outflows in the same risk currency. Whilst just over a fifth use rolling strategies (continuous hedging) or a static hedge ratio to protect funding/overseas payment expected over the next fiscal year.

Static - placing annual hedges; coinciding with the FX budget rate setting process.

Rolling - placing hedges on a frequency basis (every month, quarter, etc)

Layering - hedging an increasing amount of the exposure over time to achieve an ‘average’ rate.

Ad hoc - rate driven hedging.

Netting - naturally hedging using currency accounts.

Figure 5 - What type of hedging strategy do you adopt? FX products and services used by respondents

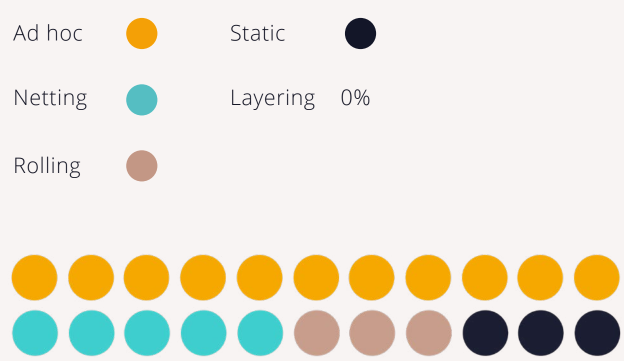
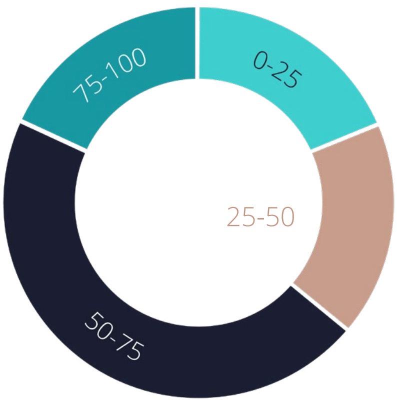


Figure 6 - What hedge ratio do respondents use



Most respondents that hedge do so at a ratio of between 50% and 100%. The amount an INGO decides to hedge is typically influenced by their’ ability to forecast cashflows, tolerance to volatility risk and level of hedging experience. Different hedging approaches reflect differing fiscal objectives and hence different management of exposures.

Interestingly, no respondents use layered hedging as their strategy despite it offering several benefits to static and rolling approaches. Arguably, hedging should be considered by more INGOs as a way of protecting funding reserves from negative FX market movements, although a lack of both expertise and impartial advice makes this difficult.

All INGOs should ensure that they have sufficient and relevant expertise in hedging strategies if they wish to undertake these activities and that they seek advice from independent financial advisors. Whilst advice from banks or brokers can be considered Boards and Executive should be mindful of their commercial interests when advice is received.

Lack of transparency on FX remittance costs

The FX market is decentralised. Liquidity is disaggregated over many different jurisdictions, outlets and counterparties. Moreover, FX is traded on a bilateral rather than an exchange basis. This means that every FX price is customised for each client of a broker or bank. Market makers do not typically earn explicit fees, instead, they seek to make profits by earning a bid-ask spread. This means that the rate executed depends entirely on who is asking the price of whom.

Access to transparent and competitive exchange rates should be an important objective for treasury departments because not availing of the best rates can represent tens of thousands of pounds lost.

33% of respondents did not understand or know how to calculate the cost of their international payments. This result means many INGOs will struggle to control or reduce remittance costs – after all it is hard to do so without accurately knowing the cost in the first place.

FX costs explained

Explicit cost: A visible charge that is applied by a liquidity provider, and acts as a dealing charge.

Implicit cost: Sometimes referred to as 'margin' or 'spread' taken by a provider and is the difference between the interbank rate and the exchange rate the charity is given when making a transfer.

Unlike the explicit cost where the fee paid is clearly visible, implicit costs are more difficult to measure. Banks and brokers are not required by law to provide transaction cost transparency, which clearly makes it very difficult for INGOs to have full visibility on costs, thus making them challenging to manage.

Unsurprisingly, 81% of respondents believe access to a tool that accurately measured the cost of their foreign exchange payments would be useful.

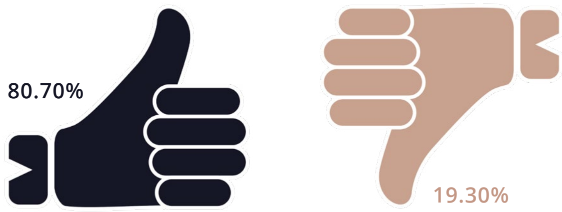


Figure 7 - Would access to transaction costs analysis software be useful?

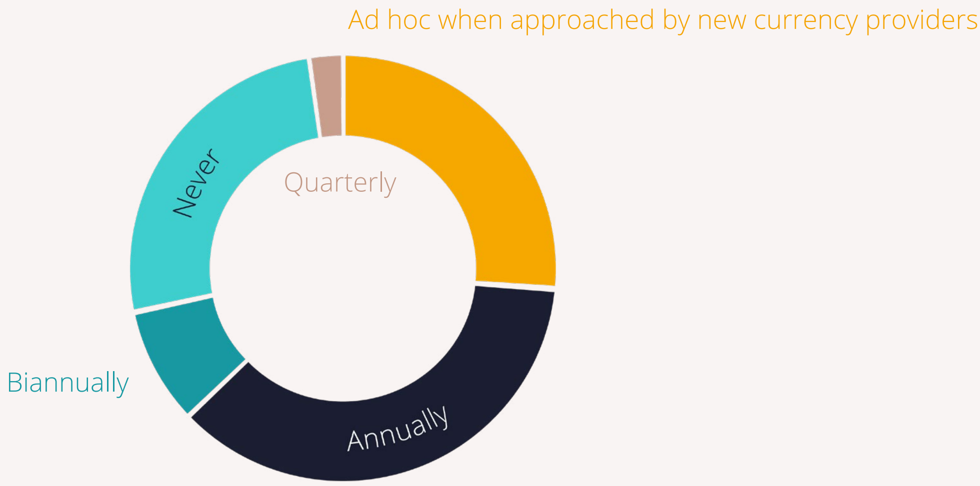
A first step to accurately monitor and thereafter control foreign exchange costs is to use transaction cost analysis ('TCA'). The process involves auditing the spread and subsequent cost on an FX payment. The methodology involves a comparison of the exchange rate received by an INGO to the interbank exchange rate at the time of execution.

Access to reliable data on FX remittance costs would enable an INGO to benchmark competitiveness between its existing providers, tender to new providers, and even attempt to secure fixed price agreements. This process should reduce this aspect of a charity's operating costs. Access to independent FX reference rate data is key. The accuracy underpins the legitimacy of the TCA and ability to negotiate improved terms.

Lack of competition when making transfers

More than 46% of respondents use one provider when executing their foreign exchange requirements and they rarely review their providers' pricing and overall proficiency. 26% never reviewed these aspects; 36% reviewed once a year. The results unfortunately suggest that many INGOs may be exposed to poor execution terms, inconsistency, and ultimately higher costs.

Figure 8 - How many respondents review their FX providers based on functionality and pricing



Increasing the number of providers and frequency of exchange rate comparisons should be an important consideration for INGOs as it provides another way to improve FX pricing competitiveness and therefore to control and reduce financial costs. Arguably, at least two providers should be used for this aspect of operations. To help prevent treasury departments picking the 'best rate from a bad bunch', we recommend regular use of TCAs for effective benchmarking and a bi-annual assessment of the existing provider's suitability and competitiveness.

Figure 9 - How many FX providers do respondents use?

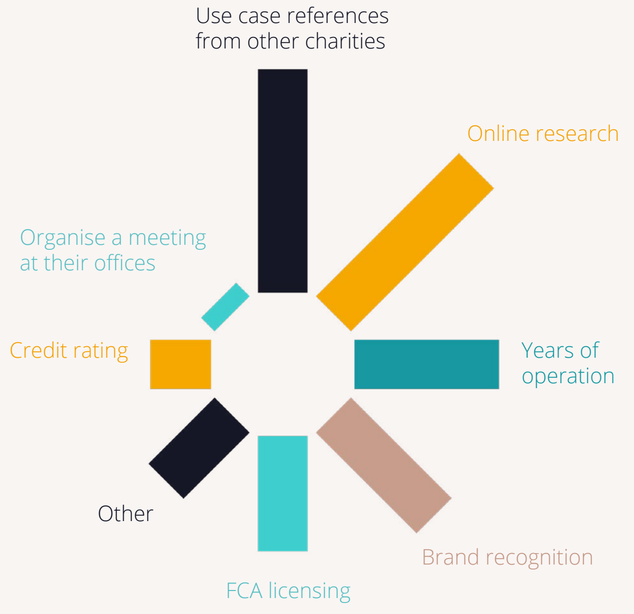
Use of banks versus FX brokers

Figure 10 - Do respondents use banks or brokers for their FX requirements?

Respondents' use of banks versus brokers for their FX transactions showed that 32% have bank relationships exclusively, 26% use a mix of banks and brokers and 40% brokers exclusively. Combined 58% of INGOs hold at least one bank relationship while 66% have at least one broker relationship. Over the past 10-15 years, the emergence and access to specialist currency brokers has increased, and so too has their capabilities versus traditional retail banks – namely their offer of better exchange rates, more flexibility and risk appetite, and wider access to hedging products.

Interestingly banks are still widely used or currency transfers. Boards and senior management should be aware of the pros and cons of using bank and non-bank providers as the price difference between the two options can be significant.

Figure 11 - How do respondents verify the legitimacy of new FX providers?



How do organisations vet new FX providers?

Boards should ensure their treasury team carries a defined due diligence process when considering the use of new non-bank currency brokers. The UK FX market is highly saturated with FX brokers – many of whom are small and newly established.

The highest percentage (42%) of respondents say the use of 'references from other charities' is the most important vetting factor. Other methods were 'online research' (articles, comparison sites, etc.) at 38%, and 'number of years in operation' (27%). The data is reassuring as reliable ways to initially vet the quality and security of a non-bank brokerage. However there should be further analysis and research into the financial position of all brokerage operations (size, experience, and sophistication of a service provider) including reviewing their financial history (ten years in operation is a good barometer here), looking at publicly available financial information and reviewing credit ratings.

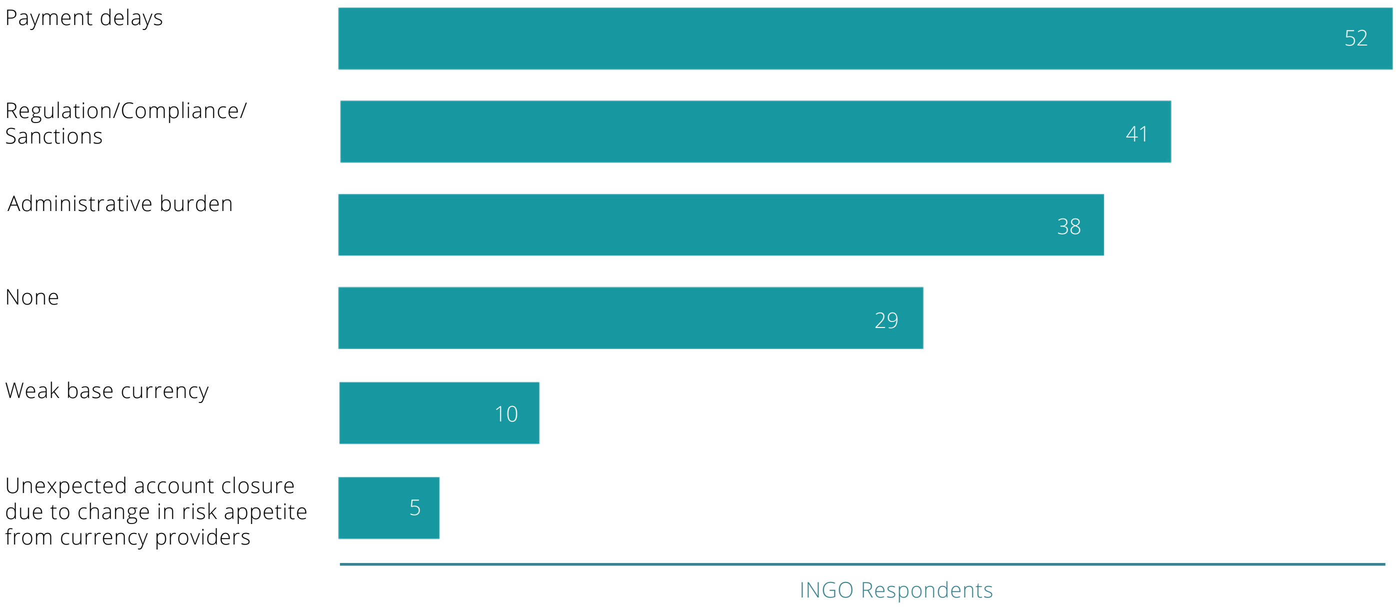
Brokerages operating globally add further security over their size and market presence.

Transaction challenges

INGOs that send funds to low-income countries face challenges. But so does the bank or brokerage performing the transfer. The data indicates that payment delays and compliance issues are the two main difficulties at 46% and 36%.

These difficulties are common where funds are sent to countries deemed 'high' risk geopolitically or countries with conflict-zones. Regulated banks and brokers are often required to perform additional customer due diligence and anti-money laundering (AML) checks in these instances. Naturally, these additional checks can cause long payment delays – an issue which can be compounded when intermediary banks are needed to perform part of the wire transfers.

Figure 12 - What difficulties have respondents encountered when sending funds overseas?



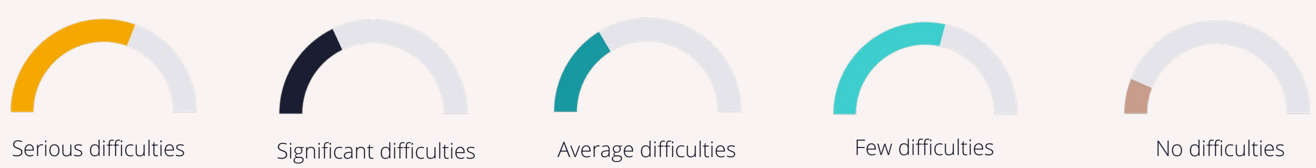
Time delay difficulties with sending international payments

The data shows that this is a major challenge faced by INGOs, with 49% stating that they had significant and serious difficulties at some point in the past 24 months, with only 35% responding with 'few to no problems'.

Working with 'specialist banks and brokers' with case studies, references, and a clear track record of sending money to low-income countries or those in conflict should form part of the vetting process for INGOs. Some providers have more experience and more wiring and tracing capabilities than others. Look for those that offer MT103 SWIFT payments since they are the gold standard and help to prevent, track, and investigate delays.

When starting to use a new provider, INGOs should have supporting 'proof of payment information' from beneficiaries to hand. Not having this can cause significant delays. Over time, requests for such information will likely reduce once the relevant compliance department becomes more accustomed to a INGO's trading activity. Further, banks and brokers have different, and ever-changing risk tolerance levels for certain countries, so keeping abreast of these changes should help INGOs find alternative brokers if necessary and limit disruptions.

Figure 13 - How easy is it to track your international payments after making a trade?
Respondents' experiences with delayed payments

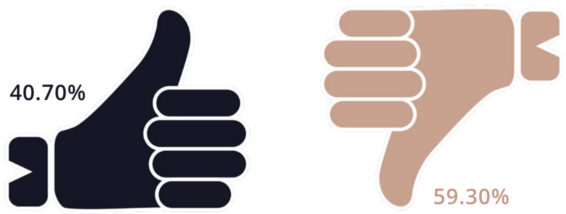


In country payments - hard versus local currency

Number of INGOs that pass on the FX conversion element to their in-country programmes.

INGOs have made significant savings by checking whether it is better to send hard currency and convert locally or to convert in the home country (pre-conversion) and send in local currencies. Depending on the market location, INGOs can, at times, achieve better rates of exchange using specialist banks and brokers based in Europe or the USA than can be achieved within country. The primary reason being that they have deeper access to liquidity (more supply to meet demand) which results in narrower margins. The data partially supports this fact with 59% of respondents opting for pre-conversion before sending to local country partners; other reasons for pre-conversion include payment simplicity, increased governance, control and less risk of in-country fraud. Also, auto-conversion policies have historically proven to be significantly less transparent for the charity world, leading to significant hidden execution costs. The exception to this condition is where INGOs can access black markets or parallel markets in-country, where indeed they can achieve preferential rates, this is typically in the most exotic markets such as Nigerian Naira (NGN).

Figure 14 - Do respondents pass on the FX execution process to in-country programmes?



However, 41% are opting for the in-country conversion method, even though the majority (63% of the participants) believe it has caused a negative impact on their financial performance, and 83% report that they cannot audit the transaction costs.

Clearly many charities have some degree of awareness of this issue. Exploring the possibilities of pre-conversion and its benefits is another way for charities to potentially reduce their FX cost base.

Figure 15 - Participants that recognize the negative impact of in-country money conversion

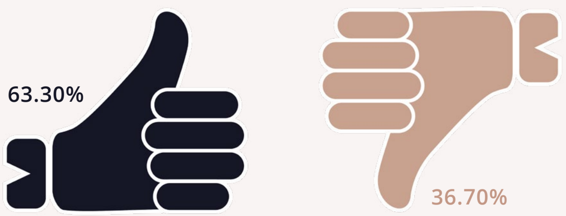
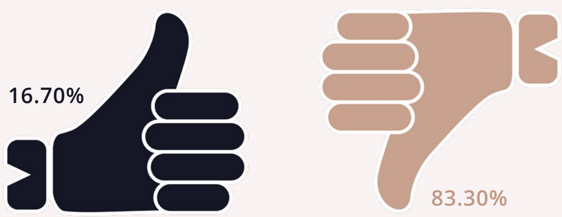


Figure 16 - Ability to audit the cost of local partner conversions



Difficulty setting accurate budget rates

The results of whether survey participants use a clear methodology when setting budget rates shows a near-even split, with 49% saying they do not use a clear methodology and 51% saying they do. The results likely reflect the fact that there is no standard approach to accurately set budget rates and the general difficulties of predicting currency volatility especially for exotic currencies which may experience large volatility, and INGOs use a wide range of methods as well as in some cases institutional funders specifying a conversion rate. The data also suggest that 46% simply use the daily spot rate and 31% exercise their own judgement.

Boards and trustees should ensure, wherever possible, their treasury departments explore and implement robust and well-tested methods. It will help avoid common pitfalls and put the INGO in a better position when planning the year ahead, and in certain cases when hedging. A data-driven budget rate and annual budget cash flow reduce the chances of unrestricted funding having to be used to cover foreign exchange losses.

Figure 17 - Do respondents have a clear methodology when setting budget rates?

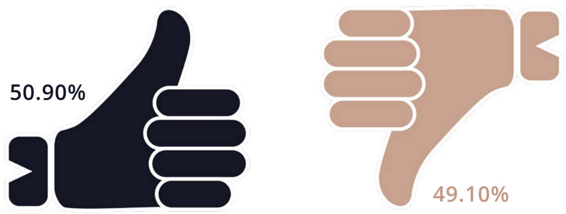


Figure 18 - How do respondents forecast budget FX rates?

Use of official policies to manage FX risk

An FX risk management policy gives finance teams or treasury departments a document that sets out the INGO's FX management objectives, the potential risks, defined tolerance levels, and agreed rules.

It should include best practices and processes which ensure timely and efficient best execution. Where appropriate it will include a hedging strategy. It is also a useful tool for accountability, performance measurement and succession planning.

More generally it ensures the charity is well prepared to manage its exposure to foreign exchange risk and provides confidence to the board, trustees, and donors.

Surprisingly, only 29% of participants have a formal policy, with 28% saying that they do not believe it is needed, 48% saying that they do not have the resources and expertise needed to put one in place. Given the current challenges faced by many INGOs, it is unsurprising that 23% state that other tasks required of their roles have been a higher priority. To overcome some of these issues, we advise INGOs with a high exposure to FX risks to consider using independent FX advisors to gain support with drafting and implementing this important governance function.

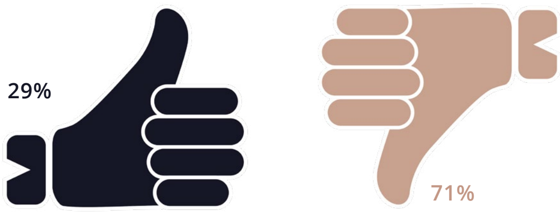
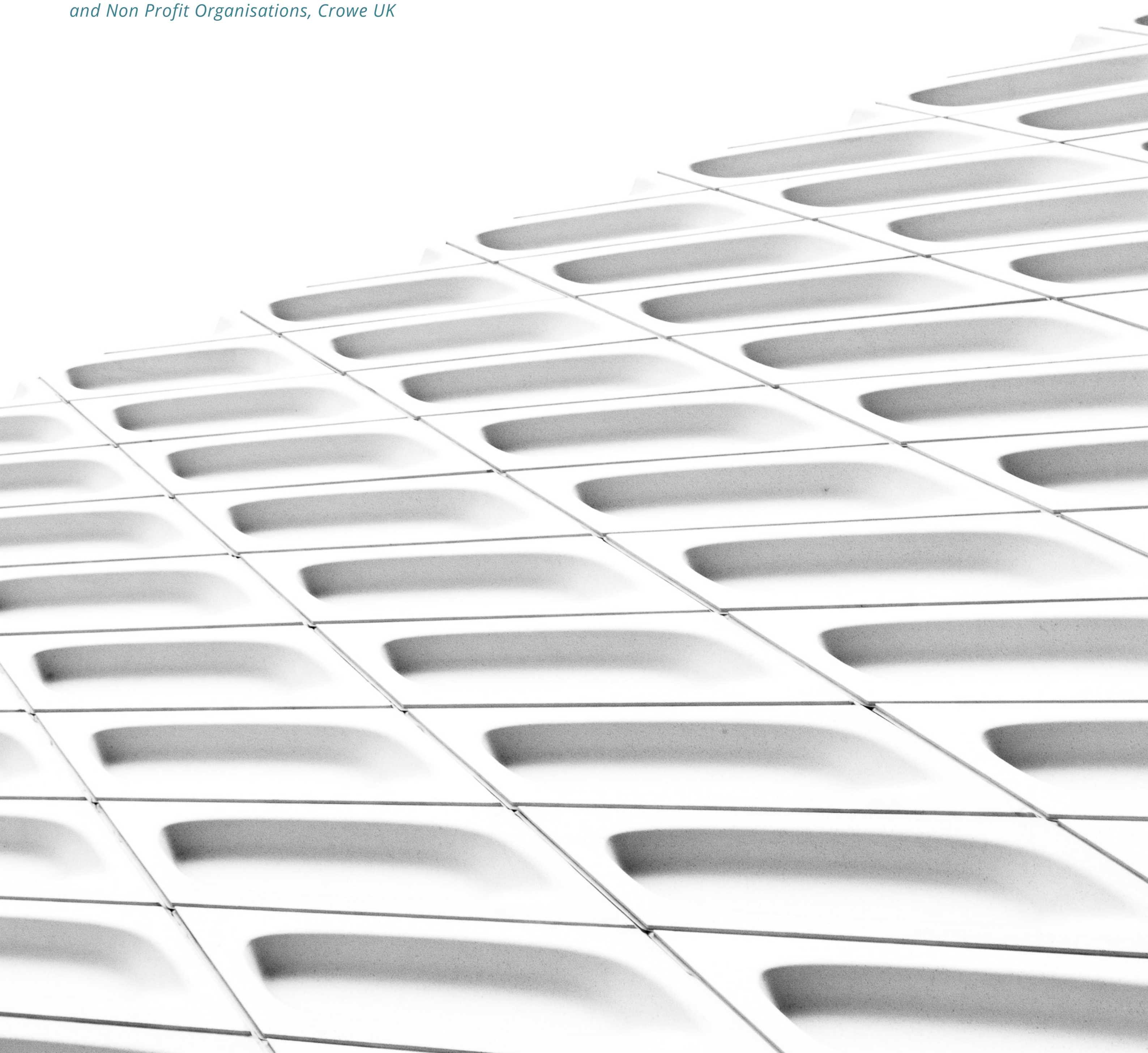


Figure 19 - Do respondents have an official FX policy?

Figure 20 - Why do some respondents have no FX policy?

“Foreign exchange has always been a difficult issue for INGOs to grapple with. Some INGOs are lucky enough to have sophisticated treasury functions but for all managing the risks from FX is critical especially during these volatile and uncertain times. As demonstrated through the results of the survey, many lack the resources and expertise to develop their own FX policy and those that do are often overtaken by higher priority tasks. Many are hampered by the administrative and regulatory burdens of remitting funds overseas. We often see INGOs who bear the costs of FX through their unrestricted funds due to funder rules and budgeting processes. There is a perceived lack of competition when making transfers and a lack of transparency on charges. These challenges make it more pertinent for INGOs to explore their options for better FX management.”

Naziar Hashemi – *National Head of Social Purpose and Non Profit Organisations, Crowe UK*



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Charitytransfers.org is the social division of a global, multi-asset risk management consultancy, Audere Solutions. Its corporate social responsibility (CSR) initiatives cover three areas, efficiency reviews, independent advice on hedging & budget setting, and optimised execution via transaction cost analysis (TCA) and competitive tenders. From working within the charity sector for over 2-years, they have already helped over 65 INGOs increased their annual impact by at least £2.7million by improving their treasury management.

Mark Goldring is a former CEO of Oxfam GB, VSO and Mencap. He now combines leading a small Oxford based refugee charity with mentoring less experienced charity leaders and advising businesses seeking to make their own contribution to international development. Mark is an active advisory board member for Charitytransfers.org.

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