Best foreign exchange practice for Charities and NGOs

How NGOs and Charities can offset their currency risk using tested strategies

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Foreword

The launch of this white paper reflects Ebury's ongoing commitment to the charitable sector, as we address the volume of money that effectively gets 'lost' in currency exchange.

Action needs to be taken throughout the third sector to ensure funds are distributed in the most effective way and have the greatest impact. It's vital that finance teams work as hard to implement effective foreign exchange strategies, as their fundraising counterparts work to raise the funds. They are at the polar opposites of the organisation, but are equally important in funding operations on the ground, where the money is needed most.

To underpin our commitment to the charitable sector, we have created a dedicated team of specialists, working with NGOs on risk mitigation strategies to reduce the currency volatility that can undermine their good work.

We look forward to working with partners and charities to maximise the potential of their funds throughout both established and emerging markets.

Beverley Traynor
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Does your charity take risks with emerging market currencies?

Charities and NGOs are driven to work in developing nations and precarious, volatile environments. Foreign exchange should benefit their work, not amplify the risks.

The recent credit crisis has been a mixed blessing for the charity sector. Cuts and austerity have created a tough operating environment, but a greater reliance on charities to deliver services. When one looks internationally, the scene becomes yet more complex. Disaster mitigation, poverty campaigning and relief work are all as demanding as ever, so ensuring the flow of funds is crucial. Many charities do not have a clear and proven strategy in place to give best value in their currency trades: this report aims to provide some guidelines to follow.

The UK government chose to safeguard their international aid budget in the face of general austerity, and institutional donors are still providing a generous flow of funding. This generosity comes with a firm responsibility for increased transparency and results. Charities have to show they are making maximum impact. There is no better place to start than in the way they procure foreign currency.

The problems of procuring currencies, particularly in volatile emerging markets, are many. They vary according to local, regional and institutional pressures, and the same challenges do not apply to all charities. In part one of this report, we will look at how to identify the challenges facing your charity – the first step to overcoming them.

Stamp Out Poverty's Missing Millions report (2009) identified potential savings to the sector of £20-50 million from competitive tender and improved procurement. Five years have passed since their report; while some charities are already transforming the way they procure currency, many are still exposed to unnecessary risk. Fortunately the lessons learned can be shared with all. We will include a full list of strategies from our own experience and knowledge in part two of this report.

One of the most important lessons from our research is that introducing a competitive element into procurement can make a substantial improvement in terms of fees, charges and service. Understanding who to work with can be difficult for charities, which may not have a focus on financial services. For these charities, we include a checklist to assist you when you select a trading partner.

Currency procurement is where charities are able to deploy the goodwill of their donors. Smarter procurement means better deployment: something that every charity welcomes.

Key findings

- Opening your procurement process up to competitive tender can achieve better rates in most cases.
- Expert FX providers may be able to offer you a better deal than larger banks and offer better service for small and mid-sized charities.
- Market insights and tracking your own trading history allows you to better understand what kind of trade to go for, such as spot or forward contracts.

Foreign exchange challenges for charities

Every charity is different, but all can suffer from similar issues with currency and emerging markets. Identifying the problems is the first step in addressing them.

Charities working in emerging markets can suffer from many problems. The nature of the territories they work in is dangerous, volatile and prone to sudden change. Local currency is therefore subject to fluctuation, and trading in it becomes even harder when a lack of liquidity is taken in to account.

What donors expect

Many charities receive a large part of their income from institutional donors. Donors like the Department for International Development provide timely and substantial amounts; these are often in the form of restricted funds. Being targeted towards a single goal, set out in advance by the donor, these are given in hard currency. The purchase of soft currency to achieve the goals set out in the restricted funding contract opens charities to risk. Funds are directed towards areas of greatest need, which logically are most open to fluctuation.

How banks behave

To banks, we are all clients; charities included. Major banks do not necessarily place a premium on the objectives of your charity. Service provision – and variable rates – is therefore dependent on the size of funds being moved. Large international banks, while convenient and reliable, may set their threshold higher than even the largest charities can manage. Even charities that are procuring millions of pounds of currency each year are not prioritised, and the currencies they commonly seek are less likely to attract the brokers of large banks.

The local issues

There are reports of charities holding on to providers because they offer a 'no service charge' deal. These are often local brokers and banks, which operate in country and have a direct relationship with the local branch of the charity or its beneficiaries. These deals are too often based on unfavourable exchange rates: the unit cost of the currency is too high, and the lack of service charge only leads to worse service. When operating in environments of wide volatility, with high local inflation and high interest, investing in good value service is paramount.

Better FX report 2011, Stamp Out Poverty

"War on Want found that although they were buying almost £1 million of currency every year (in addition to holding £1 million in reserves with the same bank), they were not seen as major clients. The second reason behind their decision to refrain from using UK retail banks in the procurement of currency was due to the uncompetitive rates some provided when compared to exotic currency firms."

"It is important for all charities operating in developing countries to maximise the foreign exchange rates that they can achieve, and this is particularly relevant for small charities. Whilst the overall currency volume may be lower, the impact on local operations and income and expenditure accounts can be proportionately much."

Lawrance Titterton, Chairman at Alongside Africa

Adopting best foreign exchange practice

If the challenges that we've already identified apply to your organisation, then it's time to address them with best practice guidance.

Increasing competition

Many charities receive a large part of their income from institutional donors. Donors like the Department for International Development provide timely and substantial amounts; these are often in the form of restricted funds. Being targeted towards a single goal, set out in advance by the donor, these are given in hard currency. The purchase of soft currency to achieve the goals set out in the restricted funding contract opens charities to risk. Funds are directed towards areas of greatest need, which logically are most open to fluctuation.

Keeping a local link for spot rate comparison

Home competition can be complemented by local banks in country sending you their best conversion rates in real time. Comparing the best rate from the UK and the best rate in-country means you can make the choice based on whether to send hard or local currency. Buying in the UK is generally better for rates, but not always – it's worth setting up the facility to check.

Centralising currency risk

For long-term planning and budgeting, programmes can be completed in their operational currencies. This removes the risk and burden of currency volatility from local offices, and places it under the central control of the head office. The local operatives no longer take de facto control of currency management. The Better FX report stated that the benefits to Oxfam of centralising were between 0.5% and 1.0% of total funds converted, which equates to between £750,000 and £1,500,000 a year.

Agree on where your rates are fixed

Some charities find it useful to set local budgets using a single source of information regarding rates; the Economist Intelligence Unit is one. This ensures consistency. (See opposite page for important data sources.)

Hold hard currency if you can

Keeping some hard currencies on the balance sheet will allow you to reduce risk from general market volatility. A balance of hard and soft currencies held in store can allow you much greater flexibility and agility in your procurement practices.

Adopting best foreign exchange practice

Keep analysing your own trades

Tracking and reviewing your trades and spot prices will help you identify the best prices from suppliers in the future, and allow you to begin assessing your reserve requirements realistically.

Group treasury responsibilities

Make your financial and management team well aware of treasury responsibilities. Are remittances and purchases managed centrally by treasury? Do they set approved banking arrangements with specific institutions and manage the relationships? How many counter parts do you need for sign off, and what is the speed with which you can act?

Make your institutional donors aware of your strategy

Make sure that institutional donors know about the problems you face when you operate in local currencies. When fixing the objectives to their funding, they may be able to adjust spending according to the volatility of the operational currency. Explain the moves you are taking to combat the risks. They will be able to share their experiences or link you up with others in their network with similar issues, or help you find providers.

Important data sources for your charity

Charity Finance Directors' Group

www.cfdg.org.uk

Charity Commission

www.charity-commission.gov.uk

Department for International Development

www.gov.uk/government/organisations/department-for-international-development

Economist Intelligence Unit

www.eiu.com

International Monetary Fund

www.imf.org

Adopting best practice with your foreign exchange provider

Market watching

Some charities, especially those operating with volatile soft currency, find it useful to contact a currency trading specialist who will track their operational currencies. When the spot rate is good, they inform the finance director, and the charity is able to trade at optimal rates, rather than a pre-arranged delivery date. There is an option to set a target rate, with automatic purchase once a threshold is reached. At a time when UK cash deposit rates are low, it can be beneficial to hold several months' worth of soft currency bought at low rates in this way.

Use specialists

Ensure you use experienced foreign exchange specialists who will give better service and rates. They are able to devote more resources to your charity and, as you make up a larger proportion of their income, they will be often be more proactive and able to assist you more effectively than a major bank.

Identify natural hedges

Where is your income coming from, and where is it going? Can you find a natural hedge through pegged currencies? For instance, can your Dollar income be a natural hedge for local currencies pegged to the Dollar? Assess your target currencies for their regional and international links and plan your hedges accordingly.

Bulk trading

If you receive the majority of your donations in hard currency and can pool the funds together for operations, then bulk trading gives you a better rate. The size of your trade guarantees more competitive rates from your providers, while the reduced number of transactions will limit your costs further.

What forward contarcts can you implement?

Find out if you can have physically deliverable forward contracts, non-deliverable forward contracts, or if neither is available, you may have to operate an offshore bank account at an international bank that lets you buy the currency up front. Forward contracts allow you to set a price for a specific volume of currency to be used within a certain time frame (Window Forward) or at a specific point agreed in the contract (Fixed Forward).

What's the difference between a forward and non-deliverable forward?

A forward contract is the agreement between two parties to buy or sell currency at a future point in time, for a rate agreed today. The difference between this price and the price you would get today is called the forward premium or discount.

A non-deliverable forward (NDF) contract is an instrument for hedging the exchange rate risk. Rather than delivering the currency in question, an NDF compensates the parties for movements in the exchange rate between the start and end dates of the contract.

Adopting best practice with your foreign exchange provider

Soft market test

Can you use your tender process to create new ideas? A soft market test involves contacting foreign exchange providers and asking them to use their experience to suggest strategies that help your specific charity. Sharing ideas can be the initial phase of a better relationship for both of you, and can be more equitable.

'No chance to improve' procedure

If you find that the prices you are being quoted from providers are widely different, then address the disparity by implementing a no chance to improve procedure: make clear in the tender that you will not offer any provider the chance to outbid another. The rate first quoted will be the rate they are judged by.

Judge on value added, not just rates

For spot purchases, it is also important to think about how quickly the funds can be delivered – track your provider's performance and consult when you are trading. Value is not just about fees and rates: the efficiency and reliability of your provider can be just as important. An experienced operations team will ensure payments into emerging markets will run a lot smoother.

Can you pay with hard currency locally?

Make your financial and management team well aware of treasury responsibilities. Are remittances and purchases managed centrally by treasury? Do they set approved banking arrangements with specific institutions and manage the relationships? How many counter parts do you need for sign off, and what is the speed with which you can act?

Why is it important to speak to a currency expert?

For most charities, properly managing foreign currency risk can be a surprisingly complex undertaking. Among the critical issues that arise are the following:

- Most charities operate in emerging markets where currency moves tend to be particularly sharp and sudden
- They often operate are often in the most exotic countries where the local currency is difficult and expensive to buy and sell - if it can be done at all
- Their projects are often long-term, magnifying the risk and potential consequences of adverse currency moves

Managing the complex interaction among currency risks can distract from the main focus of the organisation but, on the other hand, ignoring these issues altogether can seriously impact the charity's ability to do good. That's why it is highly recommended to enlist the help of a specialist organisation. In order to mitigate the above risks it is worth finding a currency specialist with the following:

- A wide offering of frontier market currencies, from the Sierra Leonean Leone to the Papua New Guinean Kina
- The ability to hedge currency risk well into the future, up to five years and beyond
- Expertise in emerging market currencies, volatility, forecasting and structuring low-cost solutions for even the most complex hedging needs, including coverage of frontier markets that most large banks overlook

Enrique Díaz, Chef Risk Officer at Ebury

Questions to ask when you procure currency

01 Have the companies tendering met with your Financial Director?

02 Have they explained their unique differences?

03 Can they provide you with references from for-profit organisations and charities?

04 Are you able to assess their compliance procedures?

05 Are they regulated and licensed by HM Revenue and Customs and the Financial Conduct Authority?

06 Do they have experience in the local currencies you require?

07 Do their rates compare with banks, remittance companies, foreign exchange specialists and local exchange rates?

08 Are you tracking your trades consistently and benchmarking your best trading partners?

“Foreign exchange is particularly important to the Manchester International Festival (MIF). We use expert foreign exchange providers only, due to generally less competitive offers from the banks. To choose a foreign exchange provider, MIF compares the overall value of the whole deal for both forward contracts and spot-rate currency purchases. This includes the exchange rate, transaction and other charges, speed of payments and the overall service. Within service it is important to consider internet-based facilities, access to the account managers and currency dealers, and the speed of their responses to queries and requests. MIF are in a regular contact with our account managers at the foreign exchange provider to bounce our ideas against their experience or forecasts.”

Vanda Hagan, Head of Finance at Manchester International Festival

About Ebury

Ebury is a fintech company specifically designed to empower organisations that want to transact internationally. Using Ebury's financial services, NGOs and charities can make and receive payments in foreign currencies, enjoy better exchange rates, access emerging-market currencies, hedge currency risk, and benefit from Ebury's liquidity. Transactions can be processed in more than 120 currencies – quickly and easily through a managed service.

Regulated by the Financial Conduct Authority and licensed by HM Revenue and Customs, we are a trusted partner for currency services, trade finance, physical metals and corporate solutions to clients worldwide.

Ebury and Charity

Ebury is increasingly involved in the third sector, with our charity proposition strengthened by our own fundraising efforts. We sponsored The Charity Awards 2014, take part in fundraising challenges, regularly attend conferences on charity finance, and have recently become a founding member of #GivingTuesday, an international phenomenon in charitable giving which has reached the UK for the first time in 2014. As part of our involvement, Ebury has pledged to introduce payroll giving on #GivingTuesday, which is on the 2nd of December.

Our charitable endeavours are headed up by Beverley Traynor, Ebury's Head of Business Development (Charities), who is also leading the foreign exchange charity proposition. Beverley brings a wealth of experience to the role having working at Charities Aid Foundation (CAF) for the past 7 years.

To find out more about our charity proposition, market insight or to discuss our services, contact:

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“We used to transfer charitable donations to our team in Kenya through our bank - this was time consuming and expensive, as I couldn’t see what rate I was getting and we were charged an administration fee to make a transaction. For a small-to-medium sized UK charity, having to pay £40 in fees every time I sent money abroad was not going to work in the long-term. When I started sending money through Ebury, I was able to choose to send at times when the best possible rates were available. More importantly, I was able to send funds without paying any administration fees. Working with Ebury has made a positive difference to S.A.F.E.’s capacity for financial planning around currency transfers, as well as saving us money.”

Sarah Kennedy, UK Director at S.A.F.E.

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