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Six Tips for Managing Brexit's Unknowns

More volatility likely, treasury's attention required

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The British vote for "Brexit," or to leave the European Union (EU), has ended. But it's only the end of the beginning. Headline news emphasizes how much we don't know about how Brexit will unfold. This lack of certainty means that in the short term a period of volatility in the financial markets is likely.

The good news is that managing for the unknown is a core skill of corporate treasury. If your company does business with Great Britain or the EU, you'll want to assess and mitigate your risks.

Avoid speculation
Brexit is complex. The life cycle will begin when the British government invokes Article 50 that lays out the fundamentals of the withdrawal process and triggers a two-year period in which to negotiate the terms of departure.

The Brexit resolution is non-binding. It's also not a binary, all or nothing proposition. Trade, capital mobility and market access will be negotiated. These are a few of the myriad variables.

Focus on what you can control
Given the ambiguity, it's important to focus on what you can control: hedging the short-term risks that accompany uncertainty. Here are some ways to do so:

1. **Hedge your income statement.** Consider hedging a greater-than-typical percentage of your GBP and EUR commercial trade transactions. You can lock in pricing by hedging in your functional currency at the time of a sales or purchase contract. If you buy and sell with various trading partners, then understand and hedge your net exposures.

2. **Hedge your balance sheet.** Companies with physical presence in Great Britain or the EU must decide how to protect their balance sheets. Assets such as property holdings or liabilities such as local currency debt may warrant hedging. There's a cost-benefit tradeoff to

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consider depending on the nature of the asset or liability and whether short-term risks can be minimized.

3. **Assess impacts on major likely future transactions.** If you need certainty for financial reporting and do your capital planning ahead, now is a good time to take stock of anticipated major events such as divestitures, acquisitions, or bond issuances in EUR or GBP and evaluate the value of locking in FX rates in advance.
4. **Maintain precautionary cash.** Excess cash provides a working capital cushion. Some companies may view holding more GBP or EUR as less risky than raising cash in the future to cover operating needs. The right amount of precautionary cash can provide a natural hedge.
5. **Use forecasting to create a natural hedge.** Local financial managers should forecast their expected cash inflows and outflows, and cash needs should be aggregated at the corporate treasury level so that you can determine the timing of cash requirements. This enables you to develop a strategy to implement a natural hedge.
6. **Evaluate counterparty risk.** The impact of Brexit on local economies could increase credit risk. It's a good idea to ramp up your focus on credit analysis. Understand potential impacts to your trading parties and other counterparties and consider any preemptive actions.

Certainty amid change
Brexit raises more questions than answers. The political, economic, and emotional stakes are high. Many negotiations, decisions, and major consequences — intended and unintended — lie ahead.

The one likelihood is we're heading into a period of opaqueness and heightened volatility. Companies would be wise to understand their Brexit-related exposures, assess the cost-benefit of hedging alternatives, and put protections in place. Doing so can create clarity and peace of mind.