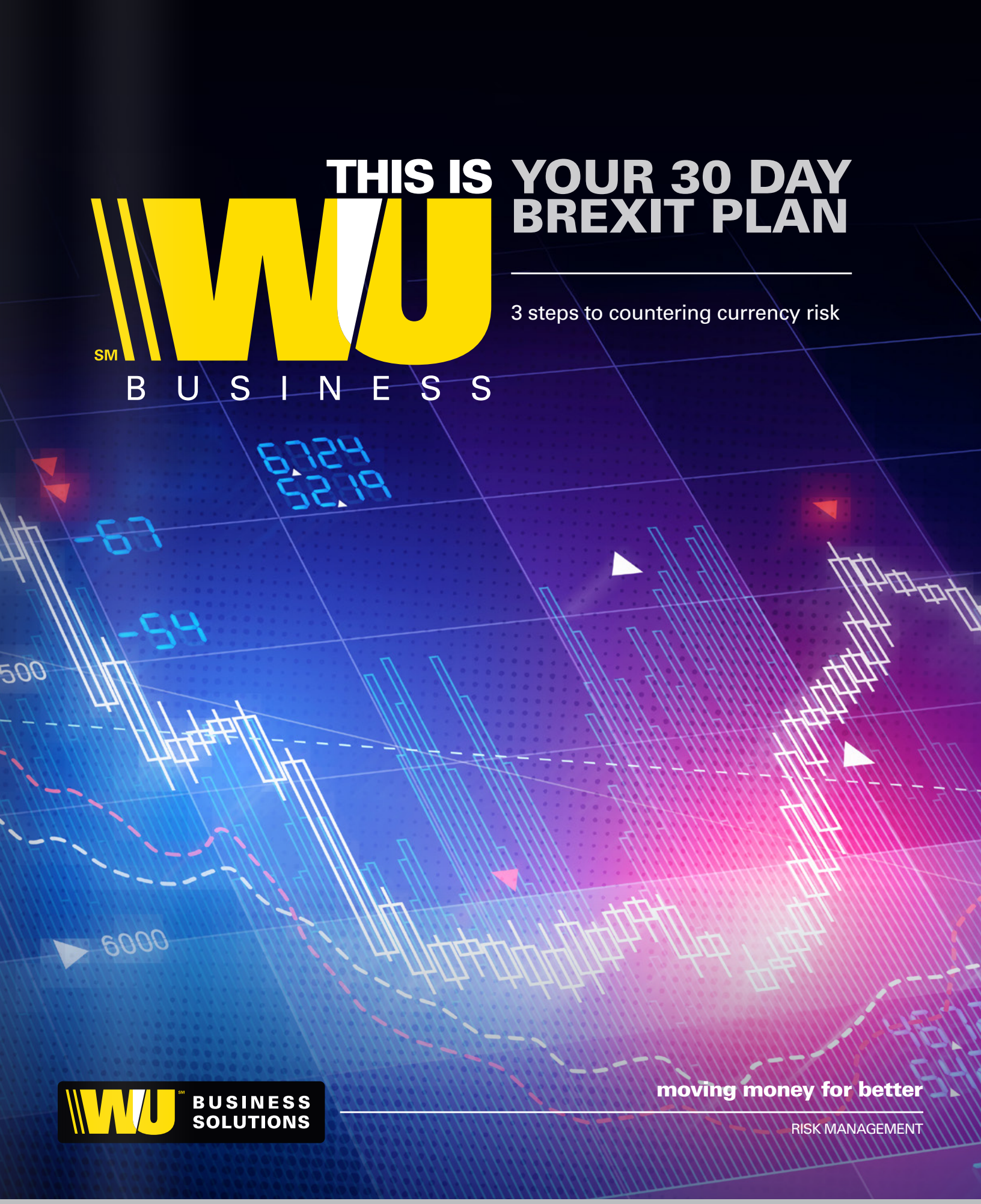


THIS IS YOUR 30 DAY BREXIT PLAN

3 steps to countering currency risk

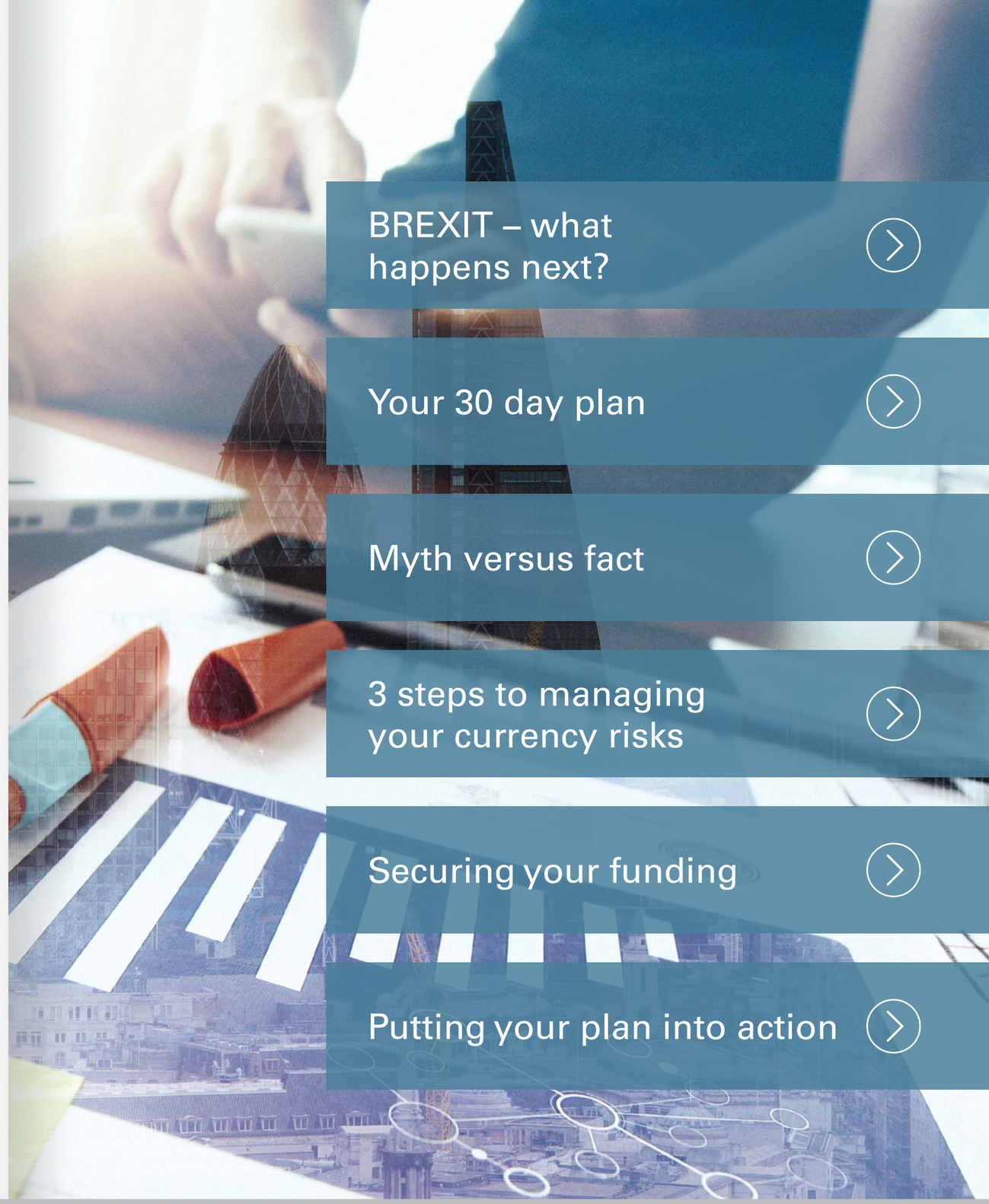
WU SM BUSINESS

WU SM BUSINESS SOLUTIONS

moving money for better

RISK MANAGEMENT

From currencies to trading relationships and funding, having a robust plan will enable your business to successfully navigate the uncertainties of BREXIT.



BREXIT – what happens next?

With the British public having voted to leave the European Union there will inevitably be a period of uncertainty as Britain transitions from its existing relationship inside the EU to a new relationship as a partner working with the EU.

From your business's point of view the important thing is not to panic as the negotiation to leave will take at least two years. That said, as no country has left the EU before, there is no precedent as to what the environment will look like through the transitional phase. Consequently, it's important that your business puts in place at least a short term plan to stabilise and protect your overseas trading relationships, your cash flow and your profits.

Your 30 day plan

In this practical guide we will help you:

- Have the right conversations to reassure overseas suppliers and customers
- Build out a plan for managing currency risk during this period of uncertainty
- Ensure that you have cash and credit lines to see your business through the transition

Myth versus fact

Conversation starters

With the 'Leave' vote confirmed, it is vital that you quickly have conversations with your overseas suppliers and customers to bring them up to speed with the implications of this decision and what it means for your trading relationships. There is a potential for lots of sensationalist, media-driven headlines, but by focusing on the facts you will be able to reassure your trading partners and work out a process for navigating the uncertainty ahead.

So, what sort of things should you be discussing now?

- The vote by the British public is just the first step in the process: The next step is for the Government to trigger Article 50 of The Treaty of Lisbon. From this point, the exit will take at least two years.
- Nothing changes in the short term: As Britain moves through the exit process the country must continue to abide by EU treaties and laws. However, it will no longer take part in any of EU decision-making. Instead, Britain's negotiations will commence regarding the withdrawal agreement and the terms of its relationship with the now 27-nation bloc.

Longer term considerations for trading with the EU:

- Potential changes in tariffs: Britain will leave the EU's "common commercial policy" and will now design and produce a brand new trade policy based on its own terms. This, however, will take a minimum of two years and potentially longer. If Britain cannot negotiate a trade agreement with the EU as favourable as the one it has now, it may become more difficult and more expensive to import/export with EU countries. If this is the case, you may need to re-evaluate the continued attractiveness of these markets or find a way to reduce costs to remain price competitive.
- Your customers' locations and supply chains: If you provide goods and services to larger corporates you may want to understand how their location and sourcing strategies might change as a result of Britain now sitting outside of the EU. Don't assume the status quo will continue.

TRIGGERING ARTICLE 50 TREATY ON EUROPEAN UNION

Processes for negotiating withdrawal from the EU (Article 50, TEU) and for negotiating a new agreement under the Treaty on European Union (TEU)

Withdrawal agreement from the EU Article 50 (TEU)

European Council (excluding the UK) agrees by consensus guidelines for the EU's negotiation

Possible further stage where the European Commission submits recommendations to the Council of the European Union and the Council (excluding the UK), by enhanced qualified majority voting, authorises the opening of negotiations and appoints negotiator.

European Commission undertakes negotiations

European Parliament consents to the withdrawal agreement by a simple majority

Council of the European Union (excluding the UK) agrees to withdrawal agreement by enhanced qualified majority voting

New agreement with the EU (excluding the UK)

European Commission submits recommendations to the Council of the European Union

Council of the European Union agrees to opening of the negotiations, and appoints negotiator/special committee. Voting procedure in the Council depends on what the agreement covers, but a detailed agreement would likely need unanimity.

European Commission undertakes the negotiation, in conjunction with negotiator/special committee

European Parliament is either consulted on the new agreement or has to give its consent, by simple majority, depending on what the agreement covered.

Council of the European Union agrees to new agreement. Voting procedure in the Council depends on what the agreement covers, but a ambitious agreement would likely need unanimity

Individual Member States ratify the final new agreement nationally if it is a mixed agreement

Source: UK HM Government Feb 2016

3 steps to managing your currency risks

Overcoming the period of uncertainty

As a business that already trades internationally you will appreciate how these political and economic challenges could result in currency volatility that in turn may have a significant impact on the costs of any goods and services that you might be buying or selling internationally. With this in mind the sensible thing to do is to protect your business against these fluctuations and to help we have put together a simple three step plan so can you work to successfully manage your currency risks over the Summer period.

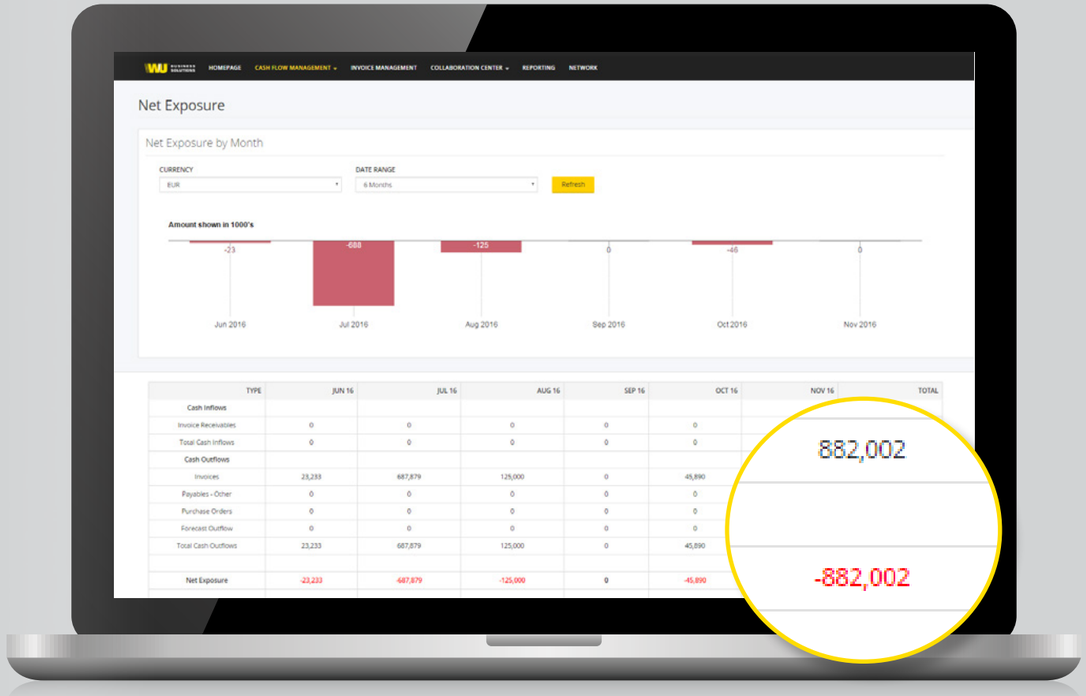
The plan is based on our free to use WU® EDGE platform. EDGE not only enables you to take control of your currency risks, but also forge better working relationships with overseas partners. You can also make fee-free payments in 22 currencies to other Western Union customers*.

1 IDENTIFYING CURRENCY RISKS

First you need to understand where currency exposure might exist in your business and what, if anything, you are currently doing to protect your business against these risks. You can start by creating a schedule of both your expected incoming and outgoing overseas payments, the amounts, due dates and the currencies they are payable in. An easy way to do this is to upload your invoices on the free WU® EDGE platform.

WORKED EXAMPLE – IDENTIFYING CURRENCY RISK

MCCM Emporium is a wholesaler of bags that imports goods from Italy to sell through retailers across the British Isles. Every month the business buys bags worth circa €75-125k from its Italian suppliers. By uploading these invoices into the EDGE platform the business can build out a profile of its potential currency exposure to the Euro (EUR) on a month-by-month basis over the next six months. From this dashboard, the user can see that the business's total exposure to the EUR is €882,000.



* Transaction fee-free EDGE Network Payment services are available between fully accredited WUBS customers that have registered to use the WU® EDGE platform and are authorised by a WUBS affiliate to access WUBS services in USA, Canada, United Kingdom, Singapore, Australia or New Zealand. EDGE Network Payment services may be initiated at any time but are only delivered 24 hours a day five days a week. In the event that a transfer involves a currency conversion a WUBS affiliate will apply a foreign currency exchange rate, which includes a margin set by WUBS.

Next you need to understand how projected exchange rates could impact on the value of your incoming and outgoing international payments. While nobody can accurately forecast where exchange rates might be headed, keeping abreast of analyst reports will enable you to understand the scenarios and probabilities. When it comes to BREXIT, the closet analogy as to what might happen over this next period of uncertainty is the financial crisis of 2008.

The chart below shows:

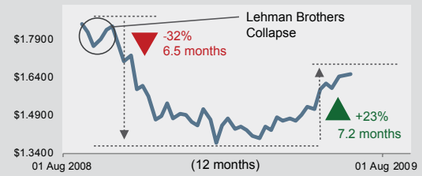
- Uncertainty in the Pound's future direction
- The magnitude of FX moves being 'priced in' by the options market
- High demand from corporate treasurers for hedge protection

What does this mean for the situation now?

- Businesses should expect a further increase in market instability and foreign exchange levels
- Erratic FX moves will make it more difficult to forecast cash flow

LESSONS FROM HISTORY?

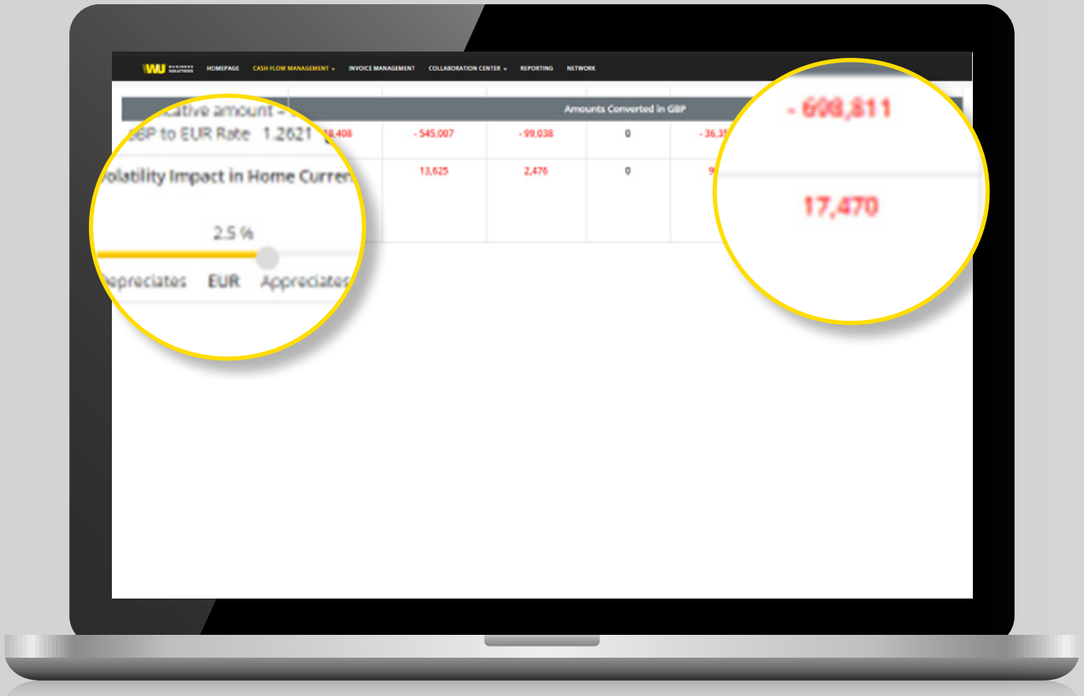
Broadly speaking, there is likely to be a two-phased market reaction to BREXIT – the short term impact and the longer-term adjustment period. This is shown in the table below

	OUT – UK VOTES TO LEAVE EU	
Potential scenarios on June 24	**Phase 1** 0-3 months	**Phase 2** Medium-term assessment
Expected impact on markets	Global run on Sterling while UK Current Account risks flare	UK/EU re-negotiation and potential Scottish Referendum
Subsequent estimated FX shift	• -15 to -20% GBP depreciation	• GBP recovery if political and economic picture improves
Anticipated FX target ranges	• GBP/USD $1.25-$1.32 • GBP/EUR €1.14-€1.20 • EUR/USD $1.08-$1.12	• Unknown – depending on re-negotiations
Considerations that will impact these forecasts	Bank of England's co-ordinated international intervention	Emergency EU re-negotiations and any further referendums
	HISTORICAL COMPARISON	
Historical examples to validate each forecast	Financial Crisis 2008-2009	Financial Crisis 2008-2009
How currencies reacted during or after these historical events	 • Freezing of foreign inflows led to a UK Current Account crisis in 2008. • However, BREXIT is not expected to cause thesame magnitude of adjustment seen in 2008.	

TOP TIP

Through WU® EDGE, you have the power to start to understand the impact of potential currency moves on your business. By using the 'Currency Volatility Slider' in EDGE you can simulate currency volatility and pinpoint potential risk.

WORKED EXAMPLE – MODELLING DIFFERENT FX RATES



Based on a 2.5% to 3% fall in the value of GBP against the EUR over a six-month period, the business can see that it is negatively impacted by £17,470. Remember, this is a relatively small movement compared to the last few months of currency volatility. However, by understanding the risk and booking a simple hedging solution, the impact of volatility will be manageable.

2 BUILD A PLAN

With an understanding of the local currency cost of foreign invoices and your potential exposure, you have the power to start making informed decisions.

Next you should:

- **Define the specific risk management goals:** This could include defining a target exchange rate to help achieve the margins or Sterling value you have set in your budget. In addition, you may want to determine what percentage of a payment to protect from currency fluctuation. By using the 'Currency Volatility Slider' in WU® EDGE, you can simulate currency volatility, pinpoint risk and with the support from our foreign exchange specialists build out the right plan for your business.
- **Build a risk management policy:** This will define the processes and responsibilities in your currency plan to ensure the right people are accountable and have the authority to execute your plan. It might sound time-consuming, but a short, robust document can easily be created with the assistance of our foreign exchange specialists.
- **Select the right mix of foreign exchange protection products:** One size does not fit all and the best solutions are created when there is a good understanding of the specific business requirements and currency exposures. Many businesses use a combination of products (refer to the foreign exchange protection products box to understand the types of solutions available) to underpin the strategy.
- **Apply the right trading tactics:** Once the most effective currency protection products have been selected for your business to support your plan, your tactical trading approach can mean the difference between success and failure. The strongest strategies recognise a framework for executing currency trades at favourable levels while protecting against material risks. This might sound complicated but it really isn't and again your foreign exchange specialist can explain how you can simply automate this process within the parameters you have decided upon.

TOP TIP

Using WU® EDGE you can review the market and identify recent trading patterns to understand the risks and opportunities available against your currency exposure. It can also help you automate the execution of your plan so you don't have to constantly be tracking the foreign currency markets on a minute by minute basis.

FOREIGN EXCHANGE PROTECTION PRODUCTS

Internal Hedging

If your business pays and receives monies in the same currency, one approach is to net incoming against outgoing cash flows to help reduce the amount of currency exposed to fluctuation. However, this isn't always practical due to timing issues which can replace currency risk with alternative forms of uncertainty.

Forward Contract

A basic hedging tool that lets you lock-in the current exchange rate for a set period of time (up to 12 months). This provides exchange rate certainty and insures your profits against adverse fluctuations. However, if you book a Forward Exchange Contract and the spot market ends up moving in your favour you cannot participate in the more favourable spot market. You are locked in for your fixed amount, at the fixed rate, for the fixed date.

Vanilla Options

Lock-in an exchange rate to insure your business against negative shifts in currency movements, while maintaining the flexibility to benefit from any positive market shifts. Vanilla Options require you to pay an upfront premium.

Structured Options

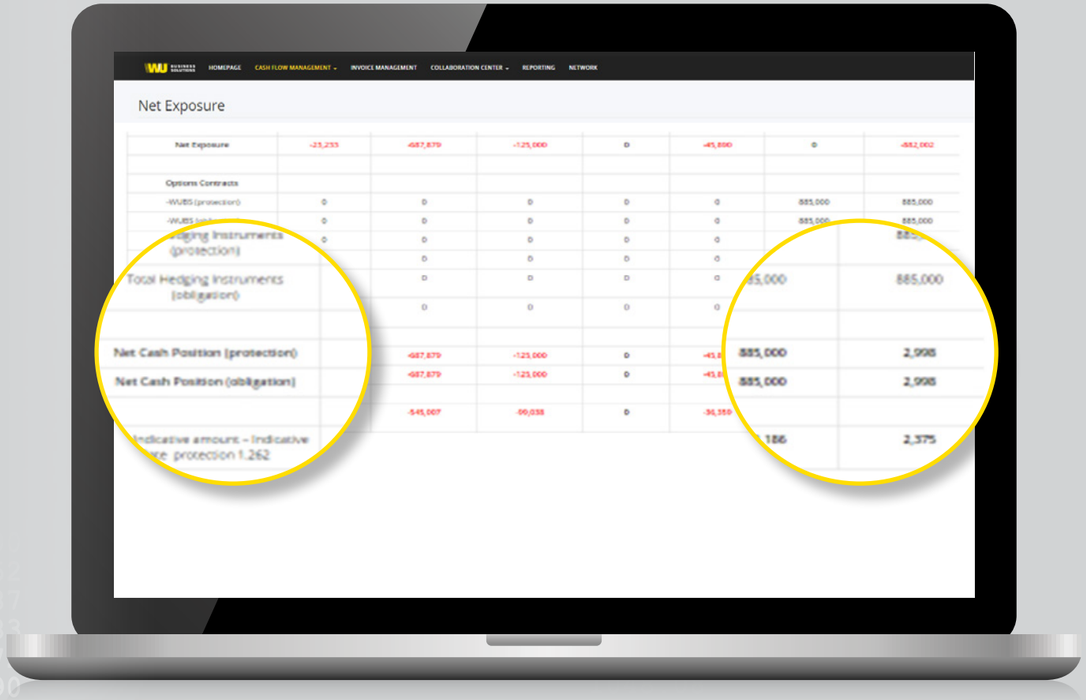
Book an exchange rate to protect your bottom line while maintaining the ability to participate in favourable market moves up to a certain point. No upfront premium required. The drawback of an option is that you typically must agree to a protection rate that is less favourable than the current market forward rate, in exchange for the potential participation you might achieve.

Are these hedging products right for my business?

There are a number of considerations to make if you believe FX hedging products could be right for your business. Forward and Options FX hedging products are derivative products which involve risks due to volatility of the FX markets. For example, if you book a Forward Exchange Contract and the spot market ends up moving in your favour, you cannot participate in the more favourable spot market. You are locked in for your fixed amount, at the fixed rate, for the fixed date. Options can be quite complex, and how and when you employ them depends on your unique business and your plan for your company over the near and long term. It is important to engage with a specialist that has in-depth knowledge of options, and especially how and when to employ them and what the consequences will be for your business. Also, the drawback of an option is that you typically must agree to a protection rate that is less favourable than the current market forward rate, in exchange for the potential participation you might achieve.

WORKED EXAMPLE - PUTTING A CURRENCY PLAN IN PLACE

Working with a currency specialist, the business has put in place a currency protection plan using some simple currency protection products, and as a result they were able to protect the cash flow and profits.



Looking back at the cash flow report we can see the exposure is protected and the business can focus on growth.

3 EVALUATE AND BE PREPARED TO ADAPT YOUR PLAN

Currency fluctuations operate independently of the key drivers of your business, such as the timing of your sales and the purchase of stock and inventory. Using the WU® EDGE platform you can monitor your strategy and adapt to new circumstances or market conditions. Identifying shortfalls and building on successes is vital. You might want to formalise this refinement process by aligning reviews with your budgeting and financial reporting periods.

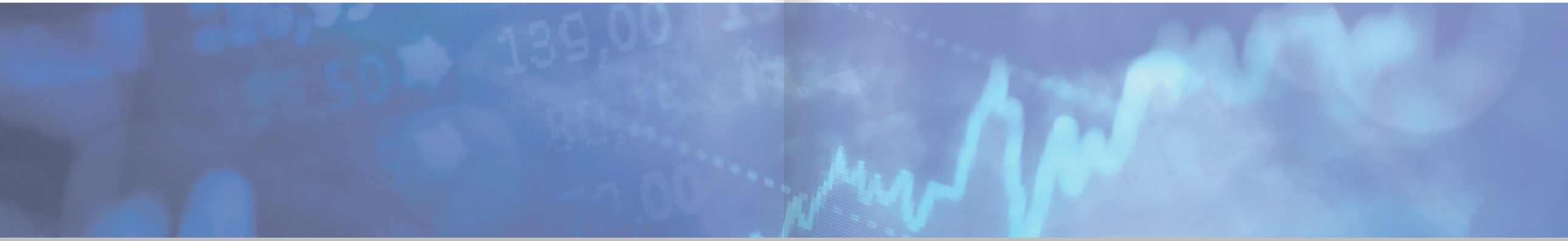
Securing your funding

Making sure you have the cash and credit you need to see your business through

Access to finance remains one of the key constraints to SME growth. With the uncertainty involved in a BREXIT, it is important that firms trading internationally can ensure that they have the cash and the credit lines to support international growth and any downturns in the economy (Britain or overseas).

So, what do you need to aware of in assessing the health of your businesses finances?

- **Your current and projected financial position:** It is important to forecast your expected working capital requirements. Using the WU® EDGE platform you can accurately establish your forecasted international incoming and out-goings taking into account expected currency fluctuations, which you can then import into your overall business forecasts.
- **Working capital terms:** If you buy goods and services on credit, or if you extend credit terms to your customers, you may want to explore how you can negotiate better commercial terms. Offering discounts for early payment or offering to take currency risk may enable you to do this.
- **Value of foreign payments:** Using WU® EDGE and working with a foreign payments specialist you can put in place a strategy to optimise the value of international payments whilst not taking undue currency risks.
- **FX credit lines:** Check with your FX provider as to what credit they may be able to provide to enable your currency purchases which could also help to free up cash flow.
- **Availability of funding:** In the short term the decision to leave the European Union could create uncertainties in financial markets which could translate into more restrictive financing conditions and less availability of funds for small and medium sized enterprises. In addition to this, the EU has special programmes for SME financing (generally facilitated by British banks), which may no longer be available.
- **Cost of funding:** A significant depreciation of GBP may result in inflation which in turn could lead to high interest rates. There might also be a longer term impact on the availability of financing stemming from the large external, current account deficit the UK has been running for quite some time now.



Putting your plan into action

Leading EDGE protection

Whilst there is a process for Britain leaving the EU, nobody is really sure how business will be impacted during the transition to life outside of the single market. But by creating a plan for your overseas business, you can at least take some control over the forces that might impact your business. The WU® EDGE platform could play a central role in not only giving you visibility over your currency exposure but in providing you with customisable reporting so that you can see patterns, identify trends and predict your future cash flow situation.

Many businesses are prepared to accept currency fluctuation as a cost of doing international business, but many more think that only large corporates have the strength to engage in currency risk management. The reality is that with our all-new technology platform and risk management experts, a business of any size can ride the ebbs and flows of currency volatility, helping to move towards international growth.

With our 3-step framework to help protect profits you can:

1. Understand your exposures

2. Create the right plan, tactics and execute

3. Evaluate and adapt your strategy

Find out more about currency risk protection here:
http://business.westernunion.co.uk/options

Gain further insight on protecting your profits from currency risk

business.westernunion.co.uk/options

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