PARA BELLUM ADVISORS

CORPORATE TREASURY · LONG-DATED REVENUE EXPOSURE

Rolling Forwards, on a Ten-Year Asset

SCENARIO TYPE	Corporate Treasury – Long-Dated Revenue Exposure
ASSET CLASS	USD revenue streams with AUD reporting currency, long-dated operating contracts
RISK FOCUS	Cumulative carry drag, re-strike risk, absence of economic certainty on structural cashflows
PRIMARY OFFER	Derivatives Portfolio Review™
RELEVANT SERVICES	Derivatives Portfolio Review™ · Hedge Rebuild™ · Cross-currency swap design · FX programme governance · Trade execution benchmarking

THE SITUATION

A corporate with USD-denominated revenue streams from long-term operating contracts had built its FX hedging programme around rolling three-month FX forwards. The treasurer understood the instrument. The relationship bank recommended it. On a line-item basis, each roll looked cheap.

Five years into the programme, a financing review revealed a different picture. The cumulative carry cost of rolling short-dated forwards over the period came to approximately three times what a cross-currency swap executed at programme inception would have cost. The damage was not visible in any individual transaction – it had accumulated invisibly across 20 quarterly rolls, compounding with each re-strike.

The business had been doing the right thing – hedging a real exposure – with the wrong instrument. Not because the team made a bad decision at the time, but because nobody had modelled the full lifecycle economics of the approach before committing.

HOW DRAG ACCUMULATES

Rolling FX forwards feel cheap because the cost is distributed. Each individual roll is small relative to the notional. The bank quotes a spread, treasury approves the roll, the position is renewed. The process is familiar and nothing looks wrong on any single transaction.

Carry drag compounds on every roll. Where an interest rate differential exists between the two currencies, rolling forwards embed that differential as a cost on every re-strike – paid 40 times over a programme designed to hedge a 10-year exposure. A cross-currency swap captures the same differential but pays it once, structured into the swap economics rather than repeatedly as a rolling cash cost.

At each quarterly roll, the forward is re-struck at the prevailing market rate. If the hedged currency has moved adversely between rolls, the new forward locks in a worse rate. The hedge is present, but the economics deteriorate with each unfavourable re-strike. Long-dated exposures with stable underlying cashflows do not benefit from this repeated exposure to reset risk – the structural nature of the revenue makes the rolling approach a poor match for the asset.

WHAT TYPICALLY BREAKS

Notional uncalibrated since inception

A contract renewal two years prior had changed the volume profile, but the hedge notional had not been updated. A structural over-hedge had been running for 24 months with no one accountable for notional alignment.

Execution pricing never benchmarked

The bank executing the rolls had never been quoted against. Treasury had no independent reference for whether pricing was competitive. Over 20 rolls, cumulative spread leakage was material and entirely invisible.

Lifecycle economics never modelled

The treasury team assumed forwards were the standard tool. Nobody had run the numbers on a cross-currency swap at inception. The swap looked expensive upfront because costs were transparent; the rolling programme looked cheap because costs were distributed.

Accounting P&L requires quarterly explanation

The rolling forward programme did not qualify for hedge accounting on the same basis as a longer-dated instrument would have. Board reporting showed FX line items with no clear link to operating performance.

THE STRUCTURAL INSIGHT

The underlying revenue was contractual, long dated, and predictable in timing. These are precisely the characteristics that make a cross-currency swap economically appropriate. Rolling forwards are the right tool for indefinite or volume-uncertain exposures – they were the wrong tool for this one.

Modelling the full cost of the rolling programme against a cross-currency swap executed at the same start date made the gap concrete. The swap would have been more expensive in year one because costs were transparent. Over the full programme life, the rolling approach cost materially more once carry, re-strike drag, and cumulative execution spreads were incorporated.

Correcting the programme going forward was achievable without crystallising losses. As each quarterly forward matured, the replacement was structured as a longer-dated instrument, progressively building cross-currency swap coverage over three to four quarters. By the end of the transition window, structural exposure had swap coverage matched to contract tenors. The rolling programme was retained only for shorter-duration exposures where re-strike flexibility remained appropriate.

INTENDED OUTCOMES

- Lifecycle cost reduction on the structural FX programme – cross-currency swap coverage established for long-dated contractual revenues; carry drag, re-strike risk, and execution spread leakage eliminated on the structural portion.
- Economic certainty on cashflows used for capital allocation – AUD equivalent of USD revenues known with certainty for the life of the contracts; debt service coverage ratios and distribution policy settable against known cashflows.
- Board reporting simplified – FX line items reflect operating outcomes rather than hedge P&L volatility requiring technical explanation each quarter.
- Trade execution quality improved – benchmarking process introduced for all FX execution above threshold notional; spread compression on the first competitive quote material.
- Rolling programme retained only where appropriate – re-strike flexibility maintained for shorter-duration or volume-uncertain exposures where it remains economically justified.

WHERE THIS APPLIES

Works best where the underlying FX exposure is contractual, long-dated, and predictable in timing and volume; the existing hedging programme uses rolling short-dated forwards as the default instrument; the programme has been running for more than two to three years without a lifecycle cost review; and accounting P&L volatility from the rolling programme requires regular board explanation.

Less relevant where FX exposure is genuinely uncertain in volume or timing, making rolling flexibility economically appropriate; the organisation already runs cross-currency swap coverage matched to underlying contract tenors; exposure duration is under two years where the economics of rolling versus structural hedging are less differentiated; or counterparty or CSA constraints make longer-dated instruments operationally impractical.

TYPICAL ENGAGEMENT PATH

Derivatives Portfolio Review™ – FX book lifecycle cost analysis, instrument suitability review, and transition pathway design.

Secondary: Cross-currency swap structuring and execution support, counterparty benchmarking framework, hedge accounting coordination, rolling programme governance redesign.

Illustrative case study for discussion purposes only. Details have been anonymised. Outcomes depend on portfolio structure, counterparty documentation, market conditions, and accounting constraints. Not investment advice.