EXECUTIVE BRIEF

When Hedges Work and Still Fail

The Case for a Monetisation Doctrine

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Executive Summary

Institutional portfolios rarely suffer because their hedges are wrong. They suffer because nothing happens when those hedges are right.

Across FX, rates, credit, and equity portfolios, hedges routinely perform exactly as designed. Mark-to-market gains accumulate, volatility metrics improve, and governance bodies are reassured that protection is in place. Yet in most cases, those gains are never converted into usable capital, re-locked protection, or improved portfolio resilience. They are observed, reported, and then quietly given back.

The problem is not hedging technique. It is the absence of a monetisation doctrine. An unrealised hedge gain is not protection. It is an unmade decision.

The Hedge That Worked and Still Failed

A long-term institutional investor holds a substantial foreign-currency asset. The exposure is strategic and persistent. A rolling FX forward programme is implemented to hedge a fixed portion of the exposure. The structure is liquid, accounting-aligned, and fully approved. Reporting shows volatility reduction. The hedge is working.

Over time, FX moves materially in the fund's favour. The hedge moves deep in-the-money. Mark-to-market gains accumulate steadily. No action is taken. There are no monetisation triggers, no authority to crystallise partial gains, and no re-hedging doctrine. The currency eventually reverses. The accumulated gain compresses, then largely disappears. Carry costs persist throughout. The opportunity to re-lock protection at materially better levels passes.

> *The hedge worked. The portfolio is still worse off than it should have been. The failure was not market timing. It was structural inaction. This pattern is not rare. It is systemic.*

Why This Happens in Otherwise Well-Run Institutions

This failure is not driven by incompetence or poor intent. It is driven by institutional design. Three forces dominate.

Career risk asymmetry

Monetising a hedge gain feels like trading. Staying hedged feels like prudence. When a hedge is visibly working, altering it is harder to defend than leaving it untouched. Over time, this creates a bias where give-back is tolerated, but crystallisation is viewed as discretionary risk. Inaction feels safer than action, even when action would improve outcomes.

Measurement mismatch

Hedge P&L is reported monthly or quarterly. Committees meet monthly or less frequently. But monetisation opportunities often exist for days or hours. Equity volatility collapses quickly. Credit spreads retrace after intervention. FX mean-reverts within weeks. The instruments move faster than governance.

Optionality worship

Keeping a hedge in place preserves the appearance of protection. Monetising it creates a new decision point. Many institutions prefer to preserve optionality rather than exercise it, even when exercising it would lock in gains. The cost of optionality, carry bleed, decay, or give-back, is treated as invisible.

> *The result is predictable: hedges are left untouched until their value disappears.*

When the Cost Is Liquidity, Not Just Give-Back

In modern derivatives portfolios, the cost of inaction is not limited to lost gains. It increasingly shows up as liquidity stress. Consider a portfolio with cleared rate and FX hedges. Markets move favourably. Hedge MTM gains accumulate. At the same time, other positions generate variation margin outflows. Treasury manages the cash drain. Investment teams point to hedge gains as reassurance. But the gains are unrealised.

They cannot be used to meet margin calls. They cannot be redeployed. They cannot relieve liquidity stress without monetisation authority. The organisation bleeds cash while sitting on paper protection. Eventually, assets are sold, facilities are drawn, or opportunities are missed.

> *This is the variation-margin trap, and it is a direct consequence of treating hedging and liquidity as separate governance problems.*

What a Monetisation Doctrine Actually Changes

A monetisation doctrine does not mean trading hedges aggressively. It means defining, in advance, how protection is converted into outcomes. At a minimum, it requires four things.

1. Explicit triggers that mandate evaluation when gains reach meaningful levels.
2. Delegated authority aligned to the speed of the instrument.

3. Procedural re-hedging logic so monetisation does not create exposure gaps.
4. Integration with liquidity planning, not separation from it.

> *If your hedge P&L volatility exceeds your operational decision-making speed, you do not have a hedge. You have a management problem.*

A CIO Diagnostic

Five questions. They should produce direct answers. If they do not, the gap is the answer.

Question	What the answer reveals
What percentage of hedge MTM gains have been crystallised over the last five years?	If close to zero, monetisation is not happening regardless of what governance documents say.
Can you monetise 50% of a hedge position without board approval?	If not, authority is misaligned with the speed at which hedge value moves.
Have hedge gains ever been used deliberately to relieve liquidity stress?	If never, hedging and liquidity management are operating as separate, disconnected functions.
Do written rules exist for when a hedge gain must trigger evaluation?	If not, monetisation is discretionary. Discretionary decisions in stress produce poor outcomes.
Can you point to an instance where a hedge gain was monetised before the risk that created it had fully played out?	If not, the programme has no track record of proactive monetisation.

Closing Perspective

Modern portfolios are complex, long-dated, and governed by layers of process designed to reduce risk. But without a doctrine for monetising protection, those same processes ensure that hedge gains remain theoretical.

Hedges that cannot be monetised when they work do not reduce risk. They defer it. Most institutions believe they are conservative because they do not trade their hedge books. In practice, they are conservative because they allow hedge gains to evaporate by default.

> *If your hedges exist but your monetisation doctrine does not, that is the problem worth solving.*

About This Brief

This Executive Brief is a companion to the Para Bellum Advisors practitioner paper: Monetising Derivative Hedges, A Practical Framework. The full paper covers trigger design, delegation structures, re-hedging protocols, liquidity integration, and case studies across asset classes.

Available at **www.parabellumadvisors.com/insights/**

About Para Bellum Advisors

Para Bellum Advisors is an independent advisory firm specialising in derivatives, structured finance, and balance sheet efficiency for institutional investors, family offices, and corporate treasury teams.

The firm focuses on hedge framework design, overlay mechanics, collateral efficiency, and portfolio resilience across FX, rates, credit, equity, and volatility exposures. Its work is practitioner-led, drawing on three decades of experience across trading, structuring, and portfolio management in APAC and globally.

Para Bellum Advisors is independent of product distribution and transaction mandates. Its objective is durable improvement in capital efficiency and liquidity resilience.

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