Results at Havenbedrijf Rotterdam have shed light on the issue of over-hedging. Fortunately there are ways to avoid or contain the problem, and specialist assistance can effectively substitute when internal resources are stretched or absent.

The announcement by the Port of Rotterdam in their half-year results that they had taken a €59mln hit on derivatives drew a fair bit of attention in the press.

At the root of the problem is the 2009 decision to hedge high anticipated investment costs with straightforward interest rate swaps. The lower funding requirements that transpired, coupled with persistent low interest rates resulted in what was in effect a standalone swap position with a very negative value for HbR.

But of course it didn't have to be that way. Over-hedging is not an unusual situation but there are a number of steps which can be taken to minimize its occurrence:

1. In an ideal world of course all funding projections would be perfect as well as the associated hedges;

2. What is possible though is scenario analysis based on different evolutions of interest rates, and on different funding requirements materializing;

3. These may then suggest hedging directly against the lower bound of funding requirements, while using swaption/collar strategies for the remainder;

4. Similarly a shorter duration can be hedged directly, leaving room for flexibility in response to longer-term developments.

All of the above can be delivered by a well-qualified derivatives advisor, deploying quantitative methods of analysis.

Also interesting are the accounting aspects. Over-hedging does not automatically result in a breach of hedge accounting criteria, however accountants will need convincing that any surplus will be absorbed in subsequent years. When this case can no longer be made there are again choices as to course of action; unwinding may not be the most economical solution, and any decision requires clarity on how the costs of unwinding are constituted between the actual value and other, often opaque, charges.

Again these are areas where a derivatives advisor can prove invaluable. Even when the required knowledge exists in-house, the time and resources are often not available to dedicate sufficient attention to an infrequent and non-core issue.

Finally, we hope the CFO of HbR has been misquoted in his belief that the money paid to partially exit the swap position can somehow be recouped as a result of this decision, for the money is of course gone for good, all future payments having been included in the termination costs.