



Chatham Financial

## Hedging e pre-hedging del rischio di tasso di interesse:

### Il caso 2i Rete Gas

# Today's Speakers



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# Today's Agenda



Introduction



Market Landscape



Common Corporate Challenges



Risk Management Leading Practices



Q&A

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Q&A

# Chatham at-a-glance



## Corporates

- HP
- GE
- Walmart
- Tiffany & Co.
- Bacardi
- Hawaiian Airlines



## Financial Institutions

- Amex
- Comerica
- Discover
- Santander
- Western Union
- Zions Banc.



## Private Equity

- Bain
- Blackstone
- Carlyle
- JPM Asset Mgt
- Morgan Stanley
- Oaktree



## Real Estate

- Brookfield
- Forest City
- Hines
- Hilton Hotels
- Simon Prop.
- Starwood

## Expertise

### *Derivatives Experts*

- 25+ Years, 450+ Employees

### *Hedge Accounting*

- 35+ Accountants from Big 4 and FASB staff

### *In-House Technology*

- 150+ Technologists on staff

## Scale

**500 billion**

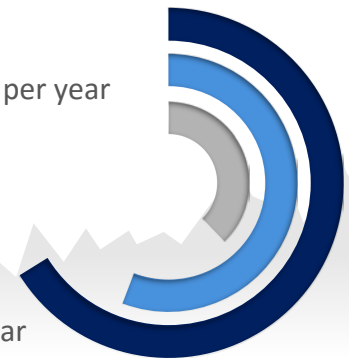
\$ of hedges executed per year

**30 million**

Valuations per year

**1 million**

Journal Entries per year



# Chatham Financial – Corporate Solutions



## Strategic Risk Assessment

- Chatham helps clients assess their risk profile & identify appropriate hedging strategies
- Our holistic view into **1,800+ clients'** best practices gives us a uniquely broad perspective



## Counterparty Setup (ISDA)

- We negotiate around **2,200 ISDA** related documents annually, more than any other firm representing derivatives end-users



## Hedge Accounting

- Chatham works with major accounting firms, the FASB, and IASB on hedge accounting issues (ASC 815 & IFRS 9)
- **Six former FASB staff members** are part of our large and highly trusted accounting practice



## Hedging Advisory & Execution

- Chatham helps clients structure & execute nearly **\$500 billion** of hedges annually across 100+ banks
- Chatham has executed derivative transactions in approximately 60 currencies



## Regulatory Compliance

- Chatham is on the forefront of derivatives regulatory changes, (Dodd-Frank, EMIR) and offers compliance solutions ranging from consulting/DIY to fully-outsourced portfolio reconciliation and reporting



## Derivatives Valuations & Reporting

- Chatham is widely recognised for its valuation and CVA/DVA expertise (including **ASC 820 & IFRS 13**)
- We sit on the valuation experts group assisting the IASB on the development of educational guidance for IFRS 13, *Fair Value Measurement*

Supported by Chatham's robust technology platform:

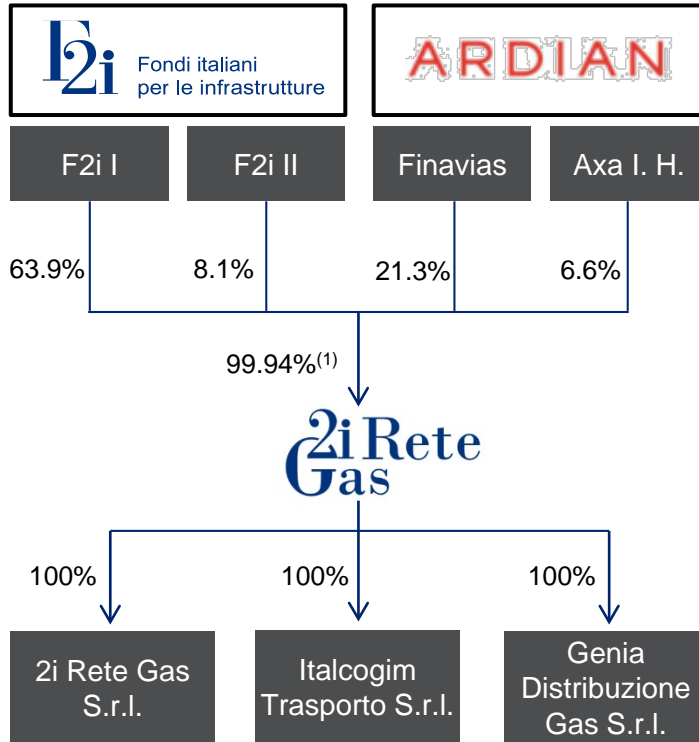


**ChathamDirect.**  
by Chatham Financial



# 2i Rete Gas - Introduction

## Current Group Structure



## Main Operating Data



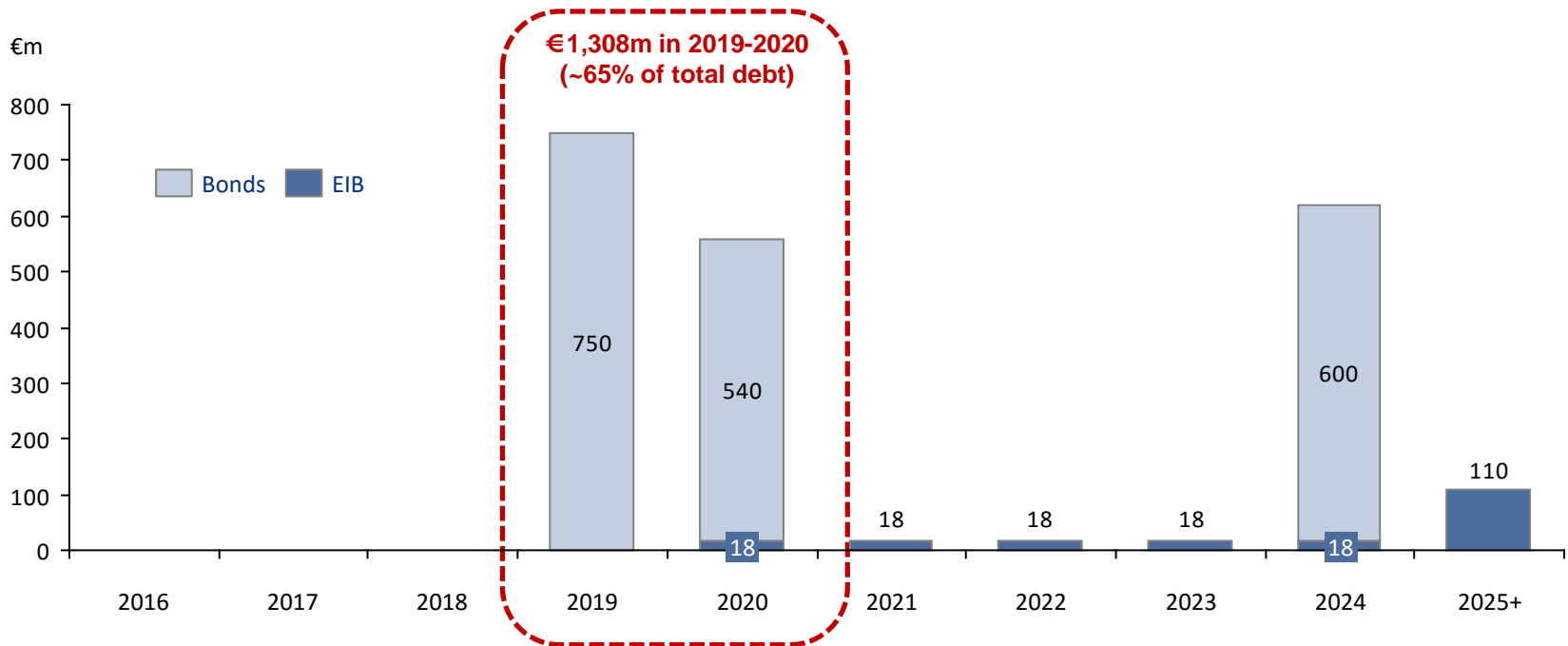
Regional presence (#)	18
ATEM presence (#)	137
Re-delivery points ("rdp") (m)	3.8
Distributed volumes (bcm)	5.4
Municipalities under management (#)	1,950
Employees (#)	1,963
Net Invested Capital (€ bn)	2.6
Grid extension ('000 km)	58
Gross capex (€ m)	198
Rating (Moody's/S&P)	Baa2/BBB

2i Rete Gas is a leading national gas distributor in Italy

(1) 0.06% minority shareholders' share

# 2i Rete Gas - Debt structure

## Debt maturities in August 2016 (€m)



Concentration of maturities and need to benefit from favorable market conditions in terms of interest rates

# Today's Agenda



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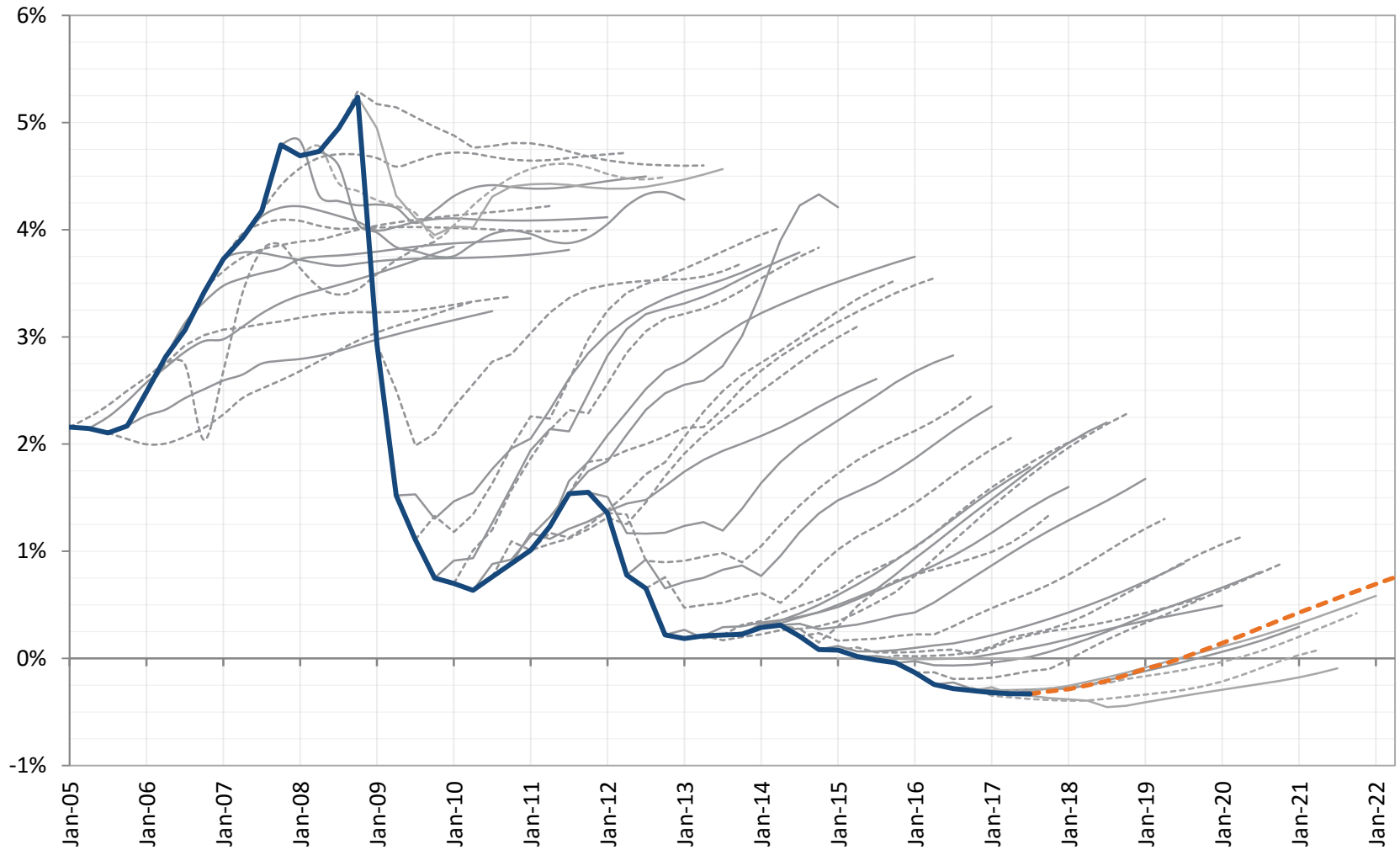


Risk Management Leading Practices

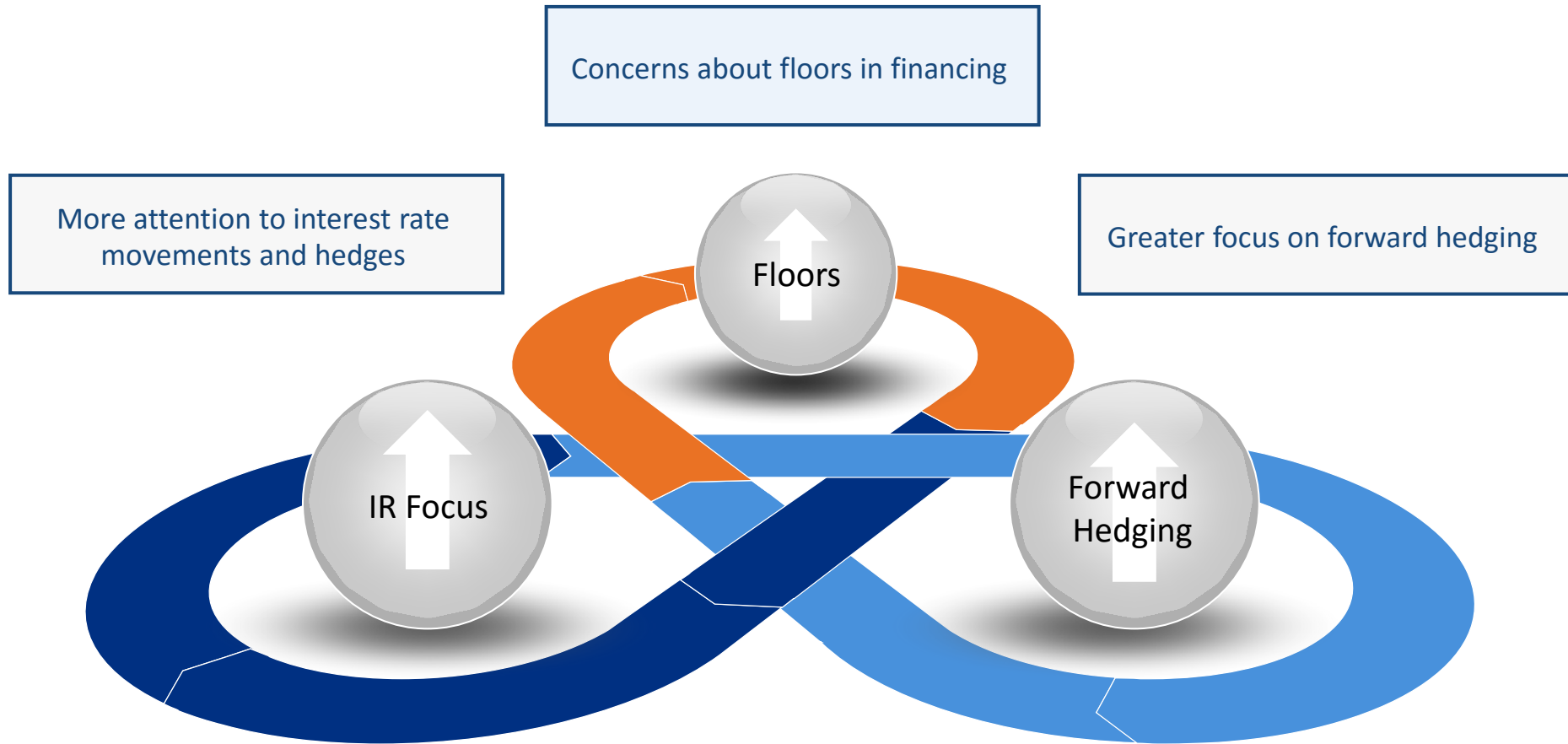


Q&A

# Historical 3 Mo. EURIBOR Fixings and Forward Curves



# How does this environment affect hedging?



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Introduction



Market Landscape



Common Corporate Challenges



Risk Management Leading Practices



Q&A

# Why floors are an issue...

The introduction of a 0% Floor in the financing causes new challenges for Interest Rate Hedging

## Normal Interest Rate environment

Swaps:	company PAYS fixed 0.093%	company RECEIVES floating Euribor 1m
Loan:		company PAYS floating Euribor 1m
Net:	company PAYS fixed 0.093%	<b>zero</b>

The floating flows from swap and from the loan offset each other

## In case of negative rates

Swaps:	company PAYS fixed 0.093%	company PAYS floating Euribor 1m
Loan:		company RECEIVES floating Euribor 1m
Net:	company PAYS fixed 0.093%	<b>zero</b>

Also in the presence of negative rates, the floating flows offset each other. Swaps are still effective instruments to reduce exposure.

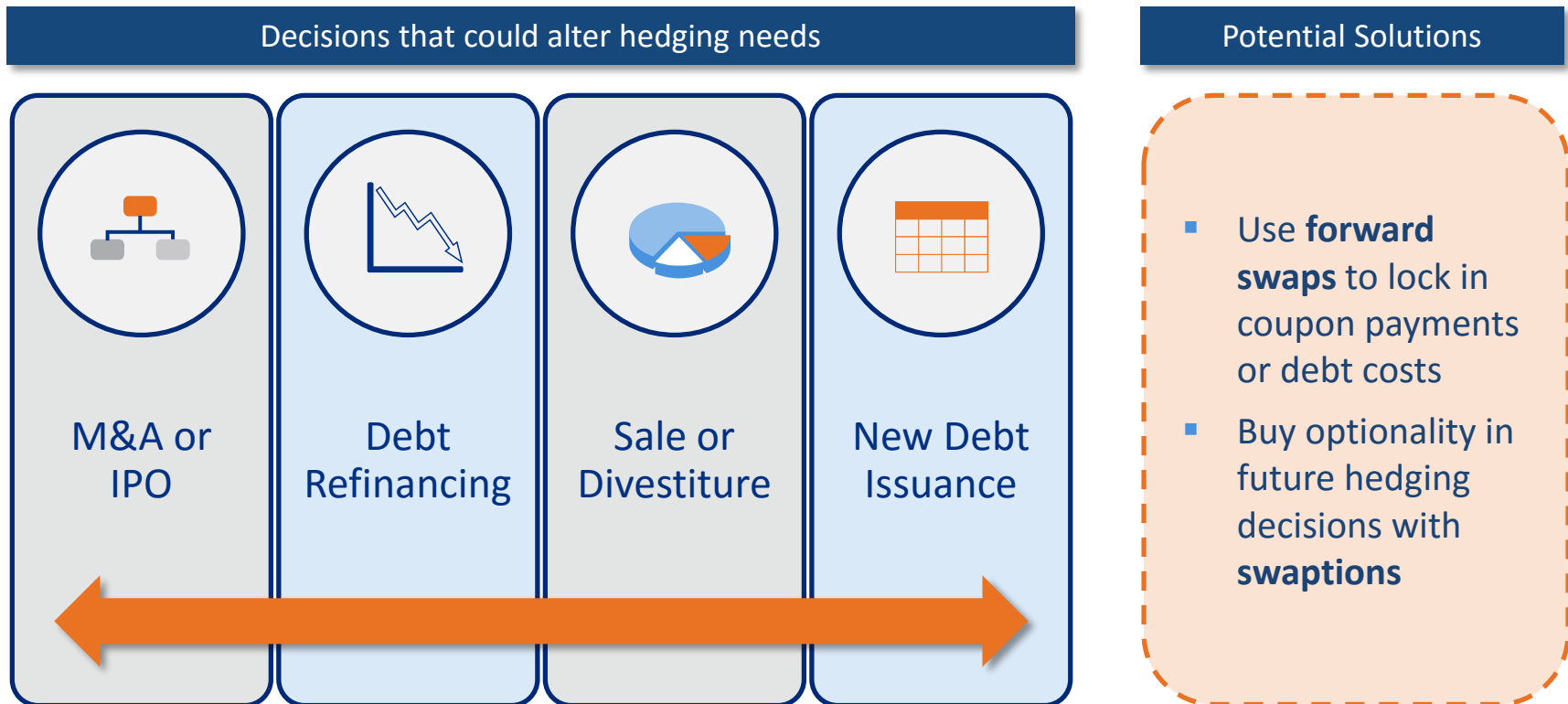
## In case of negative rates, and 0% floor in the loan

Swaps:	company PAYS fixed 0.093%	company PAYS floating Euribor 1m
Loan:		<b>company RECEIVES zero</b>
Net:	company PAYS fixed 0.093%	<b>PLUS company PAYS floating Euribor 1m</b>

However, 0% floors in the loan introduce a mismatch in case of negative rates.

# Areas which require strategic hedging decisions

In general, changes to the debt capital structure whether for financial, operational, or strategic reasons could cause a corporation to consider more advanced interest rate hedging



# Today's Agenda



Introduction



Market Landscape



Common Corporate Challenges



Risk Management Leading Practices

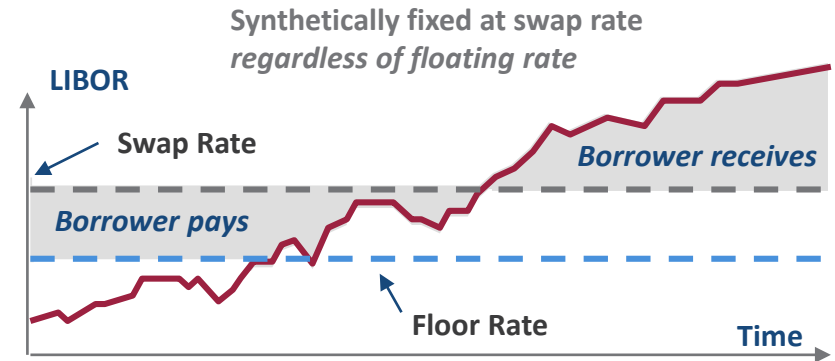


Q&A

# Interest Rate Swap with Embedded Floor

Lock product that synthetically fixes a floating rate financing with a floor component

- Borrower pays fixed to the swap provider; swap provider pays the borrower a floating rate (i.e. 1 month LIBOR)
- Floating rate received on swap cancels out floating rate paid on loan – borrower is left paying swap rate + loan spread
- Swap rate is calculated based on expectations of LIBOR + swap provider's credit/profit charge
- Floor component usually matches floor in debt (started seeing 0% floors in the previous low rate environment)



## Advantages

- No upfront payments
- Swap breakage is two-way
- Locks in a known interest expense, creating certainty of interest expense

## Disadvantages

- Requires credit – the borrower may be captive to the lender for a swap
- Swaps can become liabilities if rates fall (they can't always be unwound at no cost to the borrower)
- Additional hedging may be required if the loan contains an embedded floor

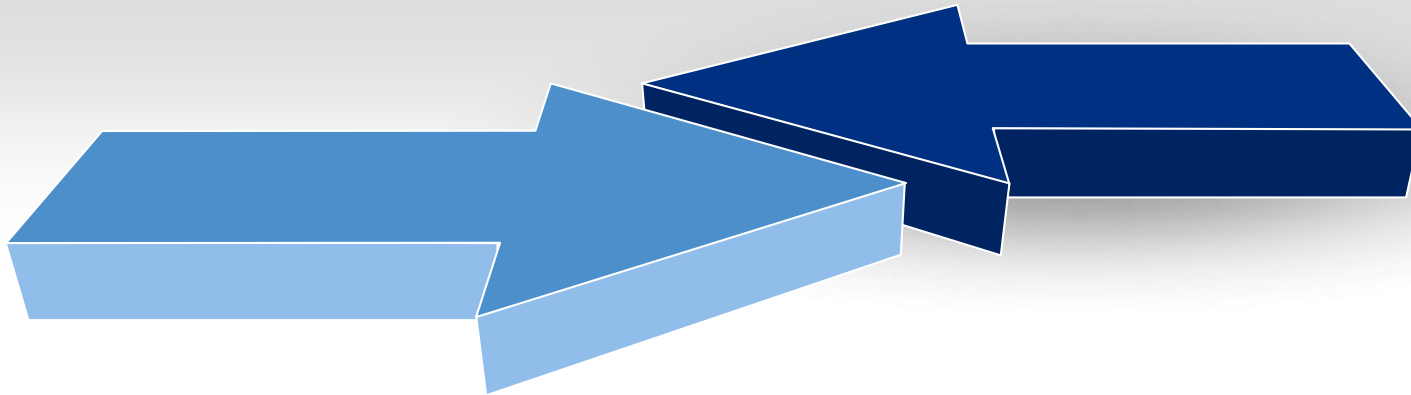
# Forward Starting Swaps

## Advantages

- Liquid market
- Efficient for short term and long term periods
- No upfront fees
- Flexibility if financing is delayed
- Cash settlement flexibility
- Hedge Accounting friendly product

## Disadvantages

- May require a cash event if rates fall, but with flexibility to align with bond issuance timing
- May be less effective if directional correlation between swap spread and borrowing spreads does not hold
- Requires credit



# Swaptions

Swaptions give the purchaser the right, but not the obligation, to enter into an IR swap at expiry

- Swaptions can be used to effectively cap the rate on a future fixed rate financing
- Borrower pays cash upfront and sets a maximum level (“strike rate”) for the swap rate
- If the swap rate exceeds the strike, borrower will cash settle the hedge and amortize the cash settlement amount to effectively reduce borrower’s fixed rate to the strike rate
- If the swap rate falls below the strike, borrower enters into fixed rate at lower market level and the option expires worthless

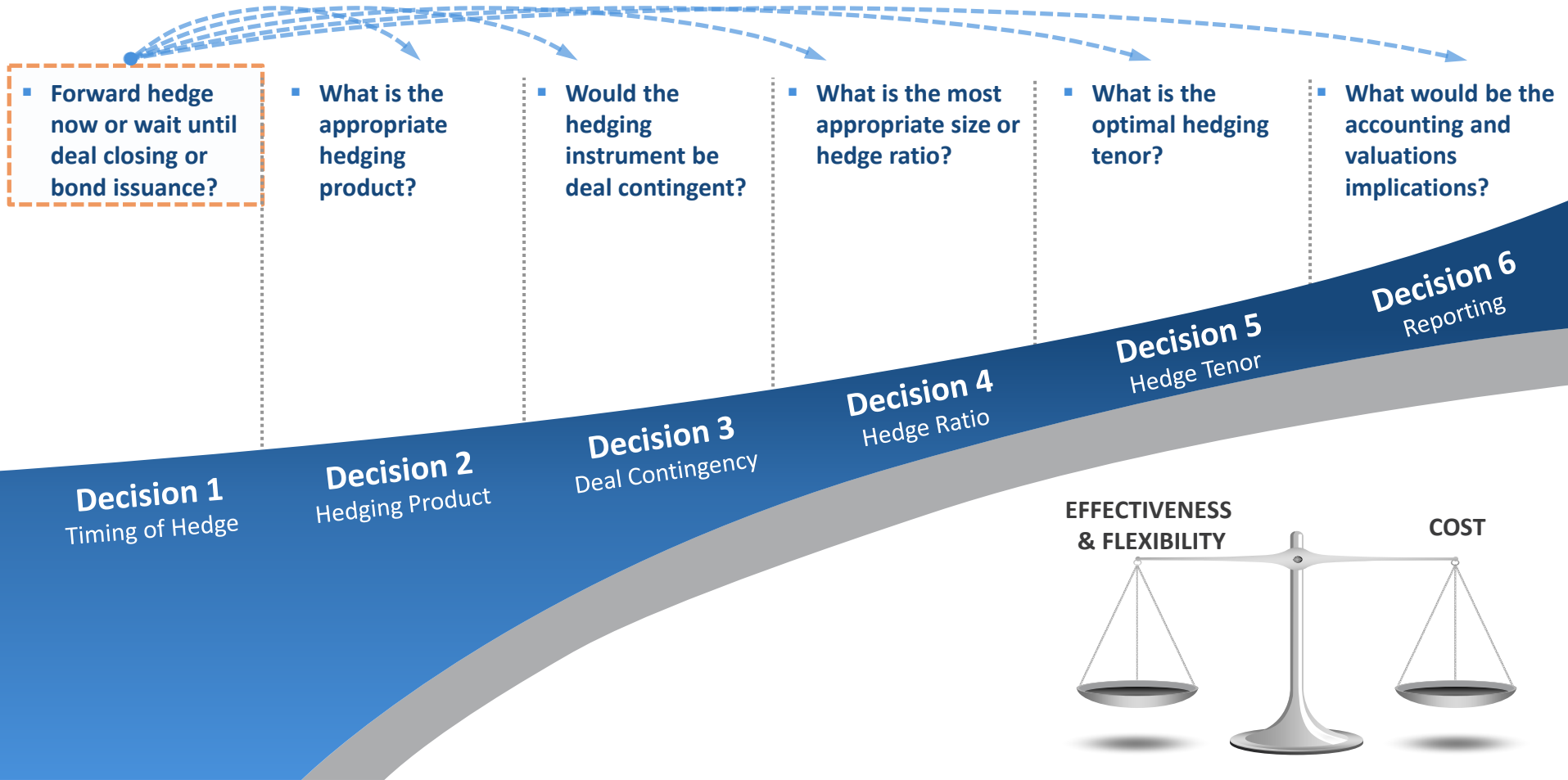
## Advantages

- These are not credit-based products because there are no payment obligations on the borrower after upfront premium is paid

## Disadvantages

- Cash premium paid upfront
- Unfavourable hedge accounting can increase earnings volatility
- Can be cost prohibitive

# Decision Points for Hedging a Changing Capital Structure



# Hedging Considerations

## Why Hedge?



### Reasons to Hedge

- To limit interest expense variability and lock in a known rate now when anticipating a future bond issuance or refinance
- Entering into an appropriate hedge will ensure that, even if rates change between now and your bond issuance, you will be economically indifferent to rate changes due to the offset created by the hedge instrument

## What to Consider

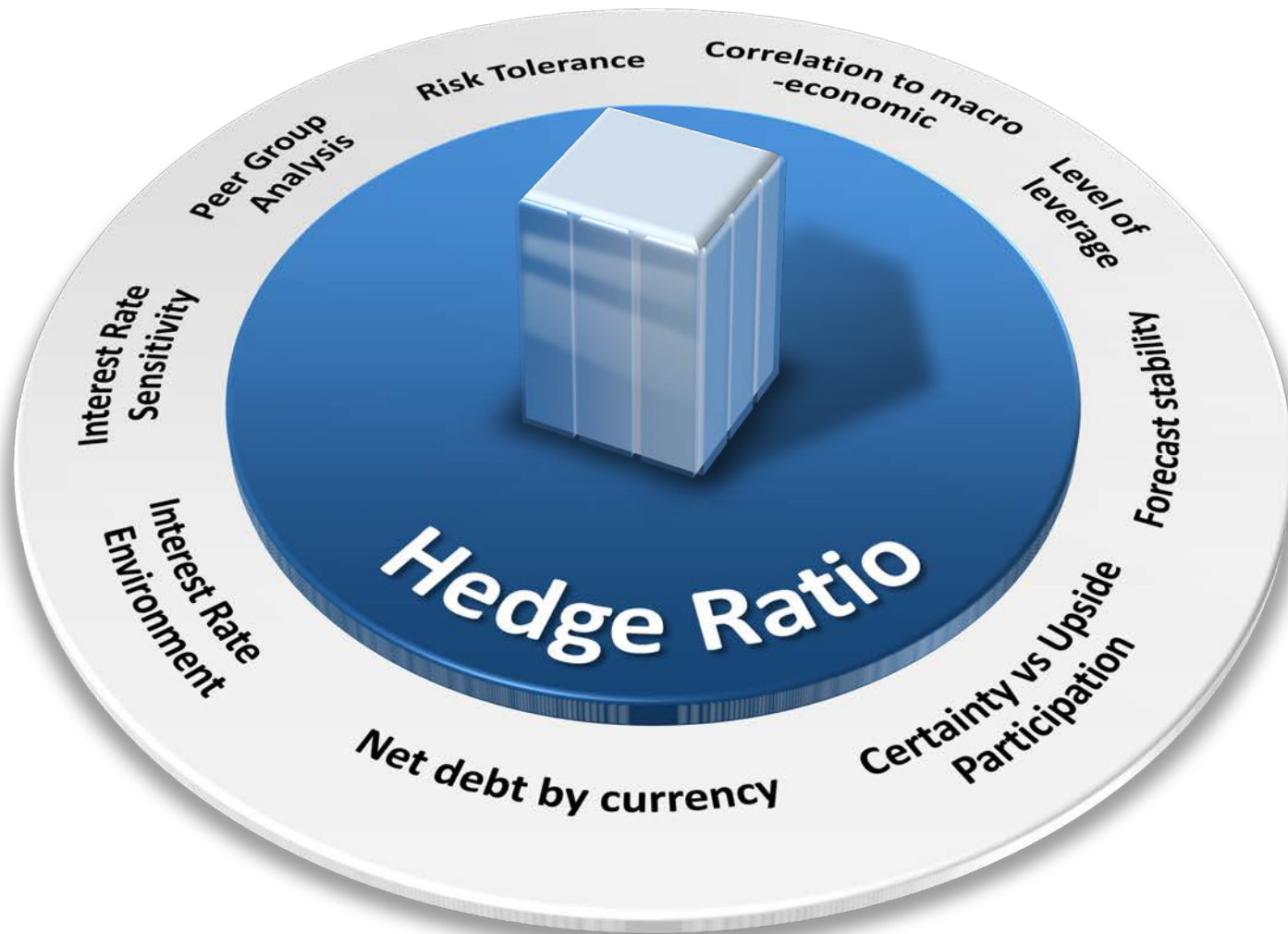


### Think About...

- Underlying Index
- Tenor of Issuance
- Notional/Principal Size and Certainty
- Issuance Timing and Certainty
- Settlement (cash vs physical settlement)
- Accounting Treatment
- Counterparties and Credit Capacity
- Documentation requirements (ISDA vs long-form confirmation)

# What should the fixed / floating mix be?

Key factors in evaluating hedge ratios



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# Questions?

[www.ChathamFinancial.com](http://www.ChathamFinancial.com)



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