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Foreign exchange product guide

Swap Contract

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Swap Contract

A Swap Contract is an agreement to buy and sell one currency for another by exchanging the notional on two separate dates. The difference in exchange rates between the near and far dates are referred to as the swap points.

Product variables

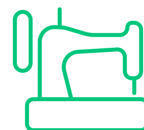
- Notional amount
- Currency pair
- Settlement date
- Pre-Agreed FX credit line
- Swap point adjustment
- Spot rate

The benefits

Swap Contracts may be used to fulfill temporary cash-shortfalls in one currency for another, whilst helping mitigate against currency fluctuations

Swap Contracts may be used to mitigate fluctuations in the valuation of assets or liabilities held in non-core currencies

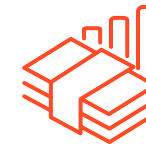
Securing spot and forward rates simultaneously helps to hedge against the risk of market fluctuations over the contract period, giving clarity on future cashflows



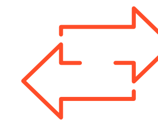
Tailored to specific objectives, giving flexibility to decide the notional amount, currencies and the settlement date

Key risks

Unable to participate in favourable market movements with respect to the contract



Should the contract no longer be required, the cost of unwind will be determined by the prevailing market rate at the time and be payable by the client



The mark to market value of the contract will become positive or negative throughout the duration of the contract in line with market fluctuations

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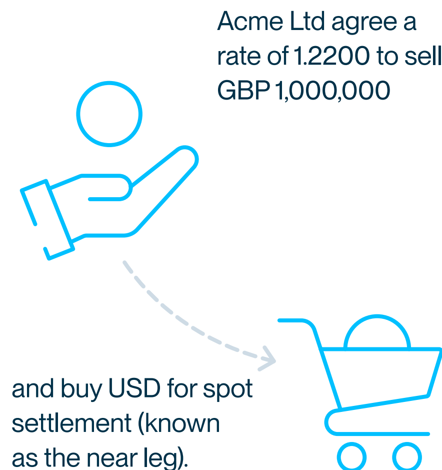
An application of a Swap Contract

(hypothetical example)

UK-based company Acme Ltd is receiving a loan to buy an office in the US as part of their global expansion plans. To get started they need to convert the GBP loan of 1,000,000 into USD but plan to repay the loan in one year using the USD revenue from the new office. This means they'll need to convert USD to GBP in time to repay the original loan.

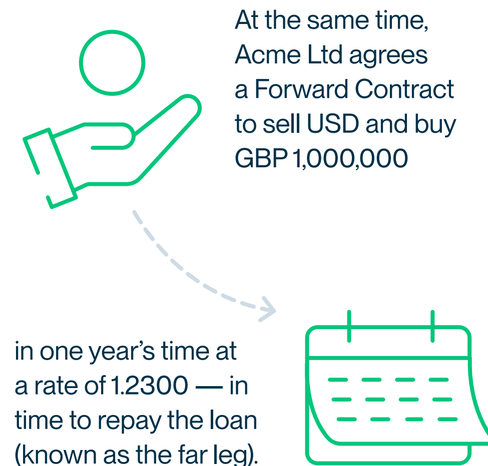
To do this, Acme Ltd executes a Swap contract:

Acme Ltd agree a rate of 1.2200 to sell GBP 1,000,000



and buy USD for spot settlement (known as the near leg).

At the same time, Acme Ltd agrees a Forward Contract to sell USD and buy GBP 1,000,000



in one year's time at a rate of 1.2300 — in time to repay the loan (known as the far leg).

Acme Ltd know the **exact cost of this exchange** in one year, thus helping with **cash flow management and budgeting.**

This will represent an opportunity cost or gain on the far leg, according to the prevailing market rate.

The forward rate (far leg) is calculated using near leg rate, plus or minus the swap points adjustment out to far leg settlement date

Contact your FX Trading Specialist to learn more or email us at **EMEAFXTraders@svb.com**

Glossary

Settlement date – Settlement of a spot contract should generally occur 2 working days after the trade is executed. Spot value for some currency pairs is the next working day.

Swap points – Swap points represent the difference in price or the time value adjustment between near leg and far leg settlement date. Swap points are added to or subtracted from the near leg rate to determine the far leg rate of a particular settlement date, and are typically depicted in pips (percentage in points). This adjustment is determined by interest rate differentials and other transaction costs.

Tenor – The length of time between execution and the final/far settlement date.

Credit line – An FX credit line allowing the company the right to buy or sell currency for a date in the future without immediate settlement of the full amount. An FX line will be tailored to the specific requirement of the business and will be approved on a collateralised or uncollateralised basis dependent on financial analysis. Clients may be subject to pay variation margin should the mark to market valuation be outside of the agreed risk parameters.

Mark to market – Measuring the fair value of the contract based on the current market price.

Notional amount – The volume of the transaction (how much currency is being bought or sold).

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