Silicon Valley Bank

Foreign exchange product guide

Forward Contract

Spot | **Forward** | Swap | NDF/NDS | FX Options

Forward Contract

An agreement between two parties to exchange one currency for another at a pre-agreed date in the future.

The rate is calculated using the spot rate and a forward point adjustment for the tenor of the contract.

The pre-agreed rate will remain fixed regardless of appreciation or depreciation of the currency pair during the period.

Product Variables

- Notional amount
- Currency pair
- Settlement date
- Spot rate
- Forward point adjustment
- Pre-approved FX credit line

The benefits

Protection against adverse movements at a predetermined rate, adding clarity on future cashflows

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

Settlement of the contract is not required until the agreed settlement date, supporting cash flow management

Key risks

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

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

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

An application of a Forward Contract

(hypothetical example)

UK-based company Acme Ltd is making a machinery purchase from a US company in 6 months. They would like to hedge against adverse currency fluctuations for that time period to ensure clarity of their costs.

To do so, Acme Ltd executes a Forward Contract:

Acme Ltd sells GBP and buys USD 500,000

with a settlement date in 6 months, at a rate of 1.2100.

The forward rate achieved is calculated using the spot rate, plus or minus the forward point adjustment, out to 6 months.

Acme Ltd has secured the cost of the machinery at a fixed rate (1.2100)

but does not need to pay the GBP until the agreed settlement date.

On the **settlement date**, Acme Ltd pays the GBP and receives USD at the **fixed rate** of 1.2100, **regardless** of where the prevailing market is trading. This will represent an opportunity cost or gain according to the prevailing market rate.

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

Glossary

Forward point adjustment – Forward points represent the difference in price or the time value adjustment between the spot rate at execution and the rate at the settlement date. Forward Points are added to or subtracted from the spot rate to determine the forward 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 expiry date.

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

Credit line – An FX 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.

Settlement date – The date on which the contract is settled, i.e. when the currency amount is delivered.

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