FUTURES

- Foreign exchange risk management
- Ensure a fixed price for a future transaction today

INFOLINE
(+420) 498 777 770
TRANSACTIONS
(+420) 498 777 777

info@akcenta.eu
www.akcenta.com

akcenta
forex and payments

FOREIGN EXCHANGE RISK

What does foreign exchange risk mean for companies?
Do you do your business with foreign partners and are you exposed to foreign exchange risk?
Can foreign exchange rate changes cause you financial losses?

USE FOREIGN EXCHANGE HEDGING

Companies and entrepreneurs who do their business with foreign partners, receive foreign currency or pay in foreign currency for imported goods are **exposed to the risk of financial losses** through foreign currency fluctuations. Currency changes may result in major or even full **loss of operating profit** if the currency loss exceeds the profit margin. This may strongly reduce a company's competitiveness or even jeopardise its further business. Foreign exchange hedging tools are a simple solution that eliminates foreign exchange risk. A simple solution for the elimination of foreign currency risks are **foreign exchange hedging tools, which become increasingly popular.** In 2017, for example, the number of hedging activities we carried out increased by 33 % compared to 2016.

EXAMPLE

Client- exporter made contract in EUR for the sale of machinery due in 6 months. The client charges its costs in CZK (Czech crown) and uses the current rate when calculating the future rate. This means that the client is exposed to the risk of CZK (Czech crown) strengthening against the euro from the moment of setting the price of the product to the transaction due date. If the CZK (Czech crowm) is stronger in 6 months' time, i.e., the rate is lower, the client gets less CZK than expected (originally calculated) for the amount of EUR.
With agreed forward rate, the company gets an effective planning tool (calculation rate) and minimises possible losses. Tools for foreign exchange risk hedging – forward transactions – are used for this purpose.

FORWARD TRANSACTION

A forward transaction is the basic type of currency hedging. It is a contract for the future purchase or sale of a foreign currency at a fixed rate setteled at agreed date in future. The forward rate is based on the spot rate and forward points (called pips). These points depend on the lenght of the forward contract and the difference between interest rates of exchange rates. With a fixed forward rate, the company gets security and eliminates the risk related to the future negative foreign exchange rate development. On the other hand, it cannot profit from any positive exchange rate development. It is therefore appropriate to consider between 100% hedging or only part of it. No charges are applied for forward transactions, and they may be made for an unlimited period of time (up to one year as standard, but may also be longer in individual cases). Neither the number of forward transactions nor their amount is limited. The transaction becomes binding at the moment it is arranged.

CONDITIONS FOR OBTAINING A FORWARD TRANSACTION:

- Conclusion of Framework agreement about payment and investment services

- You are legally obliged to have LEI number
- Deposit of cash collateral or getting a Dealing limit
- Minimum amount per transaction is EUR 10,000 or equivalent in another currency

EXAMPLE OF CALCULATIN A FORWARD RATE

CLIENT – EXPORTER:

A company has made a transaction with a foreign partner, which should pay EUR 100,000 for purchased goods in three months' time. The current (market) CZK/EUR rate is CZK 27.70 and the three-month forward rate is CZK 27.68, which is 2 hellers under the current rate, hence the three-month term points = -2.

EUR/CZK rate on the due date	CZK value without forward	CZK value with forward	Potential gain/loss vs. spot rate when due (in CZK)
27.50	2,750,000	2,768,000	18,000
27.60	2,760,000	2,768,000	8,000
27.68	2,768,000	2,768,000	0
27.80	2,780,000	2,768,000	-12,000
27.90	2,790,000	2,768,000	-22,000

FORWARD CONTRACT WITH FLEXIBLE DUE DATE

If it is difficult for an importer or exporter to estimate the future due date of collections or liabilities, it may also use hedging through a forward contract with a flexible due date. A forward contract with a flexible due date is based on the same principles as a forward contract, i.e., a precisely defined sum is hedged with a fixed rate, but it has a variable due date instead. The pre-determined forward settlement date is replaced with a three-week interval (1 week before and 2 weeks after the settlement date) during which the exchange can be made on any business day through a single transaction at a pre-agreed rate. This tool also enables companies to make a better use of the fixed rate in calculations in their financial planning

CONDITIONS FOR OBTAINING A FORWARD TRANSACTION WITH FLEXIBLE DUE DATE

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EXAMPLE

CLIENT – IMPORTER:

On 30 June, the company bought goods from a German supplier worth EUR 100,000 with delivery in 3 months' time. However, the company does not know exactly when the payment for these goods will be made and wishes to eliminate the risk of exchange rate movements. On 30 June, the company concludes a forward rate with the settlement period falling between 26 September and 14 October and can buy EUR any working day within this period.

AMORTIZATION FORWARD CONTRACT

An amortisation forward contract is based on the similar terms and conditions as a standard forward contract and may be used in some cases when it is difficult to predetermine the precise settlement date and size of individual transactions. During the agreed period, it is possible to perform the exchange at any time at a pre-agreed rate, but individual conversions do not have to be specified in advance and may be done on any business day during the given period and in any amount up to the amount of the agreed amortisation forward contract.
All withdrawals during the term of an amortization forward until the maturity date is at the originally arranged forward rate and without additional costs. If the whole of the amortization forward is not withdrawn it is possible to perform a swap and thus postpone its withdrawing until a more suitable time.

CONDITIONS FOR OTAINING AN AMORTIZATION FORWARD CONTRACT:

- Conclusion of Framework agreement about payment and investment services
- You are legally obliged to have LEI number
- Deposit of cash collateral or getting a Dealing limit
- Minimum amount per transaction is EUR 30,000 or equivalent in another currency

EXAMPLE

CLIENT – EXPORTER: A company is expecting payments from foreign companies that should pay a total of EUR 100,000 for purchased goods within 12 months, i.e., before 31 December. The company concludes an amortisation forward for period until 31st of December with fixed currency rate.

Payment receipt date	31 March	30 June	30 September	30 December
Arranged rate	27.45	27.45	27.45	27.45
Actual rate	27.82	27.04	27.49	27.18
Payment received	18,000	35,000	32,000	15,000
Potential gain/loss vs. spot rate when it is due (in CZK)	-6,660	14,350	-1,280	4,050

CURRENCY OPTIONS

This product gives the client the right to buy or sell a currency for another currency for a pre-agreed price on a specified date or during a specified period. The client pays an option premium for this right.
A currency option enables you to hedge against negative foreign exchange trends and, unlike forwards, you can profit from an opposite, positive development.

SWAP TRANSACTIONS

By making a forward transaction, the company immediately gets certainty of the future foreign exchange rate for which the currency conversion is settled in 3 months time (as at 30 June). It is an ideal solution if the forward rate is in accordance with the expected foreign exchange rate development, and it is an ideal tool in terms of the company's financial plans.

In the event that an importer or exporter makes an inaccurate estimate of the due date of the future collections or obligations and at the same time made a forward transaction against collection/payment, there is an option of putting off or shortening the settlement date of the forward transaction made through a swap. The conditions and the principle of the swap price are the same as with a forward trade, i.e., the market and term rate differ in the term (swap) points.

EXAMPLE

CLIENT – EXPORTER (using the currency forward example): According to the initial parameters where the foreign customer should have paid EUR 100,000 as at 30 June, the company has hedged its transaction with a forward contract, i.e., it must deliver EUR 100,000 by 30 June. The customer said the payment for the goods will be 14 days late and so the company concludes a swap to extend the due date of the initially agreed forward contract by 14 days. On 30 June the company buys EUR 100,000 at the current rate, thus settling the forward transaction made, and simultaneously sells the same sum with a new due date of 14 days. The new forward rate value will be based on the current rate adjusted by term points.

Transaction	Date	Transaction type	Amount EUR	Party to transaction	Due date	Rate EUR/CZK
Agreement	30 March	Forward	100,000	Sale	30 June	27.00
Settlement	30 June	Swap/Spot	100,000	Purchase	30 June	27.21
Agreement	30 June	Swap/Forward	100,000	Sale	14 July	27.208

If the company gets payment in advance for its goods, the existing forward contract may be partly or fully settled early with the help of a swap transaction.

Similarly, a swap transaction may be used if the company has excess funds in one currency and a lack of another that it needs for the payment of its due liabilities. Through a swap it can carry out two transactions (prompt and forward trades) whereby it temporarily purchases the currency it lacks by selling its excess currency. At the determined date in the future it will perform the opposite transaction at the previously arranged rate.

CONDITIONS FOR OBTAINING A SWAP CONTRACT:

- Conclusion of Framework agreement about payment and investment services
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ADVANTAGES OF FUTURES EXCHANGE:

- With derivative transactions (futures) you can gain security and fix a margin against losses arising from possible future negative exchange rate trends.
- You can fix the exchange rate within the calculation of your commission.

NOTIFICATION

- AKCENTA CZ a.s. notes that the conclusion of the futures listed in this document involves risks, which the client is required to be familiar with, understand and consider to the greatest extent possible; if necessary, the client must request further information.
- An obligation to deposit a financial security on the bank account of AKCENTA CZ, a.s., or possibly also to provide other security upon request, may be connected with the conclusion of a futures exchange.
- It is necessary to acquire a LEI number before the conclusion of a futures exchange.

For more detailed information about the risks associated with the futures, please visit the website. The information can also be provided by AKCENTA CZ a.s. traders.

If any of these products has drawn your attention and you believe that you could use them as an advantageous tool to reduce the risk associated with your business activities, please do not hesitate to contact any AKCENTA CZ dealer.

CALL
(+420) 498 777 777

AKCENTA CZ a.s.
Nerudova 1361/31
500 02 Hradec Králové 2
Czech Republic

Infoline: (+420) 498 777 770
Transactions: (+420) 498 777 777

info@akcenta.eu
www.akcenta.com