Foreign exchange spot, forward and swap transactions

The business results of import- and export-oriented companies can be affected by exchange rate fluctuations. These fluctuations are very difficult to predict. Companies (investors) can hedge this risk with forex forward transactions, or engage in forex spot transactions to buy or sell a foreign currency at the current exchange rate to the Swiss franc.

Foreign exchange spot transactions

In a spot transaction, freely tradeable currencies are bought or sold at the current exchange rate, which is called the spot rate.

Conditions

- CHF account
- Foreign currency account
- Sufficient available funds

Advantages at a glance

- Settlement is one to two business days after conclusion
- No minimum amount is required
- Immediate hedge against exchange rate changes

Risks / disadvantages

- The client cannot make use of the opportunities that will arise if the exchange rate develops better than expected after the spot transaction.

Foreign exchange forward transactions

A forex forward transaction can be used to hedge exchange rate risks for future flows of funds.

In a forward transaction, freely tradeable currencies are bought or sold for a specific maturity date. The exchange rate is agreed when the forward transaction is concluded. The exchange rate for the forward transaction is based on the spot rate, adjusted by a premium or a discount. The premium or discount is primarily calculated as the interest margin between the two currencies over the term of the transaction. The minimum amount for a forex forward transaction is CHF 50 000 or countervalue and forward transactions can be concluded for a maximum of 12 months.

Conditions

- Existing accounts in CHF and foreign currency
- Conclusion of the framework agreement for option, forward and future transactions
- Risk assessment for foreign exchange forward and swap transactions for clients without a securities account
- Collateral (percentage of contract value) plus negative replacement value

Advantages at a glance

- Exchange rate risks for future flows of funds are hedged
- Basis of calculation is fixed because exchange rate is fixed

Risks / disadvantages

- The fixed forward rate means that investors cannot benefit from any positive exchange rate developments in the future.
- As forex forward transactions are subject to changes in interest and exchange rates, the investor may have to provide additional collateral at a later date.

Foreign exchange swap transactions

A forex swap transaction (swap) is a combination of a spot transaction and a forward transaction. A swap is the simultaneous purchase and sale of identical amounts of one currency for another at a later date. The difference between the two exchange rates is again mainly determined by the interest margin between the two currencies. The minimum amount for a forex swap transaction is CHF 50 000 or countervalue and swap transactions can be concluded for a maximum of 12 months.

Conditions

- Existing accounts in CHF and foreign currency
- Conclusion of the framework agreement for option, forward and future transactions
- Risk assessment for foreign exchange forward and swap transactions for clients without a securities account
- Collateral (percentage of contract value) plus negative replacement value

Suitability / advantages

- Extension or reduction of the term of a spot, forward or another swap transaction
- Cash management support

Risk / disadvantage

- The fixed forward rate means that investors cannot benefit from any positive exchange rate developments in the future.

Examples as illustration

Foreign exchange spot transaction

Sample Company received euros paid into its EUR account. However, it needs Swiss francs to settle its obligations. As the exchange rate is currently attractive, it sells the euros for Swiss francs.

Foreign exchange forward transaction

Sample Company sold a machine for CHF 250 000 to be delivered in six months' time. To manufacture the machine, it imports components from the eurozone, which is also has to pay in six months' time. To hedge the exchange rate risk, the company buys the euros it needs in six months' time for Swiss francs at the forward rate. Six months later, the euros are credited to the EUR account and the Swiss francs are debited to the CHF account.

Foreign exchange swap transaction

Sample Company has a sizeable balance in this USD account, some of which it will only need in five months' time. The company expects the USD exchange rate to rise, and also needs a better cash flow in Swiss francs. One option is a forex swap transaction. The company sells the US dollars for Swiss francs in a spot transaction, and at the same time buys back the US dollars for a date five months in the future at the forward rate.

Limit orders in forex trading

Zuger Kantonalbank accepts limit buy and sell orders that are valid around the clock. The best known limit orders in forex trading are:

Limit order to buy or sell foreign currency

This is an order to buy or sell a currency at a specified exchange rate. The order may only be executed if the set exchange rate is reached. A limit order can be placed from CHF 50 000 or countervalue for a period determined by the client or until cancelled.

Stop loss

A stop loss order is useful as a hedge against unwelcome exchange rate fluctuations. This order should be executed when the market rate exceeds or falls below the limit set by the investor. Stop loss orders can be placed from CHF 50 000 or countervalue. It is either valid until a specified date or until cancelled.

One cancels the other (OCO)

The one cancels the other order is a combination of a stop loss and a limit order. As soon as one of the orders is executed, the other order is cancelled. This allows investors to take advantage of a beneficial exchange rate development while still hedging their risks.