UniCredit Bank

FORWARD EXCHANGE DEALS

Definition

The forward-exchange deal is the firm undertaking to buy or to sell a certain foreign currency amount at a specified date in the future or over a specified period of time at a price agreed upon contracting the deal. The delivery or receipt of the counter currency is settled by the same value date.

Return

The return (profit/loss) achieved by speculative investors is the difference between the foreign currency rate during or at the end of the maturity of the respective forward deal.

The use of foreign currency forward operations for hedging purposes means to lock oneself in the respective exchange rate so that the costs of the hedged transaction, as well as its return, cannot be influenced (they will neither rise nor fall) as a result of any exchange rate fluctuations.

Currency risk

The currency risk inherent in forward-exchange deals is, in the case of hedging transactions, the possibility that the buyer/seller could buy/sell the foreign currency at a more favourable price during or at the end of the maturity than upon contracting the deal. In the case of unmatched (unilateral) positions, the possibility that the buyer/seller must buy/sell the currency at a less favourable price on the market. The potential risk of loss may substantially exceed the original contract value.

Credit risk

The credit risk in connection with forward-exchange deals derives from the possibility of the counterparty's default due to insolvency, i.e. one party's temporary or permanent inability to fulfil obligations arising from the forward-exchange deal and the necessity to cover the transaction through the market, which may be more expensive.

Transfer risk

The transfer of some foreign currency may be restricted, in particular as a result of exchange-control regulations in the country issuing the respective currency. The proper execution of the forward-exchange transaction would then be at risk.

CURRENCY SWAP

Definition

It is a combination of two transactions – spot and forward. A currency swap means to exchange a specified amount in one currency for other currency for a certain period of time. The interest rate differential between the two currencies is reflected in a premium/discount to the re-exchange price. The delivery or receipt of the counter currency is made with the same value date.

Return

The return (profit/loss) for anyone trading in currency swaps results from the positive or negative development of the interest rate differential and can be made in the case of a counter-trade within the duration of the currency swap.

Credit risk

The credit risk in connection with currency swaps derives from the possibility of the counterparty's default due to insolvency, i.e. one party's temporary or permanent inability to fulfil obligations arising from the currency swap and the necessity to cover the transaction through he market, which may be more expensive.

Transfer risk

The transfer of individual currencies may be restricted, in particular as a result of exchange-control regulations in the country issuing the respective currency. The proper execution of the currency swap transaction would then be at risk.