Information about forward exchange contracts

Use of contracts

A forward exchange transaction is a contract for a future currency transaction. The following is agreed at the time of transaction: the currency to be bought and its amount, the currency to be sold and its amount, the value date (expiry date), and the exchange rate. This is how the forward exchange contract is used to hedge against unfavorable movements against exchange rates. Correspondingly, the opportunity to exploit positive exchange rate movements is lost.

Parties to a forward exchange contract agree to exchange two currencies at an agreed rate (a forward rate) no earlier than the third business day from the date of conclusion of the contract. Under a non-deliverable forward exchange contract, no funds are exchanged but a net payment is settled at expiry. This net payment is calculated on the difference between the forward rate of the underlying currency and counter currency and the fixing rate available from the information source mentioned in the contract.

Risks

Unlimited market risk is associated with forward exchange contracts, because the contracting party is obliged to execute the currency transaction on the value date at the forward rate specified in the contract, irrespective of the exchange rate prevailing on the value date.

In addition to market risk, the forward exchange contract's counterparty is subjected to counterparty risk. Counterparty risk refers to a risk that the counterparty does not fulfil its obligation to execute the currency transaction according to the forward exchange contract.

In addition to the abovementioned risks, non-deliverable forward contracts involve a risk of whether the customer can execute the actual currency transaction at the fixing rate specified in the non-deliverable forward contract.

The product involves a risk that a derivative position can be closed upon decision by the relevant authority in a resolution process that may be commenced due to the bank's severe financial difficulties, irrespective of the terms and conditions of the derivative. Following the closure, the amount of the debt based on the derivative contract may be reduced upon the authority's decision.

Extent of variation of forward exchange contract market value

How much a forward exchange contract's market value varies is determined by the contract validity period, the extent of exchange rate fluctuations and the interest rate differential of currencies.

Financial commitments and obligations related to forward exchange contracts

A forward exchange contract obliges its parties to execute a currency transaction at a forward rate on the value date of the contract, irrespective of the exchange rate prevailing on that date.

OP Corporate Bank plc, business ID 0199920-7, P.O.Box 308, FI-00013 OP, domicile Helsinki