FX Derivatives

Forward

ING Financial Markets

Contents

Forward

General Information

A foreign currency transaction is an agreement between two parties to exchange a specified amount of one currency for a specified amount of another currency. The rate at which the currency is exchanged is reflected in the exchange rate. This is the price of a certain currency expressed in terms of the other currency. A EUR/USD exchange rate of 1.4000 means that EUR 1 represents a value of USD 1.4000. In this case the currency pair is EUR/USD, with the EUR being the base currency and the USD being the quote currency.

Foreign currency transactions can be used to hedge (future) currency risks, but also to regulate liquidity positions. In the business world currency transactions are often used to lock in the exchange rate of (future) income and expenditure in foreign currencies. Currency transactions can protect against negative exchange rate developments, whereby it is accepted that locking in an exchange rate eliminates the benefit of any positive exchange rate developments.

There are three basic types of foreign currency transactions:

- **Spot Transaction -** a foreign currency transaction with immediate delivery is called a spot transaction. The exchange rate is called the spot rate.
- **Forward Transaction -** a forward currency transaction is a binding contract between two parties to exchange one currency into another currency at an agreed rate at a specific time in the future (delivery date). The exchange rate is known as the forward rate.
- **Currency Option -** a currency option is a contract that grants the holder the right, but not the obligation, to buy (call) or sell (put) a specific amount of currency at a predetermined exchange rate at a specified date. It is the right to exercise a spot transaction at a predetermined exchange rate. The buyer of the currency option pays a premium to the seller.

Product description

A currency transaction with delayed delivery is called a Forward contract; the exchange rate is the forward rate. The value date is the date on which the Forward contract ends. This is a fixed agreement with both parties entering into an obligation. The forward rate is determined by the spot rate. However, due to the delayed delivery, the time factor and therefore also the interest factor are a consideration. The forward rate is established by settling the interest differential between the two currencies in the rate.

Main product features

- A Forward is an agreement between two parties arranged outside the regulated financial markets.
- It is available in all commonly-traded currency pairs
- No minimum or maximum amounts apply (restrictions may apply for less saleable currency pairs)
- Terms are from one day to five years (longer or shorter terms may apply depending on the currency pairs)

- The amount and term can be adapted to specific wishes
- Transactions are confirmed by means of a separate confirmation with all relevant details
- Any delivery takes place via the account(s) stated in the confirmation

Advantages

The advantages of a Forward are:

- A Forward ensures that a predetermined amount of a currency is exchanged for a predetermined amount of another currency at the value date. This provides security.
- A Forward provides protection against negative rate fluctuations.
- Transactions can be closed out with a reverse transaction. Any rate differences (positive or negative) are settled at the predetermined delivery date.

Risks

A Forward carries the following risks:

- A Forward contract fixes the future exchange rate. That can mean settlement on the value date of the Forward contract is less favourable compared to the spot rate could be agreed in the prevailing market. Entering into a Forward contract therefore means no longer being able to benefit from favourable exchange rate movements.
- If the actual development of the exchange rate deviates from the client's expectations, there is a risk that in hindsight another currency product / currency strategy would have been better. At the moment the transaction is entered into, the client may determine the risk based on the accepted variables. In doing so the client makes a well-informed choice to accept the risk.
- The more time that transpires between the moment the contract is entered into and the moment of delivery, the greater the risk. If a Forward is a one-month contract, the risk of price fluctuations is lower than the risk for example on a 12-month contract.

Costs

No costs are charged separately for a Forward. The costs are included in the rate of the Forward.

Sample case for a Forward

Say for example a client imports gift articles from China and has to pay USD 100,000 in three months' time.

The EUR/USD spot rate is 1.4000

The 3-month EUR interest rate is 1.00%,

The 3-month USD interest rate is 2.00%

3 months = 90 days

EUR 1.0000 = USD 1.4000 based on the spot rate

In three months' time the value of EUR 1.000 is: 1.0000 + 90 days interest at 1.00% = EUR 1.0025

In three months' time the value of USD 1.4000 is: 1.4000 + 90 days interest at 2.00% = USD 1.4070

The EUR/USD spot rate: 1.4000 / 1.000 = 1.4000;

The 3-month EUR/USD forward rate is : 1.4070 / 1.0025 = 1.4035

This forward rate becomes the exchange rate for the 3-month Forward contract.

The equivalent value of this transaction in EUR can be calculated based on this forward rate:

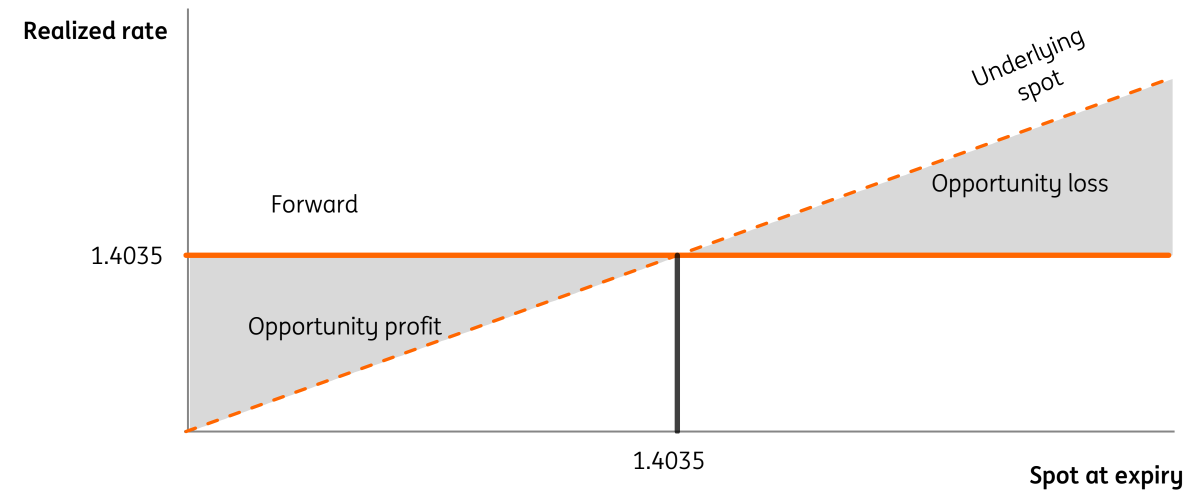
USD 100,000 / 1.4035 = EUR 71,250.44

If the USD interest rate is higher than the EUR interest rate during the respective period, the EUR/USD forward rate is higher than the spot rate. Conversely, if the USD interest rate will be lower than the EUR interest rate during the respective period, the EUR/USD forward rate will be lower than the spot rate.

A positive difference between the forward rate and the spot rate is called the premium (i.e. the forward rate is higher than the spot rate). A negative difference between the forward rate and the spot rate is called the discount (i.e. the forward rate is lower than the spot rate).

To illustrate

The following graph shows that a Forward is not sensitive to the spot rate at the end date. The end date is two working days prior to the value date. The Forward is settled on the value date at the fixed, predetermined exchange rate.



The importer will not be negatively impacted if the spot rate at the end date is below 1.4035. If the spot rate at the end date is above 1.4035, the importer will not benefit from this either.

Market value

A Forward is a freely tradable financial instrument used to hedge financial risks. The fact that a Forward can be freely traded means that the value of a Forward is not linked to the hedged notional amount of the currency. During the term of the contract the market value of a Forward depends on the underlying spot rate, forward points and volatility (fluctuations). The example above is expanded on below for clarification.

A client has entered into a Forward contract which involves purchasing USD 100,000 in three months' time at an agreed EUR/USD rate of 1.4035. In other words, the client will receive USD 1.4035 for each EUR 1.0000. Say for example the client considers closing out the Forward after one month. In that case the following three scenarios can arise:

Scenario 1: The EUR/USD forward rate for the remaining two months is 1.4035.

- There is no difference between the predetermined forward rate and the market rate; the market value of the Forward is EUR 0.

Scenario 2: The EUR/USD forward rate for the remaining two months falls from 1.4035 to 1.3500.

- There is a 0.0535 difference between the predetermined forward rate in the Forward contract and the market rate. This difference of 0.0535 on the principal sum of USD 100,000 is EUR 2,823.63 (=USD 100,000/1.4035 – USD 100,000/1.3500). This value is positive for the client as the contract is more favourable than the market rate. This translates into a positive market value and will be settled on the predetermined date of delivery.

Scenario 3: The EUR/USD forward rate for the remaining two months rises from 1.4035 to 1.4200.

- There is a 0.0165 difference between the predetermined forward rate in the Forward contract and the market rate. This difference of 0.0165 on the principal sum of USD 100,000 is EUR 827.90 (=USD 100,000/1.4035 – USD 100,000/1.4200). This value is negative for the client as the contract is less favourable than the market rate. This translates into a negative market value and will be settled on the predetermined date of delivery.

A positive or negative value is for accounting purposes. A positive or negative market value only actually needs to be settled in the event a Forward is closed prematurely.

The simplified examples provided above are realistic and serve to illustrate the scenarios. No rights may be derived from this document.

Margin requirement for non-professional clients

The bank has a legal obligation to ensure that the balances of clients who hold positions in financial instruments from which obligations (e.g. negative market value) may arise, are always sufficient for them to continue to meet their existing obligations. The client and the bank make margin agreements regarding this. In the event a margin deficit looms due to market circumstances, the bank will notify the client of this in writing without delay. If a deficit does in fact emerge, the client must take measures within five working days to eliminate this deficit, for example by providing additional securities. If the margin deficit is not eliminated within five working days, the bank will have no option but to proceed to unilaterally close all or some of the positions held, insofar as required to eliminate the margin deficit.

Contact

For more information please contact ING Financial Markets

Disclaimer

ING Belgium S.A. (ING) uses this product sheet to provide information on financial instrument(s). This product sheet is for information purposes only and has as sole purpose to provide a general explanation on the operation of a specific financial instrument.

This product sheet is not intended, and cannot be considered, as an offer, a request or a recommendation to proceed to an investment in the concerned financial instrument.

The provided information is not intended to be a substitute for expert advice and does not qualify as investment advice in accordance with Article 46, 9° and 10° of the law of 6 April 1995 concerning the legal status and the supervision of investment firms.

This information cannot and may not be used as investment, fiscal or legal advice. ING expressly points out that transacting in financial instruments involves financial risks and that ING may have transactions or positions of its own in one or more financial instruments, as indicated in this product sheet. In addition early termination of a financial instrument may result in payment obligations to ING.

The information in this product sheet may be changed without prior notice. While the outmost care is taken to ensure that the information in this product sheet is as up-to-date and complete as possible,

ING makes no representation whatsoever regarding the accuracy, validity, completeness or topicality of the information contained in this product sheet herein, except in the event of gross negligence.

ING Belgium, as a credit institution and insurance broker, is submitted to the control authorities : the National Bank of Belgium and the Financial Services and Markets Authority (FSMA).
ING Belgium SA/NV with its registered office in Brussels and entered in the Register of Companies under number 0403.200.393,

This product sheet may not be distributed in Canada, Japan or the United States of America, its territories or its possessions, any state thereof or the district of Columbia or to any U.S. person which is a resident in the U.S.A.(as such term is defined in regulations of the U.S. Securities Act of 1933).