MERCHANT WEST
TREASURY SOLUTIONS



FORWARD EXCHANGE CONTRACTS
EXPLAINED

Q – When is a spot trade the best option?

A basic example for using a spot trade is when you have an invoice that requires immediate payment. In these instances, you do not have the luxury of 'waiting' or considering forward cover.

Q – When is a forward rate a good strategy option?

A forward rate might be your answer if you have made a purchase and the invoice payment is only due in 3 months' time. Should you expect the NAM to fluctuate against you, or cannot afford / wish to take the risk that it does, choosing forward cover can limit your exchange risk. Invoices due at some point in the future allow you to have the option of certainty when it comes to the exchange rate expense and turn it into a fixed cost.

Q - Why do companies use forward cover?

The main reason for forward cover is to create certainty where risk exists. Exchange rate risk is very real and can have an adverse effect on a company's profitability. Forwarding provides the guarantee of a known exchange rate, allowing easy financial forecasting by removing the unknown of what the future exchange rate may be.

Q – What charges do you pay for a forward contract?

In reality there is no 'charge' for taking out forward cover. The spot rate is increased by what is known as "forward points". Forward points factor in the difference between the interest rates of the sending and receiving countries and volatility. As a forward contract does not require full payment (in certain cases no payment), the client is able to invest the amount to be transferred and this can offset the 'charge' of the forward points.

Q – What happens if a payment I need to make is moved beyond the forward contract date?

The FEC would be 'extended' at the prevailing spot rate and forward points added to the new maturity date. The net sum (cost) to the client would only be the forward points.

Q - What is the difference between a closed forward, a partial forward and an open forward?

A closed forward has a set settlement date, for example the 31st July; a partial forward option contract is specified between two settlement dates, for example 31st July and the 31st August; whereas an open forward contract can be settled anytime in the contract period. You should be aware that all carry different pricing, so advice should be sought if you are not entirely familiar with each option and its repercussions.

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Merchant West Treasury Solutions Pty Ltd is an authorised financial services provider, with FSP 13011 and a South African Reserve Bank approved intermediary.

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Q - How much margin / deposit needs to be paid when executing a forward contract?

Typically you would need to pay a 10% deposit on the transaction*. Please note that for qualifying clients, we are able to set up a facility where this 10% can be waived.

Q - Can an enterprise use a forward contract to speculate on the NAM?

No, corporates are not allowed to speculate on the foreign exchange market.

Q - What is an example of taking out forward cover?

Let's imagine that you have done all your costing, pricing and budgeting and decided to take out forward cover for certainty against fluctuating exchange rates:

To currently take out forward cover on $100,000 will cost you NAM 1,650,000 (at an exchange rate of 16.50 (USD/NAM). In six months' time, when you come to actually buy the dollars, the exchange rate is now 17.20 (NAM/USD).

That same $100,000, without forward cover, will now cost you NAM 1,720,000. That represents a loss of NAM 70,000, having a direct impact on your profits, margins and bottom line.

Confused?

Treasury solutions can seem complex and intimidating, possibly because they are, with so much at stake. Large corporations often have in-house expertise and / or their bank's personal attention. Unfortunately, it is often the small to medium enterprises that are left under serviced, with a lack of support and somewhat neglected.

The treasury team at Merchant West Treasury Solutions has over 50 years of experience in assisting small to medium enterprises to strategise and implement forex solutions that help minimise your risk, as well as obtain market leading exchange rates.

Next steps

For your free initial consultation, contact our corporate division on albertp@merchantwest.com.na or call us on 00264 (81) 122 6013.

Your consultation commits you to nothing other than a willingness to explore whether there is a better option that saves you time, money and mitigates your currency conversion risk.

*Qualifying clients need to be approved by the Merchant West credit process.

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