



Foreign Exchange

Forward Contract

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A forward contract is a straightforward currency hedging tool. It allows you to lock in a current exchange rate, while delaying the settlement of the contract for a period up to 12 months.

A forward contract is no different than a standard currency trade except that the settlement date is pushed forward into the future, and the rate is adjusted slightly to account for the interest rate differential between the two currencies in question.

The forward contract doesn't require any premium upfront and provides a pretermined rate of exchange for a specified amount of currency.

The downside of a forward contract is that on the day of settlement you are obligated to settle at the predetermined price. In exchange for this rate certainty, you forgo the ability to participate in the spot market if the prevailing market rate is more favorable than your predetermined forward rate. Additionally, on occasion you may be required to post margin if an outstanding forward contract is considered out of the money compared to current market rates.

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