Examples of Treasury Hedging Strategies

BEA 東亞銀行

Type of Strategies

01 Interest Rate

02 Cash Flow Management

Interest Rate Strategies

Strategies

01 Interest Rate Swap

02 Cross Currency Swap

Interest Rate Swap

An Interest Rate Swap is an agreement between two parties on exchanging a stream of fixed interest payments and floating interest payments on a specific notional amount. They are widely used throughout the market, either to convert expected cash flows into other formats, or as a tool to protect against rising or falling rates.

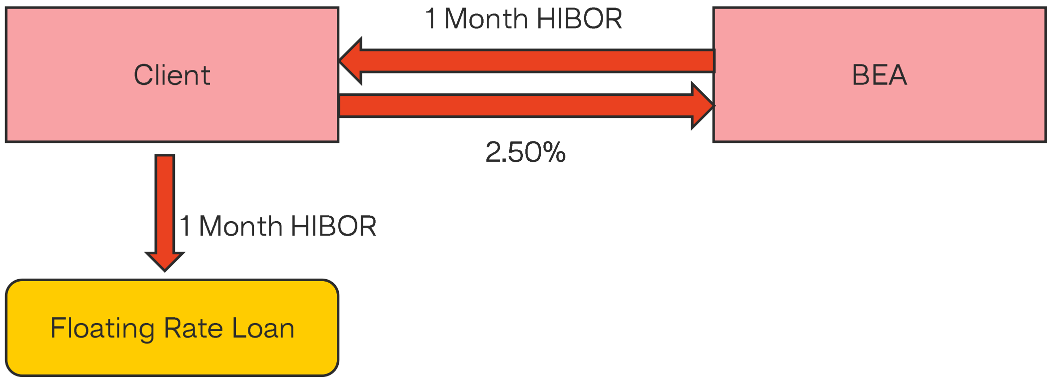
The client can either pay a fixed rate in exchange of a floating rate or pay a floating rate in exchange of a fixed rate.

In an Interest Rate Swap, there is no exchange of notional and normal settlement varies for each currency. Maturities vary from 1 year to 10 years. Client could decide the settlement frequency for the contract. Clients can also choose to enter a forward-start interest rate swap if they are going to need one in the future when they consider the present rate is lower than the rate in the future.

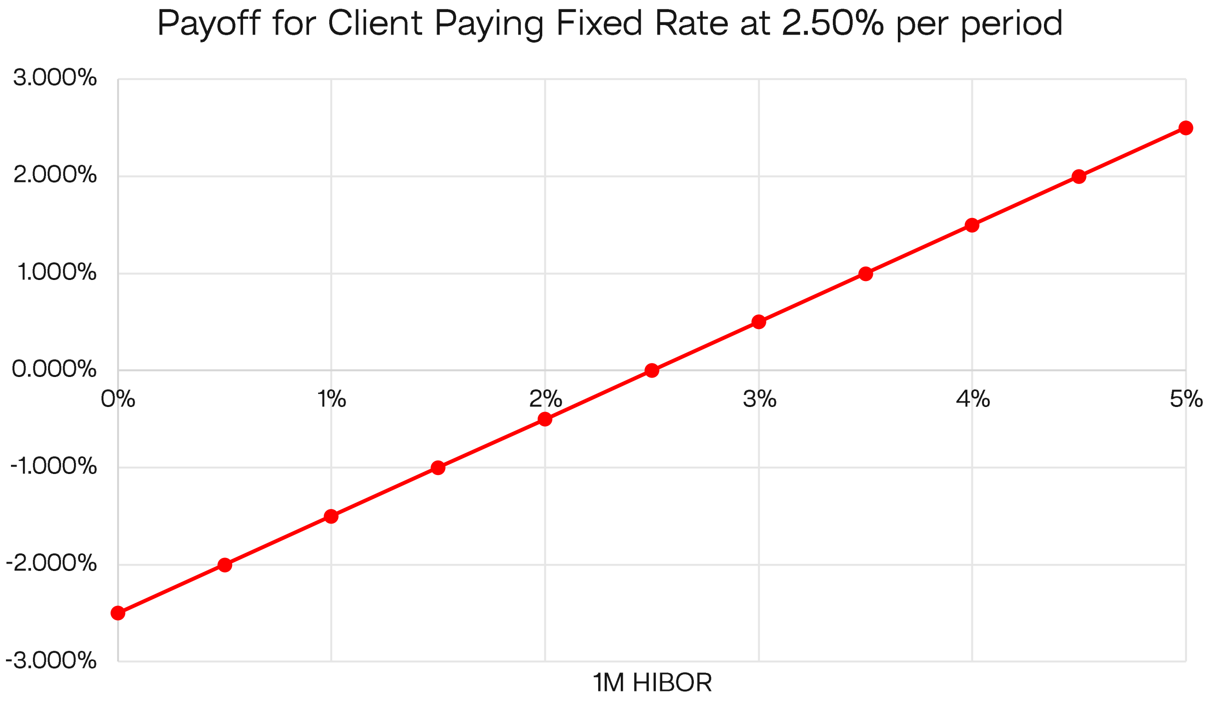
Interest Rate Swap

Example 1: Client Paying Fixed

A corporate client is borrowing a loan in Hong Kong Dollar against 1 month HIBOR from BEA with monthly interest payment. As it is expected that there will be a global interest rate hike cycle in the coming future, in order to lock its cost on interest payment, the client can enter an interest rate swap with BEA in which the client will pay a fixed interest payment in return for the floating rate (1 month HIBOR) every month.



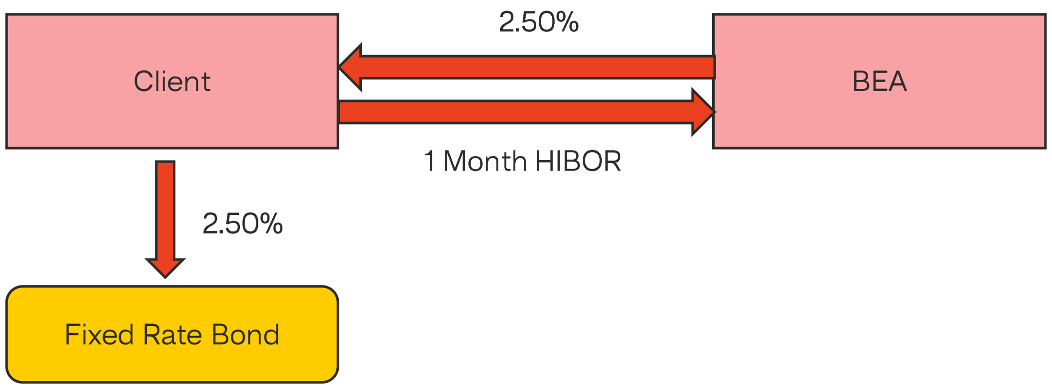
2.50% in this example is for reference only. Price of every contract will depend on the market at that time.



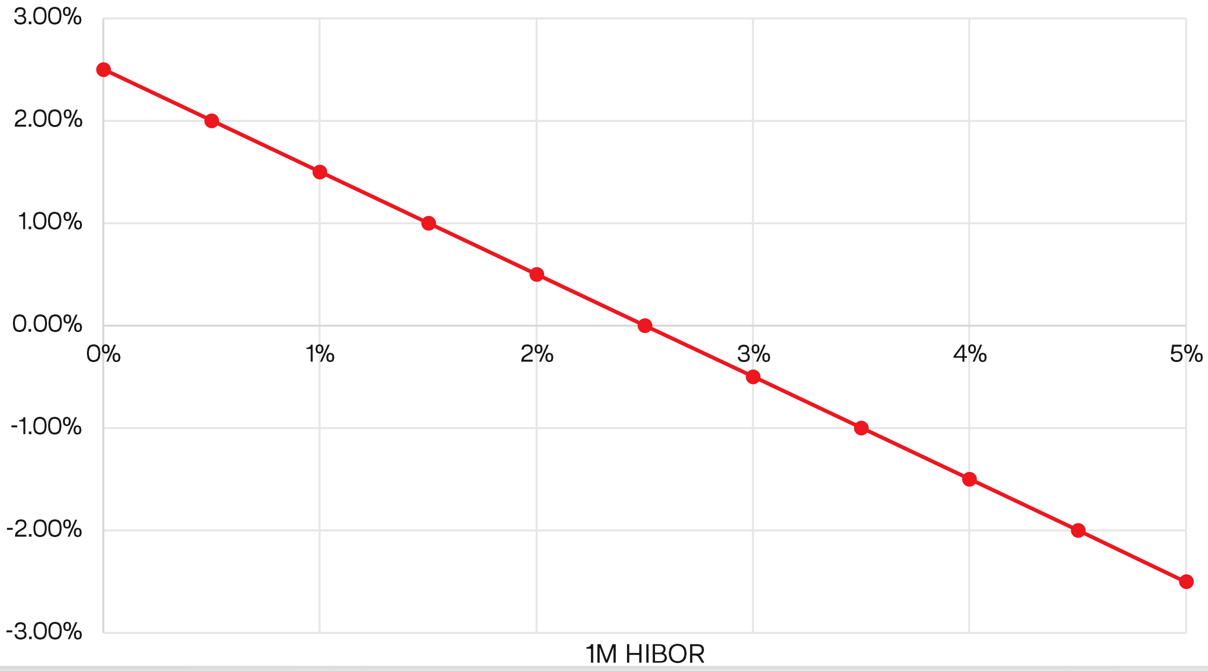
Interest Rate Swap

Example 2: Client Receiving Fixed

A corporate client is having a fixed rate HKD bond to raise funds for its project. As it is expected that there will be a global interest rate cut in the coming future, in order to make its funding cost move in line with the market, the client can enter a "receiver" swap with BEA through paying the floating rate (HIBOR) in return for the fixed rate for their bond.



Payoff for Client Receiving Fixed Rate at 2.50% per period



Interest Rate Swap

Sample of indicative terms and conditions:

The table below is a sample of term sheet with indicative terms and conditions for a client to enter HKD IRS with monthly fixed payments for 5 years.

Indicative Terms and Conditions	
Notional Amount	HKD 500,000,000.00
Effective Date	2nd January 2024
Maturity Date	2nd January 2029
Business Day Convention	Hong Kong - Modified Following
Party A	The Bank of East Asia, Limited
Party A Pays	1M HIBOR
1M HIBOR	1 month HIBOR as quoted on Refinitiv Screen HKABHIBOR Page as of 11:00 a.m. Hong Kong time
Party A Payment Dates	Monthly
Party A Day Count	Act/365
Party B	Client
Party B Pays	2.50%
Party B Payment Dates	Monthly
Party B Day Count	Act/365
Calculation Agent	The Bank of East Asia, Limited

Cross Currency Swap

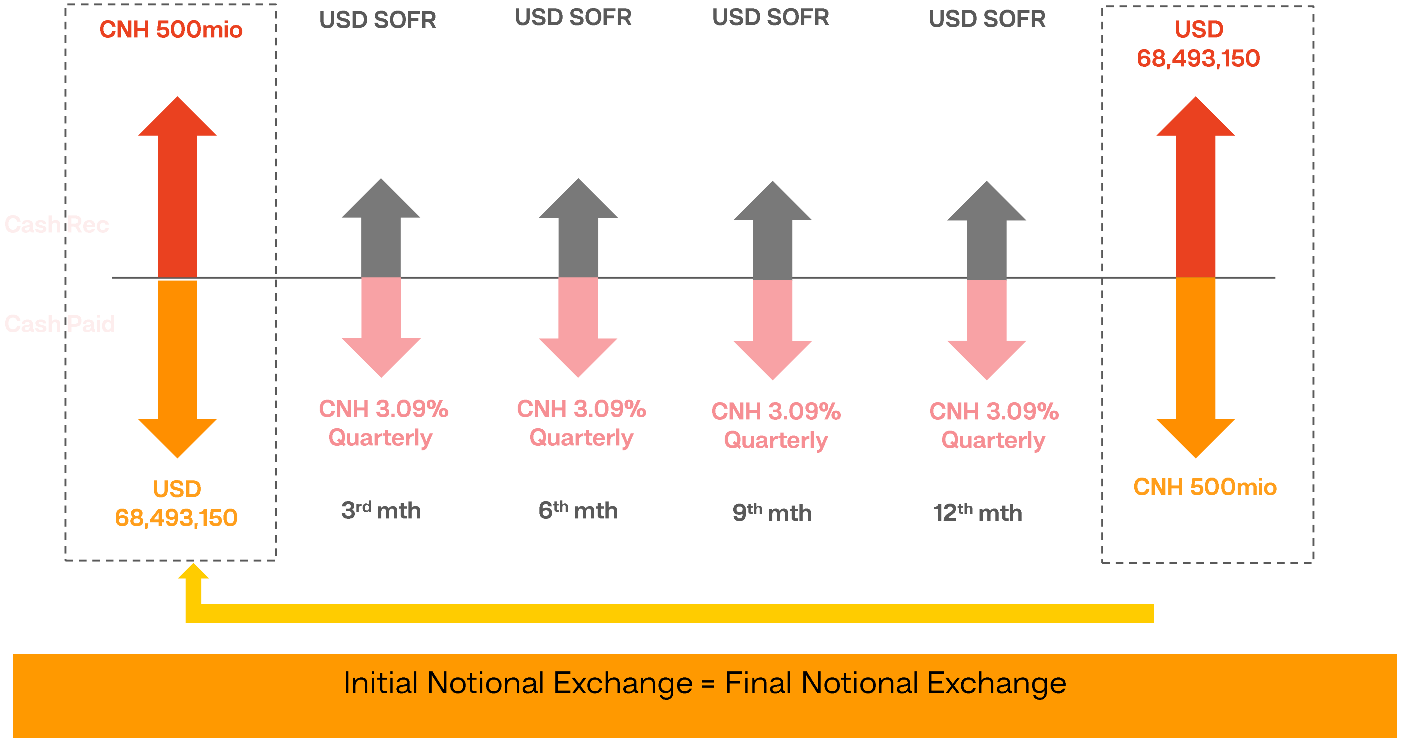
A Cross Currency Swap is a derivative contract between two parties that involves the exchange of notional amount and interest payments in one currency for notional amounts and interest payments in another. It allows the client to convert a liability or asset from one currency to another.

Generally, Cross Currency Swaps have an initial and final exchange of the notional amount although the initial exchange can be exempted subject to agreement by both parties. The exchange of notional amount is made at a pre-agreed exchange rate, which eliminates any uncertainty related to foreign exchange movements.

A Cross Currency Swap can be “floating to floating”, “fixed to fixed”, “fixed to floating” or “floating to fixed”

Cross Currency Swap

A corporate client with business in Chinese Mainland needs to raise funds for their operation. Since the funding cost of offshore CNH is considerably high at present, the client can instead borrow a loan in HKD or USD and enter a CCS with BEA to obtain CNH funds while paying lower interest rate than borrowing loan in CNH directly.



Cross Currency Swap

Sample of indicative terms and conditions:

The table below is a sample of term sheet with indicative terms and conditions for a client to enter a Quarter fix / Quarterly settle USDCNH CCS for 5 years.

Indicative Terms and Conditions	
CNH Notional Amount	CNH 500,000,000.00
USD Notional Amount	USD 68,493,150.68
Effective Date	2nd January 2024
Maturity Date	2nd January 2029
Business Day Convention	New York, Beijing and Hong Kong – Modified Following
Party A	The Bank of East Asia, Limited
Party A Initial Exchange	CNH Notional Amount on Effective Date
Party A Pays	SOFR CMP on USD Notional Amount
Party A Payment Dates	Quarterly
Party A Day Count	Act/360
Party A Final Exchange	USD Notional Amount on Maturity Date

Cross Currency Swap

Sample of indicative terms and conditions:

The table below is a sample of term sheet with indicative terms and conditions for a client to enter a Quarter fix / Quarterly settle USDCNH CCS for 5 years.

Indicative Terms and Conditions	
Party B	Client
Party B Initial Exchange	USD Notional Amount on Maturity Date
Party B Pays	2.85% on CNH Notional Amount
Party B Payment Dates	Quarterly
Party B Day Count	Act/360
Party B Final Exchange	CNH Notional Amount on Maturity Date
Calculation Agent	The Bank of East Asia, Limited

Cash Flow Management Strategies

Strategies

01 Forward

02 Optional Forward

03 Option

Forward

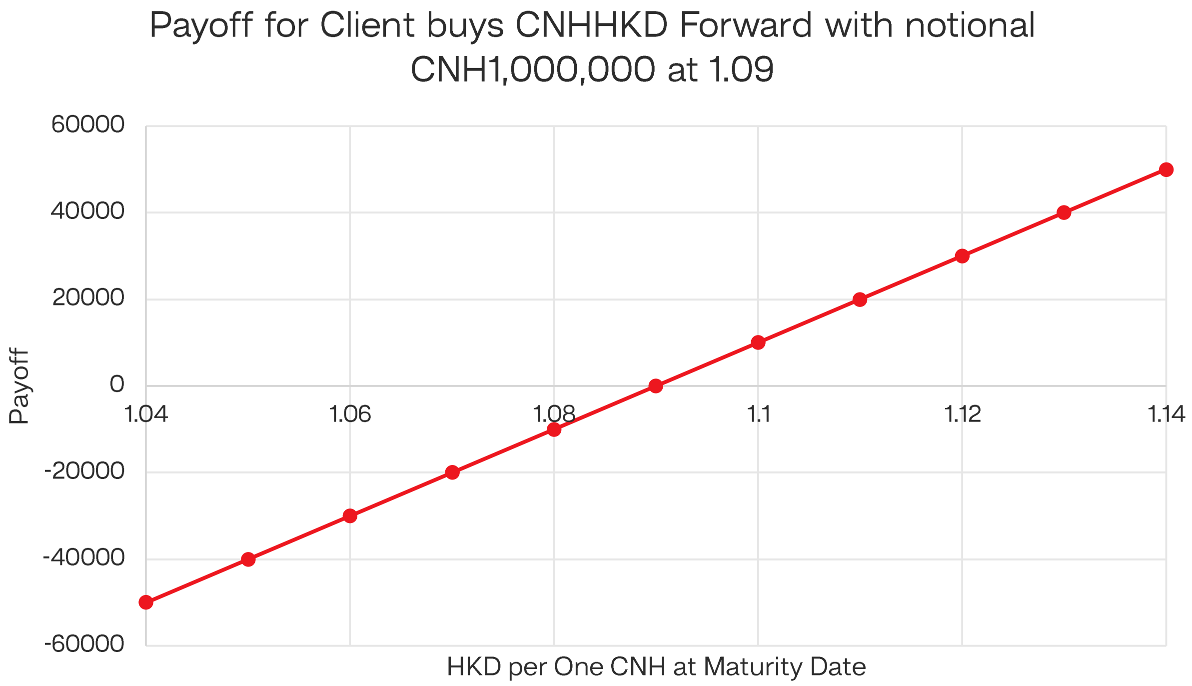
A forward contract is a customized contract between client and the Bank to buy or sell a currency pair at a specified price on a future date. The client who enters a forward contract has an obligation to buy or sell a currency pair at a specified amount and date on the delivery date. Unlike standard futures contracts, a forward contract can be customized to certain currency pair, notional amount and delivery date. Client can choose to enter a forward contract before the maturity or a value today contract on the maturity with opposite direction in order to net-settle the original forward contract if they are not willing to buy or sell the respective currency at the delivery date.

Apart from common deliverable forward contract, non-deliverable forward (NDF) contract is also available to illiquid currencies such as CNY, IDR and PHP for clients to hedge their cash flows. Different from deliverable forward, NDF counterparties settle the trade's profit or loss in a widely traded currency, most often in US dollar instead of exchanging the underlying currencies at the maturity date, using the agreed fixing rate for calculation.(E.g. SAEC [State Administration of Exchange Control] Fixing for CNY)

Forward

Example 1: Long Forward

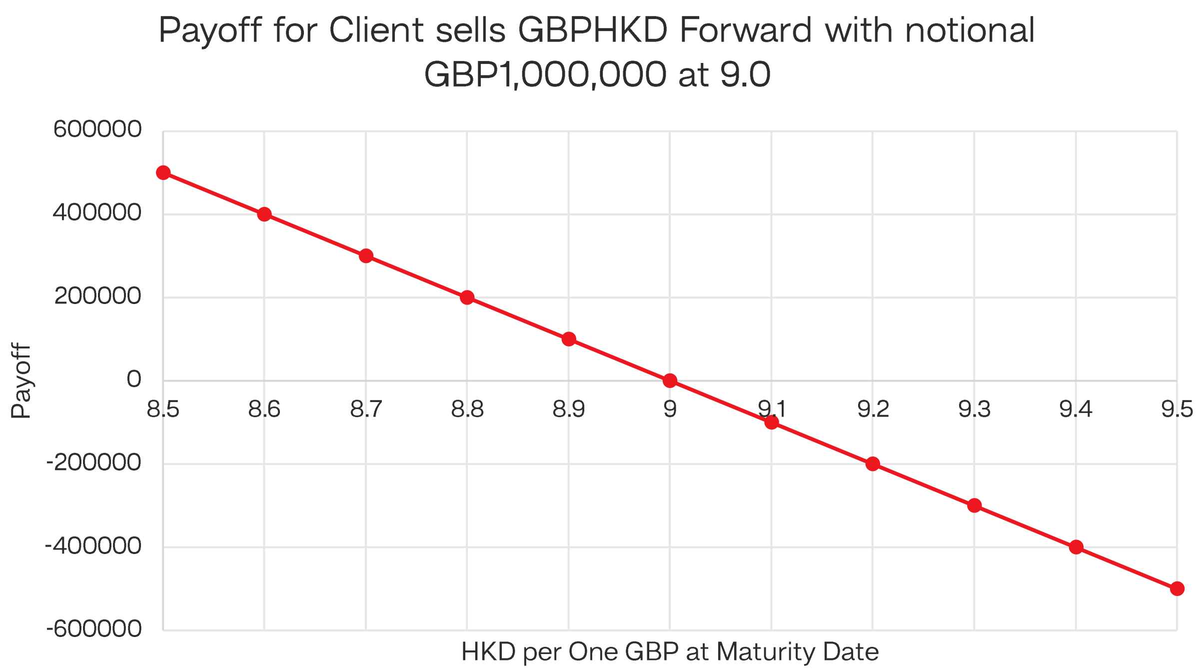
A HK based client needs to make CNH payments in Chinese Mainland in the near future. CNH has reached a strong supportive level. As the client think CNH is going to rebound against HKD and the forward rate is acceptable to them. They can therefore enter a forward contract to use HKD to buy CNH on the payment date in order to avoid currency risk through fixing the rate.



Forward

Example 2: Short Forward

A HK based client is going to receive GBP revenue from United Kingdom in the near future. GBP has been appreciating this year against HKD and reached its yearly high. As the client think GBP has peaked and is going to fall in the near future and the optional forward rate is acceptable to them. Therefore, the client can enter a forward contract to sell their GBP revenue for HKD on the payment date. As a result, they can fix the amount of revenue in HKD for their reporting purposes and eliminate currency risk.



Forward

Sample Confirmation:

The table below is a sample confirmation for a client to enter a forward contract with obligation to sell USDHKD in the future with the Bank.

Sample Confirmation	
Contract A/C	015-XXX-XXXXXXXX
Contract No.	000123456
Bank Buy	USD 1,000,000.00
Exchange Rate	7.8000
Bank Sell	HKD 7,800,000.00
Contract Date	2^{nd} January 2024
Delivery Date	2^{nd} February 2024

Optional Forward

An optional forward contract is a customized contract between client and the Bank to buy or sell a currency pair at a specified price starting from as early as spot date after trade date to maturity date. (The Spot Date of CAD is 1 day after the trade date while the remaining is 2 days after the trade date) This product allows the client to buy or sell the currency pair during business hours of the Bank in the specified period. The rates of optional forwards are usually less favorable than that of forwards as optional forward contracts provide the flexibility for buyers to execute the contract during the period.

Optional Forward

Example 1: Long Optional Forward

A HK based client needs to make a series of USD payments in the near future, but the payment dates have not been confirmed. USD has been depreciating against HKD this year and reached its yearly low. As the client think USD is going to rebound against HKD and the optional forward rate is acceptable to them, they can enter an optional forward to buy USD with HKD with the value date starting from two days after the trade date and the date for their last payment. Therefore, they can buy USD with HKD as per contract rate when they need to make payment during this period. This can help the client to fix the cost to eliminate currency risk while enjoying flexibility.

Example 2: Short Optional Forward

A HK based client will receive a series of CHF revenue from Switzerland in the coming future but they do not know the exact date of the revenue. CHF has been appreciating this year against HKD and reached its yearly high. As the client think CHF has peaked and is going to fall in the near future and the optional forward rate is acceptable to them, they can enter an optional forward contract to sell CHF for HKD with the value date starting from two days after the trade date and the date of their expected latest revenue date. Therefore, they can get HKD on the pre-agreed rate with CHF once they receive the revenue to eliminate currency rate risk.

Optional Forward

Sample Confirmation:

The table below is a confirmation sample for a client to enter an optional forward contract with the bank to sell USDHKD within the period starting from 2 days after trade date and one month later.

Sample Confirmation	
Contract A/C	015-XXX-XXXXXXXX
Contract No.	000123456
Bank Buy	USD 1,000,000.00
Exchange Rate	7.8000
Bank Sell	HKD 7,800,000.00
Contract Date	2nd January 2024
Period Start Date	4th January 2024
Period End Date	2nd February 2024

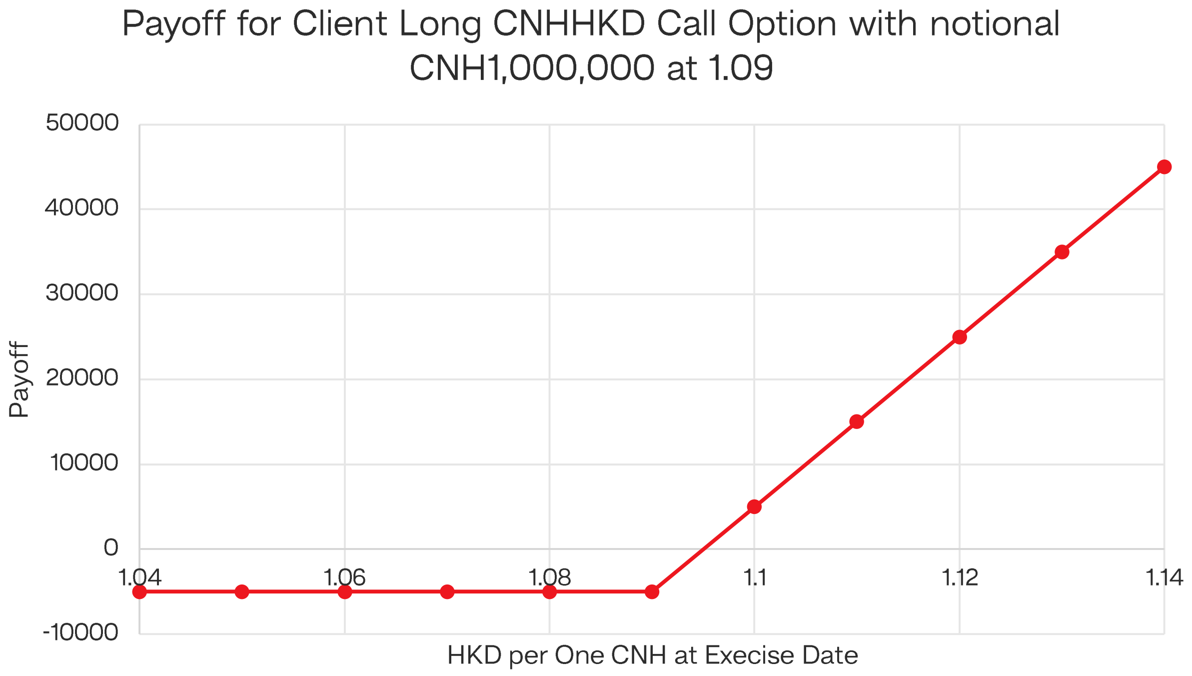
Option

An option is a financial instrument that is based on the value of underlying currency pairs. An option contract offers the buyer the right to buy or sell the underlying currency pairs. The buyer of the option is not required to buy or sell the currency pair at the maturity date. The seller of the option receives a premium and is obligated to perform when the holder exercises the right under the contract. Comparing with Forward, the pricing of Option is considered more complicated as it takes into account of several elements such as volatility, time to maturity and even interest rates. Only European-style Options (exercise only available on maturity date) are available in BEA at present.

Option

Example 1: Long Call Option

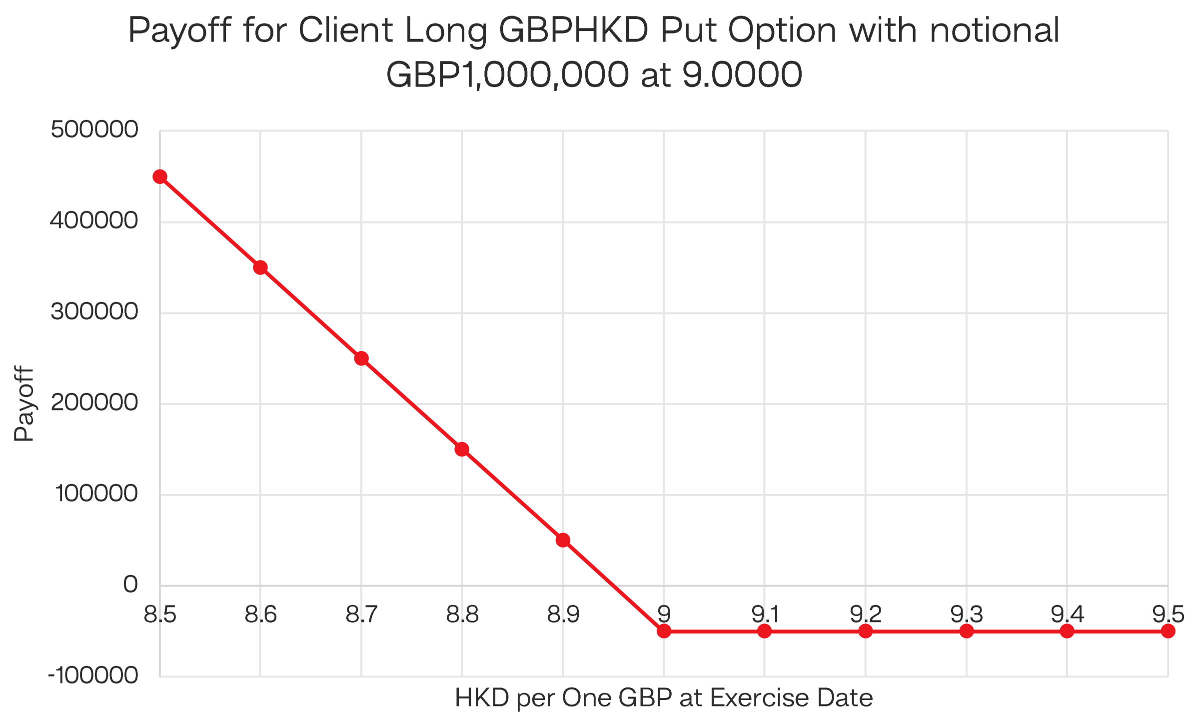
A call option gives the holder the right, but not the obligation, to buy the underlying security at the strike price at the maturity date. A call option will therefore become more valuable as the underlying currency pair rises. It can allow the client to fix the cost if wants to buy a currency in the future.



Option

Example 2: Long Put Option

A put option gives the holder the right, but not the obligation, to sell the underlying currency pair at the strike price at the maturity date. A put option will therefore become more valuable as the underlying currency pair decreases. It can allow the client to fix the exchange rate for their future cash flows in other currencies.



Option

Sample Indicative terms and conditions:

The table below is a sample of term sheet with indicative terms and conditions for a client to buy a CNH Put HKD Call option for one year from the bank.

Indicative Terms and Conditions	
Trade Date	2nd January 2024
Maturity Date	2nd January 2025
Settlement Date	4th January 2025
Business Day Convention	Hong Kong, Beijing - Modified Following
Seller of the Option	The Bank of East Asia, Limited
Buyer of the Option	Client
Currency Pair	CNHHKD
Option Style	European
Option Type	Client Buy CNH Put/HKD Call
Call Currency Amount	HKD 70,000,000.00
Put Currency Amount	CNH 64,102,564.10
Contract Rate	1.0920
Premium	HKD 2,380,000
Buyer Payment Date	4th January 2024

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The Bank of East Asia, Limited
10 Des Voeux Road Central, Hong Kong
東亞銀行有限公司
香港中環德輔道中 10 號