

2010 Annual TKW Manufacturing Conference

International Trade
&
Foreign Exchange Risk Management

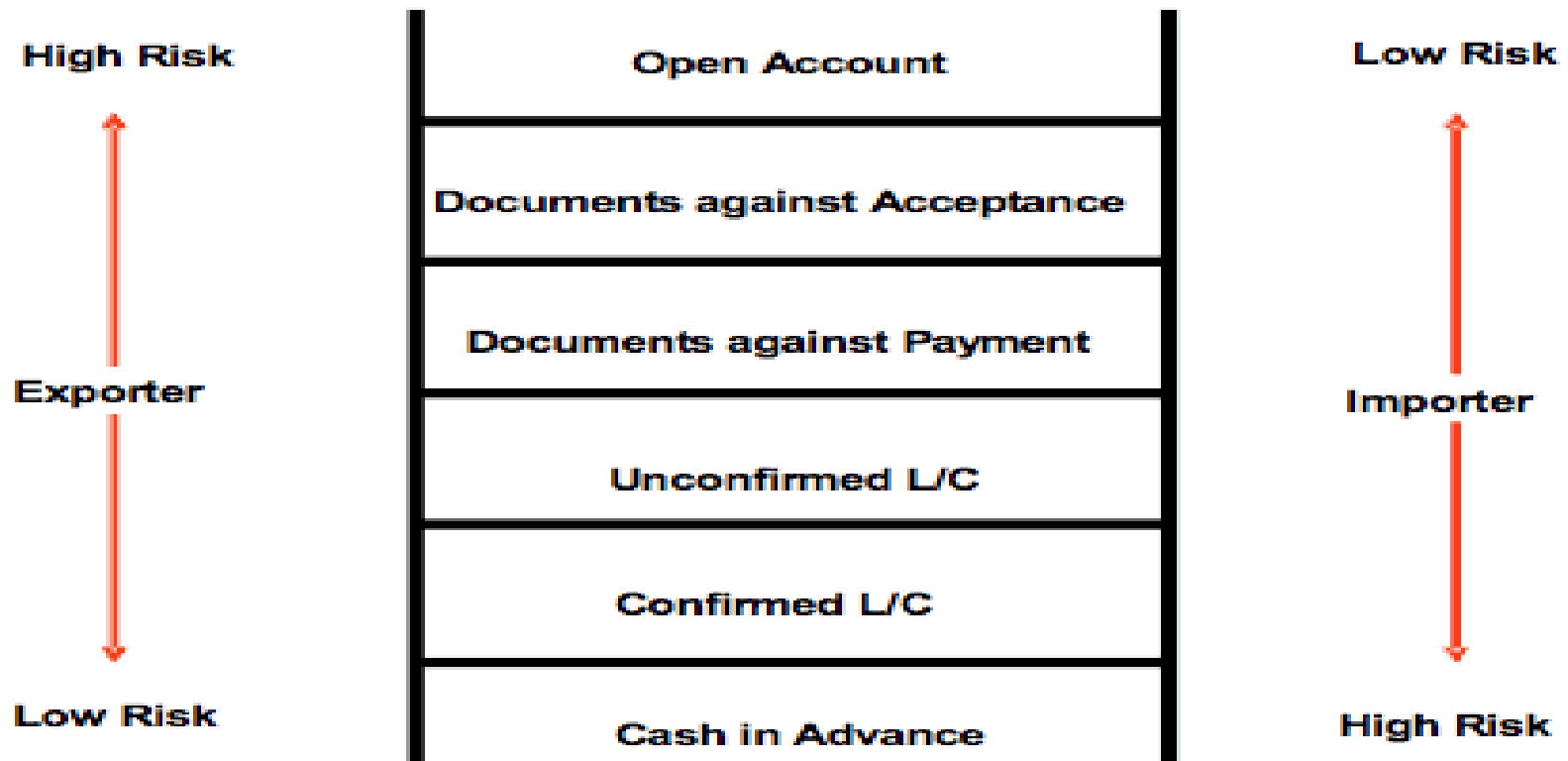
Presented by:

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International Terms of Payment

- Importers and Exporters have naturally opposing views of risk.
- Terms of payment satisfactory to one party will involve higher risk for the other party.



What is a Documentary Letter of Credit?

A method of payment that is an irrevocable undertaking by a bank, on behalf of a buyer, to pay the seller provided that the seller “performs” by producing complying documentation.

Advantages to Seller/Exporter

- Reasonable assurance of payment
- Prompt payment
- Possible financing availability

Advantages to Buyer/Importer

- Reasonable assurance of shipment
- Payment won't be made before shipment
- Terms/financing are easier to obtain

Disadvantages to Seller/Exporter

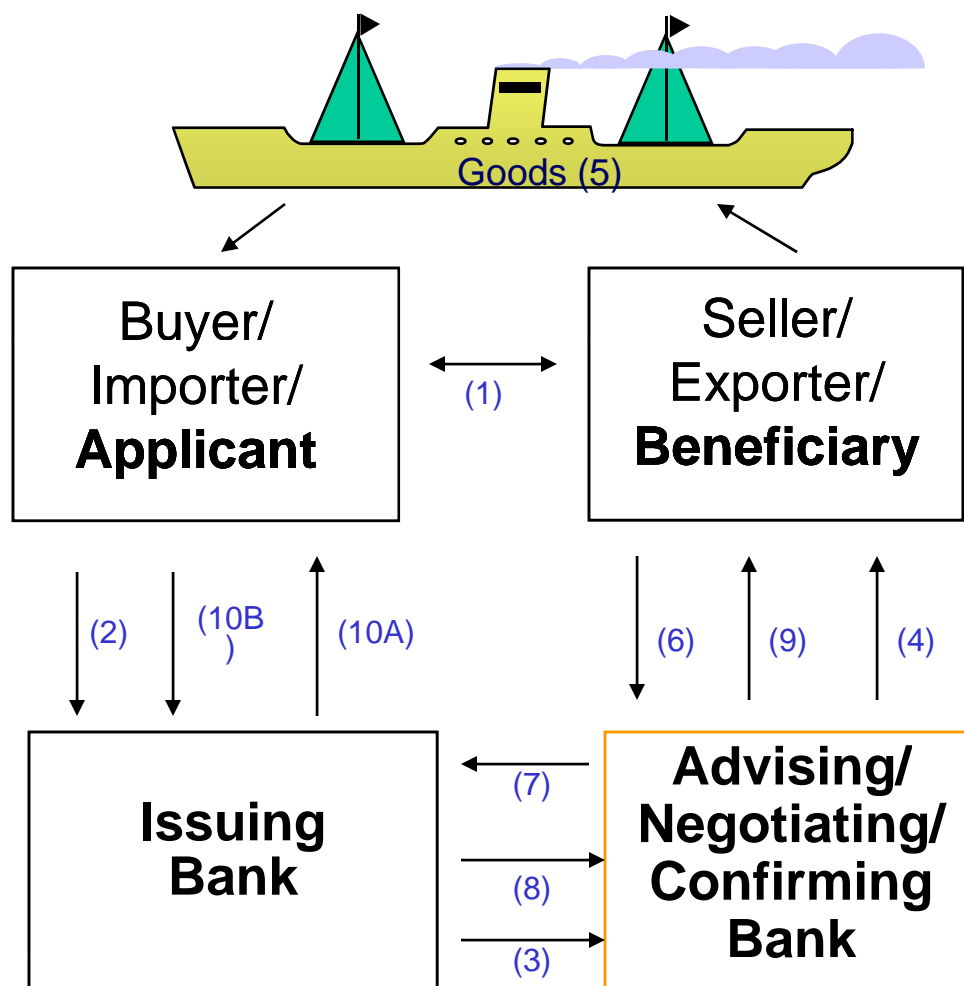
- Strict compliance required
- Cumbersome & time-consuming
- Costs

Disadvantages to Buyer/Importer

- Credit allocation from bank
- Cumbersome & time-consuming
- Costs



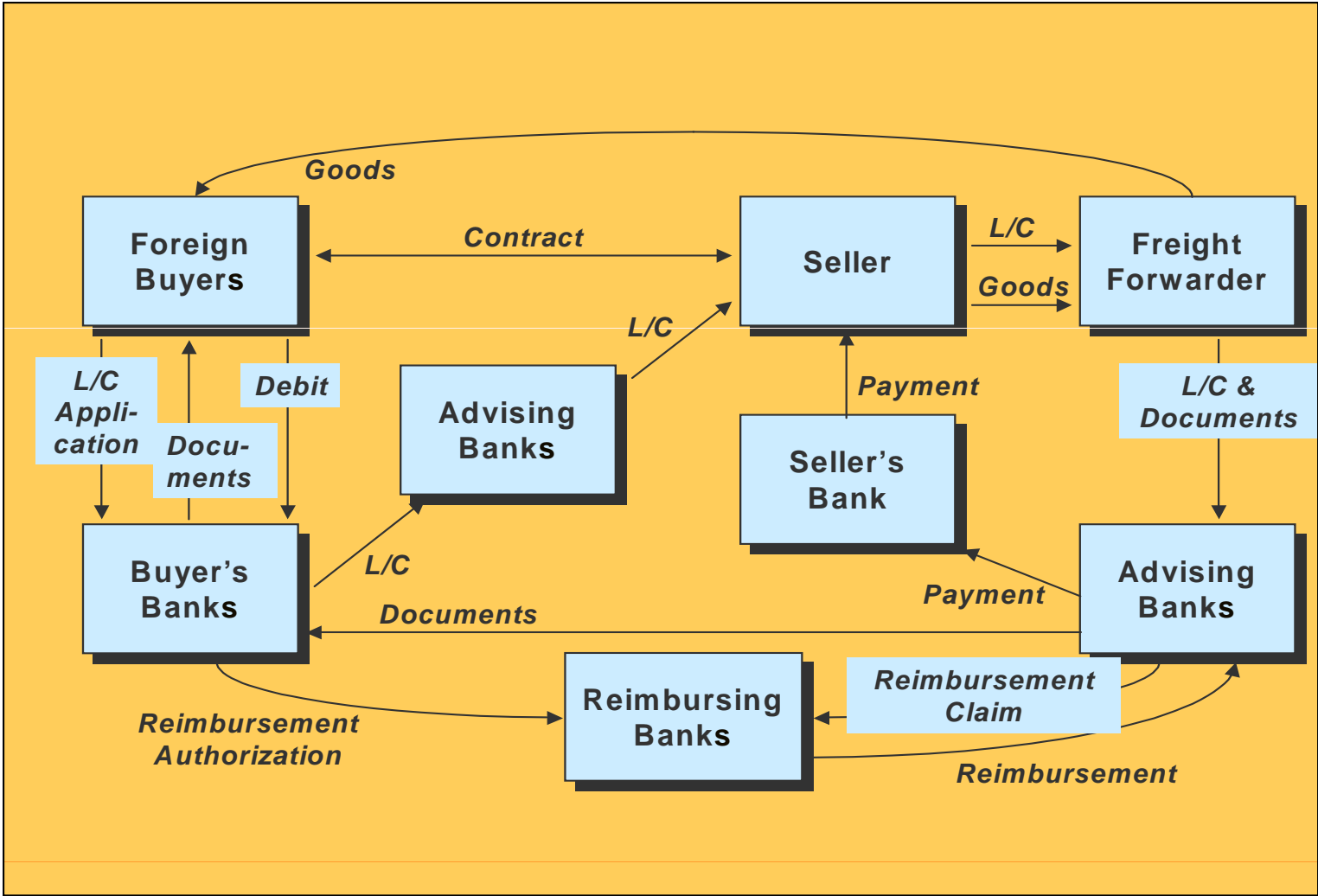
Letter of Credit Transaction Flow



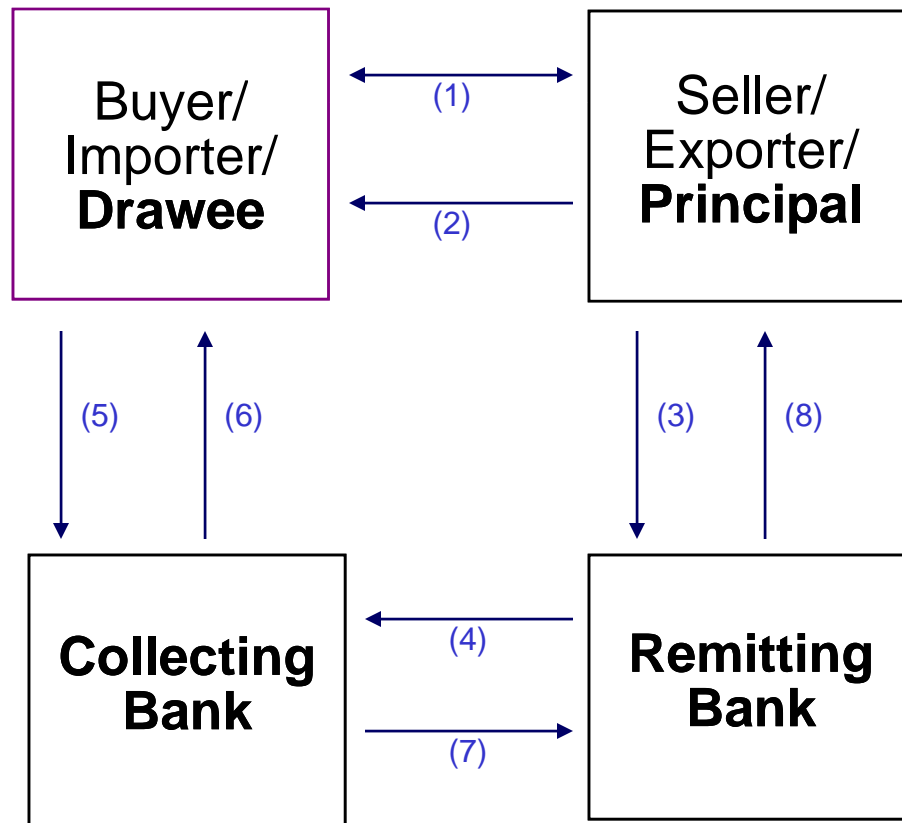
- (1) Sales Contract
Purchase Order
Pro-forma Invoice
- (2) LC Application
- (3) Original Letter of Credit
SWIFT/Mail
- (4) Original Letter of Credit to
Seller/Exporter/Beneficiary
- (5) Shipment of Goods
- (6) Dox to Negotiating Bank
- (7) Dox to Issuing Bank
- (8) Payment
- (9) Payment
- (10A) Dox to Buyer
- (10B) Payment
-
- (11) Buyer sends Dox to
Broker/Carrier



How The L/C Process Really Works!



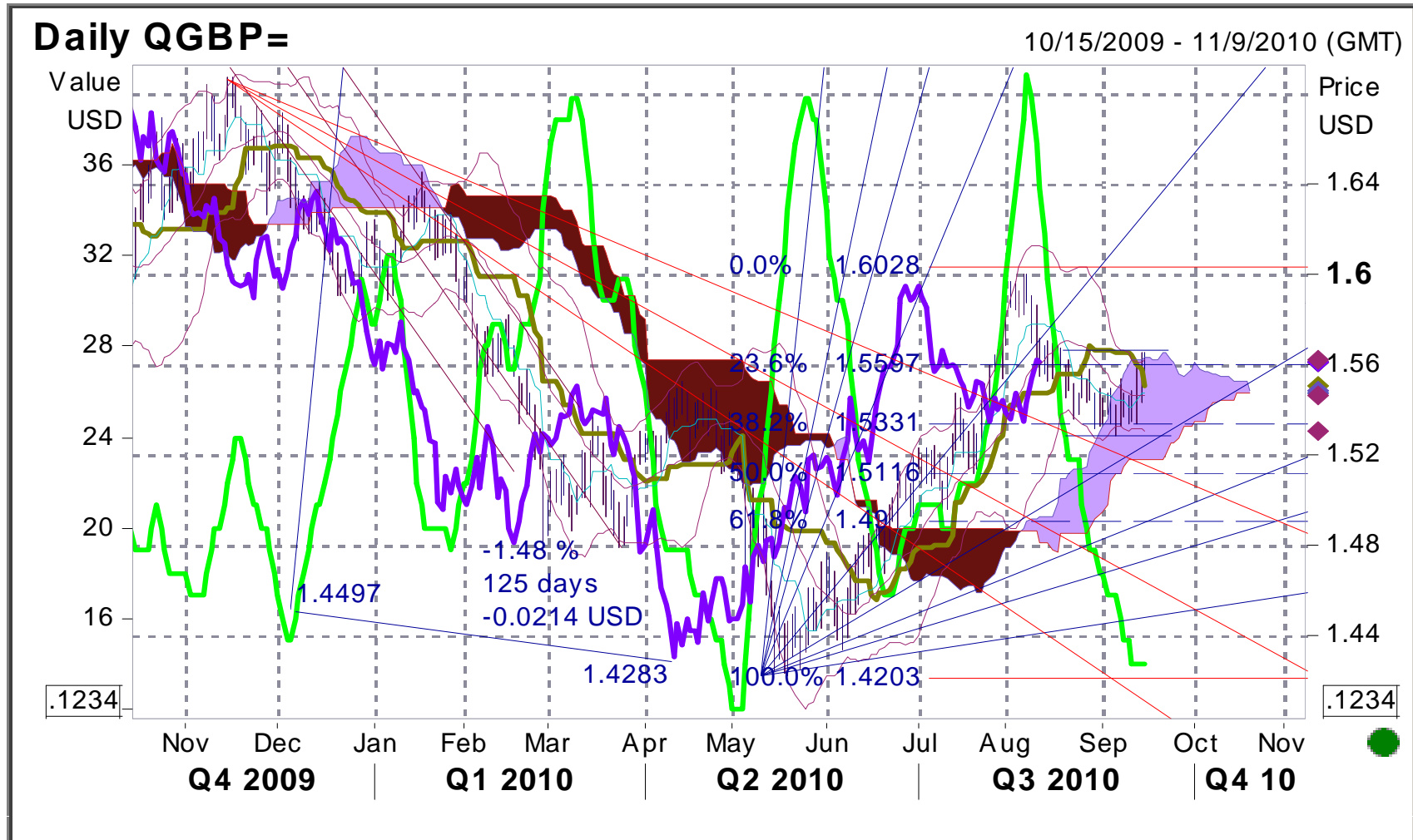
Documentary Collection Transaction Flow



- (1) Seller and buyer negotiate a sales contract or purchase order providing for payment by documentary collection (documents against payment/acceptance).
- (2) Seller dispatches goods to buyer.
- (3) Seller delivers documents and draft to remitting bank.
- (4) Remitting bank forwards documents and draft to collecting bank along with collection instructions.
- (5) Buyer makes payment to collecting bank in case of sight draft, or accepts a time draft.
- (6) The collecting bank releases documents so that the buyer can take delivery of the goods.
- (7) The collecting bank transfers funds to the remitting bank.
- (8) The remitting bank transfers funds to the seller.



What the heck is going on in the currency markets?

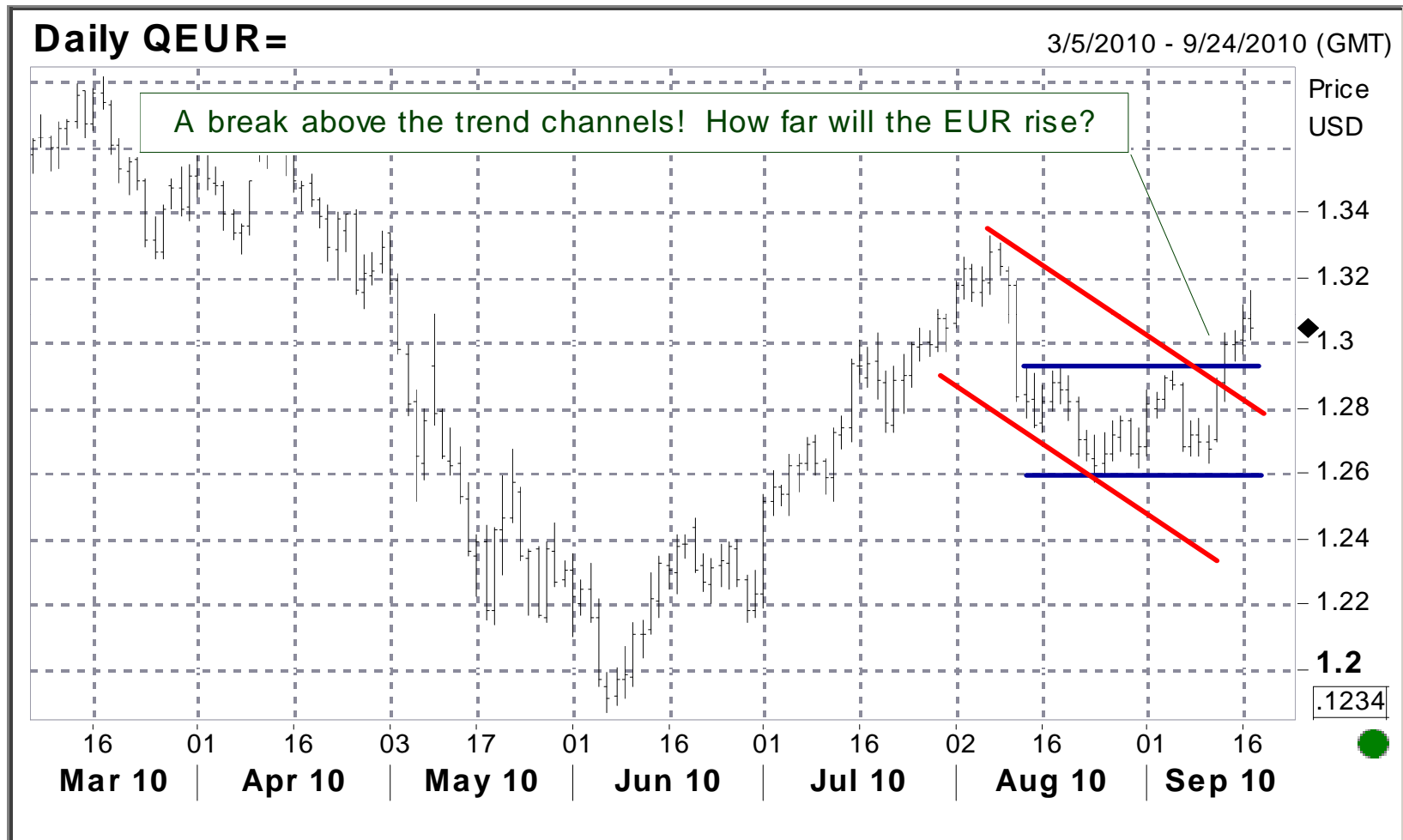


What's Moving The FX Markets?

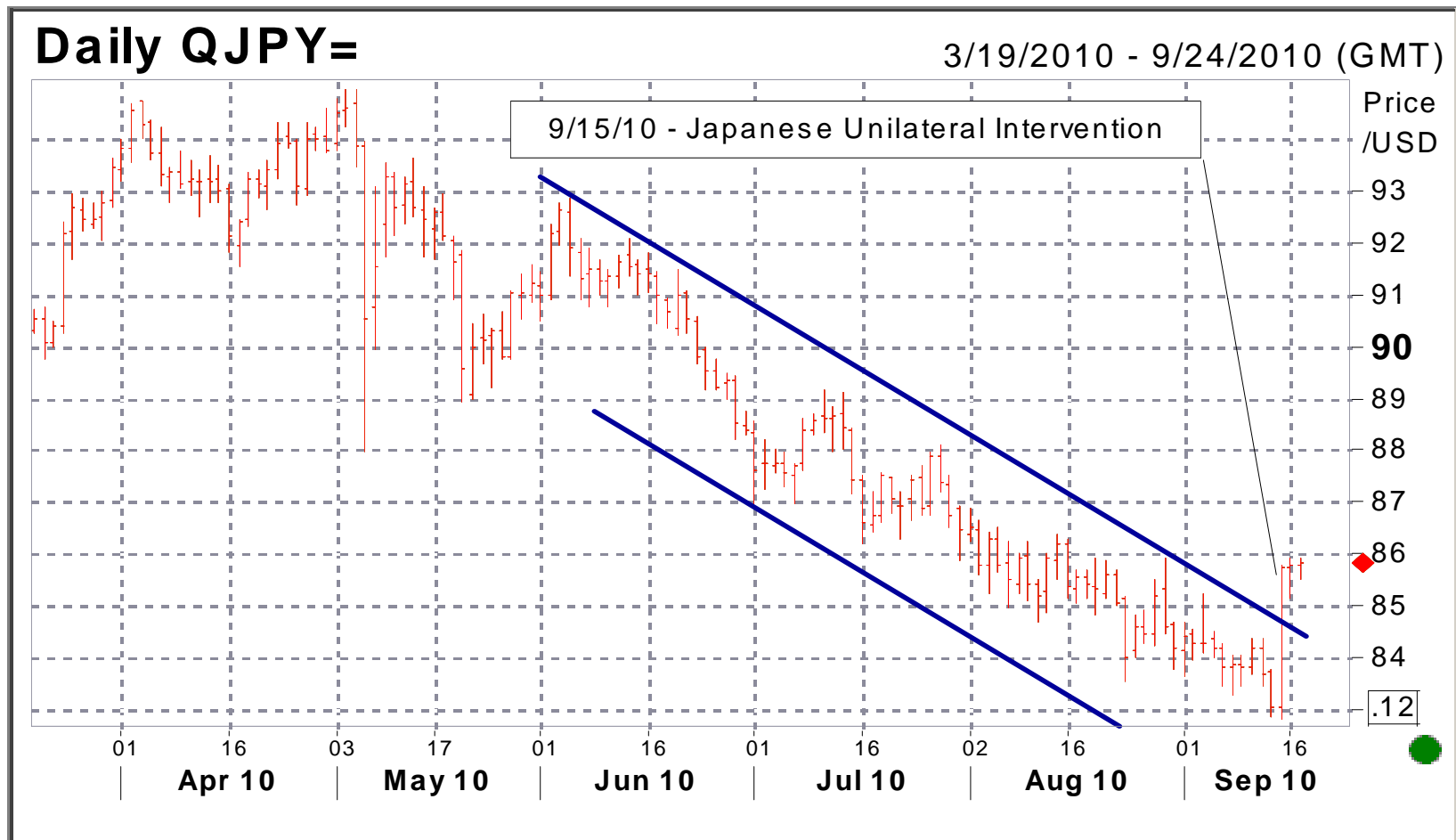
- **Risk Appetite and Risk Aversion**
 - Economic data releases
 - European budget/deficit woes
 - Flight to safety (USD, CHF & JPY)
 - Global economic growth expectations (i.e. – China)
- **Interest Rates & Expectations**



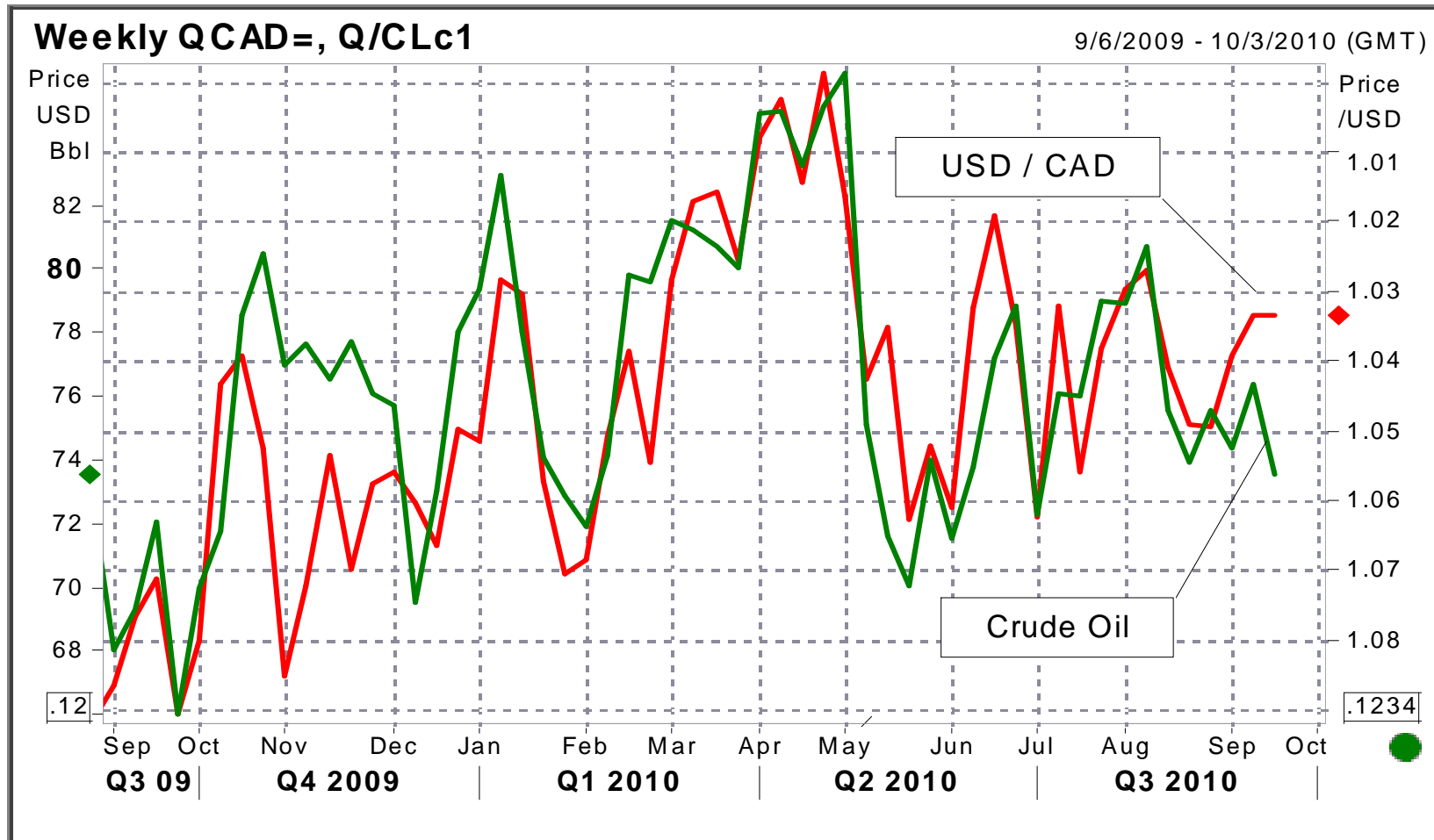
EUR Chart



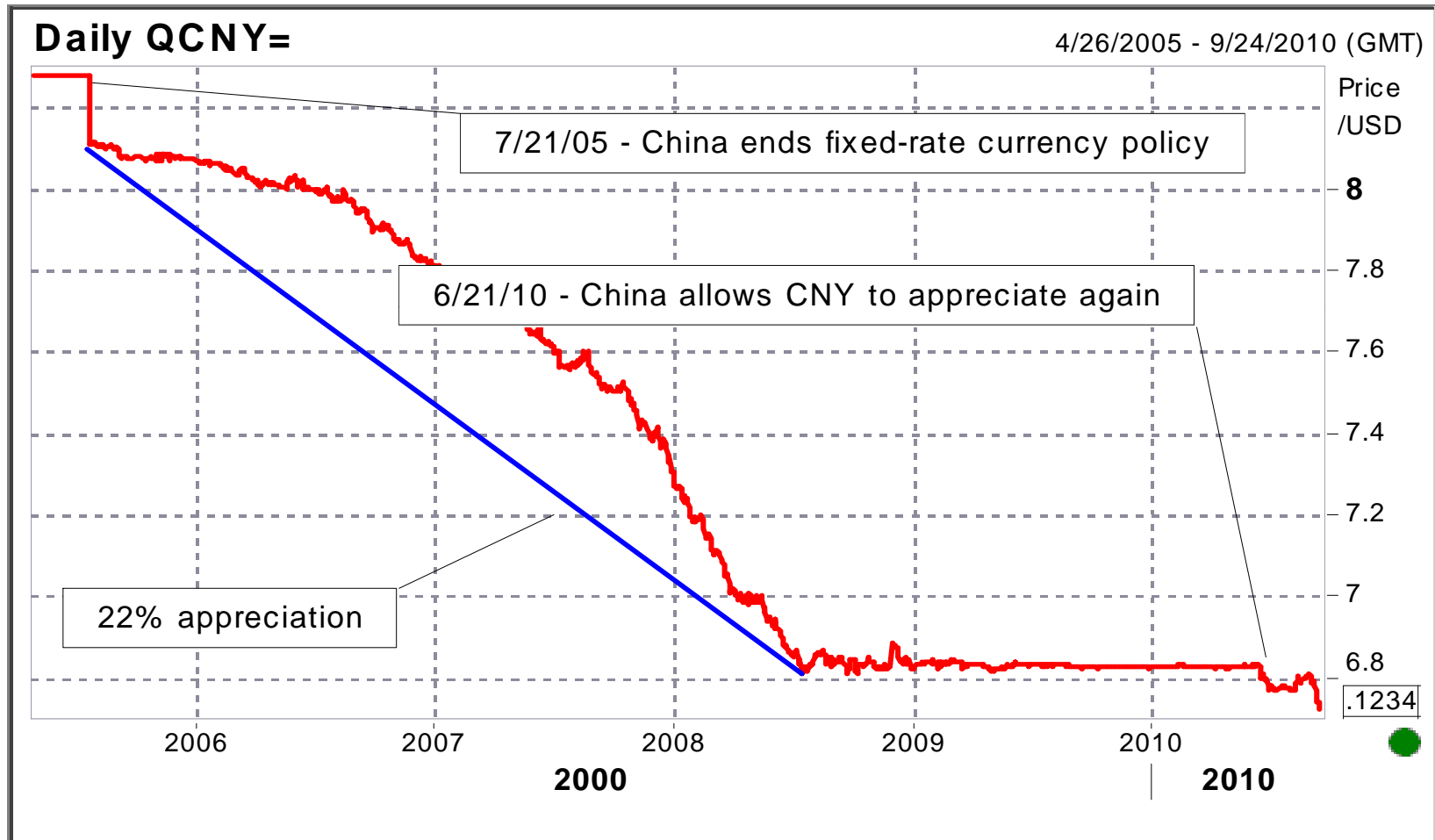
JPY Chart



CAD and Commodities Correlation



CNY Chart



What do we do now?

- Acknowledge “FX currency” exposure
- Establish a viewpoint
- Create a FX policy
 - Simple or formal
- Develop Strategies
 - Hedge or not to hedge
 - Hedge all exposure or portion of exposure
- Determine acceptable hedge structures based on objectives
 - Downside protection only
 - Downside protection & upside capture
 - Combination of structures



FX Transaction Types

- Spot Contracts
- Forward Contracts
- Forward Window Contracts
- Swaps
- Options
 - Puts & Calls
 - Range Forward Contracts
 - Participating Forward Contracts



Spot Contracts

- Buy or Sell currency to meet current requirements
- The most “immediate” settlement transaction type
 - Spot Settlement
 - Two business days after the transaction date
 - Canadian dollars are one business day
 - Special settlement (same day or one day) available for some currencies (CAD, MXN)



Rate Quote Convention

- **American Terms** – The number of USD per unit of foreign currency (i.e.- $\text{GBP/USD} = 1.9710$)
 - ❖ Currencies quoted in American Terms: EUR, GBP, AUD, NZD, FZD
- **European Terms** – The number of foreign currency units per USD (i.e. – $\text{USD/JPY} = 120.60$)
 - ❖ Currencies quoted in European Terms: JPY, CAD, MXN, CHF, SGD, KRW, CNY, DKK, SEK, NOK, HKD, ILS, MAD, THB



Rate Quote (Bid/Offer)

- Bid – Market maker buys the base currency and the market taker sells the base currency
- Offer – Market maker sells the base currency and the market taker buys the base currency

Example:

	<u>Bid</u> / <u>Offer</u>
USD/JPY	85.85 / 85.90
EUR/USD	1.3010 / 1.3017



Forward Contracts

- Buy or sell foreign currency to meet future requirements
- Rate, amount and maturity date are fixed on the transaction date
- Settlement occurs on maturity date
- Used for transactional and translational purposes
- Protects against downside rate movement
- Does not enable any capture of upside movement



Forward Rate

- A forward rate is not an indication of the future value of a currency
- The forward rate differs from the spot rate by an adjusting factor call the forward (swap) points
- The forward points (premium or discount) are a mathematical function of interest rate differentials between two currencies



Forward Window Contract

- Used when the “exact” date of delivery is somewhat unknown
- Delivery and settlement can occur anytime during a predetermined “window period” (i.e. – March 15 through April 15)
- Window periods can be as short as 2-days and as long as 6-months



Swaps

- Simultaneous Buy and Sell (or Sell & Buy) of one currency against another for settlement on two different dates
- Consists of two deals, usually a combination of one spot deal and one forward deal
- Can be two forward deals with different settlement dates (referred as a forward-forward)
- Used to hedge inter-company loans or “roll” an existing forward contract



FX Options

- Provides rate protection at a “worst” case rate level
- Enables unlimited upside potential
- Maximum Cost is premium paid (upfront)
- Premiums based on strike price, spot rate, time to maturity, interest rate differentials & currency volatility



FX Options – Puts & Calls

- **Put** – The right, but not the obligation to SELL a specific amount of currency at a specified price on a pre-set date
- **Call** - The right, but not the obligation to BUY a specific amount of currency at a specified price on a pre-set date



Range Forward Contract

- Provides a range (collar) to buy or sell a fixed amount of currency on a specified future date
- Protects against a “worst” case rate level
- Provides benefit of dealing at a better rate up to, and including the opposing end of the range
- Usually zero cost



Participating Forward Contracts

- Provides a hedge against a “worst” case rate level
- Enables participation in a percentage of any favorable move in currency hedged
- Typical ratio is 2:1 (i.e.- for any favorable move, benefit will be 50%)
- Usually zero cost



Questions?

