

MAFA : CA FINAL

**DEDICATED TO :
ASHIM JAANA SIR**

PREPARED BY : SUNIL KUMAR M. R

CA Final (2nd Group Pending)

[Email : suniludde@gmail.com](mailto:suniludde@gmail.com)

Mobile : 9902601142

BANGALORE

Disclaimer

Every effort is taken to avoid errors and omissions.

IF any mistake, error that may have crept in, it is unintentional.

Author is not responsible for any damage / loss any kind arising to any one.

International Finance

FOREX : Foreign Exchange Risk Management

Introduction

Intro	An enterprise deals with Foreign exchange, in the form of Foreign Investments Purchase / Sale of Goods Providing / receiving of Services
Result	Flow of funds, wrt above transactions Between one country to another country Due to which it encounters, various types of risk
Main risk	Foreign Exchange is the premier one

Objective

2 points	Convert One currency into another currency How to manage the Risk, associated with foreign currency transactn
----------	--

Conversion of One Currency into another Currency

Types of Conversion	One Way Quotation Two way Quotation
One way Quotation	Single Rate is given for conversion So conversion is simple Apply the same for Buying, & Selling
Two Way Quotation	Dual Rate is given for conversion It may be, Buying Rate of Dealer / Bank Selling Rate of Dealer / Bank

<u>Objective</u>	Identify, which is Buying Rate, & Selling Rate Apply such rate Accordingly
------------------	--

Ashim Jana Rule

1US\$ = INR 40-50

LHS RHS

Fixed Not Fixed

Superior Acquires LHS	Delivers Lower of RHS
------------------------------------	------------------------------------

Superior Delivers LHS	Acquires Higher of RHS
------------------------------------	-------------------------------------

Who's Superior

Between Bank & Customer
Between Bank & Market

Bank is Superior
Market Superior

Appreciation / Depreciation of CurrencySteps for determining Exchange rate after appreciation / Depreciation of currency

- Step 1 : Find out the CURRENCY, wrt which Appreciation / Depreciation is given
- Step 2 : Find out the Existing rate, wrt 1 Unit of Step (1) currency
- Step 3 : In case of Appreciation Add such %age, wrt other currency
 In case of Depreciation Deduct such %age, wrt other currency

FOREX

Cross Currency

Direct Exchange Rate Is not Available

Indirect Exchange Rate Is Available

Meaning Sometimes Exchange rate b/w 2 currencies are not available,
But Exchange rate for each such currency is available, wrt
Third currency

For example Exchange Rate b/w INR & YEN, is not available, but
Exchange Rate b/w INR & \$, is available AND
Exchange Rate b/w YEN & \$, is available.

Formulae
$$\frac{\text{YEN}}{\text{INR}} = \frac{\text{YEN}}{\$} * \frac{\$}{\text{INR}}$$

Per INR Per \$ Per INR

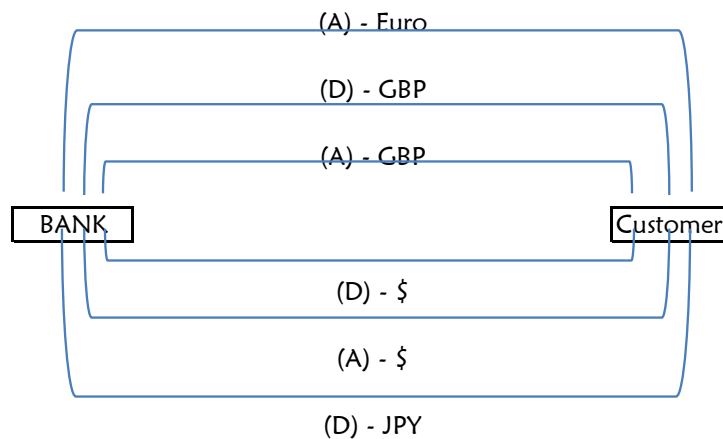
In other Words

$\frac{\text{Cur - 1}}{\text{Cur - n}} = \frac{\text{Cur - 1}}{\text{Cur - 2}} * \frac{\text{Cur - 2}}{\text{Cur - 3}} * \frac{\text{Cur - 3}}{\text{Cur - 4}} * \dots \dots \dots \frac{\text{Cur - 4}}{\text{Cur - n}}$

Important Points : Regarding Cross Currency

cross Currency b/w, 2 currencies No problem, we can findout easily
By applying above formula

Cross currency b/w, more than 2 currency Then we can apply above formula,
But there is a additional work, which to be done
That is Drawing



$\frac{\text{JPY}}{\text{EURO}} = \frac{\text{JPY}}{\$} * \frac{\$}{\text{GBP}} * \frac{\text{GBP}}{\text{EURO}}$

BID, ASK & Spread

BID Rate Price @ Which, Dealer is willing to BUY a Currency

FOREX

ASK Rate	Price @ Which, Dealer is willing to SELL a Currency
Spread	Difference b/w, BID & ASK

Forward Transaction / Contract

Meaning	It is an Agreement To buy / Sell a Currency On Future Date @ Predetermined Rate
Forward Rate	Pre-determined Rate
Spot Rate	Rate Prevailing on the date of exercising the Forward contract
Objective	Hedging Speculation

Hedging Guarding against Future Loss
Conversion of Uncertainty into Certainty
(This is mainly done by people, who deal in Foreign exchange, due to sale / purchase of goods / services)

Receivable	<u>Forward Contract, to Sell Currency</u> Receive from foreign, and sell in Forward contract
Payable	<u>Forward Contract, to Purchase Currency</u> Purchase in forward contract, and pay to foreign

Speculation Mainly entered by Speculator

A Speculator may enter into a forward contract to

Buy currency	On the expectation, that spot rate on maturity would be higher
Sell Currency	On the expectation, that spot rate on maturity would be lower

Real meaning of above contracts

Forward Contract, to Purchase Currency
Purchases under the Contract
and
Sell the same in the Market

Forward Contract, to Sell currency
Purchases from Market
And
Sells the same in forward contract

Forward Premium / Discount

Intorduction	The spot exchange rate, on the date of entering into forward cntrt and The forward rate, i.e exchange rate in the forward contract are not generally same
--------------	---

Forward Premium / discount Difference between these 2 rates
 Spot rate
 Forward rate

Expression of P / D	Can be expressed in the form of Amount , or % age form
---------------------	--

Expression in amount Such amount is known as SWAP points

Interpretation of Swap point : Swap point : Ascending order

Exchange rate	USD 1 = Rs. 47.6825 - 47.6845
Swap point for 2 month forward contract	30 - 35

Spot market interpretation : wrt Bank

Buying / Acquisition rate	Rs. 47.6825 / USD
---------------------------	-------------------

Selling / Delivery rate Rs. 47.6845 / USD

Swap points is given in : Ascending order

LHS currency i.e., USD is trading at Premium in forward market

Action : wrt swap points

Add lower margin of swap point to	Acquisition rate
-----------------------------------	------------------

Add Higher margin of swap point to	Delivery rate
------------------------------------	---------------

Result : Answer

Forward contract : Acquisition rate Rs. 47.6855 / \$

Forward contract : Delivery rate Rs. 47.6880 / \$

Interpretation of Swap point : Swap point : Descending order

Exchange rate	USD 1 = Rs. 47.6825 - 47.6845
Swap point for 2 month forward contract	35 - 30

Spot market interpretation : wrt Bank

Buying / Acquisition rate Rs. 47.6825 / USD

Selling / Delivery rate Rs. 47.6845 / USD

Swap points is given in : Descending order

LHS currency i.e., USD is trading at Discount in forward market

Action : wrt swap points

Less lower margin of swap point to Delivery rate

Less Higher margin of swap point to Acquisition rate

Result : Answer

Forward contract : Acquisition rate Rs. 47.6790 / \$

Forward contract : Delivery rate Rs. 47.6815 / \$

Expression in % age In this case, Both Forward rate and spot rate may be given

We may have to calculate forward premium / discount in percentage form

Determination of premium / discount in % age form

For currency, the amount of which is not changing

$\frac{F - S}{S} \times \frac{12}{365} \times 100$
Forward contract period
Answer in : % age pa

Determination of premium / discount in % age form

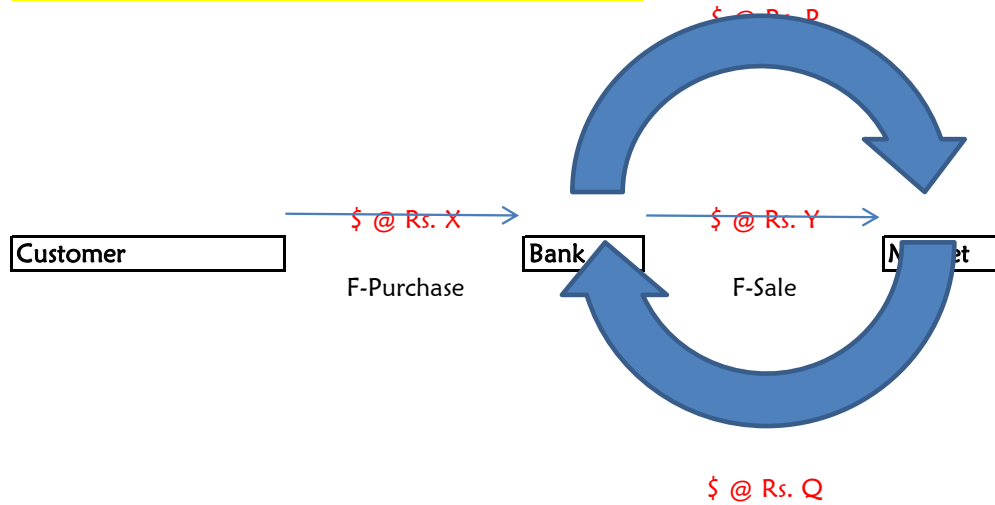
For currency, the amount of which is changing

$\frac{S - F}{F} \times \frac{12}{365} \times 100$
Forward contract period
Answer in : % age pa

Forward contract : Early Execution

Introduction	Here the forward contract is executed before the due date which is known as early execution of forward contract
AS per RBI	A forward contract, can be executed before due date @ Forward contracted price
Implications	Gain / Loss due to early execution of forward contract Net cash Inflow / Outflow due to early execution Handling charges for additional transactions
Gain / Loss	Loss suffered by the bank, due to early execution To be paid by the customer to the bank Gain enjoyed by the bank, due to early execution To be paid by the bank to the customer
Net cash in / out flow	Net cash inflow, to the bank Interest on the CIF, to be paid to the customer Net cash outflow, to the bank Interest on the COF, to be paid to the bank
Handling charges	Assumption to be paid by the customer to the bank for handling additional transactions

Forward purchase contract : By the bank



If executed @ the due date

Profit to the Bank : $Y - X$

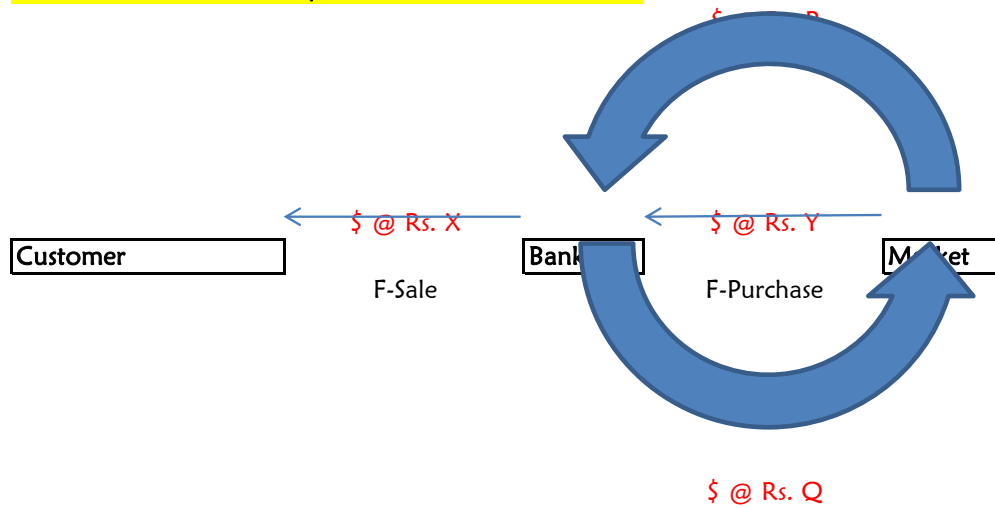
If executed @ the early date

Profit / Loss due to early execution
: $P - Q$

Net CIF / COF, due to early execution
Diff of X & P

Handling charges
Assumption Rs : 100

Forward Sale contract : By the bank



If executed @ the due date

Profit to the Bank : $X - Y$

If executed @ the early date

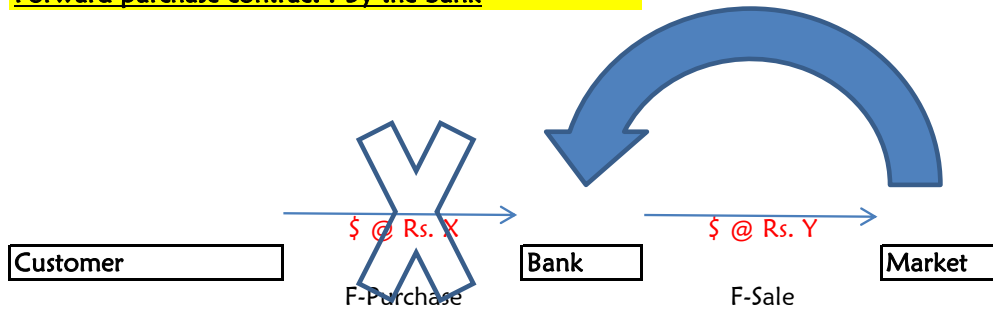
Profit / Loss due to early execution
: $Q - P$

Net CIF / COF, due to early execution
Diff of X & P

Handling charges
Assumption Rs : 100

Forward contract : Cancellation on Due date

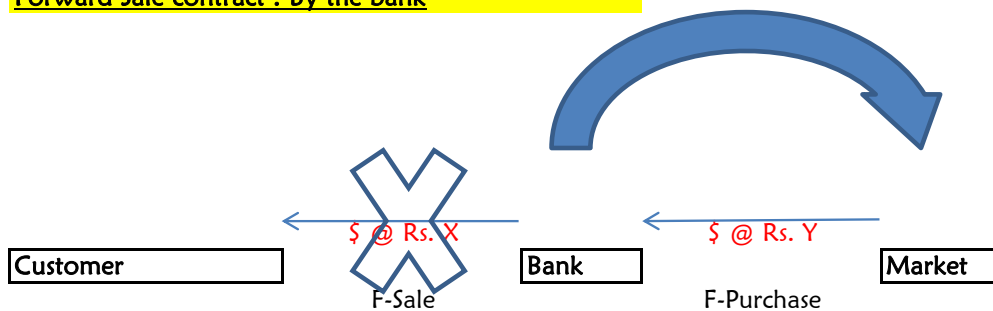
Introduction	Here the forward contract is cancelled on due date Which is known as cancellation on due date
Implications	Gain / Loss due to early execution of forward contract There will be no Net CIF / COF Handling charges ignored

Forward purchase contract : By the bank

If executed @ the due date
Profit to the Bank : $Y - X$

Canellation on due date

Profit / Loss due to Cancellation on due date
Difference b/w Z & X

Forward Sale contract : By the bank

If executed @ the due date
Profit to the Bank : $X - Y$

Canellation on due date

Profit / Loss due to Cancellation on due date
Difference b/w Z & X

Forward contract : Cancellation on early date

Introduction	Similar to Cancellation on due date But in the first case, the additional transaction by the bank was spot transaction but in this case, the additional transaction by the bank is forward transaction
--------------	--

Forward contract : Extension of contract

As per RBI	Extension of forward contract is not permissible
Solution	Cancellation of old contracts Enter into a new forward contract
Implication	Only with respect to Cancellation of old contracts and not wrt new forward contract
Cancellation of old contracts	Leads to 2 situations Cancellation on due date Cancellation on early date
Treatment	For these above 2, situations : We have already discussed