Forward-Rate Agreements (FRAs) for cash managers

The situation

Your firm will have $1,000,000 in 3 months' time for a 6-month period. You think that interest rates may fall. You want to protect the return you will get and you are looking at ways of doing this.

The product

A Forward-Rate Agreement (FRA) can offer you a solution in these circumstances. It is an agreement between you and us which is based on the amount of cash you have. It fixes an interest rate today for the cash investments you will have in the future.

The solution

Your firm arranges a Forward-Rate Agreement to cover the interest you will receive for this 6- month period beginning in 3 months' time. In Forward-Rate Agreement terms this is known as a '3v9' FRA. The Forward-Rate Agreement is for $1,000,000 and we will agree to give you a fixed rate of 4%. This guarantees your firm a 4% rate of return for the six months in question. If in 3 months' time the 6-month Libor is greater than 4%, you will have to pay us compensation over the agreed 4%. If it is less than 4%, we will pay you compensation. We will sort out any differences in the interest rate at the beginning of the FRA period. Let us see how the FRA works in practice.

January 1:	Your firm enters into a '3v9' FRA for $1,000,000 at an agreed 4% interest rate.
April 1:	6-month Libor settles at 3.5%. We pay you compensation for the 0.5% difference in the interest rate over the 6-month period. Rather than pay you this at the end of the 6 month-period, we will pay you immediately

Advantages

- Forward-Rate Agreements give you the chance to protect yourself against falling interest rates.
- Forward-Rate Agreements allow you to plan your cashflow.

Features

- You can get a Forward-Rate Agreement whenever you need one and we can tailor it to suit your needs. We provide Forward-Rate Agreements in all major currencies and for a wide range of maturities.
- You can get a Forward-Rate Agreement from a bank other than the one with which you will deposit your funds. You can use the Forward-Rate Agreement for any deposit you have or expect to have.
- If you take out a Forward-Rate Agreement it will come into force even if you do not make a deposit. You must make sure you have worked out your cashflow for the future correctly.
- The price of your Forward-Rate Agreement will depend on how interest rates are expected to do in the future. We will settle the agreement against the relevant Libor at the start of the Forward-Rate Agreement period.
- You can sell us back the Forward-Rate Agreement at any time, at market prices, if you no longer need it.