Introduction to cross currency swaps

A cross-currency swap is a financial product that can be used to change both the currency and interest rate on your loans or deposits.

With a cross-currency swap, you can, for example, convert a loan denominated in DKK to a loan in USD or EUR, or you can change the interest rate type on an existing loan, e.g. from floating to fixed interest.

The product is often used by companies and investors who need to adjust their financing or hedge against exchange rate fluctuations.

A cross-currency swap contains two legs: You exchange the principal and interest payments in one currency for a principal and interest payments in another currency for an agreed period of time.

In practice, this means that you 'borrow' one currency and lend another currency for an agreed period and that the principal is exchanged once again at maturity.

1. Opportunities offered by Cross currency swaps

You can use a cross-currency ross currency swap, if you:
- want to convert a loan from one currency to another
- want to change your interest rate profile
- want to take advantage of differences in exchange rates or interest rates
- want to hedge you risk, in case you have income/expenses in a specific currency
- need financing that cannot be obtained through ordinary loans

Example
If you have income in EUR and loans in DKK, you can enter into a swap and pay EUR while receiving DKK. This reduces the risk of fluctuations between EUR and DKK.

2. Benefits and drawbacks!

You pay fixed interest and receive fixed interest

Benefits	Drawbacks
You know your interest payments.	You will not benefit from any interest rate declines in your payer currency.
The value of the swap increases, if your receiver currency falls relatively more than your payer currency.	If the interest rate differential moves against your position, the market value decreases.
Possibility of capital gains, if your payer currency falls.	May trigger a requirement of collateral or early closing.
	Risk of incurring a capital loss, if your payer currency appreciates.
	No clear-cut market rate.
	The swap is not callable.

You pay floating interest and receive fixed interest

Benefits	Drawbacks
Chances of better loan terms, if another currency offers a lower interest rate.	You do not know the future interest rate.
You will benefit from any interest rate decreases in your payer currency.	The interest rate differential may move against your position.
Positive market value, if interest rates decrease in both currencies.	Negative market value may trigger a call for collateral.
Capital gain, if your payer currency depreciates.	No clear-cut market rate.
	The swap is not callable.

3. Returns

Cross currency swaps can yield a positive return, if:
- yield trends move favourably relative to your interest-rate profile
- the exchange rate changes in your favour
- the principal and maturity of the contract amplifies any fluctuations

4. About risk

The market value of Cross currency swaps may become negative
You must be able to tolerate:
- yield increases or sharp yield drops
- major foreign currency fluctuations
- changed benchmarks, which may be adjusted or discontinued

Major fluctuations may affect your credit terms, your borrowing capacity and your need for collateral.

5. What you should know before trading

When trading derivative financial instruments with the bank, you may be required to enter into a framework agreement. This details the ways in which the bank monitors the risk that you assume and entitles the bank to call the contract or require collateral, if the market value becomes negative and exceeds the agreed credit limits.

A cross-currency swap agreement may also contain a so-called break clause, which allows you or the bank to terminate the agreement early.

Taxation
Tax rules depend on whether you trade as a private individual, a business, a corporation or via a pension pot. For a specific assessment, we advise you to consult an accountant.

Costs and expenses
Trading in Cross currency swaps entails a premium or discount to the rate, depending on the market. The size of the premium depends on market turnover and the banks margin.

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