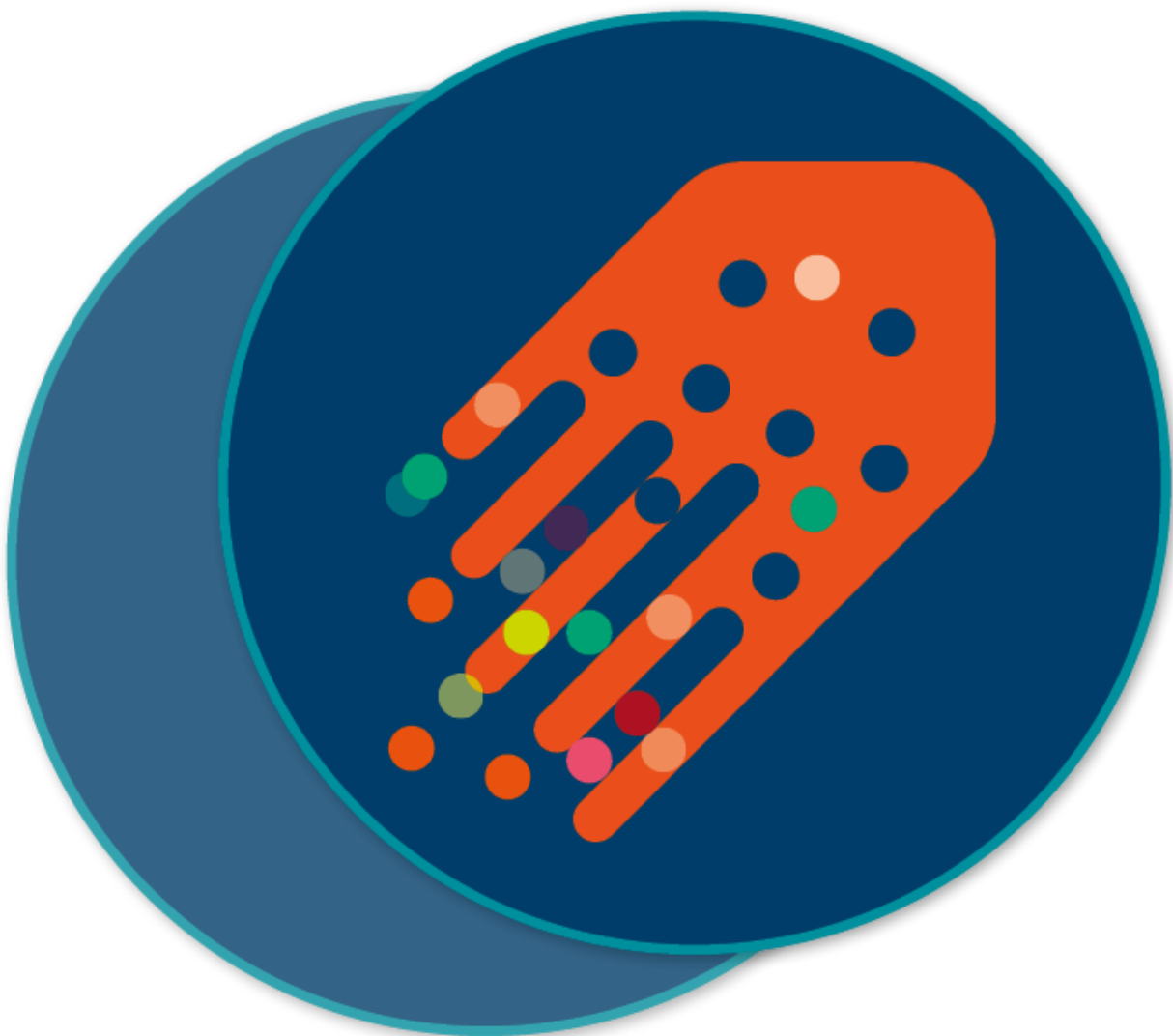


ACT Practice Paper

Certificate in Treasury – MicroCredentials
Foreign exchange & interest rate risk
Practice Paper



Practice paper for the Certificate in Treasury – MicroCredential – Foreign exchange & interest rate risk (FXIR)

Based on the syllabus assessed from 07 October 2025.

Introduction

This practice paper has been produced by the Awarding Body at the Association of Corporate Treasurers (ACT) to assist students in their preparation for the FXIR MicroTest. It contains a practice assessment for the specified MicroTopic as well as practice answers.

Ideally, you should have completed the majority of your studies for FXIR before attempting this practice paper. You should allow yourself 90 minutes to complete the exam. You should then review your performance to identify areas of weakness on which to concentrate the remainder of your study time.

Although the practice paper in this guide is typical of a FXIR assessment, it should be noted that it is not possible to test every single aspect of the Learning Outcomes in any one particular assessment. To prepare properly for the MicroTest, you should make full use of the tuition options where available and read as widely as possible to ensure that all Learning Outcomes have been covered.

Assessment technique: FXIR

The best approach to multiple choice assessments is to work methodically through the questions. You should not spend too much time on any one question. If you cannot make up your mind, you should leave the question, flagging it to come back to later.

When all of the questions have been answered, it is prudent to use any remaining time to go through each question again, carefully, to double-check that nothing has been missed. Altering just one incorrect response to a correct response could make the difference between passing and failing.

Assessment information

The FXIR assessment consist of 44 questions, split into sections A, B and C; and is worth a total of 80 marks.

FXIR MicroTest specification:

Section	Number of questions	Marks available	Question format
Section A	22 Multiple Choice questions (MCQs) and 8 Multiple Response questions (MRQs).	30	This section will test a cross-section of knowledge to achieve breadth of syllabus coverage.
Section B	2 mini scenario with 5 accompanying MCQs.	10	This section will test a cross-section of knowledge to achieve breadth of syllabus coverage.
Section C	4 longer form questions.	40	This section will be based on mini-scenarios common to practice. Questions will test knowledge, analysis, application and justification as appropriate.
Total	44	80	

Under exam conditions, 90 minutes is allowed for the FXIR MicroTest.

When you take your actual MicroTest, you will be sitting online using your own PC/Laptop. You have access to an online scientific calculator, but for the purpose of this test, you may use a non-programmable scientific calculator.

Questions

SECTION A

Section A is made up of 22 Multiple Choice questions and 4 Multiple Response questions and is worth a total of 30 marks.

22 Multiple Choice questions: 22 x 1 mark questions.

8 Multiple Response questions: 8 x 1 mark questions.

The purpose of this section is to test a cross-section of knowledge to achieve breadth of syllabus coverage.

1 Question Text:

Which of the following is the nominal yield of a 90-day NZD instrument, with a market value of NZD50,000,000, which will return NZD51,008,000 at maturity?

Options

- A 10.80%.
- B* 8.06%.
- C 8.18%.
- D 9.50%.

Mark/Score: 1

2 Question Text:

What is the future value of a deposit of SGD25m, made for three years at an annual interest rate of 3%, with interest compounding monthly and reinvested?

Options

- A SGD25.00m.
- B SGD26.52m.
- C SGD27.32m.
- D* SGD27.35m.

Mark/Score: 1

3 Question Text:

Using the market data below:

	Spot	One-mth
USD:EUR	0.8810 - 0.8905	7-5

Which of the following is the applicable rate for a corporate to sell EUR in one months' time?

Options

- A 0.8803.
- B 0.8880.
- C* 0.8900.
- D 0.8990.

Mark/Score: 1

4 Question Text:

Which of the following is the spot rate at which a bank will sell AUD given the market rates below?

AUD/NZD 1.0120-35

Options

- A 1.0085.
- B 1.0120.
- C* 1.0135.
- D 1.0155.

Mark/Score: 1

5 Question Text:

Which of the following is the annual effective rate on a GBP10m deposit paying interest monthly at a rate of 2.5% nominal?

Options

- A*** 2.53%.
- B** 2.48%.
- C** 2.50%.
- D** 2.32%.

Mark/Score: 1

6 Question Text:

A company has issued a discount instrument with a face value of USD10m, a maturity of 45 days and an annual discount rate of 3.25%.

Which of the following are the proceeds of the issue?

Options

- A** USD9,874,563.
- B*** USD9,959,375.
- C** USD9,960,091.
- D** USD9,959,539.

Mark/Score: 1

7 Question Text:

A discount instrument with a market issue price of GBP11m is issued with a maturity of 91 days, when it will return GBP11.15m. Which of the following is the periodic discount rate of this discount instrument?

Options

- A*** 1.35%.
- B** 5.39%.
- C** 5.46%.
- D** 1.34%.

Mark/Score: 1

8 Question Text:

Given the market information below, at which of the following rates would a corporate exchange USD for the immediate purchase of goods from Brazil?

Currency pair	Spot	Three months point
USD:BRL	3.8958 - 3.8965	254.34 - 274.34

Options

- A** 3.9212.
- B*** 3.8958.
- C** 3.9239.
- D** 3.8965.

Mark/Score: 1

9 Question Text:

Given the following market rates, what is the forward rate for the purchase of AUD in three months time?

	Spot	3 Month
USD/AUD	1.4285 - 1.4395	76.30 - 74.70

Options

- A** 1.43613.
- B** 1.44697.
- C*** 1.42087.
- D** 1.43203.

Mark/Score: 1

10 Question Text:

A business has a borrowing of USD100m and has bought an interest rate guarantee with a strike of 2%. The premium is 0.3% and its borrowing margin is 0.5%.

What is the effective hedge rate if the market rate at the end of the hedging period is 2.4%?

Options

- A** 2.6%.
- B** 2.7%.
- C*** 2.8%.
- D** 2.9%.

Mark/Score: 1

11 Question Text:

Which of the following defines a par bond?

A bond whose yield represents:

Options

- A*** its coupon rates.
- B** what the investor is willing to pay.
- C** the inherent risk of the investment.
- D** prevalent market rates.

Mark/Score: 1

12 Question Text:

How does the concept of arbitrage help to ensure that the interest rate parity theory holds true?

Options

- A** Corporate treasury trading disrupts markets but arbitrage realigns them.
- B** Banks will only trade at rates that hold with the theory as arbitrage ensures good value.
- C*** Misalignments in markets will be exploited by FX traders to eliminate risk free gains.
- D** Arbitrage ensures that foreign exchange losses can never be balanced by interest rate differential gains.

Mark/Score: 1

13 Question Text:

Which of the following is the most likely use of a forward yield curve?

The curve represents:

Options

- A** the rate a corporate can issue future bonds.
- B*** the market's expectation of future interest rates.
- C** the cumulative yield when coupons are absent.
- D** the forward foreign exchange market.

Mark/Score: 1

14 Question Text:

Which of the following statements relating to a discount instrument is true?

It:

Options

- A** pays face value at maturity which is less than the value at issue.
- B*** pays a return by being sold at a discount with face value paid at maturity.
- C** allows the purchaser to borrow money at prevailing market rates.
- D** is sold at a discount to prevailing market rates on issue.

Mark/Score: 1

15 Question Text:

Which of the following statements relating to participants in the foreign exchange market is true?

Options

- A The market taker buys the variable currency at the offer price.
- B* The market maker buys the variable currency at the offer price.
- C The market maker buys the base currency at the offer price.
- D The market taker buys the base currency at the bid price.

Mark/Score: 1

16 Question Text:

Which of the following statements explains why FX rates differ in the spot and forward markets?

Options

- A The rates reflect the supply and demand for the relevant currencies at different time periods.
- B There is less certainty forward so the rates are always more expensive in the forward market.
- C* The forward rates take account of interest differentials in the relevant countries for the appropriate period.
- D Forward rates take account of the risk inherent in the foreign exchange markets for the appropriate period.

Mark/Score: 1

17 Question Text:

A key objective for adopting a hedging strategy is to:

Options

- A** provide an offset to risks at no additional cost.
- B** provide potential upside to financial exposure risk.
- C** share risks with relationship bank partners.
- D*** smooth cash flows and reduce risk, without reducing expected future cash flows.

Mark/Score: 1

18 Question Text:

A company enters into an FX swap contract to roll its forward hedge involving a forward contract. The near date for the initial exchange is 1 June 2023, and the far date for the reverse exchange is 1 September 2023. The contracted date for the initial exchange is 1.25, and the pre-agreed rate for the reverse exchange is 1.30.

The forward points for the FX Swap contracts are:

Options

- A** 0.10.
- B*** 0.05.
- C** 0.15.
- D** 0.20.

Mark/Score: 1

19 Question Text:

Which of the following explains how a collar can be constructed?

Options

- A** A cap and a floor are bought with the same strike rate.
- B** A cap is bought a low strike rate and a floor is sold with a high strike rate.
- C*** A cap is bought with a high strike rate and a floor is sold a low strike rate.
- D** A cap is sold with a low strike rate and a floor is bought with a high strike rate.

Mark/Score: 1

20 Question Text:

Which of the following would allow a company to convert some of its floating interest rate exposure to a fixed rate over a five year period?

Options

- A** Interest rate swap receive fixed, pay floating interest rate.
- B*** Interest rate swap, receive floating pay fixed interest rate.
- C** Buy a FRA.
- D** Buy an interest rate floor.

Mark/Score: 1

21 Question Text:

Why would adopting an internal hedging policy of invoicing in the company's own local currency prove ineffective in most circumstances?

Because:

Options

- A** accounting systems can have difficulty translating amounts into local currency.
- B** if its own local currency appreciates, future gains on the currency would be lost.
- C** it would be difficult to decide the most appropriate price for its goods.
- D*** its overseas customers may not accept invoices in a currency which is not their domestic currency.

Mark/Score: 1

22 Question Text:

A common use of a FX swap is:

Options

- A** to fix the FX rate for a short pre-determined period.
- B** an exchange of one currency for another at a pre-defined date in the future.
- C*** to adjust the timing of an existing hedge for a specific period.
- D** to crystallise a gain on an FX contract.

Mark/Score: 1

23 Question Text:

Which of the following are benefits of using a web-based portal for foreign exchange dealing?

Select **ALL** that apply.

Options

- A** It allows for more complex foreign exchange contracts to be priced.
- B** It allows banks to provide a more personal service online.
- C*** There is less opportunity for misunderstanding when contracting with the bank.
- D** More favourable rates are always available on a web-based portal compared to other dealing methods.
- E*** It facilitates straight through processing of confirmations.

Mark/Score: 1

24 Question Text:

Which **TWO** of the following are the main roles played by central banks in major developed economies where there is no official rate of exchange?

Options

- A*** The central bank may seek to smooth out fluctuations in currency movements by trading foreign exchange with other central banks.
- B** The central bank will act as the counterparty in all foreign exchange transactions.
- C*** The central bank will maintain control over the supply of money.
- D** The central bank may speculate on domestic currency markets where they believe gains can be achieved.
- E** The central bank will limit the number of imports and exports due to their influence on the foreign exchange rates.

Mark/Score: 1

25 Question Text:

Which of the following statements explains why a yield curve would be positive?

Select **ALL** that apply.

Options

- A The interest rate parity principle means that longer dated foreign exchange rates determine higher interest rates at the further dates.
- B*** The expectation within markets is that interest rates will rise in the future.
- C The forward yield curve will always reflect the difference between the par and zero coupon curves.
- D*** Market participants will expect greater yield for tying up funds for longer periods.
- E The supply of funds will always be higher as required tenor lengthens.

Mark/Score: 1

26 Question Text:

Which of the following are the main risks of hedging foreign exchange positions relating to forecast receipts?

Select **ALL** that apply.

Options

- A The rate in the foreign exchange market becomes less attractive than the contracted rate.
- B*** The rate in the foreign exchange market becomes more favourable than the contracted rate.
- C Lack of availability of an appropriate cross-rate in the market.
- D Due to market changes the counterparty bank decides not to honour the contract.
- E*** There are actual variances in amounts received compared to the forecast.

Mark/Score: 1

27 Question Text:

Which **THREE** of the following use a 360 day count for local interest calculations?

Options

- A** AUD.
- B** CAD.
- C*** CHF.
- D** GBP.
- E*** JPY.
- F*** SEK.

Mark/Score: 1

28 Question Text:

Which **THREE** of the following describe a par yield curve?

Options

- A** Calculated from zero coupon rates using bootstrapping.
- B*** Determines the periodic coupon on a new par bond.
- C** Represents bonds that pay no coupon.
- D*** Represents bonds traded at face value.
- E** The applied yield for future starting cashflows.
- F*** Used to construct simple interest rate swaps.

Mark/Score: 1

29 Question Text:

Which of the following are drivers of foreign exchange rate movements?

Select **ALL** that apply.

Options

- A** Foreign governments investing in infrastructure assets.
- B** International banks making payments on behalf of their corporate clients.
- C*** International corporations investing in foreign subsidiaries.
- D** International corporations paying their consolidated tax liability.
- E*** International corporations repatriating funds from foreign subsidiaries.

Mark/Score: 1

30 Question Text:

Your organisation needs to obtain a price now to exchange a significant amount of EUR for GBP in one months' time. Which of the following are appropriate ways in which a quotation could be obtained immediately?

Select **ALL** that apply.

Options

- A** A foreign exchange cross rate.
- B** A forward rate agreement.
- C*** A separate spot rate and forward points.
- D*** A single outright forward price.
- E** Swap pricing.

Mark/Score: 1

SECTION B

Section B consists of 2 case study based scenarios, each containing 5 multiple choice questions (MCQs), **worth 1 mark each**, relating to the case study.

These questions are all single response MCQs.

Section B will focus on smaller sections of the syllabus and requires more depth of knowledge and application to practice.

Section B - case study 101-3-2

Diversified Holdings Group (DHG) is a large international business comprising numerous individual subsidiaries. It has a small team of treasury specialists working within its head office. The team is available to provide guidance to the subsidiaries when required. One of the DHG subsidiaries is reviewing different investments. Its preferred investment will return EUR145.6M after one period for an initial investment of EUR140.0M. The subsidiary has tasked its treasury manager (TM) with undertaking a review to calculate the real rate of return on a potential investment, on which there are no tax implications. In addition, the TM has contacted the bank and arranged a rate for a future currency transaction. The subsidiary is expecting to receive a large amount of USD from a client in two months' time and the TM wants to fix the rate now. The TM books the rate but the client experiences financial issues and is unable to pay on the due date.

31 Question Text:

The TM fixed a USD/EUR rate two months ahead for an expected USD receipt, but the client couldn't pay on the due date.

What is the most likely consequence for the subsidiary?

Options

- A The bank cancels the deal at no cost since no funds arrived.
- B The bank must roll the deal forward at the same rate and no fees.
- C* The subsidiary will face a close-out/penalty for the unmatched forward, settled at prevailing market rates.
- D The central bank intervenes to void the deal.

Mark/Score: 1

32 Question Text:

What is the real rate of return on the preferred investment, if inflation over the period is 2.0%?

Options

- A*** 1.96%.
- B** 2%.
- C** 4%.
- D** 2.04%.

Mark/Score: 1

33 Question Text:

The TM's review will take which of the following into consideration?

Options

- A** Accessibility.
- B** Covenants.
- C*** Inflation.
- D** Tax.

Mark/Score: 1

34 Question Text:

Which of the following has the TM arranged with the bank?

Options

- A** Currency option.
- B*** Forward contract.
- C** Increased credit line.
- D** Overdraft limit.

Mark/Score: 1

35 Question Text:

What are the implications for the subsidiary of its client's financial issues?

The subsidiary:

Options

- A** can use collateral to avoid all fees.
- B** has taken insurance so will have nothing to pay.
- C** has the option of whether to settle or not.
- D*** will still have to settle with its bank.

Mark/Score: 1

Section B – case study 101-3-3

European Electrical Products (EEP) is a EUR reporting business. All of EEP's costs and revenues are from countries using the Euro as currency. However, EEP has just agreed to source materials from the UK and will have to pay in GBP, representing a new area of risk for EEP's treasury function to manage. The initial order will cost EEP GBP93,750. The EUR/GBP rate is 0.8369 (ie one Euro = GBP0.8369). The rate has been booked with an intermediary so EEP will know precisely how much the materials cost in Euros (excluding fees). EEP's treasurer has commissioned a review of existing policies and has prioritised rewriting its internal policy aimed at preventing fraud. The objective is to involve several people in the process of a single deal, from initiation to settlement. EEP currently has surplus funds to invest for a year or so, but the treasurer is concerned about the impact of inflation on the value of the investment over time.

36 Question Text:

Two weeks before settlement, GBP appreciates versus EUR relative to the booked forward rate.

What happens to EEP's EUR cash outflow?

Options

- A*** No change and it remains fixed at the booked amount.
- B** It increases versus the booked amount.
- C** It decreases versus the booked amount.
- D** It depends on the final supplier invoice rather than the FX rate.

Mark/Score: 1

37 Question Text:

To prevent fraud through proper segregation of duties, who should receive and check the bank's trade confirmation?

Options

- A** The front-office dealer.
- B*** The back-office staff.
- C** The external supplier.
- D** A senior executive.

Mark/Score: 1

38 Question Text:

What type of investment would be the best to address the treasurer's concern?

Options

- A** Fixed rate.
- B*** Index-linked.
- C** On demand.
- D** Short-term.

Mark/Score: 1

39 Question Text:

How much is the EUR equivalent that EEP will have to pay its supplier for the materials?

Options

- A** EUR51,037.
- B** EUR78,459.
- C** EUR107,539.
- D*** EUR112,020.

Mark/Score: 1

40 Question Text:

The intermediary that EEP has transacted with is most likely to be which of the following?

Options

- A** Central bank.
- B*** Commercial bank.
- C** Hedge fund.
- D** Pension fund.

Mark/Score: 1

SECTION C

Section C is made up of 4 case study questions and is worth a total of 40 marks.

4 longer form questions: 4 x 10 mark questions.

Please note that some questions may be broken into sub-questions (for example a,b,c) on the next page.

Questions will be based on mini-scenarios common to practice. Questions will test knowledge, analysis, application and justification as appropriate to level descriptors.

Please ensure you open and read the associated Case Study information before answering the question. This can be found above the answer box.

Case Study 102-2

Your treasury manager has substantial surplus USD funds to invest and has identified two different investments which they wish to research further before making a final investment decision. They have provided you with the following details of the two investments:

- a deposit account with a nominal annual yield of 3.0%, paying interest quarterly
- a 60-day discount instrument quoted at a nominal annual discount rate of 2.95%.

The treasury manager has asked you which of these two alternatives will provide the best annual effective rate of return, as that information will be a key part of their eventual decision.

41 Question Text:

Calculate the annual effective rate of return for the deposit account.

Show your workings

(2 marks)

Mark/Score: 2

42 Question Text:

Calculate the annual effective rate of return for the 60-day discount instrument.

Show your workings

(3 marks)

Mark/Score: 3

43 Question Text:

Recommend to your manager the best alternative for the investment, based on return alone.

Show your workings

(1 mark)

Mark/Score: 1

44 Question Text:

Explain briefly TWO other relevant factors you would mention to your manager which could impact on the eventual investment decision, regardless of the rate of return.

(4 marks)

Mark/Score: 4

Case Study 103-3

You are working in the foreign exchange (FX) team within your organisation's treasury department. You have been asked to support a new team member who is learning how to undertake spot transactions. The global nature of your organisation means that transactions are required in a range of currencies.

The new team member has been asked to find an applicable rate for a forthcoming transaction which will involve the purchase of Hong Kong Dollars (HKD) and the sale of Swiss Francs (CHF).

The new team member is uncertain as to how to proceed because they cannot find a quote for this currency pair. They have therefore asked for your help, having established the following:

Currency Pair	Bid Price	Offer Price
USD/HKD	7.7514	7.7515
USD/CHF	0.9177	0.9180

45 Question Text:

Explain to your colleague how an appropriate spot rate for this currency pair would be established in practice.

(3 marks)

Mark/Score: 3

46 Question Text:

Calculate the spot exchange rate for the CHF/HKD deal.

Show your workings

(4 marks)

Mark/Score: 4

47 Question Text:

Explain to your colleague the impact on the spread for currency deals like these, compared to commonly traded currency pairs.

(3 marks)

Mark/Score: 3

Case Study 515-2

Fair Pumping (FP) is a UK manufacturer of pumps for garden ponds. It supplies to garden centres which are its main sales outlets, and it has an online presence where it sells directly to consumers. It imports pump components from Asia but has recently noticed an increase in costs. Additionally, local labour costs have risen which has contributed to smaller margins on the product and the expectation is that the UK economy is weakening too.

FP has financed itself with bank borrowing, including term loans and an overdraft that has not been used so far. It has invested in upgrading its production facility and took out a five-year borrowing facility from its main relationship bank. This was for GBP40m based on six-month SONIA and no margin was quoted. There is still one year to run on this outstanding debt and the loan is fully drawn.

FP has some covenants on its debt such as interest cover which it is keen to maintain so that it can maintain its credit rating.

The group treasurer believes that interest rates are going to increase in the near term and so wishes to lock into current rates. FP's bank has offered to arrange a short swap where FP will pay 4.75% fixed for one year and receive six-month SONIA.

For simplicity ignore any discounting of cashflows for the calculations.

48 Question Text:

Calculate the annual cashflow cost/benefit of the swap if:

1. the SONIA rate increases and remains at 6.0% per annum for the full year
2. the SONIA rate is 6% per annum for the first six months and increases to 8% per annum for the second six-month period.

(5 marks)

Mark/Score: 5

49 Question Text:

Discuss FP's risk management approach and the actions taken.

(5 marks)

Mark/Score: 5

Case Study 515-4

Zen Mode (ZM) is a UK online fashion retailer which has experienced strong growth over the last five years. Its main market initially was the UK, but it has now expanded its sales to Europe, US, Asia and the rest of the world (ROW). Its main competitors are in the UK and in Germany.

The business has been very successful as it has a large and constantly changing product range which customers appreciate.

ZM's main suppliers are based in Asia, with over 70% of its products sourced from countries in this region. Most of these purchases are paid for in USD.

A breakdown of ZM's revenues and costs is shown in Table 1.

Table 1

	UK	Europe	US	Asia	ROW	Total
Sales	40%	30%	12%		18%	100%
Cost of Sales	10%	20%		70%		100%

As an online business, ZM's operations are minimal. its central functions including its treasury team are based in the UK. ZM's sales invoices are raised in local currencies.

A summary of information taken from ZM's latest financial accounts is shown in Table 2. The cash held is mostly invested in money market deposits and a money market fund. The debt was raised last year over a five-year term on a variable rate to fund an investment in a distribution centre in France.

Table 2

	GBPm
Sales	3,200
Cost of Sales	1,800
Operating Profit	150
Cashflow	400
Cash	350
Gross debt	300

50 Question Text:

Discuss the types of **financial risk** that are of significance to ZM at the current time.

(6 marks)

Mark/Score: 6

51 Question Text:

Explain the actions ZM could take to manage TWO financial market risks it is currently experiencing.

(4 marks)

Mark/Score: 4

Case study mark scheme

Case study 102-2

Q2a	<p>Mark Scheme</p> <p>Calculations as follows:</p> <ul style="list-style-type: none"> • Convert to periodic yield; $[0.03 \times (3/12)] \times (365/360) = 0.007604167$ • Convert to EAR; $(1 + 0.00760417)^4 - 1 = 0.03077$ (3.077%) 	
Q2b	<p>Calculations as follows:</p> <ul style="list-style-type: none"> • Convert to periodic discount; $0.0295 \times (60 / 360) = 0.0049167$ per 60 days • Convert periodic discount to periodic yield as follows; $0.0049166 / (1 - 0.0049167) = .0049410$ per 60 days • Convert to EAR; $(1 + 0.0049410)(365/60) - 1 = 0.03044$ (3.044%) <p>c) As the discount instrument has a lower EAR than the deposit account (3.044% compared to 3.077%) then the recommendation should be to invest in the deposit instrument.</p>	
Q2c	<p>The relevant factors are:</p> <ul style="list-style-type: none"> • Risk – Better returns are usually offered because the investor is willing to accept a higher degree of risk. The alternative suggested needs to be reviewed to ensure that the level of risk is acceptable to the organisation; i.e. is the bank/organisation offering the investment sufficiently trustworthy and reputable to ensure the funds invested are as safe as they would be with a bank/organisation offering lower rates of return. 	
Q2d	<ul style="list-style-type: none"> • Maturity – consideration needs to be given as to when the funds might be required. In this scenario, the discount instrument offers a higher return and a shorter maturity date than the deposit account, so maturity isn't a consideration; however in many circumstances a higher return is only achievable by accepting a longer maturity. In those circumstances maturity becomes an issue because liquidity has to be foregone for longer and this might create operational issues. 	<p>Total: 10 marks</p>

Case study 103-3

Q3a	<p>Mark Scheme</p> <p>The process required is to enter into a cross currency deal. This process enables appropriate rates to be calculated for less common currency pairs. As most currencies traditionally are quoted against the USD, it is possible to use USD as a basis for calculations.</p> <p>Two transactions take place behind the scenes, involving trades with USD. For example, to handle the CHF / HKD deal, deals involving (i) the sale of HKD and the purchase of USD and (ii) the sale of USD and the purchase of CHF would take place. The USD transactions would take place behind the scenes at the bank and would not be visible to the customer.</p>																	
Q3b	<p>Calculations as follows:</p> <ul style="list-style-type: none">As USD is on the same side of each currency pair, quotes are cross divided as follows: USD/HKD USD/CHF = CHF / HKD <table><tr><td></td><td>BID</td><td>OFFER</td><td></td></tr><tr><td>USD/HKD</td><td>7.7514</td><td>7.7515</td><td></td></tr><tr><td>Divided by USD/CHF</td><td>0.9180</td><td>0.9177</td><td>Crossed over – bigger number first</td></tr><tr><td>=CHF/HKD</td><td>8.4438</td><td>8.4467</td><td></td></tr></table> <ul style="list-style-type: none">As the requirement is to sell CHF, the bid price is applicable, i.e. 8.4438.		BID	OFFER		USD/HKD	7.7514	7.7515		Divided by USD/CHF	0.9180	0.9177	Crossed over – bigger number first	=CHF/HKD	8.4438	8.4467		
	BID	OFFER																
USD/HKD	7.7514	7.7515																
Divided by USD/CHF	0.9180	0.9177	Crossed over – bigger number first															
=CHF/HKD	8.4438	8.4467																
Q3c	<p>The impact of a cross-currency deal is to increase the spread between the bid and offer prices quoted; the reason being that the market maker is effectively undertaking two transactions to meet the customer requirements rather than just one, leading to more costs.</p>																	
		Total: 10 marks																

Case study 515-2

2a			Interest rates & cashflow	Explanation	
	i)				
	Net Benefit	%	1.25	6 - 4.75	1 mark
	Swap benefit	GBP	500,000		1 mark
	ii		Interest rates & cashflow	Explanation	
	1st 6 months	%	3		½ mark
	2nd 6 months	%	4		½ mark
	Annual therefore	%	7		½ mark
	Net benefit	%	2.25	(7- 4.75)	½ mark
2b	Swap Benefit	GBP	900,000		1 mark
					(up to 3 marks)
	Discussion of risk management approach:				
	<ul style="list-style-type: none"> the swap rate seems very low compared to the SONIA rate and it is very beneficial to lock the 4.75% rate in now for the year 				1 mark per point
	<ul style="list-style-type: none"> Given FP has some interest covenants, it would be sensible to fix the GBP40m if profitability and margins are being squeezed 				1mark per point
	<ul style="list-style-type: none"> However, given FP is still borrowing GBP40m, it would be more sensible to lock in a swap for a number of years rather than just one year 				(3 marks)
	<ul style="list-style-type: none"> FP should be taking a more holistic view of the debt portfolio rather than one specific borrowing. It should then carry out some modelling to find out the sensitivity of its covenants to rising interest rates and an economic downturn 				1 mark per point
	<ul style="list-style-type: none"> Bank borrowing will always have a margin, so the loan documentation should be checked to verify what this is 				(4 marks)
	Other relevant observations will be rewarded				Total: 10 marks

Case study 515-4

<p>4a</p>	<p>Financial Risk identification</p> <ul style="list-style-type: none"> •Foreign exchange: transactional: This is a key risk for ZM in terms of sales and especially cost of sales. The fact that the purchases are in USD, potentially hides the underlying currency from an import country. There is a definite mismatch of currencies shown by the segmental analysis. •Foreign exchange: Economic: with competitors both locally and in Europe, there will be strategic FX risk relating to pricing. •FX translation: ZM has operations in France and these will result in FX gain/losses on consolidation. •Counterparty risk: commercial transactions: Whenever ZM enters into a transaction with another entity, there is the risk that the counterparty will not fulfil obligations by paying the amount due or delivering goods. •Counterparty risk: banks: As ZM have invested its cash in MMD and MMF there is some potential counterparty risk. •Interest rate risk: with long term debt, ZM will have some interest rate risk. This will be partly offset assuming, profitability grows with a rising economy and interest rates. 	<p>½ mark to identify and ½ mark to discuss per bullet</p> <p>(up to 6 marks)</p>
<p>4b</p>	<p>Other valid responses will be rewarded.</p> <p>NB: Students should only be rewarded for coverage of financial market risks, namely interest rate and types of FX risk.</p> <p>Appropriate coverage for each financial market risk relevant to ZM:</p> <ul style="list-style-type: none"> •FX Transactional: Attempting to net same currencies flows as much as possible. For the remainder take out foreign exchange forward contracts for a proportion of the exposure, where material. •FX Economic: Monitor competitors, aim to understand their cost bases and then diversify production and operations outside of the UK. •FX translation: This is likely to be less material than the other FX risks. Action could be to borrow in EUR and fund the operation in France with this debt. 	<p>½ mark per appropriate financial risk identified</p> <p>(maximum 2 risks) and up to 1½ marks for each explanation of actions that could be taken.</p> <p>(up to 4 marks)</p>

	<ul style="list-style-type: none">•Interest rate risk: Converting the debt to a fixed/capped interest basis would remove volatility; possible options would be IRS or purchase of a cap. <p>Other valid responses will be rewarded.</p>	Total: 10 marks
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