DERIVATIVES & FIXED INCOME SECURITIES
MAF308

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Forwards vs Futures

Futures	Forwards
Traded on orgainised exchange	Traded over the counter (OTC) markets
Standardised contract	Privately negotiated
Limited number of delivery dates	Delivery any time
Marked to market	Settled @ maturity
Virtually no counterplay default risk – counter party is clearing house	Subject to counterplay default risk

- **Futures are similar to forward contracts**: an agreement to exchange currencies @ a specified time for a specified price.
- **Futures are different from forwards**: futures are standardised contracts trading on orgainised exchanges with daily settlement or marking to market.
  - **Daily settlement**: the gain/loss made on a futures contract is calculated and added/subtracted from the marginal account (MA) @ the end of each trading day.
    - Margin Account: investors are required to hold a MA with their broker.
  - **Marking to Market**: an investor will receive a margin call if their MA balance falls below the minimal margin. The investor is required to top up their MA to the initial margin upon receiving a margin call.
- **Forward/Futures Arbitrage**: keeps futures rate in line with forwards rate.
- **Futures – Advantages:**
  - Smaller sized contracts, highly liquid, well orgainised market
- **Futures – disadvantages:**
  - Available in a limited number of currencies, limited delivery dates, rigid contract sizes

Margin Account

- **Margin Account**: a type of brokerage account that allows investors to buy securities with borrowed funds, requiring a deposit of cash or assets as collateral to cover the risk on such transactions.
- **Margins**: cash or marketable securities deposited by an investor with their broker.