



# Buyer's Guide: Forward Rate Agreements (FRAs, UK-Focused)

## This includes:

- Clear explanations
- Due diligence questions
- Integration with **British standards**
- How FRAs align with **regulations and policies**
- Roles and **responsibilities**
- A **summary** for decision-makers

## 1. What is an FRA?

A **Forward Rate Agreement (FRA)** is an over-the-counter (OTC) contract between two parties to exchange the difference between a **fixed interest rate** and a **floating interest rate** (usually based on a reference like **SONIA** or **LIBOR**), applied to a **notional principal amount** over a specified future period.

### FRA Use Cases:

- Hedging against interest rate volatility
- Locking in borrowing/lending rates
- Speculative positioning on future interest rate changes



## 2. Key Features

Feature	Description
<b>Notional Amount</b>	Hypothetical amount on which interest is calculated
<b>Fixed Rate</b>	Agreed upon in the contract
<b>Floating Rate</b>	Based on SONIA (UK), SOFR (US), EURIBOR (EU), etc.
<b>Settlement</b>	Based on the difference between fixed and floating, paid upfront
<b>No Principal Exchange</b>	Only the interest differential is exchanged

## 3. Questions to Ask Before Buying an FRA

### Strategic Alignment

- What is the purpose of the FRA: **hedging or speculation?**
- How does this support our broader **treasury/risk management policy?**

### Market Conditions

- What is our **interest rate forecast?**
- How do market trends (e.g. BoE base rate changes) affect our FRA pricing?

### Risk & Compliance

- What are the potential **market, credit, and operational risks?**
- Is our counterparty compliant with **UK financial regulations?**



## Operational Readiness

- Do we have **internal capacity** to manage FRA accounting and settlements?
- Is this transaction within our **financial authority limits**?

## 4. British Standards, Regulations & Governance

### UK Financial Regulatory Framework

Standard/Regulation	Description
<b>FCA Oversight</b>	All UK financial services must comply with <b>FCA</b> rules, especially regarding conduct, transparency, and risk management
<b>SONIA (Sterling Overnight Index Average)</b>	UK's risk-free rate replacing LIBOR in FRAs and other derivatives
<b>EMIR (European Market Infrastructure Regulation)</b>	Applies to UK post-Brexit under UK EMIR; requires reporting of OTC derivatives, central clearing, and risk mitigation
<b>UK MiFID II</b>	Covers transparency, reporting obligations, and investor protections
<b>IFRS 9</b>	Accounting treatment of derivative instruments (e.g. hedging, fair value)
<b>ISDA Master Agreement</b>	Legal framework for FRA transactions, widely used in the UK

### British Standards & Best Practices

Standard	Relevance
<b>BS 13500 (Code of Governance for Organisations)</b>	Ensures good governance of financial decisions including hedging



## Standard

**BS ISO 31000 (Risk Management Guidelines)**

**BS 10008**

## Relevance

Framework for identifying, managing, and reviewing risks

Ensures legal admissibility of electronic records — important for FRA documentation and compliance

## 5. Responsibilities of Parties

### Internal Stakeholders

Role	Responsibility
<b>Treasury Team</b>	Market analysis, hedge strategy, execution
<b>Finance Director / CFO</b>	Approval authority, oversight of financial risks
<b>Risk Officer</b>	Evaluate risk exposure and monitor policy compliance
<b>Legal Counsel</b>	Review ISDA and contract terms
<b>Compliance Officer</b>	Ensure adherence to FCA, EMIR, and internal policies
<b>Auditor</b>	Confirm correct accounting treatment and disclosures

### External Parties

Party	Role
<b>Counterparty (Bank or Broker)</b>	Provides pricing, enters FRA contract
<b>Clearing House (if used)</b>	Reduces counterparty risk (for cleared FRAs)
<b>Regulators (e.g. FCA)</b>	Oversight and reporting requirements
<b>Trade Repository (e.g. DTCC)</b>	EMIR reporting of the FRA transaction



## 6. Risks to Consider

<b>Risk Type</b>	<b>Explanation</b>
<b>Market Risk</b>	Rates move opposite to your position
<b>Counterparty Risk</b>	Party defaults on their payment
<b>Liquidity Risk</b>	Difficult to unwind before maturity
<b>Operational Risk</b>	Mismanagement, poor documentation, or settlement errors
<b>Regulatory Risk</b>	Non-compliance with EMIR or FCA rules leads to penalties

## 7. Documentation & Compliance Checklist

### Legal & Compliance

- ISDA Master Agreement in place
- Confirm SONIA as the floating rate (post-LIBOR)
- EMIR reporting obligations met
- Trade reported to a registered Trade Repository
- FCA disclosure and conduct requirements reviewed

### Internal Governance

- Treasury policy authorises FRA use
- Risk analysis documented (hedge vs speculation)
- Senior management approval obtained
- Hedge accounting treatment defined (IFRS 9)

Stress testing or scenario analysis conducted



## 8. How FRAs Integrate with Other Policies

Policy	How FRA Fits
<b>Treasury Management Policy</b>	FRAs are tools to manage rate exposure within limits
<b>Risk Management Policy</b>	FRA must align with the defined risk appetite
<b>Compliance Framework</b>	Must be executed and reported under regulatory compliance
<b>ESG Policy</b>	While FRAs have no direct ESG impact, good governance contributes to ESG goals
<b>Procurement &amp; Financial Delegation</b>	FRA commitments must fall within financial authority levels

## 9. Summary for Decision-Makers

FRAs are powerful instruments for hedging or speculating on interest rates. However, their use requires strong governance, compliance with UK and international regulations (FCA, EMIR), and alignment with corporate financial policies.

### Key Takeaways:

- Use FRAs to manage interest rate risk for **specific future periods**.
- Ensure the **purpose is clear**, the **counterparty is reliable**, and **documentation is robust**.
- Comply with **FCA, UK EMIR**, and use **SONIA** as the new benchmark rate.
- Follow **British Standards** in governance, risk, and documentation.



- Internal stakeholders must be aware of **roles and responsibilities**.