Silicon Valley Bank

Foreign exchange product guide

FX Options: Risk Reversal/Collar

Spot | Forward | Swap | NDF/NDS | FX Options

Risk Reversal/Collar

SVB UK only offers this product to clients classified as 'Professional' under MiFID regulation.

This option strategy provides certainty of a protected, pre-agreed low strike rate, whilst giving the opportunity to participate in favourable market movement up to a pre-agreed high strike rate, on or up to a predetermined expiry date.

The settlement of the contract will occur within two days after the expiry date.

Product Variables

- Notional amount
- High strike rate
- Low strike rate
- Spot rate
- Currency pair
- Expiry date
- Settlement date
- Pre-approved FX credit line

The benefits

Protection against adverse movements at a predetermined rate, adding clarity on future cashflows

Tailored to specific objectives, giving flexibility to decide the notional amount, currencies and the settlement date

The right to participate in more favourable exchange rates up to a pre-agreed high strike rate

Can be structured as a zero-cost strategy

Key risks

Should the contract no longer be required, the cost of unwind will be determined by the prevailing market rate at the time and will be payable by the client

The mark to market value of the contract will become positive or negative throughout the duration of the contract in line with market fluctuations

An application of a Risk Reversal/Collar

(hypothetical example)

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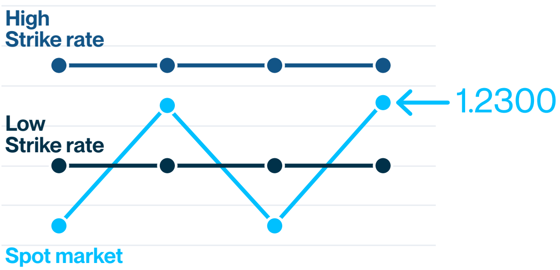
UK-based company Acme Ltd needs to make a purchase of USD 500,000 in 6 months. They would like to have protection against adverse market movements, but the ability to participate in favourable movement should this occur. They do not want to pay an upfront premium.

Acme Ltd executes an FX Collar Option to buy USD 500,000 with an expiry date in 6 months, at a low strike rate of 1.2000 and a high strike rate of 1.2500.

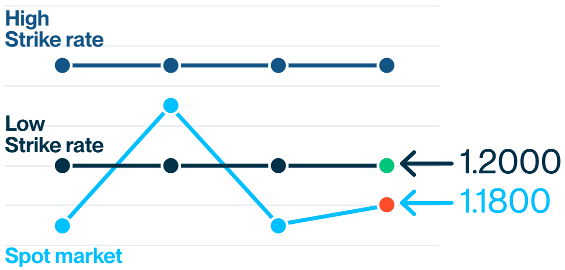
At expiry there are three possible outcomes:

Outcome 1



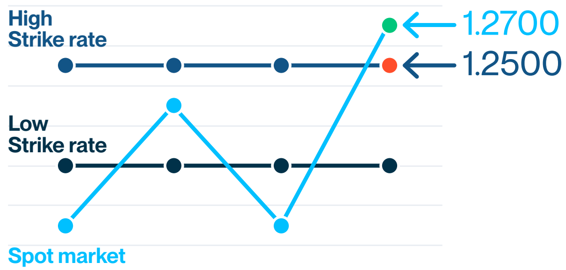
GBP/USD is trading at 1.2300. Acme Ltd lets the **option expire** and instead **executes a spot trade** at the prevailing market rate, benefiting from favourable levels. Settlement will then occur two days after the spot trade has been executed.

Outcome 2



GBP/USD is trading at 1.1800. Acme Ltd exercise their right to **buy USD at the low strike rate** of 1.2000, which is advantageous compared to the prevailing market rate. Settlement will then occur two days after the option has been exercised.

Outcome 3



GBP/USD is trading at 1.2700. Acme Ltd is **obligated to trade at their pre-agreed high strike rate** of 1.2500, which is disadvantageous compared to the prevailing market rate. Settlement will occur two days after the option has been exercised.

Contact your FX Trading Specialist to learn more or email us at **EMEAFXTraders@svb.com**

Glossary

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Tenor – The length of time between execution and the expiry date.

Notional amount – The volume of the transaction (how much currency is being bought or sold).

Credit line – An FX line allowing the company the right to buy or sell currency for a date in the future without immediate settlement of the full amount. An FX line will be tailored to the specific requirement of the business and will be approved on a collateralised or uncollateralised basis dependant on financial analysis. Clients may be subject to pay variation margin should the mark to market valuation be outside of the agreed risk parameters

Mark to market – Measuring the fair value of the contract based on the current market price.

Strike rate – The specific price at which the holder of the option can exercise the option to buy or sell a currency.

Expiry date – The date in which an options contract expires and the rights of the option may be exercised. An option can be structured as an American option (allows the holder to exercise the option anytime up to and including the expiry date) or a European option (allows the holder to exercise the option only on the expiration date).

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