Silicon Valley Bank

Foreign exchange product guide

FX Options: Vanilla

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Vanilla

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

This option strategy gives the buyer the right, but not the obligation to exchange one currency for another, at an agreed strike rate, on or up to a pre-agreed expiry date. Settlement of the contract will occur two days after expiry.

A non-refundable premium is payable within two days of execution, this is usually calculated as a percentage of the notional amount.

Product variables

- Notional amount
- Strike rate
- Currency pair
- Spot rate
- Expiry date
- Settlement date
- Premium payable within 2 days of execution

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The benefits

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

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

The right to participate in favourable market movement

No obligation to exchange currencies giving full flexibility

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

Non-refundable premium is payable upon purchase of a Vanilla Option within two days of execution

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 Vanilla FX Option

(hypothetical example)

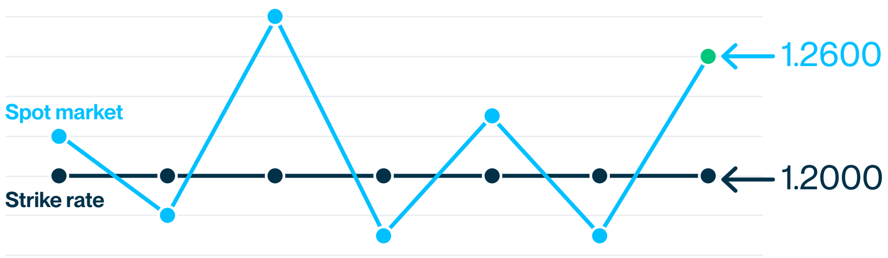
UK-based company Acme Ltd has a potential need to sell GBP and buy USD in 6 months. To hedge against market volatility, Acme Ltd purchases a Vanilla Option.

This provides a worst case (strike rate) that they have the right to transact at, but allows participation in favourable market movement at expiry should it occur.

Acme Ltd purchases a vanilla option with an expiry date in 6 months and a strike rate of 1.2000. The premium payable is 2.5% of the notional.

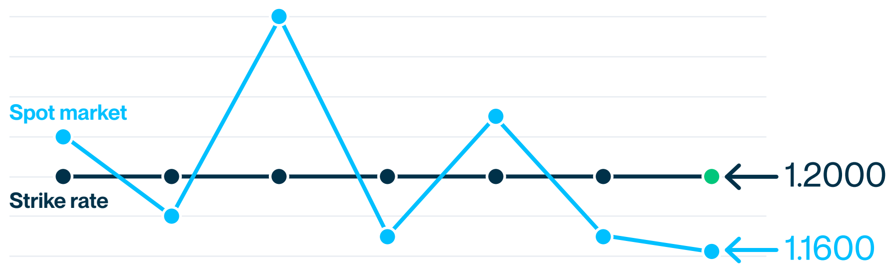
At expiry there are two possible outcomes:

Outcome 1



GBP/USD is trading at 1.2600, **higher** than the strike rate. Acme Ltd lets the option expire without exercising and instead **executes a spot trade** at the current market rate, benefiting from a more favourable exchange rate.

Outcome 2



GBP/USD is trading at 1.1600, **lower** than the strike rate. Acme Ltd exercises their right to buy USD at the **pre-agreed strike rate** of 1.2000, which is more favourable than the prevailing market rate.

Glossary

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).

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).

Settlement date – The date on which the contract is settled, i.e. when the currency amount is delivered. Settlement of an option contract usually occurs 2 working days after the expiry date.

Currency pair – The two currencies involved in the exchange, where the value of one currency is quoted against the other.

Spot rate – The rate available for immediate settlement of the currency.

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