Covered Call option

This Product Disclosure Statement is in reference to RBI Circular dated 16.09.2021, Master Direction – Reserve Bank of India (Market-makers in OTC Derivatives) Directions, 2021.

This document contains standard information about the product which may enable the user to determine if the product will meet its risk management objectives and to facilitate comparison with other products.

Features

In this product, the user writes (sells) a standalone plain vanilla European Call Option against its receivable exposure at a particular strike price for an expiry/delivery date. This sell call option allows user to receive upfront premium and along with the underlying, limits the upside on the currency movement to the strike of sell call option.

This strategy should not be considered as a hedge and should be monitored closely.

Illustration:
For a receivable underlying in USD where INR is domestic currency, user sells a covered USD call option.

The underlying exposure for this product is a USD receivable. User is exposed to risk of INR appreciation against USD resulting in lower INR revenue. This sell call option allows user to receive upfront premium and limits the upside on the currency movement to the strike of sell call option.

Building Blocks:

The building blocks of this option are as below:

a. Spot FX rate,
b. Forward FX rates
c. Time to expiry and
d. Implied volatility.

Costs and fees, including break-up and details

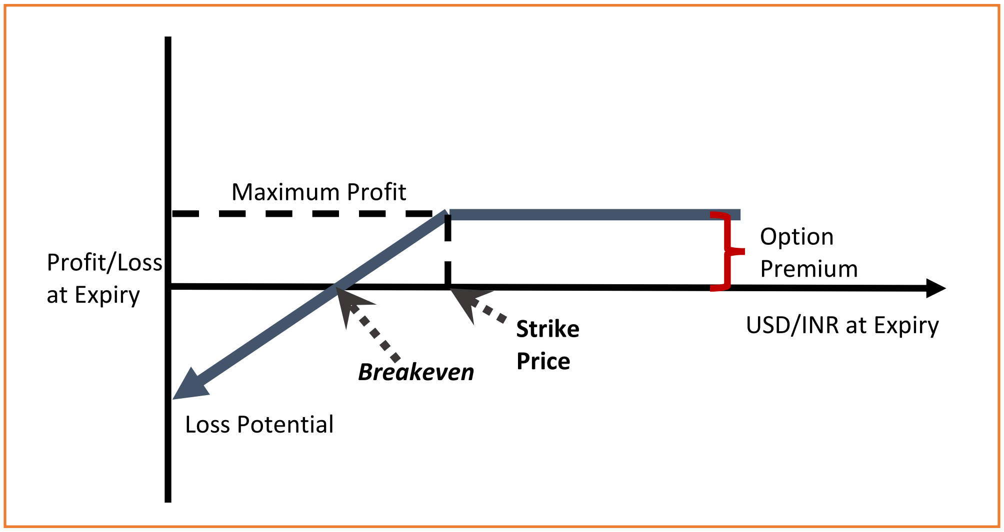
The option cost consists of market cost which is determined through a financial model taking above building blocks as input parameters and the price is dependent on Bid/Offer spread of the spot rate, forward rate, implied volatility; along with administrative costs; transaction handling charges.

An illustration of how the product works

User sells USD Call/INR Put at strike price for agreed expiry day/delivery day against its USD receivables

On expiry day, if the USDINR spot rate is –
(1) Below strike price, User sells USD at market spot rate
(2) Above strike price, User sells USD at strike price

Pay-off profile (Sold Call + Unhedged Underlying):



Impact Analysis

Option: Covered Call
Spot at the time of deal: 73
Strike Price: 75
Option Premium: 1

Spot at Expiry	Sell price if Unhedged	Option Payoff	Option Payoff net of Premium	Net Selling Price
73	73	0	0	73
74	74	0	0	74
75	75	0	0	75
76	76	-1	0	76
77	77	-2	-1	76
78	78	-3	-2	76
79	79	-4	-3	76

Benefits

It allows user to receive upfront premium and also participate in INR depreciation till sell call strike price for the unhedged portion of its exposure

Risks

(1) The strategy caps the upside gain on the underlying if spot on maturity is above sell call strike, however, it does not mitigate the currency risk and has unlimited downside risk in case spot is below the strike price
(2) Bid-offer spreads in case of unwind
(3) Liquidity risk

The terms and conditions applicable for booking/termination will be guided by deal term sheet/sanction letter/ISDA document