<u>FX Forward and LTFX Contract</u>

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 hedging needs and to facilitate comparison with other products.

Features

A forward contract is a customized Over The Counter (OTC) contract between two parties to buy or sell an asset at a specified price on a future date. The non-standardized nature of forward contract along with simplicity and linear payoff makes it widely used instrument for hedging. The forward contract comprises of spot and forward premium (depending on the tenor of the contract).

Forward Rate = Spot Rate + Forward Premium

Forward premium can be negative as well depending on the interest rate of both currencies.

Any forward beyond 13 month tenor is known as a Long term Forward (LTFX).

Illustration:

For a receivable/payable underlying in USD where INR is domestic currency, user (exporter/importer) sells/buys USD INR forward for a future date.

The underlying exposure for this product is a USD receivable/payable. User is exposed to risk of INR appreciation/depreciation against USD resulting in lower/higher INR realization/payable. The export/import side forward acts as a hedge against INR appreciation/depreciation and offsets the payoff of the standalone underlying.

For USDINR currency pair, the exporter receives forward premium and the importer pays forward premium.

<u>Building Blocks:</u>

The building blocks of this foreign exchange forward are as below:

a. Spot FX rate,
b. Difference in applicable interest rate of both currencies

c. Time to maturity
d. Currency Basis, which is determined by demand/supply for forward dollars

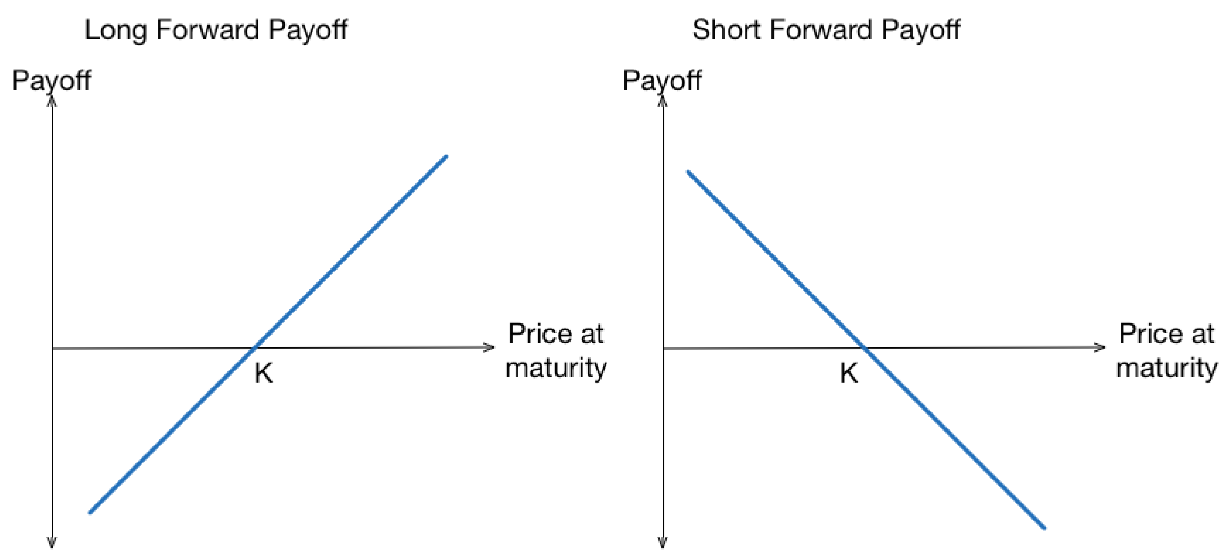
Costs and fees, including break-up and details

The forward rate 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 and interest rate differential along with administrative costs, capital charge and transaction handling charges.

An illustration of how the product works

User (exporter/importer) sells/buys USD INR forward at forward price for agreed contracted rate on maturity day.

Pay-off profile:



K is the forward contracted rate
Long means buying the asset and short means selling the asset

Impact Analysis

Forward: Sell USD INR
Spot at the time of deal: 73
Forward Rate: 75

Spot at Maturity	Sell price if Unhedged	Sell price due to forward	Forward Payoff
70	70	75	+5
71	71	75	+4
72	72	75	+3
73	73	75	+2
74	74	75	+1
75	75	75	0
76	76	75	-1
77	77	75	-2
78	78	75	-3
79	79	75	-4
80	80	75	-5

Forward: Buy USD INR			
Spot at the time of deal: 73			
Forward Rate: 75			
Spot at Maturity	**Buy price if Unhedged**	**Buy price due to forward**	**Forward Payoff**
70	70	75	-5
71	71	75	-4
72	72	75	-3
73	73	75	-2
74	74	75	-1
75	75	75	0
76	76	75	+1
77	77	75	+2
78	78	75	+3
79	79	75	+4
80	80	75	+5

Benefits

Under this transaction, User (exporter/importer) sells/buys a forward contract that entitles it to a contracted price to sell/buy USD against INR. If INR appreciated/depreciated, user receivables/payables is protected at the contracted price. This ensures hedging for the user and protects the user against adverse market movements. This will crystallize the future cash flow.

Risks

(1) User is fixing its receivable/payable rate in case of an exporter/importer respectively. Market rates can be better at maturity date (i.e USDINR rate being higher/lower compared to rate at which forward contract was entered into)
(2) Bid-offer spreads in case of unwind

Terms and Conditions

The terms and conditions applicable for booking/termination will be guided sanction letter/forward confirmation/Forward contract declaration/ISDA

Risk Disclosure Statements:

Various risks in the transaction have been set out while describing the transaction, providing scenarios, impact or sensitivity analysis. All statements, whether mentioned as risks or not but are likely to adversely impact the user in its own assessment shall be considered as risk disclosed to it. The risks have been disclosed basis the Bank's understanding of the markets and scenarios as they exist as on date. The user confirms the suitability of the Transaction for itself given the nature of its business/trades. The risks set out hereunder are in addition to those disclosed in the product disclosure statement.

1) Description of the Transaction

A forward contract is a customized Over The Counter (OTC) contract between two parties to buy or sell an asset at a specified price on a future date. The non-standardized nature of forward contract along with simplicity and linear payoff makes it widely used instrument for hedging. Any forward beyond 13 month tenor is known as a Long term Forward (LTFX).

2) Purpose & Rationale of the Transaction

The underlying exposure for this product is a FCY receivable/payable. User is exposed to risk of INR appreciation/depreciation against FCY resulting in lower/higher INR receivable/payable. The export/import side forward acts as a hedge against FCYINR spot rate going lower/higher than the spot price by locking his rate at the prevalent forward rate.

3) Scenario Analysis

All analysis is from user's perspective.

1. The scenarios are not exhaustive and the values of these market parameters may be higher or lower than the range of values given below

2. In case the user wishes to know the payoff for any specific scenario, the user can contact the Bank for the same
3. The standalone hedge may result in unlimited liability

P&L Scenario from User perspective

Maturity Date	10-Mar-23
Forward Contract Type	USD sell
Amount (in USD)	100,000
Contracted Rate	78.7
Spot on maturity	**P&L in INR**
74	470,000
75	370,000
76	270,000
77	170,000
78	70,000
79	(30,000)
80	(130,000)

4) Sensitivity Analysis:-

The key parameters that affects the valuation of this hedge are-

(1) Spot FX rate,
(2) Difference in applicable interest rate of both currencies
(3) Time to expiry
(4) Currency Basis, which is determined by demand/supply for forward dollars

Variable	Movement	Impact on Unwind of sell (export) forward	Impact on Unwind of buy (import) forward
Spot	Increases	Negative	Positive
	Decreases	Positive	Negative
Forward Premium (function of interest rate differential)	Increases	Negative	Positive
	Decreases	Positive	Negative

Please note that:
1. This is generally, but not necessarily the direction of valuation change.
2. These changes cannot be extrapolated for large shifts

3. This sensitivity analysis is only for important but limited market variables and assumes other variables are constant

5) Other Disclosures:

a) This Product Disclosure Statement and Risk Disclosure Statement will be applicable to all the transactions done with the bank on this product and the user is advised to refer to these before dealing in each such transaction
b) The user has to assess and be satisfied on the Transactions' suitability, inherent risks, merits and any tax, legal and accounting implications, which it may have before entering into a transaction
c) The user should have the necessary knowledge and skill to understand the nature, pricing and risks of the Transaction
d) The user should execute transactions in accordance with its internal risk management policy;
e) Kotak Mahindra bank is not acting as a fiduciary for or an adviser to the user