Range Forward

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.

Range Forward for FCY Receivable

Features

Exporter range forward is a combination of options that allows the user to create a forward contract with a range of exercise prices through two different market positions. The user buys a PUT option which gives it a right, but not an obligation, to sell an underlying at a specified price (strike price of the PUT) at a specific time period and pays upfront premium for the same. At the same time the user sells a CALL option in which it takes on an obligation to sell the underlying to the buyer of the call option should they exercise their right to buy, at the same specific time period at a specified price (strike price of the CALL) and receives premium for the same. In an exporter range forward the strike price of the CALL is higher than the strike price of the PUT. This derivative product can be used to hedge FCY receivables. This is usually zero premium structure.

Illustration:
For a receivable underlying in USD where INR is domestic currency, user enters into an Exporter Range forward contract

The underlying exposure for this product is a USD receivable. User is exposed to risk of INR appreciation against USD resulting in lesser INR realization. The exporter range forward acts as a hedge against USDINR spot rate going lower than strike price of the put while at the same time capping the upside favorable movements at a certain strike in case USDINR spot rate is higher. In other words, the USDINR rate gets bounded in the range between the strike prices of the put and the call. Under this product user pays an upfront cost to purchase the put option while it receives premium for selling the call option. On a net basis, premium can range from zero to payable by user.

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

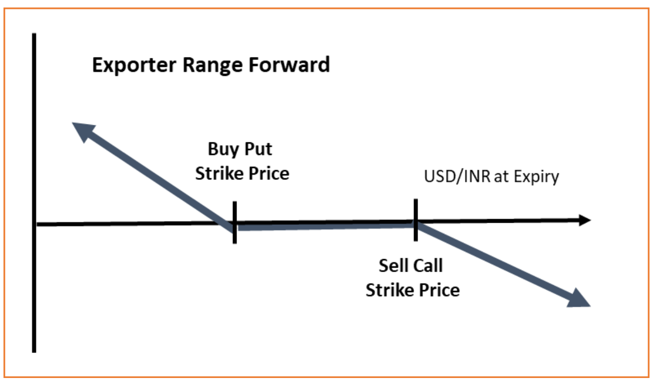
The option cost consists of market cost which is determined through a financial model taking above building blocks as input parameters and the price is dependent on Bid/Offer spread of the spot rate, forward rate, implied volatility; along with administrative costs; and transaction handling charges.

An illustration of how the product works

User enters into an exporter range forward contract to buy USD Put/ INR Call at a certain strike price while at the same time selling a USD Call/INR Put at a higher strike price for an agreed expiry day/delivery day

On expiry day, if the USDINR spot rate is –
(1) Below strike price of the BUY PUT, User sells USD at the strike price of the PUT
(2) In between the strike prices of BUY PUT and SELL CALL, User sells USD at the spot market rate
(3) Above strike price of the SELL CALL, User sells USD at strike price of the CALL

Pay-off profile:



Impact Analysis

Exporter Range Forward
Option: Buy Put @ Strike Price: 73
Option: Sell Call @ Strike Price: 75
Option Premium Payable: 1
Option Premium Receivable: 1
Net Option Premium: 0
Spot at the time of deal: 74

Spot at Expiry	Sell price if Unhedged	Option Payoff	Option Payoff net of Premium	Net Selling Price
71	71	2	2	73
72	72	1	1	73
73	73	0	0	73
74	74	0	0	74
75	75	0	0	75
76	76	-1	-1	75
77	77	-2	-2	75

Benefits

Under this transaction in case of unfavorable INR appreciation, user receivable is protected at the strike price of the put. If INR depreciates, user benefits up to a certain range while benefiting from nil/lower upfront premium cost on account of the premium received from the sell CALL.

Risks

(1) In case of premium paid exporter range forward, option expiring without getting exercised, effectively reducing INR realization compared to unhedged transaction on account of option premium paid
(2) Liquidity risk
(3) Bid-offer spreads in case of unwind

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

Range Forward for FCY Payable

Features

Importer range forward is combination of options that allows the user to create a forward contract with a range of exercise prices through two different market positions. The user buys a CALL option which gives it right, but not an obligation, to buy an underlying at a specified price (strike price of the CALL) at a specific time period and pays upfront premium for the same. At the same time the user sells a PUT option in which it takes on an obligation to buy the underlying from the buyer of the put option should they exercise their right to sell, at the same specific time period at a specified price (strike price of the PUT) and receives premium for the same. In an importer range forward the strike price of the CALL is higher than the strike price of the PUT. This derivative product can be used to hedge FCY payables. This is usually zero premium structure.

Illustration:
For a payable underlying in USD where INR is domestic currency, user enters into an Importer Range forward contract

The underlying exposure for this product is a USD payable. User is exposed to risk of INR depreciation against USD resulting in higher INR outflow. The importer range forward acts as a hedge against USDINR spot rate going higher than strike price of the call while at the same time capping the downside favorable movements at a certain strike in case USDINR spot rate is lower. In other words, the USDINR rate gets bounded in the range between the strike prices of the put and the call. Under this product user pays an upfront cost to purchase the call option while it receives premium for selling the put option. On a net basis, premium can range from zero to payable by user.

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

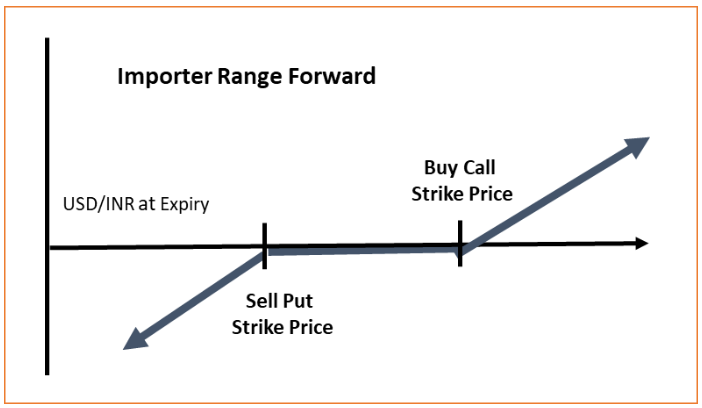
The option cost consists of market cost which is determined through a financial model taking above building blocks as input parameters and the price is dependent on Bid/Offer spread of the spot rate, forward rate, implied volatility; along with administrative costs; and transaction handling charges.

An illustration of how the product works

User enters into an importer range forward contract to buy USD Call/ INR Put at a certain strike price while at the same time selling a USD Put/INR Call at a lower strike price for an agreed expiry day/delivery day

On expiry day, if the USDINR spot rate is –
(1) Below strike price of the SELL PUT, User buys USD at the strike price of the PUT
(2) Above strike price of the BUY CALL, User buys USD at strike price of the CALL
(3) In between the strike prices of SELL PUT and BUY CALL, User buys USD at the spot market rate

Pay-off profile:



Impact Analysis

Importer Range Forward
Option: Buy Call @ Strike Price: 75
Option: Sell Put @ Strike Price: 73
Option Premium Payable: 1
Option Premium Receivable: 1
Net Option Premium: 0
Spot at the time of deal: 74

Spot at Expiry	Buy price if Unhedged	Option Payoff	Option Payoff net of Premium	Net Buying Price
71	71	-2	-2	73
72	72	-1	-1	73
73	73	0	0	73
74	74	0	0	74

75	75	0	0	75
76	76	1	1	75
77	77	2	2	75

Benefits

Under this transaction in case of unfavorable INR depreciation, user payable is protected at the strike price of the call. If INR appreciates, user benefits up to a certain range while benefiting from lower upfront premium cost on account of the premium received from the sell PUT.

Risks

(1) In case of importer range forward, option expiring without getting exercised, effectively increases cost compared to unhedged transaction on account of option premium paid
(2) Liquidity risk
(3) Bid-offer spreads in case of unwind

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