MBH BANK

Currency Option

The key parts of the product:

A foreign exchange option is an agreement that, in consideration of payment of an option premium, provides the buyer the right to buy or sell, according to the nature of the option, a specific amount of foreign currency for another currency at a predetermined price at a predetermined time.
In return of the option premium, the buyer of the option can eliminate his exchange rate risk, but does not have to forego the benefits of any favourable exchange rate movements.

Who is it for?

- Those who expect the market rate at maturity to be significantly more favourable than the forward rate at the time of the transaction, but want to limit their exchange rate risk.
- Anyone who has a specific exchange rate level compared to which they do not wish to convert at a worse level, but would like to benefit from a favourable movement in the exchange rate.

Benefits:

- The buyer of the option receives the unlimited benefits of favourable price movement.
- Exchange rate risk is limited, the worst possible exchange rate is known in advance and can be calculated.

Disadvantages:

- The buyer of the option pays an option premium to the seller.
- For the option seller, the option premium is the maximum profit, but the potential loss is unlimited.

Key elements of a currency option agreement:

Currency pair:	The currency pairs to be bought and sold.
Amount:	Minimum amount of €100 000, which can be specified in the currency denomination to be bought or sold.
Maturity:	Typically, the deal can be concluded for a period of T+3 days up to T+1 year.
Expiration:	The future date later than the spot value date (T+2) when the buyer of the option can exercise his option right, i.e. when he can exercise the option (usually at 16:00, 12:00 for options against HUF).
Settlement date:	Second business day following the date of exercise of the option, the date of financial settlement of the conversion.
Option price (Strike rate)	The rate at which the option buyer has the right to make the conversion.

Option type	**The buyer of a call option** has the right to purchase the quoted currency at the option price from the option seller. **The buyer of a put option** is entitled to sell the quoted currency at the option price to the option seller
Exercise type:	The right to exercise options can only be exercised on the expiry date, i.e. currency exchange options are of European type.
Premium or option fee:	The price of the currency option, expressed as a percentage of the currency amount or in exchange rate points, payable at the time of trade.

Components of the option price:

- **Intrinsic value,** which shows the profit content of the option under current market conditions. An option has a profit content ("in the money") only if the option price is more favourable (lower for put option, higher for call option) than the current forward rate for the expiry of the option. Otherwise, the option has no intrinsic value, that is, "out of the money".

- **The time value** determines the probability that the price will move in the favorable direction over the life of the option.
  The time value is greater
  - the longer the time remaining until the option expires
  - the greater the fluctuation (volatility) of the currency pair
  - the closer the forward price calculated for the expiry of the option is to the option price for an "out of the money" option

Conditions for entering into a currency exchange option:

  - Master Agreement for entering into derivatives contracts outside an exchange or other regulated market
  - MIFID suitability test and EMIR related statements
  - valid LEI code
  - HUF account
  - Freely available treasury limit and collateral according to the initial margin requirements of the master agreement and general terms of business.
- Minimum trade amount equivalent to 100 000 euro per transaction.

Settlement, exercise of option rights

It is worthwhile to exercise an option if the spot price at expiry is higher than the strike rate in the case of a call option and lower than the strike rate in the case of a put option. Otherwise, the buyer will not exercise his option and will convert at the more favourable spot market rate.
In all cases, the Client is obliged to contact the Bank between 9 a.m. and 12 noon in the case of HUF options and 4 p.m. in the case of other options on the expiry date.

1. If the Client is the buyer of the option and exercises the option, he has the following alternatives:

    a) If you have sufficient funds for conversion, you may request that the Bank convert it into the countercurrency on the date of settlement.

b) If you do not have collateral or have it but do not wish to convert it, you can enter into a closing trade in the opposite direction to the option as a value date for the settlement date. On the settlement date, the Bank shall settle the result of the exchange rate difference.

c) If you exercise the option but do not have collateral and do not conclude a closing transaction by 12 noon on the settlement day, the Bank will close the open position at its officially announced bid or ask rate (depending on the direction of the open position) and settle the result of the exchange rate difference.

d) If the profit that can be realised by exercising the option at expiry is clearly more than 1%, i.e. the price is more than 1% higher in the case of a call option and more than 1% lower than the strike price in the case of a put option, and you have not exercised the option (nor indicated that you do not wish to exercise it), an automatic exercise will occur. Automatic exercise means that the Bank closes out the option as described in the previous point and credits the profit to the Client's settlement account on the settlement date.

2. If the Bank has a right of withdrawal and wishes to exercise it, it shall notify the customer on the expiry date. If notification is not possible at any of the contact details provided by the Client, the Bank will exercise the option and notify the Client thereof. The Client may decide to deliver the amount purchased by the Bank or to enter into a closing transaction. In the absence of delivery or closing transaction, the Bank shall close out the option as described in paragraph 1(c) and settle the difference on the settlement date.

Example for importers

Your company has incurred a payment obligation of EUR 100 000 due in 3 months from your foreign supplier. You expect a significant fall in the exchange rate, but based on your calculations, an increase in the exchange rate would be a big burden for your company. The spot rate is 392 HUF and the forward rate for 3 months is 395 HUF. At level 396.50, you purchase a right to buy €100 000 and pay an option fee of €1 300. If at maturity the market rate is

- above 396.5, you exercise your option and buy the euro at 396.5.
- below 396.5, you do not exercise your option and buy the euro at market price.

Example for exporters

In 1 month, your company will generate 100 000 euros in revenue, a foreign buyer will transfer the price of goods sold by you. You expect the exchange rate to rise significantly, but based on your calculations, a fall in the exchange rate would be a big burden for your company. The spot rate is 392 HUF, the forward rate for 1 month is 392.80 HUF. At level 391, you buy a right to sell €100 000 and pay an option fee of €1 000. If at maturity the market rate is

- below 391, you exercise your option and sell the euro at level 391.
- above 391, you do not exercise your option and sell the euro at market price.