MBH BANK

Zero Cost FX Collar

The key parts of the product

A zero-cost FX collar is a cost-free currency risk hedging instrument whereby our Client agrees a minimum and a maximum exchange rate level with the Bank for the future exchange of a specific amount of foreign currency.

- If at maturity the market rate is between these two levels, our Client may convert at the current market rate and no obligation arises from the transaction.
- If at maturity the market rate is lower than the minimum level, the conversion will be made at the minimum level.
- If, at maturity, the market rate is higher than the maximum level, the conversion is made at the maximum level.

In contrast to a forward exchange contract, the parties do not fix a specific exchange rate, but a range of exchange rates, so our Client is subject to a limited extent to both positive and negative movements in the exchange rate. The forward rate at the time of the transaction will always fall between the minimum and maximum levels. The distance between the minimum and maximum levels is determined by the Client, but in general a range of 2% is more conservative relative to the exchange rate, while a range of 5% is more risky.

Who do we recommend this product to?

- To those, who expect the market rate at maturity to be more favourable than the forward rate
- To those, who are willing to take a limited amount of exchange rate risk

Advantages:

- Cost-free hedging instrument, no option premium is paid to either party.
- Our client has a limited exposure to favourable movements in the exchange rate.
- The most unfavourable exchange rate at which the conversion will take place is known in advance.

Risks:

- In the event of an unfavourable directional exchange rate movement, our Client will convert at a level less favourable than the forward rate prevailing at the time of the transaction.

Key elements of a zero-cost option agreement:

Currency pair:	The currency pairs to be bought and sold
Amount:	minimum commitment amount of 100 000 euro per transaction, which can be specified in the currency to be bought or sold.
Maturity:	Typically, transactions can be concluded for a period of T+3 days to 1 year.
Expiration:	The future date later than the spot value date at which the buyer of the option can exercise his option right, i.e. exercise the option (usually at 4 p.m., or 12 p.m. in the case of options against forint).
Settlement date:	The second business day after the option exercise date, the date of financial settlement of the conversion.

Option rates:	The strike price of the call option gives the maximum level, while the strike price of the put option gives the minimum level at which the buyer of the option has the right to convert.
Type of zero-cost option:	In the case of a **zero-cost option with a call direction**, our Client acquires a call right at the maximum level (buys a call option) and a call obligation at the minimum level (sells a put option) for a specific amount of foreign exchange and on a predetermined date. In the case of a **zero-cost put option**, the Client acquires a put right at the minimum level (buys a put option) and a put obligation at the maximum level (sells a call option) for a specific currency amount and a predetermined date.
Exercise type:	The option can only be exercised on the expiry date, i.e. currency options are of the European type.
Option premium:	The zero-cost option structure consists of a currency option bought and a currency option sold. The price of the two options is the same, so neither party pays an option premium at the time of the transaction.

Calculation of zero-cost option rates:

A zero-cost option is always a combination of a call and put option of equal value, so the option premiums payable for the option bought and the option premiums payable for the option sold offset each other. Consequently, for each minimum level there is a specific maximum level and vice versa. A lower minimum level is associated with a higher maximum level, i.e. the range between the two levels increases, and with it the risk assumed.
In all cases, the forward price at the time the trade is concluded and quoted on the expiration date of the option falls within the range defined by the minimum and maximum levels.

The conditions for concluding a zero-cost option agreement:

- 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 the option

In the case of a zero-cost option, three outcomes are possible, depending on the price at expiration:

1. The exchange rate is above the maximum level, so the call option buyer exercises the option and buys the currency at the maximum level.
2. The exchange rate is between the maximum and the minimum level, neither option is exercised and the client can convert at the current market level if required.
3. The exchange rate is below the minimum level, so the buyer of the put option exercises the option and sells the currency at the minimum level.

Drawdown and settlement are carried out in accordance with the simple foreign exchange option product description.

Example for importers

Your company will have to pay €200 000 in 3 months. The spot exchange rate is 391,00 and the forward strike rate is 394.10. By taking out a zero-cost option, you have the opportunity to buy euros at a more favourable level than the forward rate, but you are only protected if the forint weakens.

EUR/HUF Spot rate	391.00
Bottom rate-level	**389.00**
Top rate-level	**405.00**

The following outcomes are possible:

- If, after 3 months, the exchange rate is below the lower band, i.e. 389.00, the transaction will be settled at the forward strike price of 389.00, irrespective of the current exchange rate (by delivery or close-out by an opposite transaction).
- If, after 3 months, the exchange rate is between the two bands, i.e. above 389.00 but below 405.00, you can convert your euro into forint at the current market rate.
- If, after 3 months, the exchange rate is above the upper band, i.e. 405.00, the transaction will be settled at the forward strike price of 405.00, regardless of the current exchange rate (by delivery or clouse-out by an opposite transaction).

Example for Exporters

Your company expects to earn €200 000 from a foreign customer in 6 months. The spot rate is 370.50 and the forward strike rate is 371.35. You fear a strengthening of the forint, but you do not expect a significant weakening of the forint, so you enter into a zero-cost option. By entering into a zero-cost option, you have the possibility to sell the euro at a level more favourable than the forward rate, but you are only protected against a strengthening of the forint at a level less favourable than the forward rate.

EUR/HUF Spot rate	391.00
Bottom rate-level	**396.00**
Top rate-level	**405.00**

The following outcomes are possible:

- If, after 6 months, the exchange rate is below the lower band, i.e. 396.00, the transaction will be settled at the forward strike price of 396.00, regardless of the current exchange rate (by delivery or clouse-out by an opposite transaction).
- If, after 6 months, the exchange rate is between the two bands, i.e. above 396.00 but below 405.00, you can convert your euro into forint at the current market rate.
- If, after 6 months, the exchange rate is above the upper band, i.e. 405.00, the transaction will be settled at the forward strike price of 405.00, irrespective of the current exchange rate (by delivery or close-out by an opposite transaction).