

Tailoring Options to suit your needs

How can I tailor these options? What can I change to affect the available terms?

Protection Rate

As a general rule, the more favourable the protection rate, the less upside potential there will be and vice versa.

types of option exclusively will leave the buyer either under or over-hedged. These option types also have a significantly less favourable mark to market profile than other hedge products, greatly increasing the chances of having to meet a margin call.

Participation percentage

A standard Knock In option permits 100% participation up to the barrier rate. By switching to a Knock In Participator which only permits 50% participation, the barrier rate and/or the Protection rate can be improved. All options that offer 100% protection will have a less favourable protection rate than an equivalent forward; however, as the participation percentage is reduced – i.e. the more like a forward the option looks – the closer to the Forward Rate the Protection Rate will get.

Lower protection
vs Obligation ▼



▲ Higher
protection rate

Participation ▲



▼ Lower
protection rate

Participation ▼



▲ Higher
protection rate

Protected Amount

Reducing the Protected Amount in comparison to the potential Obligated Amount will enhance the Protection Rate and/or amount of potential Participation. Known as Leverage, dealing these

Duration

This measure is less straightforward as the effect of varying the duration depends on the underlying Option structure.

As a general rule, products where a significantly higher underlying rate produces a better outcome, such as uncapped upside products like the Vanilla or the Participator, will have more favourable protection rate terms in the short term and less favourable terms over the longer term.

Products which have a potentially detrimental outcome if the rate moves too far, such as those with knock-in barriers or Leveraged Products, will price better in the long term, but less so in the short term.

The reason for the above has to do with the relative value of the protection you are buying against the value of the potential obligation that you are selling. If the terms you are being quoted are not quite what you are looking for, you should ask whether altering the duration will have a positive effect. Sometimes adding a month or two to the start or end of an option strip can have a significant effect on the overall terms.

Initial Option Quote

Increase Obligation to Improve initial Protection/Participation

Alter the duration to improve terms. Longer if a Knock In or Leveraged Type, Shorter if a Vanilla or Participator Type

Decrease Participation Percentage to Improve Protection Rate

Lower Protection Rate to increase Participation

The diagram above shows the ways of amending the terms or flexing an Option and the associated risk level



Decreasing the participation percentage

This makes the Option more like a Forward Contract and improves the protection rate. Doing this reduces the risk (and potential benefit) of the Option.



Lowering the protection rate to increase participation

This makes the option less like a forward contract by worsening your protection rate in exchange for a greater potential benefit. As your outcome will be less favourable if the market moves against you, this increases your risk – although not necessarily by a significant amount.



Altering the tenor of an Option

Looking at hedging four months' risk instead of three, or starting your hedge sooner, reduces your risk in the market and potentially improves the Option terms available, without changing the risk profile of the Option itself.



Adding leverage

By doing this you are reducing your Protection relative to your potential obligation. It will improve the initial terms on offer but will worsen the potential outcome if the market moves adversely. This is the riskiest way of flexing an option structure and is not appropriate for all customers. Ask your Hedging Manager to explain more.

Please refer to the **Product Disclosure Statement** for information on our full range of option structures. This can be found at business.westernunion.com/compliance-legal

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Business Solutions

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