

Zero-Cost/Zero-Cash Cylinders for currency sellers

The situation

You are in business exporting to Europe and you will be receiving payments in Euros in the next 6 months. You are happy with the current exchange rate, but you think the Euro will gain value during the period and you do not want to commit yourself today to a fixed forward rate for the future. You have thought about an FX Option, which would be very suitable for your situation, but you are unwilling to pay the up front cash premium.

The product

A Zero-Cost Cylinder might be the answer in your situation. A Zero-Cost Cylinder involves buying a Euro Put Option and selling a Euro Call Option. By buying a Euro Put Option you protect yourself against the Euro becoming much weaker. The Euro Put Option gives you the chance to make unlimited 'windfall' gains when the Euro is strong. You can choose to give up some of this possible windfall by selling a Call Option to us at a set level, which would allow the bank to buy your Euro's at this improved price. When the Call Option you sell has the same value as the Put Option you buy, this is known as a Zero-Cost Cylinder.

The solution

You want to protect the USD value of the Euros you will receive in the next 6 months - in total US\$1 million. The forward rate is .90 but you have budgeted for a rate of .87 and it is this level you want to protect. You arrange a Zero-Cost Cylinder with us. The Zero-Cost Cylinder involves you buying a Euro Put Option at .87 (allowing you to sell your Euros to us at this rate and protecting your budget target) and you selling a Euro Call Option to us at .93. Your firm then has to sell Euro to us at .93 if this rate is reached.

This means a possible improvement of 3 cents, but you may no longer benefit from any strength in the Euro beyond .93. The value of the option sold is the same as the value of the option you have bought. This involves no up front cost and guarantees that you can sell your Euros at some price between .87 and .93.

The benefits

- The cylinder offers you some protection when the Euro is particularly weak.
- The cylinder allows you to benefit when the Euro is strong.
- You do not need to pay an up front cash premium.
- You can reverse the cylinder at any time.

Features

- We provide Zero-Cost Cylinders for all currencies that can be exchanged for USD
- The cylinder is available for most maturities - but generally no longer than 12 months.
- We can change the structure slightly so that the option you sell has a greater or lesser value than the option you buy. A cylinder is still created but you may have to pay a small premium or you may receive a small premium.