

Average Rate Option for Currency Sellers

Product Description Sheet

Customer Treasury Services UK



Your view anticipates exchange rate uncertainty ✓	Rate protection with this product ✓	Cost paid as a premium ✓
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The product – in brief

Features

An Average Rate Option is a product that gives the holder the right but not the obligation to hedge against an adverse currency move at a pre-determined strike rate, which is compared to the average of an agreed number of future spot fixings, to determine a settlement outcome. The option is settled on a cash settled basis.

Average rate options are typically purchased for daily, weekly or monthly time periods but this product can be customised to suit specific dates and amounts in all major currencies. Active periods for options commence and finish at 10am New York time as per market convention, unless otherwise stated.

You can sell a purchased option back to the bank before expiration and receive any residual value.

Scenario

Your company has a currency exposure arising every month for the next three months.

You believe that the spot rate may trade at levels beneficial to your business over the course of the period and you want to take advantage of such a move. You also want a degree of rate protection should the spot rate trade at levels detrimental to your business.

Action

You purchase a three month Average Rate Option at an agreed strike rate.

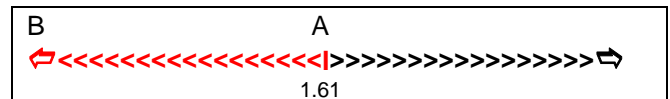
You will also have to sell your underlying currency requirement in the spot market during the hedging period, as the option product will not deliver currency but will only provide a cash settled hedge.

When evaluating this product you must incorporate the cost of the premium and whether the average rate hedge is appropriate for your underlying risk exposure.

How does the product work?

Example: GBP Buyer USD Seller

- 1) You pay up front premium to purchase a three month Average Rate USD Put Option with a strike of 1.6100. On an agreed date, every month for the three months, a spot fixing is recorded. At expiration, the average of the spot rate fixings will be compared to your strike rate.
- 2) If the average rate calculated is less favorable than the strike rate, the bank will cash settle the difference with the customer.
- 3) If the average rate calculated is more favorable than the strike rate, the option expires worthless and no payment is made.
- 4) Area between A and B (below) highlights the range of your possible achieved rate.



- A. Option Strike Rate
- B. Best Case Rate - Unlimited

Potential outcomes at expiration in three months time

Outcome (1)

The average of the three spot fixings is above 1.6100. You exercise your option and the bank will compensate you for the difference between 1.6100 and the average.

Outcome (2)

The average of the three spot fixings is below 1.6100. Your option expires unutilised. It will mean that the average spot price over the period was better than the strike price.

If you do not sell your underlying spot exposure at the option spot fixings, your hedge rate may be worse than the option strike rate.



Do not use this product if:

The use of this structure is out of line with your company's treasury policy.

You do not have the underlying commitment outlined in this structure.

You do not understand the benefits/risk of this structure.

In the worst case scenario, you cannot forego rate gains and endure any potential loss embedded in this structure.

Products to consider

Below are a number of FX products for your consideration when evaluating FX risk.

Average Rate Option
Cylinder Option
Foreign Exchange Option
Foreign Exchange Swap
Forward Contract
Forward Extra
Participating Forward

For further details on these products refer to the relevant product description sheet.

Note: Rates are based on indicative mid-rates at the time of production and for illustration purposes only.

Other issues to consider

The Bank may require confirmation as to the capacity of an entity to enter into particular treasury transactions. The requirements will vary depending on the type of entity involved and its place of incorporation. For example, for entities incorporated in overseas jurisdictions, a legal opinion which confirms capacity to enter into treasury transactions may be required. For certain companies, the Bank may require that the entry into treasury transactions is included as a specific object in the memorandum of association. These requirements can be discussed with you.

Having considered these points, your Treasury Relationship Manager at Customer Treasury Services UK would be pleased to discuss any queries you may have and also to offer you a competitive price should you wish to proceed.

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