

➔ 2. accrual deposit

MIFID complexity

careful

The accrual deposit is a possible alternative to regular term deposits. This investment gives you an opportunity to achieve higher interest than in a regular term deposit if your exchange rate expectations prove to be right, while enjoying guaranteed minimum interest (and the repayment of your capital on expiry). Both capital and interest will be paid in the same currency as in which the deposit was made, and changes in the exchange rates will have a bearing only on what interest is accrued.

product description

A client places a deposit with a bank. The interest paid on this deposit is determined as a function of the evolution of the cross exchange rate between two specific currencies (one of them being the currency in which the deposit was made). If the exchange rate remains within the range defined on concluding the deal for a longer period of time, then interest above the regular term deposit interest is achievable. Every day, the bank will inspect whether on the given day the official daily fixing rate quoted by the National Bank of Hungary (or the European Central Bank, up to the client's choice) is within the range specified when the deposit was made. If the fixing rate is within the range, then the bank pays enhanced interest for that day, but for the rest of the days only the minimum interest rate is guaranteed.

interest rate premium's conditions can be the following:

- within the exchange rate range fixed on the trade day, without touching the range limits
- out of the exchange rate range fixed on the trade day, without touching the range limits
- below the exchange rate level fixed on the trade day
- above the exchange rate level fixed on the trade day

Based on the above, your investment can yield high interest not only if the exchange rate is less volatile but also by large exchange rate fluctuations or when it evolves in the direction you predicted.

The client will receive 100% of the capital back on expiry in every case, in the same currency as in which the deposit was made. The deposit will not be broken before the end of the investment period (security deposit), the interest is paid on the end of the tenor in one sum.

This product has a variant in which not only one exchange rate condition is defined. In that case you can have different interest rate premiums tied to different conditions.

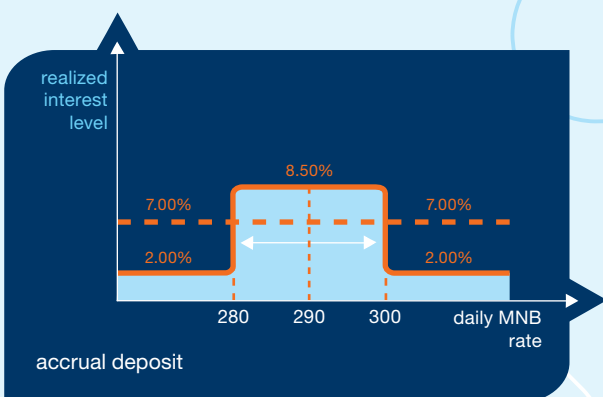
example HUF investment – premium interest accrued on days when the exchange rate is inside the range: an investor has HUF 100 million, which he intends to deposit for the next three months. The regular market interest rate for three-month term deposits is 7% per annual. The spot EUR/HUF rate is 290, and the investor in question does not expect the exchange rate to fluctuate widely in the coming three months. He is of the opinion that over the term of the deposit, the official EUR/HUF exchange rate quoted by the NBH will not leave (for long) the range between 280-300. He would like to turn this prediction into an extra yield, but by no means would he accept an interest less than 2%. Therefore, he places an accrual deposit which pays 8.50% interest for the days when the fixing rate is within the range and the 2% is guaranteed for each day during the tenor.

possible outcomes on expiry

number of days, when NBH's fixing is within the pre-defined range	realised interest rate in case of a range accrual deposit (%)	realised interest rate in case of a standard deposit (%)
30	4.17	7.00
60	6.33	7.00
90	8.50	7.00

parameters of the range accrual deposit

notional	HUF 100 000 000
tenor	3 months
expiry date	end of tenor
exchange rate monitoring period	one banking date before end of tenor
number of fixing days	90
3-month BUBOR at time of pricing (annualised)	7.00%
spot exchange rate	290 EUR/HUF
ATMF volatility	10.00%
EUR/HUF exchange rate range	280 – 300 EUR/HUF
maximum interest (annualised)	8,50%
minimum interest + premium	8.50%
condition to payment of maximum interest	the NBH's official EUR/HUF exchange rate does not leave the range on any business day during the tenor
premium	6.50%
minimum interest (annualised)	2.00%
interest income (annualised)	$6.50\% * (N/90) + 2.00\%$ where N = the number of days when the NBH fixing rate stays within the EUR/HUF range during the tenor. In the case of weekends and holidays, the fixing rate of the preceding business day will be taken into account. If the fixing rate is exactly the same as either boundary of the range, the minimum interest will be paid.
transaction charges	none



example of the accrual deposit – in case of more exchange rate levels: an investor has HUF 100 million, which he intends to deposit for the next three months. The regular market interest rate for three-month term deposits is 7% p.a. The spot EUR/HUF rate is 290, and the investor in question does not expect forint depreciation in the coming three months. He is of the opinion that over the term of the deposit, the official EUR/HUF exchange rate quoted by the NBH will not be (for long) above 290 and 295. He would like to turn this prediction into an extra yield, but by no means would he accept an interest less than 2%. Therefore, he places an accrual deposit which pays 4% interest for the days when the fixing rate is between 290-295, and 10% interest for the days when the fixing rate is below 290, while the 2% minimum interest is guaranteed for the rest of the days.

possible outcomes on expiry

number of days, when NBH's fixing is below 290	number of days, when NBH's fixing is above 290, but below 295	realised interest rate in case of a range accrual deposit	realised interest rate in case of a standard deposit
90	0	10.00%	7.00%
30	30	5.33%	7.00%
0	90	4.00%	7.00%

parameters of the range accrual deposit	
notional	HUF 100 000 000
tenor	3 months
expiry date	end of tenor
exchange rate monitoring period	one banking date before end of tenor
number of fixing days	90
3-month BUBOR at time of pricing (annualised)	7.00%
spot exchange rate	290 EUR/HUF
ATMF volatility	10.00%
exchange rate condition of maximum interest	290 EUR/HUF
maximum interest (annualised) minimum interest + premium	10.00%
condition to payment of maximum interest	the NBH's official EUR/HUF exchange rate is not above 290 on every day over the tenor
premium	8%
exchange rate condition of intermediate interest	295 EUR/HUF
intermediate interest	4.00%
intermediate premium	2.00%
condition to payment of intermediate interest	the NBH's official EUR/HUF exchange rate is not above 295, but it exceeds 290 on ever day over the tenor
minimum interest (annualised)	2.00%
interest income (annualised)	$8.00\% * (N/90) + 2.00\% * (n/90) + 2,00\%$ where N = the number of days when the NBH fixing rate stays below the EUR/HUF level tied to the maximum interest rate during the tenor. n = the number of days when the NBH fixing rate stays below the EUR/HUF level tied to the intermediate interest rate during the tenor. In the case of weekends and holidays, the fixing rate of the preceding business day will be taken into account. If the fixing rate is exactly the same as either boundary of the range, the lower interest will be paid.
transaction charges	none

advantages

- it is possible to achieve higher yield than in a regular term deposit, while it is guaranteed that your capital and a minimum interest will be repaid at the end of the investment term.
- it is possible to profit from your predictions about the evolution of the cross exchange rate between a given pair of currencies (that is, to achieve extra yield) if your predictions prove to be right
- the maximum interest rate, the minimum interest rate or the width of the range can be set at your will, and the rest of the parameters will be calculated accordingly; the change of one parameter will cause the rest of the parameters to change, too.

risks

- if during the tenor the exchange rate remains outside the range for a longer period, then the interest paid on your deposit may be lower than the market rate prevailing on the date when the deal is concluded
- the deposit will not be broken before expiry (security deposit)
- further risks, arising not exclusively from the characteristics of the product described here but from other factors, are explained in chapter I/b. of the “K&H Treasury Handbook of Market Risk Management” on risk factors.

product structure

This deal is the combination of a bank deposit and a number of digital options. The explanation concerning digital options, provided in chapter I/c. entitled “5 Basic Products” of “K&H Treasury Handbook of Market Risk Management” also applies to this product