Standard option

An insurance policy or a yield enhancement tool

What you should know about standard options
A standard option protects the buyer (also referred to as the holder) against unfavorable exchange rate fluctuations. At the same time, the holder can still profit from advantageous foreign exchange movements. Purchasing an option is the equivalent of taking out an insurance policy.
By paying a premium, the buyer of an option acquires the right to buy (call) or sell (put) a currency at the agreed price on the due date (so-called strike price).
The seller (or writer) of the option is obliged to honor the option if the buyer exercises his/her right. For this the seller receives the premium.

Option buyer
Plain standard options are commonly bought for hedging purposes. The potential loss is limited to the premium, whereas the potential profit is unlimited.
The call option is suitable for importers who have to pay in foreign currencies and who want to hedge against rising exchange rates. It guarantees a maximum rate.
The put option is suitable for exporters who are expecting future payments received in foreign currencies and want to hedge against falling exchange rates. This option guarantees a minimum rate.

The four basic positions

	Long Buy Hold	Short Sell Write
Call	Right to buy	Obligation to sell
Put	Right to sell	Obligation to buy

Your advantages as a buyer
- Provides a full hedge against an unfavorable exchange rate move.
- Allows you to benefit in full from a favorable move.
- The maximum loss is limited to the premium.
- No credit line required.

Possible risk as a buyer
- A premium has to be paid upfront.

Option seller
Standard options are commonly sold for yield enhancement purposes. The potential profits are limited to the premium, whereas the potential loss is unlimited.
By selling a call option, you waive the right to benefit from further exchange rate appreciation and you are not hedged against a fall in the exchange rate. By selling a put option, you waive the right to benefit from further exchange rate depreciation and you are not hedged against a rise in the exchange rate.

Your advantages as a seller
- Allows you to enhance the yield on your foreign currencies.

Possible risk as a seller
- If the option buyer exercises their right you are obligated to fulfill the obligation regardless of the spot level at expiry, which can result in a significant loss.
- The potential profit is limited to the premium, whereas the potential loss is unlimited.

An OTC trading limit is required for selling options.

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