Deposit Plus Advance Knowledge

Sam: Simon, it's been quite a while! Did you trade any Deposit Plus that I've mentioned to you last time?

Simon: Of course I did! I've done several deals already. The Deposit Plus investment tenor is quite short, so when the deal matures I use the proceeds to re-invest. The interest return is better than normal time deposits. But I noticed that recently the foreign exchange market is quite volatile.

Sam: Yes, you're right. That's why when I do my Deposit Plus, I set the conversion rate to be farther away from the spot rate.

Simon: Could you elaborate?

Sam: Sure! At HSBC, you can choose any of the two currencies as the deposit currency and the linked currency, according to your view and risk attitude. You can also decide the conversion rate to reach the target interest return. If you set a conversion rate which is more discounted to the spot rate, that means the chance of receiving the linked currency at maturity is lower and so as the interest return. But if you hold a bullish view on the linked currency, you may choose a conversion rate which is closer to the spot rate to take a higher risk and also a higher interest return. However, that also means, there is a higher chance of receiving the linked currency at maturity. Therefore if the foreign exchange market is volatile, you can balance out the risk by choosing a conversion rate more discounted to the spot rate. For an example, assume I have a Deposit Plus with Hong Kong Dollar linked to Australian Dollar, if the Australian Dollar to Hong Kong Dollar exchange rate on fixing date is lower than the conversion rate, the principal and interest will be converted into Australian Dollar at the conversion rate. Assuming the spot rate is 8.5, the more discount that the conversion rate has compared to the spot rate, let's say 8.20, the lower the interest return since there is lower chance to be converted into Australian Dollar at maturity. On the other hand, if I am bullish on Australian Dollar, I can set the conversion rate nearer to the spot rate, such as 8.47. In this case, that will make a higher interest return as well. I have a graph handy which I can show you the concept of breakeven rate. We've discussed just now how you will receive the interest return in either the deposit currency or the linked currency. Since you'll receive interest return under any circumstances, the actual exchange rate that you buy the linked currency at is in fact discounted to the conversion rate. In other words, you'll not have a loss on your principal as long as you convert the linked currency back to the deposit currency at a rate not lower than the breakeven rate.

Simon: Then how do I find out what is the breakeven rate?

Sam: Take another example, assume the principal in 300,000 Hong Kong Dollar and linked to Australian Dollar, conversion rate is a 6.98. At maturity, if your proceeds are converted to Australian Dollar, you will receive 43,202 Australian Dollar. The breakeven rate will be 300,000 Hong Kong Dollar divided by 43,202 Australian Dollar, which equals to 6,944, lower than the conversion rate of 6.98.

Simon: I get your point. What other factors will affect the interest return on a Deposit Plus?

Sam: In general, interest return will be affected by the investment tenor, conversion rate, interest rate of the deposit currency and also volatility of the currency pair. By the way, have you heard of another product called Cross Currency Deposit Plus?

Simon: No, I haven't. Is that a different product?

Sam: Cross Currency Deposit Plus' payoff is the same as a Deposit Plus. The difference is that both deposit currency and linked currency of a Cross Currency Deposit Plus are non-Hong Kong Dollar or US Dollar. An example would be New Zealand Dollar linked with Australian Dollar; or Euro linked with Pound Sterling.

Simon: That looks suitable for my friend who are not locals. Their main deposit currencies are in non-Hong Kong Dollar and have little demand for Hong Kong Dollar and US Dollar. A colleague of mine is from Australia, his family members are in Sydney but his children are studying in London, I believe a Cross Currency Deposit will fit his foreign currency needs and earn a higher yield than normal time deposit. I'll tell him about the product once I go back to office!

Sam: Cross Currency Deposit Plus is not only suitable for investors with little Hong Kong Dollar or US Dollar demand, it also fits investors who hold a bearish view on Hong Kong Dollar or US Dollar and do not wish to risk the foreign currency holdings to be converted into Hong Kong Dollar or US Dollar. If you hold Australian Dollar and wish to earn higher than time deposit return, at the same time you hold a bullish view on Canadian Dollar, you may consider setting up a Cross Currency Deposit with Australian Dollar as deposit currency and links to Canadian Dollar.

Simon: I see.

Sam: Right, but don't forget there are risks involved. If Canadian Dollar depreciates and you convert the proceeds back into Australian dollar you may suffer a loss on your principal. Be sure you have read the offering documents to learn about how Deposit Plus works and the risks involved before making any investment.

Simon: Sam, thank you for explaining the Deposit Plus concept in details, I have a much clearer picture now. Today's coffee is definitely my treat.