Classic ‘Kick-Out’ Autocall

How It Works...

An auto-callable (or ‘autocall’) product is a fixed term investment which can automatically mature prior to the scheduled maturity date if certain pre-defined conditions are met. The product is designed to offer a pre-determined coupon over a fixed term, based on the underlying asset being above its initial strike level on any given predetermined observation date.

The criterion for deciding whether the product autocalls is whether the specific underlying is above a predetermined trigger level (the autocall level) This autocall test is usually carried out on a set of pre-defined dates (for example, annually, quarterly, etc.). If a product is autocalled, the investor normally receives a pre-determined coupon along with the capital on that autocall date.

Most autocall products incorporate a protection feature so that, if the autocall trigger has not occurred before the scheduled maturity date, the invested capital benefits from a level of protection. The performance of the underlying in relation to the protection barrier level will determine how much capital is protected and so how much will be returned at maturity.

The diagram below demonstrates how a simple autocall product linked to an index operates. For illustration purposes only, it is assumed that a single index and final level (European-style) barrier have been used. In this example of a five-year semi-annual autocall investment, the autocall barrier is 100%. Consequently the investment autocalls if the underlying index is above its original start level on any of the semi-annual autocall observation dates. The coupon of x% is paid if the product calls on the first observation date, two times x% if the product autocalls on the second date and so on up to and including the maturity date. Should the index level be below the protection barrier level (set at 50%), then capital will be at risk and will be reduced on a 1-for-1 basis.