An Autocall – the generic components

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Assumptions made by the Issuers will be unique to their own modelling although the general pricing methodology will be the same. There are 3 components to an autocall; one to deliver the coupon; the second to deliver the return of capital; and a third which equates to the risk to the capital which results from providing the first benefits

Component 1: A call option on a series escalating / snowballing coupons, the payment of which are contingent on the underlying being above pre-defined level

Component 2: A bond, the duration of which is dependent on when or if the structure autocalls.

Component 3: A put option which places some downside risk on the investor in exchange for a premium; a risk that disappears in the event of an autocall.

The values of each of these components are dependent on prevailing implied volatility, interest rates, any dividend expectations as all financial derivatives are, but **probability assumptions** are at the heart of pricing.

- Whilst the rate of the conditional coupon is known, its value will need to take into account that the payment may be made at any one of a number of points in the term of the note.
- Assumptions are made as to the probability of the autocall being triggered at the first observation, then the probability that it will be at the second observation etc.
- Those assumptions in turn will determine what value needs to be invested into the bond component so that the capital is available to repay
- The value of the put is impacted heavily by the implied volatility of the underlying as it is this movement in volatility which will have the greatest impact upon where the risk will be crystallised.

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