



## The Danger of “Busted” Instalments

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I would like to delve a little deeper into a category of Instalment which I will term a “Busted” Instalment. Interestingly both normal Share Instalments and a Turbo’s can become a “Busted” Instalment. Think of them very much in the same light as one would consider a Fallen Angel.<sup>1</sup> In essence a “Busted” Instalment is one where the share price has fallen close to the exercise price of the Instalment, meaning in essence that there has been a large decline in the price of the underlying since the Instalment was issued.

Why is this relevant?

The relevance comes from the fact that in the structuring of Standard Bank Share Instalments the bank prices in some share price protection for the purchaser. What this means is that in a worst case scenario, if a share over which a Share Instalment is issued falls below the exercise price of the Share Instalment, that the maximum amount the client will lose is the amount invested in the Share Instalment.

This is achieved by including a put option as part of the structure with an exercise price and expiry date the same as that of the Share Instalment. When an Instalment is issued the cost of the put option is very little for a normal Instalment (due to the fact that it’s a 12-month 50% out the money option) and higher for a Turbo Instalment (being a 12-month 25% out the money option). But for a “Busted” Instalment it will be high as you are paying for an at-the-money put which is much more expensive, this is especially true if the Instalment still has a long time till expiry.

The important point to note is that not only are you in essence borrowing a much larger amount (the strike price) but the added cost of the put increases the implied funding rate for “Busted” Instalments, making it higher than would normally be the case and resulting in the time decay of these Instalments being elevated. The effective gearing of “Busted” Instalments can also be extreme – in some instances up to 10 times or more.

In Summary Busted Instalments will be:

- Where the underlying is trading within 10% of the strike price of the Instalment

They will have

- Very high levels of gearing
- Very high implied funding rates i.e. high levels of time decay

Please bare the above in mind when selecting an appropriate Instalment.

### [Share Instalment Brochure](#)

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<sup>1</sup> a **fallen angel** is an angel that has been exiled or banished from Heaven

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