COMMERZBANK

Product Group

Foreign Exchange Forwards, Foreign Exchange Swaps, NDFs

In this information sheet, Commerzbank provides information on the underlying characteristics as well as the opportunities and risks of the Foreign Exchange Forwards, Foreign Exchange Swaps, NDFs product group.

General characteristics and opportunities
Foreign Exchange Forwards, Foreign Exchange Swaps and NDFs (**N**on-**D**eliverable **F**orwards) are contractual agreements between Commerzbank AG and customer. They are referred to as OTC derivatives because they are derived from a so-called underlying instrument. OTC (**o**ver **t**he **c**ounter) relates to over-the-counter derivatives that are individually tailored to customer needs.

The motivation for using these instruments can vary widely. Users may want to hedge an existing position with a derivative as an offsetting position (hedging). The derivative mirrors the payment structure of the so-called underlying transaction and has the purpose of minimising risk. If Foreign Exchange Forwards or Foreign Exchange Swaps are entered into for hedging purposes, they may be classified as means of payment instead of a financial instrument for regulatory purposes.

If derivatives are used to bet on a specific market trend or price change without reference to an underlying transaction, this constitutes a speculative transaction. In this case, investors cannot offset losses incurred against gains in an underlying transaction. Commerzbank AG only offers derivatives transactions to customers relating to underlying transactions.

Foreign Exchange Forwards
In a Foreign Exchange Forward, the counterparties agree to exchange an amount denominated in a certain currency for an amount denominated in another currency on a future date ("expiry date"). The nominal amount and the rate at which the currency exchange is executed ("forward rate") are determined at the time of the transaction.

The forward rate is calculated as the aggregate of the spot rate and a premium or discount (the so-called swap rate) of the relevant currency pair. The swap rate is basically a function of the interest rate differential between the two relevant currencies. This offsets any interest rate advantages or disadvantages for the respective term of the Foreign Exchange Forward. The parties are obliged to exchange the currencies on the expiry date.

A Foreign Exchange Forward with a term option is another type of Foreign Exchange Forward. This type allows the forward holder to call the notional amount at any time, even in instalments, within a defined time frame. The uncalled amount will be exchanged on the expiry date. This affects the pricing of the Foreign Exchange Forward.

A predetermined forward rate allows for predictability and hedging of foreign currency positions against exchange rate fluctuations. This rate provides a reliable basis for calculation at the time of buying the option. Customers do not need to provide extra liquidity, e.g. for a premium. However, customers do not participate in a positive performance.

Foreign Exchange Swaps
A Foreign Exchange Swap allows investors to manage liquidity flows by shifting the maturities of currency positions along the time axis. Customers do not have to provide extra liquidity for entering into this transaction.

In a Foreign Exchange Swap, the counterparties agree to exchange an amount denominated in a certain currency for an amount denominated in another currency for a defined period. All exchange rates for the entire Foreign Exchange Swap transaction are based on a single exchange rate reference (usually the current spot rate) and the interest rates of the two currencies. The interest rate difference between the involved currencies is settled between the customer and Commerzbank AG via so-called swap rates. This offsets any interest rate advantages or disadvantages for the respective term of the foreign exchange swap. The swap rates are traded on the currency market as a premium or discount to the relevant exchange rate for the respective transaction term. The parties are obliged to exchange the currencies on the respective maturity date.

Non-Deliverable Forwards (NDFs)
If currencies are not fully convertible (e.g. currencies of Brazil, India), the products described above can only be realised in a modified version. An NDF tracks the performance of the underlying currency in the same way as a Foreign Exchange Forward. However, no currency exchange takes place in this case. At maturity, the exchange rate difference is settled in cash in fully convertible currency, e.g. EUR or USD.

Material risks of the product group:
By entering these transactions, customers benefit from return opportunities, but are also exposed to additional material risks. These include the following:

<u>Fair value risk:</u>
The fair value of a transaction is mainly influenced by the change in the exchange rate, the swap rate and the remaining term. If the transaction is terminated early, the customer will have to recognise a loss on termination in case the fair value is negative.
<u>Liquidity and trading risk:</u> In special market situations, it may not be possible to liquidate a financial instrument at all or at a fair market price.
<u>Transfer risk:</u> Government policies may impose restrictions on movement of capital, making it difficult or impossible to transfer or convert currencies.
<u>Default risk:</u> In the event of insolvency of Commerzbank AG as a counterparty, Commerzbank AG may default on some or all existing claims. Moreover, if Commerzbank's going concern as a financial institution is jeopardised due to bank supervisory regulations, customers are exposed to a default risk in the form of a bail-in even before insolvency, i.e. in the event of a resolution procedure, the relevant resolution authority may order the transaction to be terminated early. If the termination results in a right to payment for the counterparty, the resolution authority might order this to be partially or fully written down or converted into equity (shares or other partnership interests). If Commerzbank AG does not fulfil its obligations under the financial instrument, does not pay or is unable to pay, the customer loses part of the investment or suffers an unlimited financial loss.
If the customer does not hold the currency to be delivered on the expiry date, the currency must be obtained at current market rates.

The financial instrument and the underlying transaction are legally separate transactions and can be entered into or terminated separately. The financial instrument can only be terminated early by mutual agreement. The financial instrument may have a negative fair value at the time of the transaction due to structured costs and differing buying and selling prices (bid/ask spread). The cancellation or non-fulfilment of the underlying transaction does not result in automatic termination of the financial instrument. In such case, the economic objective pursued at the time of the transaction may have to be reassessed.

Further information and costs:
For further details on these aspects and the products, please refer to the relevant basic or product information sheet. When acquiring, holding and eventually selling derivatives, costs will impact their fair value. For further details, please refer to the respective cost information sheet before entering into a derivatives transaction.
For further details on the characteristics and risks of the products, please refer to the brochure “Basic Information on Financial Derivatives”.