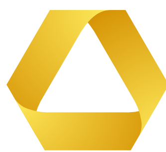

Product Group

Structured Foreign Exchange Products

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

General characteristics and opportunities
Structured Foreign Exchange Products 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 (in this case currency pairs). The valuation of these derivatives is determined by the exchange rate of the relevant currency pair. 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). In this case, the purpose of the derivative is to reduce risks from an underlying transaction.

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.

Structured Foreign Exchange Products comprise several linked option components. The currency hedges in this product group provide a hedging exchange rate for one or more future dates, allowing for reliable calculations and better planning of foreign currency positions.

Some products also offer the chance of receiving an additional payment from the Bank, depending on relevant exchange rate movements during a specified observation period or on a specified date. In these cases, however, the hedging rate is less favourable than that of a comparable conventional currency forward transaction. If and at what exchange rate currencies are exchanged on a particular date is determined by the individual product terms.

If the customer pays a premium upon conclusion, it can improve the hedging rate and/or the product terms. Conversely, the terms become less favourable if the customer receives a premium payment.

The hedging rate can also be improved by using leverage. If the customer can exchange currency at a more favourable rate than the hedging rate on the determination date, the customer must still exchange the amount multiplied by the leverage factor at the agreed rate.

On the respective settlement date (usually two banking days after the respective determination date), the currencies are physically exchanged (physical delivery) and/or a corresponding cash settlement is paid. The following descriptions present selected products from the product group, whereby to simplify matters, the cash settlement procedure is not included again.

Synthetic forward
A synthetic forward is an agreement to exchange an amount denominated in one currency for an amount denominated in another currency on an agreed date. The parties are obliged to exchange the currencies on the expiration date.

Average rate forward
On specified dates, an amount denominated in one currency is exchanged for an amount denominated in another currency. This takes place at a uniform rate, irrespectively of actual exchange rate movements.

Risk reversal
In a risk reversal, currencies are exchanged if the reference rate on the fixing date trades outside a specified range. In this way, the customer secures a guaranteed minimum exchange rate while also having a limited chance of achieving a more favourable rate.

Participating forward
On a specified date, an amount denominated in one currency is exchanged for an amount denominated in another currency at the participating forward rate. If the reference rate has moved in favour of the customer, the customer might receive an additional payment, the amount of which depends on the difference between the reference rate and the participating forward rate and the level of participation.

Forward plus
On a specified date, an amount denominated in one currency is exchanged for an amount denominated in another currency. In addition, a payment is made on the respective settlement date if a specified barrier has not been reached during the respective observation period. If the reference rate has moved in favour of the customer, the difference between the hedge rate and the reference rate is paid out based on the notional amount.

Forward extra
On a specified date, an amount denominated in one currency is exchanged for an amount denominated in another currency. This product is special in that the customer can receive a payout if the exchange rate for his underlying transaction moves in the opposite direction and a barrier is not reached during the respective observation period. The payout amount is calculated based on the difference between the hedging rate and the reference rate based on the nominal amount.

Butterfly forward
On a specified date, an amount denominated in one currency is exchanged for an amount denominated in another currency at the butterfly forward rate. A settlement payment is made if the agreed exchange rate range is not breached during the respective observation period. The payout amount is calculated based on the difference between the butterfly forward rate and the reference rate based on the nominal amount

Range forward
If, during the observation period, the reference rate always remains within an exchange rate range, the customer can exchange currencies at the favourable range forward rate or forgo the currency exchange. If the exchange rate range limit is reached or breached, the customer is obliged to make the currency exchange at the worst-case exchange rate.

Ratio step forward
This product consists of an exchange of an amount denominated in a certain currency for an amount denominated in another currency on an agreed date ("expiration date of the underlying nominal amount") at the strike price. The strike price is better than the forward rate and is obtained by committing to further conditional currency exchanges at later dates. These must be fulfilled if the customer on the respective determination dates is able to obtain a more favourable exchange rate on the market than the ratio step forward rate.

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

Fair value risk:
The fair value of a transaction is mainly influenced by the actual and expected change in the exchange rate (volatility), the interest rate level 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.

Liquidity and trading risk:
In special market situations, it may not be possible to liquidate a financial instrument at all or at a fair market price.

Transfer risk:
Government policies may impose restrictions on movement of capital, making it difficult or impossible to transfer or convert currencies.

Default risk:
In the event of insolvency of Commerzbank AG as a counterparty, Commerzbank AG may default on some or all of 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 expiration 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 key information document. 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".