COMMERZBANK

Product Group

Interest Rate Options

In this information sheet, Commerzbank provides information on the underlying characteristics as well as the opportunities and risks of the Interest Rate Options product group.

General characteristics and opportunities
Interest Rate Options are contractual agreements between Commerzbank AG and customer. They are referred to as OTC derivatives because they are derived from a so-called underlying asset. 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 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.

The main products in the Interest Rate Options product group are Floors and Caps, which are typically used to hedge against interest rate volatility, for example in the case of floating-rate loans.

Interest Rate Option (buy)
An Interest Rate Cap (call option) is a contractual agreement that sets a maximum interest rate, while an Interest Rate Floor (put option) is an agreement that sets a minimum interest rate. By purchasing a cap, the buyer hedges against a possible interest rate increase, while the buyer of a Floor locks in a minimum interest rate. For this purpose, the buyer pays a premium to Commerzbank AG (seller of the option) on conclusion or distributed over several dates. On the determination date, the underlying reference interest rate (e.g. 3-month Euribor) is compared with the agreed Interest Rate Cap or Floor (the "strike price"). If the reference rate exceeds (cap) respectively falls below (Floor) the interest rate barrier, the option seller is obliged to make a settlement payment. Otherwise, the option expires worthless. The paid premium is non-refundable.
The agreed Interest Rate Cap or Floor allows option buyers to manage their asset/liability positions and hedge against interest rate risks. It provides a reliable basis for calculation at the time of entering into the transaction. In addition, buying Interest Rate Options allows participation in a positive performance.

Interest Rate Option (sell)
The seller of an Interest Rate Cap or Floor agrees to make a settlement payment to the buyer on a future date (the expiry date) for an interest period if the current reference interest rate (e.g. 3-month Euribor) on the determination date is above the agreed strike price (Interest Rate Cap) or below it (Interest Rate Floor). Otherwise, the option expires worthless. The seller receives a premium for assuming this obligation.

The settlement payment for an Interest Rate Option, whether bought or sold, is calculated based on a notional principal amount agreed at the time of conclusion of the contract, multiplied by the respective difference between the reference interest rate and the strike price.

Interest Rate Options have an asymmetric risk profile. While the maximum risk for the buyer is the loss of the paid premium, the option seller (“writer”) is exposed to an unlimited risk. If the option is exercised, the seller must make the settlement payment and thus incurs a financial loss. The financial loss is greater the more the reference rate on the expiration date diverges from the agreed Interest Rate Cap or Floor. In contrast, the maximum return is limited to the collected premium. Selling an Interest Rate Option is not an interest rate hedging transaction.

Interest Rate Options can be individually designed by varying strike prices and nominal amounts.

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:

<u>Fair value risk:</u>
The fair value of a transaction is mainly influenced by the actual and expected change in the reference interest rate (volatility), the interest rate level, forward interest rates 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>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.

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 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”.