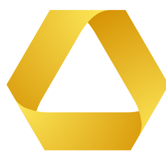

Product Group

Commodity Options

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

General characteristics and opportunities
Commodity 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 Commodity Options product group are Floors and Caps, which are typically used to hedge against price volatility, for example by commodity buyers or suppliers. Depending on the respective commodity, European-style price hedging is used if the date for the receipt or delivery of the commodity is already known, whereas Asian-style price hedging based on an average of all reference prices in an agreed calculation period is used for recurring commodity purchases or sales.

Commodity Options (buy)
A Commodity Cap (call option) is a contractual agreement that sets a maximum commodity price, while a Commodity Floor (put option) is an agreement that sets a minimum commodity price. By purchasing a Cap, the buyer hedges against a possible price increase, while the buyer of a Commodity Floor locks in a minimum price. For this purpose, the buyer pays a premium to Commerzbank AG (seller of the option) on conclusion. On the determination date, the relevant reference price for the respective underlying (e.g. Gas Oil – ICE) is compared with the agreed commodity price barrier (strike price). If the reference price exceeds (Commodity Cap) or falls below (Commodity Floor) the commodity price barrier, the option seller is obliged to make a settlement payment. Otherwise, the option expires worthless. The paid premium is non-refundable.

The agreed commodity price barrier allows option buyers to manage their commodity positions and hedge against commodity price risks. It provides a reliable basis for calculation at the time of entering into the transaction. In addition, buying Commodity Options allows participation in a positive performance.

Commodity Options (sell)
In exchange for a premium, the seller of a Commodity Cap or Commodity Floor agrees to make a settlement payment to the buyer upon the occurrence of the event described below. On the determination date, the relevant reference price for the respective underlying (e.g. Gas Oil – ICE) is compared with the agreed commodity price barrier (strike price). If the reference price is higher (Commodity Cap) or lower than the agreed strike price (Commodity Floor), the option seller must make a settlement payment. Otherwise, the option expires worthless.

The settlement payment for a Commodity Option, whether bought or sold, is calculated based on the agreed quantity of the underlying commodity, multiplied by the respective difference between the reference price and the strike price.

The motivation for selling an option is usually to generate additional income from the premium and/or to anticipate a specific market trend.
Commodity 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 of the price movement of the underlying relative to the agreed price barrier. 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 price diverges from the agreed price Cap or Floor. The maximum return is limited to the collected premium. Selling a Commodity Option is not a price hedging transaction.

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:

Hedging through the financial instrument does not fully protect against all fair value risks. Pricing dynamics between the underlying transaction and the financial instrument may vary as a result of fluctuating transport costs, taxes and duties, supplier margins or unevenly spread purchases/sales over the term.

Fair value risk:
The underlying commodity may be especially affected by political risks, economic trends, weather risks, production capacities and inventories, as is true for the whole commodity asset class. The fair value of a transaction is mainly influenced by the actual and expected change in the price of the underlying (volatility), commodity forward 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.

Currency risk:
If the reference price is denominated in a currency other than the contract currency, it is converted into the contract currency. The customer might be exposed to higher payment obligations or lower payment streams from the financial instrument if the exchange rate changes unfavourably.

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.

Default risk:
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. If the payments from the financial instrument and the underlying transaction differ, e.g. due to different investment horizons, the customer might experience a financial loss.

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”.