



COMMERZBANK

Product Group

Foreign Exchange Options, NDOs

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

General characteristics and opportunities

Foreign Exchange Options and NDOs (Non-Deliverable 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 instrument. OTC (over the counter) relates to over-the-counter derivatives that are individually tailored to customer needs.

The motivation for using Foreign Exchange Options and NDOs 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.

For Foreign Exchange Options, an actual currency exchange (physical delivery) or cash settlement of the exchange rate difference takes place when the option is exercised ("expiry date") on the settlement date (usually 2 bank working days after the expiry date).

Besides this variant of a specific exercise date, transaction parties might also agree on an exercise period.

Foreign Exchange Option (call)

With a Foreign Exchange call Option, the buyer of the option has the right to exchange an amount denominated in a certain currency for an amount denominated in another currency on a future date ("expiry date"). To gain this right, the option buyer pays a premium to Commerzbank AG (seller of the option) when entering the transaction. The option buyer locks in a specific exchange rate ("strike price") and would still benefit from a favourable exchange rate trend. The option buyer acquires an option right and is accordingly under no obligation to exchange currency.

On the expiry date, if the option buyer can exchange currency on the currency markets at a more favourable rate, the option expires without value. In this case, the currency can be exchanged at the current market rate. The paid premium is non-refundable.

A predetermined exchange 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. In addition, buying Foreign Exchange Options allows participation in a positive performance. This requires the buyer to pay a premium.

Foreign Exchange Option (put)

A Foreign Exchange put Option obliges the seller of the option to exchange an amount denominated in a certain currency for an amount denominated in another currency on a future date ("expiry date"), provided the option buyer exercises the option right. The seller receives a premium for assuming this obligation.

If the option buyer can exchange currency on the expiry date by exercising the option more favourably than at market rates, the option is exercised, and the seller is obliged to exchange currency at the agreed rate ("strike price"). If no financial benefit can be realised by exercising the option, the option is not exercised. The option seller always retains the premium.

Selling a Foreign Exchange Option involves an asymmetrical 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 exchange the nominal amount at an unfavourable rate compared to the current market rate and thus incurs a financial disadvantage. The financial disadvantage is greater the more the market rate on the expiry date diverges from the agreed strike price. In contrast, the maximum return is limited to the collected premium. Selling an option is not a hedging transaction.

The Average Rate Option is another option type. In contrast to standard options, where the strike price is compared with the closing exchange rate on the expiry date, the Average Rate Option compares the strike price with the average exchange rate for a period specified at the time of the option transaction. If the

option buyer benefits from the strike price compared to this average rate, the buyer receives a cash settlement on the expiry date.

Non-Deliverable Options (NDOs)

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 NDO tracks the performance of the underlying currency in the same way as a currency option. However, no currency exchange takes place in this case. When exercising the NDO, the exchange rate difference is always settled in cash in fully convertible currency, e.g. EUR or USD.

Material risks of the product group:

By entering these transactions, 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 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".