UniCredit Bank

COMMODITY SWAPS AND COMMODITY OPTIONS WITH CASH SETTLEMENT ("COMMODITY FUTURES TRANSACTIONS")

Commodity futures transactions are special contracts that involve rights or obligations to buy to sell certain commodities (mineral resources, farming product) at a predetermined price and time or during a specified period. Commodity futures transactions are involved in the instruments described below.

Basic information about the individual instruments

Commodity swaps

A Commodity Swap is an agreement involving the exchange of a series of commodity price payments (fixed amount) against variable commodity price payments (market price) resulting exclusively in a cash settlement (settlement amount).

The buyer of a Commodity Swap acquires the right to be paid a settlement amount (compensation) if the market price rises above the fixed amount. In contract, the buyer of a Commodity Swap is obliged to pay the settlement amount if the market price falls below the fixed amount.

The buyer of a commodity Swap acquires the right to be paid a settlement amount, if the market price rises above the fixed amount. In contract, the seller of a commodity Swap is obligated to pay the settlement amount if the market price falls below the fixed amount.

Both streams of payment (fixed/variable) are in the same currency and based on the same nominal amount. While the fixed side of the swap is of the benchmark nature (it is constant), the variable side is related to the trading price of the relevant commodities quoted on a stock exchange or otherwise published on the commodities futures market on the relevant fixing date or to a commodity price index.

Commodity Options with Cash Settlement

The buyer of a Commodity Put Option pays a premium for the right to receive the difference between the strike price and the market price in relation to the nominal amount of the market price follows below the fixed amount.

The buyer of a Commodity Call Option pays a premium for the right to receive the difference between the strike price and the market price if the market price rises about the fixed amount.

RISK – DETAILS ON THE VARIOUS INSTRUMENTS

Risk of Commodity Swaps and Commodity Options with Cash Settlement

If the trend does not live up to your expectations, you will have to pay the difference between the underlying price when you signed the agreement and the current market price when the transaction reaches maturity. That difference constitutes the loss. The maximum amount of loss cannot be determined in advance. It may possible exceed the security posted.

Risk when buying Commodity Options – Price loss

A price change in the underlying asset (e.g. of mineral resources, farming product) that underlies the option as the subject matter of the contract may reduce the value of the option. A loss of value may occur in the case of a call option in the event that the respective commodity price falls. In the case of a put option, loss of value may occur if the price of the respective commodity rises.

A loss in the value of the option may occur even if the price of the underlying assets does not change because the value of the option is also influenced by other price formation factors (e.g. the term or frequency and intensity of the price fluctuations of the underlying asset).

Risk when selling commodity options – leverage effect

The risk in the case of selling commodity options is that the value of the underlying asset will not move in the directions originally anticipated by the seller by the time that the option expires. The resulting potential loss is unlimited for the options written.

Risk of commodity futures transactions in general

Price fluctuations

The amount of the payment obligations arising out of commodity futures transactions is determined by the prices on a certain commodity futures market.

Commodity futures markets may be subject to strong price fluctuations. Many factors related to supply and demand for commodities may influence the prices. It is not easy to forecast or predict such pricing factors. Prices may be significantly influenced by unforeseen events, such as natural disasters, illnesses, epidemics, or orders given by the public authorities, as well as unpredictable developments, such as the effect of weather, variations in harvest, or transport and storage risks.

Currency risk

Commodity prices are often quoted in foreign currency. You will also be exposed to currency market risk if you enter into a commodity transaction in which your obligation or right to counter-performance is denominated in the foreign currency, or the value of the subject matter of the contract is determined thereby.

Liquidity risk

Commodity futures markets are generally tighter than financial futures markets and may therefore be less liquid. You may also be wholly unable to liquidate a commodity futures position at the desired time because of insufficient market liquidity or to liquidate it only partially. Moreover, the spread between the bid and ask prices in a contract may be relatively wide. It may be difficult or impossible to liquidate commodity futures positions under certain market conditions. Most commodity futures exchanges are for example authorized to set limits on price fluctuations. Such limits prohibit asks or bids outside certain limits during a certain period. This may make it difficult or impossible to liquidate certain positions.

Limited orders / Stop loss orders

Limited orders or stop loss orders are instructions that are to limit trading losses in the event of certain movements on the market. Although such possibilities of limiting risk are permitted on most commodity futures markets, Limit Orders or Stop Loss Orders cannot benerally be set for OTC commodities.

Forward Markets and Spot Markets

It is especially important to understand the relationship between forward contract prices /price of future trades) and current (spot) market prices. Although market forces may equalize the differences between the forward contract price and the spot market price of the commodities in question to such an extent that the price difference on the delivery date is practically null, a variety of market factors, including supply and demand, may still result in differences between the contract price and spot market price of the commodities in questions.

Determination of the market price

Market prices are either quoted on the commodity futures exchanges or published in the manner usual for the respective market. Due to system failures, system malfunctions on the exchange or for other reasons, it sometimes happens that no market price can be determined for the agreed fixing date. If no arrangement is made for a substitute method of price determination, the calculation agent is usually authorized to set the market price according to his own reasonable exercised discretion.

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