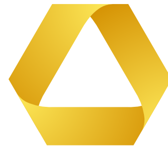

Product Group

Commodity Forwards, Commodity Swaps

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

General characteristics and opportunities
Commodity Forwards and Commodity Swaps 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 physical position with a derivative as an offsetting position (hedging). The derivative mirrors the payment structure of the so-called underlying, physical 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.

Commodity Forwards
In a Commodity Forward, the parties agree to buy or sell a certain commodity quantity (“underlying commodity”) on a future date ("value date") in an agreed contract currency. The commodity amount and the price at which the Commodity Forward is executed (“contract price”) are determined at the time of the transaction.

A Commodity Forward is generally a financial hedge without physical delivery at settlement date (“cash settlement”). The cash settlement is calculated as the difference between the fixed amount (contract price multiplied by the commodity quantity) and the floating amount determined on the valuation date (reference price in the contract currency multiplied by the commodity quantity).

If the floating amount exceeds the fixed amount, the commodity buyer receives the cash settlement. In the opposite case, the commodity buyer must pay the cash settlement.

If physical delivery is agreed, the commodity seller must deliver the agreed quantity of the underlying commodity to the buyer at the contract price and the buyer must take delivery.

A predetermined contract price allows for predictability and hedging of commodity positions against commodity price fluctuations. It provides a reliable basis for calculation at the time of entering into the transaction. Customers do not need to provide extra liquidity, e.g. for a margin call. However, customers do not participate from favourable market movements due to their fixed price.

Commodity Swaps
In a Commodity Swap, the parties agree to buy or sell a certain commodity quantity (“underlying commodity”) on future dates ("value dates") in an agreed contract currency. The price ("contract price"), the calculation periods and the commodity quantity purchased are determined at the time of the transaction.

A Commodity Swap is a financial hedge without physical delivery at settlement date (“cash settlement”). The cash settlement is calculated as the difference between the fixed amount (contract price multiplied by the commodity quantity) and the floating amount determined on the valuation date (floating price in the contract currency multiplied by the commodity quantity). In contrast to Commodity Forwards, to determine the floating amount in a Commodity Swap the arithmetic mean of the reference prices of the respective calculation period (“floating price”) is used.

If the floating amount exceeds the fixed amount, the commodity buyer receives the cash settlement amount. In the opposite case, the commodity buyer must pay the cash settlement amount.

Commodity Swaps allow for predictability for the underlying transaction. They are ideal for hedging recurring commodity transactions. Customers do not need to provide extra liquidity, e.g. for a margin call. However, with Commodity Swaps, customers cannot benefit from commodity price fluctuations in the favourable direction due to their fixed price.

Alternatively, it is possible to agree a transaction with floating payments for both parties, whereby different calculation periods (for price averaging, this is similar to Commodity Swaps) or fixing dates (for fixing prices at a specific date, this is similar to Commodity Forwards) are used to determine the floating amounts.

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

If the amount payable exceeds the amount receivable, the customer incurs a financial loss. The loss is greater the more the floating amount deviates from the agreed fixed amount. If the floating price drops to zero, only the fixed amount is paid.

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 change in the price of the underlying commodity as well as 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”.