Description of Risk Related to Financial Market Instruments

INTRODUCTION

In this document, we present the characteristics of transactions in over the counter (OTC) financial instruments and the risks associated therewith. These are hedging products – which you will use to hedge against market risks associated with your business. These transactions must not be executed for speculative purposes.

We have prepared the characteristics of the transactions for you – our Clients, whom we have classified in accordance with the MiFID Directive as:
- retail clients,
- professional clients or
- eligible counterparties.

Characteristics of transactions

Each characteristic of a transaction includes:
- name,
- brief description,
- pros and cons, and
- risk symbols associated with a particular type of transaction.

We include a table with a description of risks. There you will also find the symbols in the first column of the table (e.g., A, B) and a commentary on the risk in question.

Additional information

- As Clients who conclude transactions, you make decisions on your own or with the assistance of a professional advisor.
- This material is not investment advice, as referred to in the Act of 29 July 2005 on Trading in Financial Instruments. Nor does it provide tax or accounting advice or legal assistance.
- This document does not define the rules of application of hedge accounting nor does it explain how and when they should be applied. To better understand hedge accounting, you can refer to the accounting standards.

Risk symbol	Symbol name	Description
A	**Market risk**	Market risk consists of three categories: - FX risk (A1), - Interest rate risk (A2), - Commodity price risk (A3). The prices of financial instruments may change due to market factors, such as, among others: - exchange rates, - interest rates, - commodity prices, and these prices can consequently reduce financial results. Market factors, in turn, depend, among others, on: - general macroeconomic situation, - economic situation, - activities and expectations of financial market participants. Policies pursued by market participants (including possible speculative transactions) can significantly affect market factors and as such - the valuation of financial instruments and financial results. Market factors, in most cases, affect the valuation of transactions on a proportionate (linear) basis, and as such - the financial results. However, there may be cases in which market factors affect the valuation of transactions on a disproportionate (non-linear) basis.

A1	**FX risk**	Market risk category. Change in the exchange rate (price) of one currency against the other currency of a transaction may adversely affect its valuation and, consequently, reduce your financial results. Currency risk mainly depends on: - market participants' expectations vis-a-vis the volatility of a currency pair - with the underlying instrument being the exchange rate, - time remaining to be settled, - interest rates for transaction currencies and - currency of the underlying instrument.
A2	**Interest rate risk**	Market risk category. Changes in domestic or foreign interest rates may adversely affect the valuation of transactions and, consequently, reduce your financial results. Interest rate risk mainly depends on: - market participants' expectations of interest rate volatility - with the underlying instrument being a given interest rate, - time remaining to be settled.
A3	**Commodity price risk**	Market risk category. Changes in the commodity price may adversely affect the valuation of transactions and, consequently, reduce your financial results.
B	**Liquidity risk**	This risk means that the market does not allow at all or allows limited trading in a particular financial instrument. An increased liquidity risk may occur in particular in the event of recession. In such case, you may be hindered or prevented from concluding a transaction at a given time - and the strike price may significantly differ from the price obtainable in a fully liquid market. If you wish to close a transaction before the agreed date, this may be considerably difficult, require time or may involve additional costs or losses on your part. Costs arise in particular from differences (spread), that are negative for you, between the buy and sell prices of specific instruments. Losses may result from valuation of the transaction which, depending on market factors, is adverse for you at any given time. Liquidity risk is higher if the transaction currencies are not: EUR, USD, JPY, GBP and PLN. For non-vanilla options, liquidity risk can increase significantly due to lower trading volume vis-a-vis vanilla options.
C	**Risk of the need to establish collateral**	As a bank, we determine the value (valuation) of transactions on a daily basis, which depends on FX rates, interest rates and other market parameters. If the valuation of transaction concluded with you is negative, we may ask you to establish collateral. We determine its type and value pursuant to the rules defined in regulations and agreements used for a given transaction type. If the negative valuation aggravates, you will be requested to complement the required value of collateral.
D	**Counterparty credit risk**	Counterparty credit risk affects both us and you. It is strongly related to market risk and the duration of a transaction: it can be assumed that for a given type of transaction, higher market risk entails increased counterparty risk, and that the longer the duration of the transaction, the higher the risk. When concluding a transaction, there may be a risk that one of the parties – either us or you – will not be able to fulfil its obligations to the other party (for example, due to bankruptcy or poor financial condition). If we assess that this risk is increased, we may ask you to establish collateral or, as a last resort, to early terminate the transaction, which may involve incurring a loss.
E	**Risk of incurring a financial commitment as a result of concluding a transaction**	When parties conclude a transaction, they incur a commitment to each other. Depending on the transaction, your commitment may, e.g., concern: - currency purchased – if you are buying currency, - net settlement amount – in the case of transactions without physical delivery of currency, interest settlements or commodity transactions, - premium - if you are buying an option, - delivery of the currency being sold – if you are selling currency.

F	**Risk of hedging mismatch**	A given transaction should be matched and consistent with the terms of the commitments from which the financial risks arise and which the transaction hedges. The risk of a mismatch in a hedging transaction increases when the flow from business activities differs from that of the hedging transaction. The difference may be reflected in: - flow volume, - settlement time, - currency. We settle hedging transactions irrespective of whether they are covered by flows from the business activity being hedged. If a commitment – in connection with which a certain transaction was concluded – changes or has previously been fulfilled, you are obliged to match the transaction in question to the current commitment: either close or modify it. This means that you may incur costs associated with changing the transaction terms or closing the transaction.
G	**Risk of an early transaction closing unilaterally by the bank**	As a bank, we can unilaterally terminate a transaction before the agreed date – in cases determined in the relevant agreement and regulations (in particular, in events of default). Such early transaction termination may entail costs or losses for you. Costs arise in particular from differences (spread), that are negative for you, between the buy and sell prices of specific instruments. Losses (if any) may result from valuation of the transaction which, depending on market factors, is adverse for you at any given time.
H	**Political and legal risks**	This risk relates to changes in the legal system or unlawful actions, and among others: - political changes in the given country, - actions of other countries undertaken towards the country where transactions are made, - changes in tax or customs regulations, - changes in ownership rights or profit repatriation rules (or failure to comply with them). The aforementioned changes and actions may lead to deterioration in the economy parameters, thereby adversely affecting FX rates, interest rates and commodity prices, and ultimately the valuation or settlement of the transaction.
I	**Force Majeure risk**	Situations or circumstances which cannot be foreseen in advance and which are beyond human control, but which can adversely affect the activities pursued.
J	**Operational risk**	The parties or the parameters of the transaction may be affected – directly or indirectly - by such factors as: - system failures, - staff or procedural problems, - intentional actions of persons representing the parties to the transaction or third parties, aimed at obtaining illegal profit.
K	**Reinvestment risk**	A rate of return on reinvestment in the transaction may not be achievable in the future due to changes in market conditions. This risk may in particular relate to hedging transactions which cannot be concluded under the same terms as the originally concluded transactions.
L	**Tax risk**	Your tax settlements may be challenged by tax authorities. To mitigate this risk, we recommend that you approach a tax advisor for assistance in determining tax consequences associated with concluded transactions.
M	**Inflation risk**	Inflation may have a negative impact on the return on the transaction. This risk means that due to inflation the proceeds received on the transaction settlement date may have a lower purchasing power (it will not be possible to purchase the same basket of goods) than on the transaction date.

OTHER ISSUES RELATED TO THE RISK OF DERIVATIVE INSTRUMENTS

Risk and timing of options exercise

The option seller is exposed to unlimited losses as its obligation depends on FX rates, interest rates or commodity prices.

The option buyer pays a premium to the seller – to obtain the right stipulated in the option transaction terms – and the buyer's loss is limited only to the amount of the premium. It does not apply to a loss of potential, alternative benefits.
Options are classified according to their execution date on which the buyer can execute the transaction:
- European options – this will be a specific date defined in the transaction terms,
- American options – this will be any date during the term of the option contract,
- Window options – this will be a date during the period defined in the transaction terms.

Hedging transactions

Hedging transactions are concluded for the purpose of mitigating or offsetting financial risks that may arise as a result of your business activities. You conclude transactions to protect specifically against currency risk, interest rate risk, commodity price risk.
You can hedge against the identified financial risks in full or in part. It is your decision whether to hedge against financial risk or not.
Since you are aware of your financial situation and risks, as a bank we will rely on your instructions and information which you have provided when agreeing upon transactions.

Leverage effect

By purchasing, e.g., a call option, you can make profit equal to that made on the purchase of the underlying instrument but the amount invested is much smaller considering that the value of a derivative (premium) is only a fraction of the value of the underlying instrument.
The leverage effect works both ways, which means that if the valuation of the underlying assets decreases (e.g. the exchange rate changes), the percentage change in the value of the option may be much higher than the percentage change in the value of the underlying assets.
The leverage effect may also be observed in option strategies, where the value of the whole strategy will be affected by the proportion of notional values of options purchased and sold.

Swap points

Each currency transaction with a settlement date other than the spot date (the day that falls on the second business day after a transaction date) is subject to adjustment by the amount of swap points. Swap points (forward) mean a negative or positive amount resulting from:
- the difference in interest rates of currencies comprised in the transaction,
- the duration of the transaction,
- the level of a spot rate for a pair of transaction currencies.
If the transaction is settled later than two business days after the transaction date and the interest rate of the base currency is:
- lower than the interest rate of the settlement currency – the points are positive, with the settlement rate being higher than the spot rate,
- higher than the interest rate of the settlement currency – the points are negative, with the settlement rate being lower than the spot rate.
If the transaction is settled earlier than two business days after the transaction date and the interest rate of the base currency is:
- lower than the interest rate of the settlement currency – the points are negative, with the settlement rate being lower than the spot rate,
- higher than the interest rate of the settlement currency – the points are positive, with the settlement rate being higher than the spot rate.

CURRENCY RISK HEDGING TRANSACTIONS

We classify the following currency risk hedging transactions:
- FX Forward, NDF (Non-Deliverable Forward), Flexiterm Forward,
- FX Swap,
- currency options.

1. FX Forward, NDF (Non-Deliverable Forward), Flexiterm Forward

In a FX Forward transaction, the seller undertakes to sell the agreed transaction amount, while the buyer is obliged to buy it for the amount that is equivalent to the transaction amount denominated in the settlement currency, calculated at the exchange rate determined in the transaction terms.
A FX Forward transaction is settled on the settlement date, which falls not earlier than on the third business day after the transaction date.
In a NDF transaction there is no physical transfer of amounts in both transaction currencies – as in a FX Forward transaction. In a NDF transaction, the net payment amount is calculated on the fixing date. This is the product of the transaction amount and the absolute value of the difference between the set exchange rate and the reference rate.

If the exchange rate on the fixing date is higher than the reference rate, the buyer will pay the payment amount to the seller on the settlement date. However, if the exchange rate on the fixing date is lower than the reference rate, the seller will pay the payment amount to the buyer (on the settlement date).
A NDF transaction is settled on the settlement date, which falls not earlier than on the third business day after the transaction date.
In a Flexiterm Forward transaction, the parties – that is, us and you – determine: the amount and currency of the transaction, the automatic exchange date, the settlement date, the exchange period, the minimum exchange amount and the exchange rate. They also determine which party is the buyer and which party is the seller of the transaction currency.
You may at any time during the exchange period notify us if you wish to have the transaction settled partially (or fully). You then have the right – depending on whether you are the buyer or the seller – to buy or sell the transaction currency (at least in the amount equal to the minimum exchange amount) in exchange for the settlement amount. There can be several such partial settlements in a single transaction.
On the automatic exchange date, we settle the difference between the agreed transaction amount and the amount(s) of partial settlements. If the difference differs from zero, you are obliged to buy or sell the transaction currency in this amount – at the exchange rate.

Pros

Transactions operate in a liquid foreign exchange market - that is, as a bank, we will easily deliver the currency. You can select: the currency and settlement date for the currency pair.

Cons

The transaction is unconditional, whereas FX rate is fixed. This means that one cannot withdraw from the transaction or change the settlement terms, e.g. take advantage of a favourable change in FX rates on the market, if any.
If the negative valuation exceeds the level specified in the contract, a cash collateral may be required. Due to the fact that particular transactions are tailored to your needs and that these instruments are not traded on the exchange, the availability of transaction valuation may be temporarily limited.

Risks

There are risks associated with the above-mentioned FX transactions, which we describe in the table under the following symbols: **A** and **A1**, **B**, **C**, **D**, **E**, **F**, **G**, **M**.

2. FX Swap

FX Swap is a contract in which the parties - we as a bank and you - undertake to exchange a certain amount in a given currency for the equivalent of that amount in another currency. Then, after a certain period of time, the parties make a return exchange at predetermined rates.
The parties undertake to conclude two FX transactions:
- the first one for the Initial Exchange, the First Leg of the Swap, and
- the second one – for the Final Exchange, the Second Leg of the Swap.

The transactions are opposed to each other. This means that if you sell currency in the initial transaction, you buy it in the second one (and vice versa) – at the same amount.
Each of the exchanges (Initial Exchange and Final Exchange) may be concluded and settled in the future. Depending on the settlement date, the time at which the exchange will be settled changes. The settlement date may be:
- the conclusion date (FX Today),
- the immediately following business day (FX Tomorrow),
- the second business day falling after the conclusion date (FX Spot) or
- the business day falling not earlier than on the third business day after the conclusion date (FX Forward).

Naturally, the second transaction is settled later than the first one.

Pros

Transactions operate in a liquid foreign exchange market – that is, as a bank, we will easily deliver the currency. You can select: the currencies and settlement dates for the currency pair.

Cons

The transaction is unconditional, whereas FX rates are fixed. This means that one cannot withdraw from the transaction or change the settlement terms, e.g. take advantage of a favourable change in FX rates on the market, if any.
If the negative valuation exceeds the level specified in the contract, a cash collateral may be required. Due to the fact that particular transactions are tailored to your needs and that these instruments are not traded on the exchange, the availability of transaction valuation may be temporarily limited.

Risks

There are risks associated with the currency swap transactions, which we describe in the table under the following symbols: **A** and **A1**, **B**, **C**, **D**, **E**, **F**, **G**, **M**.

3. Currency call and put options

We classify the following currency call and put options:

- Vanilla (European) option,
- American option,
- Asian option
- Knock-In barrier option,
- Knock-Out barrier option.

In currency call options, the parties agree on the transaction terms which give the buyer the right (but not the obligation) to buy a certain amount in a fixed currency – at the price and on the date or within the period agreed upon conclusion of the transaction. In exchange for the acquisition of the above-mentioned right, the buyer pays a premium to the seller.
In currency put options, the parties agree on the transaction terms which give the buyer the right (but not the obligation) to sell a certain amount in a fixed currency – at the price and on the date or within the period agreed upon conclusion of the transaction. In exchange for the acquisition of the above-mentioned right, the buyer pays a premium to the seller.
In a vanilla (European) option, the buyer may conclude the transaction on the exercise date, i.e. a specific date agreed upon conclusion of the transaction.
In an American option, the buyer may conclude the transaction on any day of its term.
In an Asian option – its settlement is made without the delivery of currency (net only). For this option the reference exchange rate (for Average Rate Options) or strike price (for Average Strike Options) is determined as a (weighted) arithmetic mean or (weighted) geometric mean of the underlying exchange rate in the period defined in the transaction terms.
In a Knock-In barrier option, the buyer acquires the right to exercise a specified underlying option on the condition that in the barrier period, the barrier reference rate reaches the barrier level. If this is the case - the buyer acquires the right to exercise the option. Otherwise, the option expires.
In a Knock-Out barrier option, the buyer acquires the right to exercise a specified underlying option on the condition that in the barrier period, the barrier reference rate does not reach the barrier level. If the rate does not reach the barrier level, the buyer acquires the right to exercise the option. Otherwise, the option expires.

Pros

If you exercise the option you bought, you receive the profit that results from favourable market conditions. This profit is reduced by the premium, which is the only potential loss you may incur - in both call and put options.
In addition, for the Asian option, we use a weighted strike price or reference rate which makes the option less sensitive to short-term fluctuations in market FX rates.

Cons

If you sell a currency option – which can only be done as part of an option strategy - you are exposed to unlimited losses – in both call and put options.
If you buy a currency option but are unable to exercise it due to the exchange rate, you will lose the potential benefits of the transaction while you have paid a premium.
The market risk of currency options translates directly into the level of counterparty risk. This means that you must pay the valuation amount if you sell a currency option and if, at the time of settlement of this option, its valuation is adverse to you.
Option valuation depends on market conditions. This means that you may not exercise the option because the expected exchange rate will not be achieved.
For barrier options, option valuation is very sensitive to changes in the reference rate, in particular when it is near the barrier level.

Risks

There are risks associated with the currency options, which we describe in the table under the following symbols: **A** and **A1**, **B**, **C** (only if you sell currency options), **D**, **E**, **F**, **G**, **M**.

INTEREST RATE RISK HEDGING TRANSACTIONS

We classify the following interest rate risk hedging transactions:
- options: Cap and Floor,
- Interest rate swaps (IRS)
- Currency-interest rate swaps (CIRS)

4. Options: Cap and Floor

Cap Option

In Cap options, the parties determine the transaction terms which give you as the buyer the right (but not the obligation):
- to receive from us as the seller on each interest settlement date for the interest period at the reference rate, and
- to transfer to us as the seller of interest at the strike rate.

In exchange for the acquisition of this right, you as the buyer pay us as the seller a premium.
The parties may agree upon:
- the number of interest periods: one or more,
- the method of payment of the premium to the seller: as a lump sum or in installments.

Cap options are settled on the settlement date – by us paying you the settlement amount if the reference rate is higher than the strike rate. In this case, the settlement amount will be calculated:
- as the product of the notional amount and the difference between the strike rate and the reference rate, and then
- as the quotient of the number of days in the interest period and the number of days in the year (according to the established interest calculation convention).
If the reference rate in a given interest period is lower than or equal to the strike rate, neither you nor we are obliged to make any payment on account of settlement.
Floor Option
In Floor options the parties determine the transaction terms which give you as the buyer the right (but not the obligation):
- to receive from us as the seller on each interest settlement date for the interest period at the reference rate, and
- to transfer to us as the seller interest at the strike rate.
In exchange for the acquisition of this right, you as the buyer pay us as the seller a premium.
The parties may agree upon:
- the number of interest periods: one or more,
- the method of payment of the premium to the seller: as a lump sum or in installments.
Floor options are settled on the settlement date – by us paying you the settlement amount if the strike rate is higher than the reference rate. In this case, the settlement amount will be calculated:
- as the product of the notional amount and the difference between the strike rate and the reference rate, and then
- as the quotient of the number of days in the interest period and the number of days in the year (according to the established interest calculation convention).
If the strike rate in a given interest period is lower than or equal to the reference rate, neither you nor we are obliged to make any payment on account of settlement.
Pros
If you exercise the interest rate option you bought, you receive the profit that results from favourable market conditions. It is reduced by the premium, however, which is the only potential loss you may incur – for both Cap and Floor options.
Cons
If you sell an interest rate option - which can only be done as part of an option strategy - you are exposed to unlimited losses – in both Cap and Floor options.
If you buy an interest rate option but are unable to exercise it due to the amount of the interest rate, you will lose the potential benefits of the transaction while you have paid a premium.
The market risk of interest rate options translates directly into the level of counterparty risk. This means that you must pay the valuation amount if you sell an interest rate option and if, at the time of settlement of this option, its valuation is adverse to you.
Option valuation depends on market conditions. This means that you may not exercise the option because the expected interest rate will not be achieved.
Risks
There are risks associated with the interest rate options, which we describe in the table under the following symbols: **A** and **A2**, **B**, **C** (only if you sell interest rate options), **D**, **E**, **F**, **G**, **M**.

5. IRS (Interest Rate Swap)
By concluding an IRS transaction, the parties to the transaction undertake to exchange interest payments from the effective date to the termination date on the payment dates. Interest is accrued in a given interest period, and the payment date falls at the end of that period.
Interest is charged at two interest rates, which the parties specified in the transaction terms and which may be fixed or floating:
- You will transfer to us the interest charged on the notional amount at the Client's reference rate,
- us – at the bank's reference rate.
The parties may also agree that:
- the notional amount will be floating in the period from the effective date until the termination date,
- settlement of all interest payments will be on a net basis – i.e., by payment of the amount of the interest difference by the party to whom the amount of interest due is higher (the party to whom the amount of interest due is lower).
Pros
According to your needs, you can determine at what interest rate you transfer interest to us: floating or fixed. This choice allows you to hedge the risk of interest rate volatility to which you are exposed.
An IRS transaction will secure the amount and timing of interest payments on financing (e.g., a loan) – depending on market conditions.
Transactions are available in major currencies, and the duration of transactions and the timing of individual interest periods are flexible.
Cons
Your choice of transferring interest (i.e., at a fixed or floating rate) applies during the entire term of the transaction. This means that you may not change this choice.

If, in an IRS transaction, you choose to transfer interest to us at a fixed rate - and receive from us interest at a floating rate – you may not take advantage of a drop (if any) in the market (floating) interest rate.
If, in an IRS transaction, you choose to transfer interest to us at a floating rate - and receive interest from us at a fixed rate – you face the risk that the market (floating) interest rate will rise above the fixed rate.
If both you and we transfer interest at a floating rates, you face the risk that your floating rate will be higher than the bank's variable rate. This means that you will transfer to us a higher interest rate than you will receive from us.
If the negative valuation exceeds the level specified in the contract, a cash collateral may be required. Due to the fact that particular transactions are tailored to your needs and that these instruments are not traded on the exchange, the availability of transaction valuation may be temporarily limited.

Risks

There are risks associated with the interest rate swap transactions, which we describe in the table under the following symbols: **A**, **A1** and **A2**, **B**, **C**, **D**, **E**, **F**, **G**, **M**.

6. Cross Currency Interest Rate Swap (CIRS)

By concluding a CIRS transaction, the parties agree to apply the following rules to the exchange of notional amounts and interest from the effective date until the termination date. Both the notional amounts and interest are expressed in two different currencies in this product – with the currency of the notional amount and the interest charged thereon being the same.
The parties will exchange notional amounts in such a way that:
- if the parties have agreed on the initial and final exchange of the notional amounts, these are transferred on the effective date and termination date, respectively - or
- if the parties have agreed only on the final exchange of the notional amounts, these are transferred only once – on the termination date.

If the parties agree that the notional amounts will be floating during the term of the transaction – they will also agree on the timing and conditions for the exchange of these amounts.
At the initial exchange, you transfer the bank's notional amount to us – and we transfer the Client's notional amount to you. At the final exchange, you transfer the Client's notional amount to us – and we transfer the bank's notional amount to you.
The parties to the transaction exchange interest payments. Interest is accrued in a given interest period, and the payment date falls at the end of that period. We transfer to you interest calculated on the bank's notional amount and at the bank's reference rate. You transfer to us the interest charged on the Client's notional amount and at the Client's reference rate.

Pros

According to your needs, you can determine in which currency and at what interest rate (variable or floating) you transfer interest to us. This choice allows you to hedge the risks of interest rate and exchange rate volatility to which you are exposed.
A CIRS transaction will hedge the amount and timing of interest payments on financing (e.g. a loan) while hedging the currency risk – depending on market conditions.
Transactions are available in major currency pairs, and the duration of transactions and the timing of individual interest periods are flexible.

Cons

Your choice of transferring interest (i.e., at a fixed or floating rate) applies during the entire term of the transaction. This means that you may not change this choice.
If, in a CIRS transaction, you choose to transfer interest to us at a fixed rate – and receive from us interest at a floating rate – you may not take advantage of a drop (if any) in the market (floating) interest rate.
If, in a CIRS transaction, you choose to transfer interest to us at a floating rate – and receive interest from us at a fixed rate – you face the risk that the market (floating) interest rate will rise above the fixed rate.
If both you and we transfer interest at floating rates, you face the risk that your floating rate will be higher than the bank's variable rate. This means that you will transfer to us a higher interest rate than you will receive from us.
If you sell currency in the final exchange, you face the risk that the market exchange rate will rise above the exchange rate for the CIRS transaction.
If you sell currency in the final exchange, you face the risk that the market exchange rate will drop below the exchange rate for the CIRS transaction.
If the negative valuation exceeds the level specified in the contract, a cash collateral may be required. Due to the fact that particular transactions are tailored to your needs and that these instruments are not traded on the exchange, the availability of transaction valuation may be temporarily limited.

Risks

We can assume that CIRS transactions are a combination of IRS and FX transactions and therefore the risks generated for CIRS contract buyers are the same as in IRS and FX transactions:
A, **A1** and **A2**, **B**, **C**, **D**, **E**, **F**, **G**, **M**.

COMMODITY PRICE RISK HEDGING TRANSACTIONS

7. Commodity Swap

By concluding a commodity swap transaction, the parties undertake that in the period from the effective date until the termination date on the payment settlement dates, they will settle by paying or receiving the payment settlement amount.

In the transaction terms the parties agree what price – fixed or floating – they pay in settlement of the transaction. You can choose between a fixed price and a floating price. On this basis, the payment settlement amount is calculated.

The payment settlement amount is the amount on a given payment settlement date, in the currency of the transaction, equal to the absolute value of the difference between:

- a fixed amount and a floating amount or
- the floating amount of one party to the transaction and the floating amount of the other party to the transaction.

If on a given payment settlement date:

- You make settlement at a fixed amount, and we make settlement at a floating amount:
  - if the floating amount is <u>greater</u> than the fixed amount, we will pay you the payment settlement amount,
  - if the floating amount is <u>lower</u> than the fixed amount, you will pay us the payment settlement amount,
- You make settlement at a floating amount, and we make settlement at a fixed amount:
  - if the floating amount is <u>greater</u> than the fixed amount, you will pay us the payment settlement amount,
  - if the floating amount is <u>lower</u> than the fixed amount, we will pay you the payment settlement amount,
- You and the bank make settlement at two variable amounts - calculated on the basis of two different floating prices:
  - if your floating amount is <u>greater</u> than our variable amount, we will pay you the payment settlement amount,
  - if your floating amount is <u>lower</u> than our floating amount, you will pay us the payment settlement amount,

Pros

You can exchange a floating commodity price into a fixed one, or a fixed one into a floating one, or a floating one into another floating one -—according to your needs.

Transactions are available in major currencies.

You can hedge the prices of a number of commodities and choose transaction periods.

Cons

The choice of the price you pay (fixed or floating) applies during the entire term of the transaction. This means that you may not change this choice.

If you choose that in a commodity swap you pay us a <u>fixed price</u> – and receive from us <u>a floating price</u> – you may not take advantage of a drop (if any) in the market (floating) commodity price.

If you choose that in a commodity swap you pay us a <u>floating price</u> – and receive from us <u>a fixed price</u> – you may not take advantage of a rise (if any) in the market (floating) commodity price.

If both you and we pay floating prices, you face the risk that your floating price will be greater than our floating price.

If the negative valuation exceeds the level specified in the contract, a cash collateral may be required. Due to the fact that particular transactions are tailored to your needs and that these instruments are not traded on the exchange, the availability of transaction valuation may be temporarily limited.

Risks

There are risks associated with the commodity swaps which we describe in the table under the following symbols: **A**, **A1** and **A3**, **B**, **C**, **D**, **E**, **F**, **G**, **M**.

STRATEGIES

8. Combinations of several transactions – strategies (structures)

You may conclude related transactions in which you buy and/or sell several financial instruments at the same time. Such a group of transactions is called a strategy or structure. When you conclude transactions as part of a strategy (structure), you may receive a different payout profile than that which results from concluding single transactions. The payout profile is understood as a relation between the level of market interest rates, FX rates, etc. and the level of profit or loss.

The analysis of strategies prior to their conclusion should be much more detailed than in the case of transactions using single financial instruments. Only after understanding in detail how a given strategy can work at diverse levels of market:

- interest rates,
- exchange rates or
- commodity prices,

you can tailor the strategy to your needs.

Regardless of the number of elements of the strategy, you will receive separate confirmations of the conclusion of all transactions on single financial instruments. However, each confirmation states that the transaction is part of the strategy.

Zero-Cost Strategies

In zero-cost strategies, you select the financial instruments you buy and sell in such a way as to reduce or even eliminate the cost of acquiring a particular strategy. In zero-cost strategies , however, it is often necessary for you to bear more of the risk associated with a given strategy (e.g. which results from the sale of options).

The most popular type of zero-cost strategies are option strategies. They can also be symmetrical or asymmetrical, knock-in or knock-out.

Symmetrical or Asymmetrical Strategies

In symmetrical strategies, you sell options for the same amount as you buy from us.

In asymmetrical strategies, you sell options for a higher amount than you buy from us. This means that when adverse market scenarios materialize for you, you may incur greater losses than with symmetrical strategies.

“Knock-in barrier” or “Knock-out barrier” strategies

The operation of such strategies depends on whether there are specified levels of interest rates or FX rates on the market which activate (knock in) or deactivate (knock out) the entire strategy or its part. Strategies of this type frequently offer attractive prices compared to strategies without barriers, but give no assurance as to their effectiveness. It may happen that they will not be activated or will be deactivated and deprive you as a buyer of the hedging or fail to give you the opportunity to earn the income planned.

One-period or Multi-period Strategies

Strategies can be prepared in such a way that they will cover one or multiple periods of transaction settlements. A one-period strategy is a combination of transactions that are settled on a single – predetermined date. A multi-period strategy is a combination of transactions, some of which are settled (or expire) earlier while some instruments are settled later – whereas the later settlements can in particular be made many times.

A specific case of multi-period strategies are such strategies where their selected components can be knocked in or knocked out depending on the existence of specific conditions defined in the transaction parameters.

Pros

Combining transactions allows you to create a solution tailored to your established goal. The strategy is more flexible than in cases of single transactions. You can also conclude a strategy for which you do not pay a net premium.

Cons

Strategies are often so complex that in order to conclude, monitor and evaluate them, you need a specialist knowledge and considerable resources. If the negative valuation exceeds the level specified in the contract, you will be required to establish cash collateral. Each strategy carries the risk of unlimited losses.

In asymmetrical strategies the amount of your obligations (commitments) – if we exercise the option – is higher than the amount of potential benefits (rights) -– if you exercise the option.