



# Financial instruments and related risks

## Foreign Exchange and Money Market products

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## Introduction

This document describes the nature of the financial products that are distributed by ČSOB, and their associated risks, in order to enable the client to take investment decisions on an informed basis. It is first and foremost intended for hedgers and investors that are in direct contact with the ČSOB dealing room.

The financial instruments are grouped in different product classes based on the type of underlying asset:

- Foreign Exchange products (FX)
- Interest Rate products (IR)
- Fixed Income instruments (FI)
- Other (including credit, equity and commodity related products)

For each type of financial instrument, the brochure describes the main features, the risk profile and also provides an overview of the variants of the basic products.

The financial products are grouped in levels of complexity, ranging from 1 to 3 (structures). The more complex financial instruments are linked to a higher level of complexity. Please note, however, that a higher level of complexity does not automatically mean that the risk associated with the financial instrument is higher.

ČSOB has defined three levels of complexity in order to make it possible to assess the knowledge and experience a client requires for every possible combination of product class and complexity.

Product Class\Complexity	Level 1	Level 2	Level 3
FX			
RV			
VR			
Other			

The volatility and leverage of the financial instruments have been assessed from the perspective of a hedger. These risk profiles may differ considerably if seen from a speculative point of view.

This brochure defines three reasons for concluding transactions:

- 1) *Hedging*: the conclusion of a contract with the same amounts and duration as a predetermined underlying risk. The purpose of the use of financial instruments is to eliminate the possible negative impact on the results of that risk. The use of financial instruments like options has a cost (premium), but from the point of view of the entire position of a hedger, there is no "risk of losing the entire underlying amount.
- 2) *Active risk management*: the managing of underlying risk positions by keeping them temporarily open or hedging them partially or by concluding hedging contracts with durations and amounts which are not exactly covering maturity and amounts of the underlying risk. The risk related to active risk management lies between the risks associated with hedging and investment.
- 3) *Investments*: the placement of available money into financial instruments in order to make a return.

## Definitions

### *Risk definition*

Credit risk	Risk that a financial counterparty will fail to fulfill its obligations. In most cases, this will be because of its poor financial status or imminent bankruptcy.
Liquidity risk/Limitations on the available market	Risk that an instrument may prove difficult to be dealt in at a reasonable price (prior to maturity).
Currency risk	Risk that the value of an investment or product is impacted by currency movements.
Interest-rate risk	Risk that the value of an investment or product is impacted by interest rate fluctuations.
Risk related to external factors	Risk that the value of an investment or product is impacted by external factors, such as the tax regime, etc.

### **General**

#### **OTC (“over the counter”)**

Financial instruments traded over the counter are instruments that are traded outside a regulated market.

#### **Leverage**

The degree that the price of a financial instrument changes due to a change in the price of the underlying assets.

#### **Volatility**

The variability of the price of a security, fund, market index or interest rate over a given period of time.

#### **Deliverable**

The contract is settled through delivery of the underlying assets (physical settlement).

#### **Cash settled**

The contract is settled in cash (in a major currency), as opposed to being physically delivered.

#### **Non-deliverable**

The contract is settled in cash (in a major currency), because the underlying currency is non-convertible.

#### **Complexity**

ČSOB divides products according to the scale of complexity /1 = the least complex, 2 = more complex, 3 = the most complex/

## **Option-related features**

The features are typical properties of optional financial instruments (Complexity level 2 or above).

### **European**

A property of a contract or feature meaning that it can be exercised only at maturity.

### **American**

A property of a contract or feature meaning that it can be exercised during the entire duration of the contract.

### **Barrier**

A barrier is a predetermined boundary or limit in the market, potentially impacting the outcome of a contract.

By using barriers, different contract features can be defined:

- Single: the outcome of the contract is potentially impacted by one barrier
- Double: the outcome of the contract is potentially impacted by two barriers
- Standard: the barrier is applicable during the entire life of the contract
- Partial: the barrier is only applicable during part of the life of the contract (window)

### **Knock-in**

A feature where a provision is included in a contract suspending its operation until a specific condition is fulfilled (suspensive condition).

### **Knock-out**

A feature where a provision is included in a contract suspending its operation at the moment that a specific condition is fulfilled (dissolving condition).

### **Binary**

A binary option is an option where the payoff on behalf of the buyer is defined as a payment of a price fixed in advance and made in certain currency upon meeting a certain condition. Should the condition not be met the buyer will not receive any payoff.

### **One touch**

This is a subset of Binary options. A type of contract stipulating that a predetermined payout will be made, provided that a certain predetermined price threshold (of the underlying asset) is achieved in the scheduled time.

### **No-touch**

This is a subset of Binary options. A type of contract stipulating that a predetermined payout will be made, provided that a certain predetermined price threshold (of the underlying asset) is not achieved in the scheduled time.

### **Digital**

This is a subset of Binary options. A type of contract stipulating that a predetermined payout will be made, provided that a certain predetermined price threshold (of the underlying asset) is not achieved at a specified moment of time.

### **Range**

A feature of a contract where the outcome of the contract depends on the market rate either staying within predetermined levels or exceeding those levels in either direction.

## List of abbreviations

FX	Foreign eXchange
FI	Fixed Income
IR	Interest Rate
MM	Money Market
CM	Capital Market
OTC	Over The Counter

## Risk of losing entire investment

Depending on the perspectives of the client, the risk of losing the entire investment should be considered in light of the risks associated with the underlying positions (see 'Introduction').

## Tax Treatment

The tax treatment of financial instruments depends on the characteristics of the financial product, the individual circumstances of each client and may differ from one country to another.

Clients who are in any doubt as to their tax position should consult their financial or own independent tax advisers. In addition, potential purchasers should be aware that tax regulations and their application by the relevant tax authorities change from time to time. Accordingly, it is not possible to predict the precise tax treatment which will apply at any given time.

## Description of financial instruments: FX

In addition to the building blocks described hereafter, ČSOB offers a wide scope of complex structures (composed of these building blocks). Since the spectrum of the structures changes regularly, this brochure only contains a selection of the available products. For more detailed information and a more detailed risk description, please refer to the term sheets of the available products.

## Complexity 1

### FX Swap

#### Description

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A foreign exchange swap is a transaction where two parties exchange a given amount of one currency for another with two different value dates (normally spot to forward). The two parties agree a currency exchange on one day and simultaneously agree to reverse that deal on a date in the future (typically less than 12 months).

Prospectus	<b>N/A</b>
Guarantee	<b>N/A</b>
Financial commitments and other additional obligations	<b>N/A</b>
Volatility	<b>Medium (Depending on the nature and volatility of the underlying currencies)</b>
Leverage (and its effects)	<b>Low</b>
OTC product?	<b>Yes</b>
Complexity level	<b>1A on a scale of 1 to 3 (structures)</b>

#### Risk profile

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Credit risk	<b>Low</b>
Liquidity risk/Limitations on the available market	<b>Low</b>
Currency risk	<b>High</b>
Interest-rate risk	<b>Medium (Proportionate with maturity)</b>
Risk related to external factors	<b>Low</b>

#### Variants

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N/A

## FX Forward

### Description

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A FX forward is an agreement between two parties to purchase/sell a certain amount of foreign currency, whereby the due date (or term) of the exchange transaction lies in the future (generally within a time scale of less than 12 months). The exchange rate at which the buying and selling occurs is the forward rate.

Prospectus	<b>N/A</b>
Guarantee	<b>N/A</b>
Financial commitments and other additional obligations	<b>N/A</b>
Volatility	<b>Medium (Depending on the nature and volatility of the underlying currencies)</b>
Leverage (and its effects)	<b>Medium</b>
OTC product?	<b>Yes</b>
Complexity level	<b>1A on a scale of 1 to 3 (structures)</b>

### Risk profile

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Credit risk	<b>Low</b>
Liquidity risk/Limitations on the available market	<b>Low</b>
Currency risk	<b>High</b>
Interest-rate risk	<b>Medium (Proportional to maturity)</b>
Risk related to external factors	<b>Low</b>

### Variants

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#### OTC

Standard variant

#### Exchange (FX futures)

No in group FX.

## Forward exchange operation with a limit rate

### Description

A Forward exchange operation with a limit rate is a specific product of ČSOB. It is an agreement between two counterparties about the purchase/ sale of a specific amount of foreign currency for a forward rate before or on a Date of settlement with a maximum maturity of 12 months. On the maturity date, there is no change of currency for the other since one of the parties closes a counter-operation trade prior to the maturity date and thus achieves an exchange profit or loss. The condition of opening a forward exchange operation with a limit rate is sufficient financial funds on a current account; during this operation these are blocked. By opening this operation, the stop loss limit rate is set. When this limit is reached, the bank has a right to close the operation.

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Prospectus	<b>N/A</b>
Guarantee	<b>N/A</b>
Financial commitments and other additional obligations	<b>N/A</b>
Volatility	<b>Medium (Depending on the nature and volatility of the underlying currencies)</b>
Leverage (and its effects)	<b>High</b>
OTC product?	<b>Yes</b>
Complexity level	<b>1B on a scale of 1 to 3 (structures)</b>

### Risk profile

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Credit risk	<b>Low</b>
Liquidity risk/Limitations on the available market	<b>Low</b>
Currency risk	<b>High</b>
Interest-rate risk	<b>Medium (Proportional to maturity)</b>
Risk related to external factors	<b>Low</b>

### Variants

N/A

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## Complexity 2

### FX option (plain vanilla)

#### Description

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An FX option gives the buyer the right, but not the obligation, to buy (**call**) or to sell (**put**) an agreed amount in a specific currency at a predetermined exchange rate on a specific date (**European type option**) or up to a specific date (**American type option**).

The seller (or writer) of a foreign exchange option has the obligation, if the buyer of the foreign exchange option exercises his right, to deliver or to buy the amount in the agreed currency at the predetermined exchange rate. To obtain this right, the buyer of the foreign exchange option pays a premium to the seller.

Prospectus	<b>N/A</b>
Guarantee	<b>N/A</b>
Financial commitments and other additional obligations	<b>N/A</b>
Volatility	<b>High</b> <b>(Depending on the nature and volatility of the underlying currencies)</b>
Leverage (and its effects)	<b>Low</b>
OTC product?	<b>Yes</b>
Complexity level	<b>2A on a scale of 1 to 3 (structures)</b>

#### Risk profile

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Credit risk	<b>Low</b>
Liquidity risk/Limitations on the available market	<b>Low</b>
Currency risk	<b>High</b>
Interest-rate risk	<b>Medium (Proportional to maturity)</b>
Risk related to external factors	<b>Low</b>

#### Variants

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##### European/American

See definitions

##### OTC

Standard variant

##### Exchange

No in group FX

##### Deliverable

Standard

##### Seagull, Risk Reversal, Participating Forward

Specific combinations of vanilla options

## Average Rate Forward (ARF)

### Description

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An Average Rate Forward is a type of currency forward with settlement in cash. A spot currency operation will not be closed, only automatic "cash" settlement will be performed. These forwards have a reference rate where a strike price is compared to the average official rate in the reference period.

Prospectus	<b>N/A</b>
Guarantee	<b>N/A</b>
Financial commitments and other additional obligations	<b>N/A</b>
Volatility	<b>Medium (Depending on the nature and volatility of the underlying currencies)</b>
Leverage (and its effects)	<b>Low</b>
OTC product?	<b>Yes</b>
Complexity level	<b>2A on a scale of 1 to 3 (structures)</b>

### Risk profile

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Credit risk	<b>Low</b>
Liquidity risk/Limitations on the available market	<b>Medium</b>
Currency risk	<b>High</b>
Interest-rate risk	<b>Medium (Proportional to maturity)</b>
Risk related to external factors	<b>Low</b>

### Variants

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N/A

## Complexity 3

Barrier, binar options, combinations of options (option structures) which include barrier, binar or other exotic options - for example European Forward Plus which is described below in this brochure.

### European Forward plus (structure)

#### Description

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An European Forward Plus is a structured product which is an analogy to the forward and vanilla option. The resulting process (whether an option or a forward) depends on the level of a market rate on the Option Claiming Date. Two resulting situations can occur:

- 1) if a Rated rate is not achieved by the Conclusive rate on the Option Claiming Date, EFP acts identically as if the client owned a vanilla option with a pre-agreed strike price.
- 2) if a Rated rate is achieved by the Conclusive rate on the Option Claiming Date, EFP acts like a forward with pre-agreed rate.

Premium: zero

Prospectus	<b>N/A</b>
Term sheet	<b>Yes</b>
Guarantee	<b>N/A</b>
Financial commitments and other additional obligations	<b>N/A</b>
Volatility	<b>Medium (Depending on the nature and volatility of the underlying currencies)</b>
Leverage (and its effects)	<b>Medium</b>
OTC product?	<b>Yes</b>
Complexity level	<b>3A on a scale of 1 to 3 (structures)</b>

#### Risk profile

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Credit risk	<b>Low</b>
Liquidity risk/Limitations on the available market	<b>Medium</b>
Currency risk	<b>High</b>
Interest-rate risk	<b>Medium</b>
Risk related to external factors	<b>Low</b>
Risk related to structure compared to risk related to each building block	<b>The structure is risky like the combination of the building blocks</b>

#### Variants

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N/A

## Barrier option

### Description

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A barrier option is an option where the buyer can exercise his right depending on whether or not the underlying FX rate has hit or exceeded a predetermined price (trigger) either during the life of the contract or on the maturity date.

Prospectus	N/A
Guarantee	N/A
Financial commitments and other additional obligations	N/A
Volatility	High (Depending on the nature and volatility of the underlying currencies)
Leverage (and its effects)	High
OTC product?	Yes
Complexity level	3A on a scale of 1 to 3 (structures)

### Risk profile

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Credit risk	Low
Liquidity risk/Limitations on the available market	Medium
Currency risk	High
Interest-rate risk	Medium (Proportional to maturity)
Risk related to external factors	Low

### Variants

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#### European/American

See definitions

#### Knock-in/Knock-out

See definitions

Knock-in/Knock-out barrier options have a higher leverage than standard barrier options.

#### Double knock-in/double knock –out

See definitions

#### Window (Partial)

See definitions

## Digital option

### Description

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A digital option is a type of currency option where the future payoff is defined as a payment of an amount fixed in advance and made in a certain currency (called Payout). The right to exercise an option depends on meeting the condition of the relation between the market rate and the agreed upon rate at a specified moment of time.

Prospectus	<b>N/A</b>
Guarantee	<b>N/A</b>
Financial commitments and other additional obligations	<b>N/A</b>
Volatility	<b>High (Depending on the nature and volatility of the underlying currencies)</b>
Leverage (and its effects)	<b>High</b>
OTC product?	<b>Yes</b>
Complexity level	<b>3A on a scale of 1 to 3 (structures)</b>

### Risk profile

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Credit risk	<b>Low</b>
Liquidity risk/Limitations on the available market	<b>Medium Digitals can be highly illiquid when close to maturity.</b>
Currency risk	<b>High</b>
Interest-rate risk	<b>Medium (Proportional to maturity)</b>
Risk related to external factors	<b>Low</b>

### Variants

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**European/American**  
See definitions

**Knock-in/Knock-out**  
See definitions

**One-touch/Double One-touch**  
See definitions

**No-touch/Double No-touch**  
See definitions

The information provided in this document is general in nature and may in no way be regarded as an offer in respect of any financial instrument mentioned, or as investment advice. More detailed information and specific, personal investment advice may be obtained from your personal adviser.

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