



# **Financial Market Products and Their Risks**

## **Foreign Exchange and Money Market Products**

Valid and effective from 06.12.2021

## Contents

Introduction	3
Explanatory notes	4
Description of risks	4
General	4
Characteristics of options	5
List of abbreviations	6
The risk of loss on a trade	6
Taxes	6
Description of financial instruments: Foreign Exchange and Money Market Products	6
Product complexity level 1	7
FX Swap	7
FX Forward	8
Product complexity level 2	9
FX options (plain vanilla)	9
Structured Deposit	10
Product complexity level 3	11
Average Rate Forward (ARF)	11
European Forward Plus (Structure)	12
Barrier options	13

## Introduction

The aim of the document is to provide the client with information about the nature of the Investment instruments for risk hedging purposes (hereinafter “hedging products”) offered by Československá obchodní banka, a. s. and about the risks of these products so that the client can make a qualified decision on purchasing/selling based on sufficient information.

Hedging products are classified into product groups/classes by the type of the underlying asset:

- Foreign Exchange and Money Market Products (FX).
- Interest Rate Products (IR)
- Investment Products – Debt instruments <sup>1</sup>
- Other Products (including products linked to commodities, credit or ownership interests).

We give the main characteristics, risk profile and a summary of variants derived from the basic product for every hedging product type.

Hedging products:

Hedging products are grouped by the level of complexity that may reach values of 1 to 3 (structures). The higher the group level the higher the product complexity. Please note that the higher complexity does not automatically mean that the risks of this product are higher. However, the structure complexity may mean that the product and its performance in various situations is more difficult to understand.

Československá obchodní banka, a. s., has set three complexity levels for hedging products to allow for the client’s knowledge and experience needed for every combination of product group and complexity.

Product group\ Complexity level of products within a group	Level 1	Level 2	Level 3
FX			
IR			
Other			

This brochure defines two reasons for using hedging products:

1. **Hedging:** The client buys a hedging product with the structure and **maturities so as to exactly eliminate the risk/risks to which the client is exposed**. The purpose of this hedging product is to eliminate/remove the negative influence of a particular risk. Using hedging products such as options incurs costs (the premium), but from the overall position of the hedging party the risk of losing the entire underlying amount is completely eliminated.
2. Active risk management: is managing basic risk positions, provided that
  - a) these positions remain temporarily open; or
  - b) these positions are partly hedged; and/or
  - c) hedging deals will be closed with maturities and amounts that may not fully match the maturities and amounts of the hedged items.

The active risk management risk is the risk of hedging and investment.

The information in this document is of a general nature and may not be considered as an offer under Section 1732 of Act No. 89/2012 Coll., the Civil Code, as amended (hereinafter the “Civil Code”) or as a public offer under Section 1780 of the Civil Code to invest in any instrument mentioned or as investment advice.

This document contains information that is the property of Československá obchodní banka, a. s. This document or any part of it may not be reproduced, published, distributed or otherwise used without the express consent of Československá obchodní banka, a. s.

<sup>1</sup> The Structured Deposit product only

## Explanatory notes

### Description of risks

#### Credit risk

The risk of the counterparty's inability to fulfill its obligations. In most cases, this is caused by the counterparty's poor financial situation or imminent threat of bankruptcy.

#### Liquidity risk/Limited market availability

The risk of a hedging product being difficult to trade for a reasonable price (before maturity) or a hedging product being difficult to trade at any price.

#### Currency risk

The risk of the value of a hedging product being influenced by exchange rate movements.

#### Interest rate risk

The risk of the value of a hedging product being influenced by interest rate movements.

#### Risks of external influences

The risk of the value of a hedging product being influenced by external factors such as a tax regime, etc.

#### Commodity risk

The risk of the value of assets being influenced by price movements on the commodity market.

#### Inflation risk

The risk of the value of a hedging product being influenced by price level movements.

### General

#### OTC ("over the counter")

A product traded over the counter is a hedging product traded outside regulated markets.

#### Leverage effect

The rate of change in the price of a hedging product as a result of a change in the price of the underlying asset.

#### Volatility

Variability in the price of a security, funds, a market, an index or an interest rate within a specified period.

#### Settlement with delivery

The trade is settled with the delivery of the underlying asset (physical delivery).

#### Settlement in cash

The trade is settled in cash (in the main currency), as opposed to the settlement with physical delivery.

#### Settlement without delivery

The trade is settled in cash (in the main currency), because the underlying asset is not convertible.

#### Complexity level of products within a group

ČSOB divides its products by their level of complexity (1 = least complex, 2 = moderately complex, 3 = most complex).

## Characteristics of options

These characteristics are related to option financial products (with a complexity level of products within a group of 2 or higher).

### European

The holder can exercise the option only at the exactly defined option maturity date (Option Exercise Date).

### American

The holder can exercise the option at any time during the contract term.

### Barrier

A barrier is a predetermined limit on a market parameter of the underlying asset, potentially affecting the outcome of a contract.

Different product parameters can be defined y using barriers:

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

### Knock-in

The option does not come into effect until a barrier is breached (suspensive condition).

### Knock-out

The option is effective until a barrier is breached; once a barrier is breached, the option will cease to be effective (dissolving condition).

### One touch

A contract feature stipulating that if a predetermined level (of the price of the underlying asset) is reached, then a predetermined payout will be made.

### No-touch

A contract feature stipulating that if a predetermined level (of the price of the underlying asset) is not reached, then a predetermined payout will be made.

### Range

A contract feature stipulating that the outcome of the contract depends on the price of the underlying asset either staying within or outside a predefined range.

## List of abbreviations

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

## The risk of loss on a trade

The client should assess the risk of a loss with regard to the risks of the underlying asset (type of product, see "Introduction").

## Taxes

The taxes on financial instruments depend on the characteristics of the product and the individual situation of each client and may vary by country.

A client with doubts about taxes is recommended to consult an independent financial or tax advisor. Investors should also take into account that tax regulations and their consequences interpreted by the competent authorities change over time. Therefore, the exact future tax impact on the investment cannot be predicted.

## Description of financial instruments: Foreign Exchange and Money Market Products

In addition to the basics described below, ČSOB also offers a wide range of complex structures (composed of these basics). As the range of these structures frequently changes, this brochure only contains a selection of available products. More accurate information and a more detailed description of the risks can be found in the detailed descriptions of available products ("term sheet" or "product sheet").

## Product complexity level 1

### FX Swap

#### Description

FX Swap is a transaction involving an exchange of two currencies at a spot rate and a subsequent reverse exchange of the amounts of both currencies at a forward rate. Therefore, it is a combination of a spot transaction and a forward transaction, with the first Settlement Date normally being of the spot type and the second being of the forward type (usually within 12 months).

Prospectus (Statute)	N/A
Guarantee	N/A
Financial commitments and other additional obligations	N/A
Volatility	Medium (depends on the type and volatility of the underlying currencies)
Leverage effect	Low
OTC product	Yes
Product complexity level	1 on a scale of 1 to 3 (structures)

#### Risk profile

Credit risk	Low/Medium
Liquidity risk/Limitations on the available market	Low
Currency risk	Low/High
Interest rate risk	Medium (depends on maturity)
The risk of external influences	Low

## FX Forward

### Description

FX Forward is an agreement between two parties to purchase/sell a certain amount of a foreign currency at a forward rate on the Settlement Date (usually within 12 months, with a value date other than the spot value date). Thus, the parties must deliver to each other certain amounts in different currencies on such a date.

Prospectus (Statute)	N/A
Guarantee	N/A
Financial commitments and other additional obligations	N/A
Volatility	Medium (depends on the type and volatility of the underlying currencies)
Leverage effect	Medium
OTC product	Yes
Product complexity level	1 on a scale of 1 to 3 (structures)

### Risk profile

Credit risk	Low
Liquidity risk/Limitations on the available market	Low
Currency risk	High
Interest rate risk	Medium (depends on maturity)
The risk of external influences	Low

## Product complexity level 2

### FX options (plain vanilla)

#### Description

By purchasing an FX option the buyer gains the right to buy (CALL) or to sell (PUT) an agreed amount of a specific currency in exchange for the corresponding amount in another currency at an agreed exchange rate (strike price) on an agreed date (European option) or up to an agreed date (American option). The option buyer pays a premium to the seller for this right.

Prospectus (Statute)	N/A
Guarantee	N/A
Financial commitments and other additional obligations	N/A
Volatility	High (depends on the type and volatility of the underlying currencies)
Leverage effect	Low
OTC product	Yes
Product complexity level	2 on a scale of 1 to 3 (structures)

#### Risk profile

Credit risk	Low
Liquidity risk/Limitations on the available market	Low
Currency risk	High
Interest rate risk	Medium (depends on maturity)
The risk of external influences	Low

## Structured Deposit

### Description

A Structured Deposit is a deposit product where the interest depends on the developments of exchange rates, prices and other parameters of financial market instruments. It allows the client to participate in financial market developments, while guaranteeing the investment made.

Prospectus (Statute)	N/A
Guarantee	N/A
Financial obligations and other additional duties	N/A
Volatility	Low
Leverage effect	Low
OTC product	Yes
Product score	2 on a scale of 1 to 3 (structures)

### Risk profile

Credit risk	Low
Liquidity risk/Limitations on available markets	High
Currency risk	Low/Medium
Interest rate risk	Low/Medium
The risks of external factors	Low
The structure risk compared to the risks of individual basics	N/A

### Product complexity level 3

Barrier options, binary options, combinations of options (option structures) that include barrier, binary or other alternatives such as European Forward Plus described below.

### Average Rate Forward (ARF)

#### Description

An Average Rate Forward is a type of currency forward with settlement in cash, i.e. no spot currency operation is closed, but only automatic "cash" settlement will take place. These forwards have a reference rate where a strike price is compared to the average official rate in the reference period.

Prospectus (Statute)	N/A
Guarantee	N/A
Financial commitments and other additional obligations	N/A
Volatility	Medium (depends on the type and volatility of the underlying currencies)
Leverage effect	Low
OTC product	Yes
Product complexity level	3 on a scale of 1 to 3 (structures)

#### Risk profile

Credit risk	Low
Liquidity risk/Limitations on the available market	Medium
Currency risk	High
Interest rate risk	Medium (depends on maturity)
The risk of external influences	Low

## European Forward Plus (Structure)

**Description**

A European Forward Plus (EFP) is a structured product that is an analogy to the forward and vanilla option.

The outcome (i.e. whether an option or a forward) depends on the level of a market rate (Decisive Rate) on the Option Exercise Date.

Two situations may occur:

1. if the Defined Rate is not reached by the Decisive Rate on the Option Exercise Date, the EFP acts identically as if the client owned a vanilla option with a pre-agreed strike price,
2. if the Defined Rate is reached by the Decisive Rate on the Option Exercise Date, the EFP acts like a forward with a pre-agreed rate.

Prospectus (Statute)	N/A
Guarantee	N/A
Financial commitments and other additional obligations	N/A
Volatility	Medium (depends on the type and volatility of the underlying currencies)
Leverage effect	Medium
OTC product	Yes
Product complexity level	3 on a scale of 1 to 3 (structures)

**Risk profile**

Credit risk	Low
Liquidity risk/Limitations on the available market	Medium
Currency risk	High
Interest rate risk	Medium
The risk of external influences	Low
The structure risk compared to the risks of individual basics	A structure involves the same risk as a combination of individual building blocks.

## Barrier options

### Description

Barrier options are part of the group of currency options where the right to exercise the option depends on reaching or not reaching a certain rate level during the period between closing the deal and the maturity of the option or during the maturity period of the option.

Prospectus (Statute)	N/A
Guarantee	N/A
Financial commitments and other additional obligations	N/A
Volatility	High (depends on the type and volatility of the underlying currencies)
Leverage effect	High
OTC product	Yes
Product complexity level	3 on a scale of 1 to 3 (structures)

### Risk profile

Credit risk	Low
Liquidity risk/Limitations on the available market	Medium
Currency risk	High
Interest rate risk	Medium (depends on the Settlement Date)
The risk of external influences	Low