S|E|B

Commodity derivatives
Information sheet

Financial instruments are all types of instruments that are intended to be traded on the securities market. They can be divided into complex and non-complex instruments. Before you trade in a financial instrument, we are required to ascertain whether you have sufficient knowledge and experience to understand the properties and risks involved in trading in financial instruments. Below is some information about the most important qualities and risks associated with a type of instrument in which you have shown an interest. If you do not have sufficient knowledge and experience, we recommend that you do not trade in this instrument.

Introduction
A commodity derivative is a collective term for, for instance, options, futures, forwards and swaps. The value of commodity derivatives is linked to the price movement of an underlying commodity or a commodity index. Commodity derivatives are normally used to reduce risk by guaranteeing the future price of a commodity, but can also be used to speculate on a rise or fall in the price of a commodity or commodity index. Commodity derivatives are categorized as complex financial instruments.

Derivative instruments vary in regard to their risk level and the factors that affect the financial outcome. It is therefore important that you understand what applies to the derivative you intend to trade in.

How commodity derivatives work
Commodity prices are determined by various factors such as balance between supply and demand, economic growth, climate factors and political decisions. This means that commodity prices can fluctuate significantly, not least between different seasons. Commodity derivatives can be used to increase or reduce the effects of future changes in commodity prices.

Commodities are normally divided into three main categories: agricultural products, metals and energy. A characteristic of commodity derivatives is that the value of the derivative is determined by the value of an underlying commodity or a commodity index. Derivatives always have a predetermined term.

When you trade in commodity derivatives, for instance options and forwards, you will be required to pledge collateral. The collateral requirement changes in line with changes in the price of the underlying commodity.

For whom are commodity derivatives suitable?
Commodity derivatives are normally used by commercial hedgers that stock, buy or sell commodities and want to reduce the risk of price fluctuations by guaranteeing the price of a future sale or purchase. It might, for example, be a grain producer wanting to guarantee the selling price of next year's wheat harvest.

Commodity derivatives can also be used for investment or speculative purposes to generate returns on invested capital. In such cases, the use of commodity derivatives can increase the risk in a portfolio of assets, because the value of the derivative may change more than the value of the underlying commodity. This leverage effect can result in either a higher gain or a higher loss in relation to your capital investment than if you had invested directly in the underlying commodity.

Trading in commodity derivatives
Commodity derivatives can be unlisted financial instruments that are not traded on a stock exchange. Unlisted commodity derivatives are tailored to the customer's needs and traded OTC (Over the Counter), i.e. directly between the customer and the bank. In order to trade in commodity derivatives with SEB, it is necessary to set a limit for how much you can trade in the derivative in question. Commodity derivatives traded with SEB are settled in cash on the closing day, meaning that there is no physical delivery of the underlying commodity.

SEB's commodity derivatives are normally priced in USD or EUR. If you trade commodity derivatives OTC via SEB, you may have the option of securing the price in the currency of your choice, e.g. SEK.

Types of commodity derivatives
There are various types of commodity derivatives. Below you can read about the most common commodity derivatives offered by SEB.

Commodity forwards
A commodity forward or future is a binding agreement between two parties in which both parties have an obligation to buy or sell an underlying commodity at a predetermined price (forward price). A commodity forward or future gives the buyer a long position that increases in value if the price of the underlying commodity rises, while the seller´s position increases in value if the price of the commodity drops.

The price difference between a forward or future and the market price (spot price) of the commodity is determined by, among other things, the market's pricing of supply and demand and a margin or deduction reflecting interest rates, storage costs etc., calculated to the expiry date of the forward or future. Note that the forward price can be either higher or lower than the spot price. SEB often trades in commodity forwards rather than futures, which means that the contract is settled on the closing day.

With SEB as the counterparty, the contract is always settled in cash and there is no physical delivery of the commodity.

Commodity swaps
A swap is an agreement between two parties (e.g. you and the bank) to exchange cash flows, which means they also exchange price risks. SEB trades commodity swaps in the form of an average rate contract or a bullet swap. Both alternatives are tailored commodity forwards suitable for customers who regularly buy or sell commodities.

The difference between an average rate contract and a bullet swap is that an average rate contract is settled at an average price for a specific period, while a bullet swap is settled at the price valid on the termination date. The difference between the settlement price and the pre-agreed fixed price creates a cash flow that is settled between the parties.

Commodity options
A commodity option is an agreement between two parties that gives the buyer (holder) a right, but not an obligation, to buy (call option) or sell (put option) an underlying commodity (forward) at a predetermined price (strike price) on a predetermined date (termination date). The buyer of the option pays a premium to the issuer for this right, and the buyer cannot lose more than the value of the premium.

If the price on the closing day is lower than the strike price (call option), higher than the strike price (put option) or equal to the strike price, the option falls due and is worthless and all the invested capital is lost.

The seller (issuer) of a commodity option has an obligation to sell (call option) or buy (put option) an underlying commodity (forward) at a predetermined price (strike price) on a predetermined date. If you issue an option, you always get to keep the initial premium, but your profit can never be greater than this premium. On the other hand, the loss can be unlimited.

If the price on the termination date is higher (call option) or lower (put option) than the strike price, the seller must sell or buy the forward at the strike price.

Note that with SEB as the counterparty, the option is always settled in cash and there is no physical delivery of the actual commodity.

Less capital is needed to buy an option than to buy the underlying commodity/commodity forward. Options can generate a higher value increase in terms of percentage than the underlying asset, but also carry a higher risk.

Risk
In the context of commodity derivatives, the term "risk" denotes the probability that the value of your instrument will decline. A higher risk often means a greater opportunity for a high return, but at the same time the risk of losing your invested capital increases.

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Risk varies substantially between different derivatives. Commodity derivatives can be used to avoid or reduce the risk associated with future commodity price changes, but can also be used to speculate with the aim of increasing the value of an investment. Speculating with commodity derivatives involves higher risk. When you trade in certain commodity derivatives, you risk losing more than you invested.

Trading in commodity derivatives always carries a counterparty risk, i.e. the risk that the counterparty (e.g. SEB) will not fulfil its commitments.

When commodity derivatives are used to secure the price of future business transactions, there is always a risk of the future transaction being miscalculated or not taking place. For this reason, it is crucial to always monitor the underlying business risk and not secure more than the volume of the expected future transactions.

More information

Companies or sole proprietors trading in financial instruments are covered by the European Market Infrastructure Regulation (EMIR). Among other things, this means that you must sign the contract named "Agreement regarding portfolio settlement" in order to trade in these instruments at SEB.

As a company or sole proprietor, you are also obliged to report your transactions to a transaction register, which requires you to have a Legal Entity Identifier (LEI). This can be obtained from various issuers, such as Nordlei (www.nordlei .org) or GMEI Utility (www.gmeiutility.org). You must have a LEI in order to trade in these instruments with SEB. You can also delegate the task of reporting your transactions to SEB, via an agreement. In that case, we will do the reporting for you.

Things to remember:

- The historical return of a financial instrument is not a guarantee of future return. The value of financial instruments can rise or fall, and it is not certain that you will get back all the capital you have invested.
- In order to trade in these instruments, you must familiarise yourself with the terms and conditions that apply to trading in financial instruments. The contracts that apply depend on the instrument you are trading in.
- Certain instruments require you to be liable to make payments in future. It is important that you are prepared to comply with your undertaking.
- Check the information on the statement and other reporting relating to your holdings, and inform us immediately of any errors.
- Regularly monitor changes in the value of your holdings and positions.
- You are responsible for taking any action necessary to reduce the risk of losses.
- Always ask for supplementary marketing material or further information with more details about the financial instrument you are interested in.

Check your experience

How long have you invested in this type of instrument?	What is the average amount of money you have invested in this type of instrument?	How many times per year have you traded in this type of instrument?
☐ No experience	☐ Up to 50 000	☐ Up to 2
☐ Less than one year	☐ Up to 100 000	☐ Up to 5
☐ 1 to 5 years	☐ Up to 250 000	☐ Up to 10
☐ More than 5 years	☐ Up to 500 000	☐ More than 10
	☐ More than 500 000	

Check your knowledge

1. As the seller of a commodity forward, what have you undertaken to do on the termination date?

A) ☐ To sell a commodity at a previously agreed price
B) ☐ To sell a commodity at the price on the termination date
C) ☐ Nothing – you can decide whether you still want to sell the commodity on the termination date

2. If you hold a call option on an underlying commodity, what does this mean?

A) ☐ You are entitled to sell the underlying commodity at a predetermined price
B) ☐ You are obliged to sell the underlying commodity at a predetermined price
C) ☐ You are entitled to buy the underlying commodity at a predetermined price

3. If you issue a call option on an underlying commodity, what does this mean?

A) ☐ You are entitled to sell the underlying commodity at a predetermined price
B) ☐ You are obliged to sell the underlying commodity at a predetermined price
C) ☐ You are entitled to buy the underlying commodity at a predetermined price

4. What is the difference between an average rate contract and a bullet swap?

A) ☐ An average rate contract is settled with the price of the commodity on the termination date
B) ☐ In an average rate contract the settlement is based on an average price for a predetermined period
C) ☐ An average rate contract is settled with the starting price of the commodity on the termination date

5. What risk are you taking if you buy a put option?

A) ☐ No risk at all
B) ☐ The maximum you can lose is the premium you paid
C) ☐ The loss could potentially be unlimited

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6. Most OTC-traded commodity derivatives are settled in cash. What does this mean?

A) ☐ You have to go to the bank with cash to pay for the derivative
B) ☐ The underlying commodity is paid in cash on delivery
C) ☐ No physical delivery of the commodity takes place

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7. The price of a commodity forward with a term of two months...

A) ☐ ... may only be higher than the spot price for the day
B) ☐ ... may both be higher and lower than the spot price for the day
C) ☐ ... is where the bank decides that the rate will be in the future

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