Commodity Swap

What is a Commodity Swap?

A Commodity Swap is an agreement to exchange payments based on a pre-agreed notional quantity of raw material on future dates, which are determined at the time of the transaction. Usually, one party to the transaction makes fixed payments and the other – floating, based on a certain index, futures or another reference price. For the Asian commodity swap, the reference price for the swap is the average reference price for the period, and for the European one – the price on maturity.

Who is the Commodity Swap for?

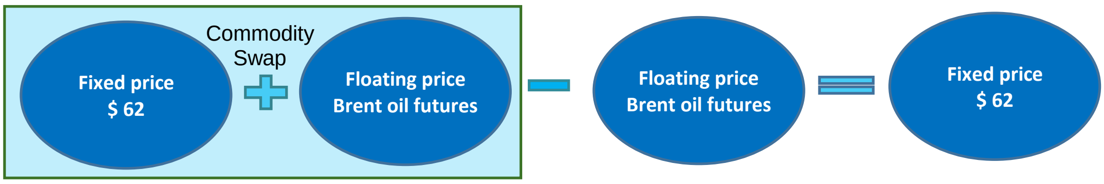
The Bank offers a commodity swap for hedging exposures to exchange traded goods.

How does a Commodity Swap work?

In case a client expects to buy or sell a commodity traded on a certain future date, it can protect itself from the change in the price of this commodity by concluding a commodity swap. For this purpose, the buyer of the exchange traded goods makes fixed swap payments and receives floating ones. On the opposite – sellers of such goods make floating payments on the swap and receive fixed. Thus, the combined result of the commodity swap and the payment for the commodity is the fixed price for the commodity swap.

Example:

A company must buy Brent oil after 3 months at the price of the maturing futures at the time. The company enters into a commodity swap at which it pays a fixed price and receives a floating one based on the price of Brent oil futures for the respective period.



Main advantages:

- **Protection** – The clients, who use Commodity Swap for hedging, receive protection against price moves of the commodity.
- **Cash flow management** – With the Commodity Swap, the cash flows, related to the commodity hedged commodity become known in advance.
- **Flexibility** – The Commodity Swap is an OTC instrument and its parameters are negotiated between the counterparties of the deal.
- **No premium** – The clients do not pay a premium in advance for a Commodity Swap transaction.

Main risks and requirements:

- **Early termination** – Depending on the value of the instrument, clients receive or pay a certain amount upon early termination.
- **Opportunity costs** – Clients who make fixed payments or receive such payments on a commodity swap can realize opportunity costs at falling/ rising prices.
- **Market risk** – The value of the instrument is influenced by market conditions, mainly by changes in the price of the respective commodity.
- **Currency risk** – If the swap payments are denominated in a foreign currency, there is a currency risk.
- **Limit for concluding deals** – The clients, who enter into a commodity swap transaction must provide cash collateral or have a pre-approved limit.

Can the customer terminate a Commodity Swap early?

Yes, the client can terminate its swap early. This is done by concluding a new swap deal with the same parameters, but in the opposite direction at the current fixed price. Depending on the difference between the two fixed prices, the client must pay or receive a certain amount at the maturity of the respective maturities of the transaction.

Collateral/ limit to Commodity Swap:

In order to conclude a transaction with a Commodity Swap, the client must provide cash collateral or be granted an investment services sub-limit. The limits for investment services are prepared and approved by the respective client service unit – Corporate Banking Directorate or the Small and Medium Enterprises and Agribusiness Department.

Collateral/ limit management:

Definitions:

- **The Principal collateral/Investment services sublimit** for the deals is the initially approved limit/ collateral for this type of deals.
- **The Initial margin** for the deal is the minimum required limit for this type of deals.

- **Variable margin** – means the negative market revaluation (from client's point of view) of all concluded and unmatured deals.
- **Coverage ratio** – the ratio of the sub-limit for investment services/ principal collateral, reduced by the variable margin and increased by the additional collateral provided by the Client, divided by the initial margin multiplied by the notional value of the concluded and unmatured transaction/s.

Collateral/ limit management process:

The Bank runs a **daily valuation of the financial instrument**. As a result of the valuation if the coverage ratio is:

- less than or equal to 100% as of the date of the revaluation, the Bank suspends the conclusion of new transactions with the Client.
- 90% or less than 90% at the date of the revaluation, the Bank shall inform the Client by telephone and/or e-mail and shall send a written request to the Client to provide additional collateral, so that the coverage reaches 100%. If the Client is unable to provide the necessary collateral, the Bank has the right to close the Client's open position by applying the current market price on the day of termination.
- 70% or less than 70% at the date of the revaluation, the Bank shall inform the Client of the decline and shall send a written request to the Client to provide additional collateral up to 100% within 24 hours of sending the written request. If Client is unable to provide the necessary collateral, the Bank has the right to close the Client's open position by applying the current market price on the day of termination.
- 50% or below 50%, the Bank closes the Client's open position by applying the current market price on the day of termination.

Documents:

- Framework agreement for Commodity Swap trading
- General terms & conditions applicable to agreements for the provision of investment services and activities to the clients of DSK Bank AD
- Additional Agreement to settle their relationship in relation to the fulfilment of their obligations under Regulation (EU) No 648/2012 (EMIR)
- Notification-questionnaire for client categorization under the Markets in Financial Instruments Act (MFIA)
- Product’s Target Market Compatibility Test
- Information on the nature and risks of financial instruments
- Information on costs

Key Information Document:

A key information document has been prepared for the financial instrument FX Option Collar, which every client should become acquainted with before entering into such a transaction. The KID can be obtained at the following address: 5 Georgi Benkovski str., Sofia or can be downloaded from the following web address: https://dskbank.bg/бизнес-клиенти/корпоративно-банкиране/финансови-пазари-и-инвестиции on the DSK Bank website.

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