

Information regarding characteristics and risks associated with financial instruments

All investments are related to risks, which in short can be described as possibility to fail to achieve the investment target. This document is designed to provide client with information regarding characteristics and risks associated with financial instruments.

Please Note – the description of financial instruments and related risks which follows is of a general nature. The terms and conditions applying to individual instruments can vary, and investors should always take care to ensure that they investigate and are fully informed about the particular characteristics of instruments in which they invest. AS “SEB banka” (hereinafter – “SEB banka”) will accept no liability towards clients who rely on what is written below without making such independent investigations.

The information contained in this document, as well as the General Terms and Conditions for entering into investments in financial instruments with SEB banka, including SEB banka's Order Execution Policy, are available at www.seb.lv and also from SEB banka's offices, or by contacting one of our client representatives.

1. REGARDING FINANCIAL INSTRUMENTS IN GENERAL

Financial instruments, (that is shares, bonds, units of funds, custody certificates or other rights or obligations which are the subject of trading in financial instruments markets), normally yield a positive return in the form of a dividend (in the case of shares), or interest (in the case of bonds). In addition, the price (i.e. market value) of the financial instrument may appreciate and depreciate relative to its price / market valuation at the time when the investment was made. In what follows, the word 'investment' is also used in the case of negative positions in financial instruments - i.e. the “short” sale by an investor of a security which it does not own, but has borrowed.

The total return on an investment is the sum of dividends/interest rate payments and any change in the market value of the financial instrument. Derivative instruments, such as options, forwards, futures, swaps etc., are issued for a variety of underlying assets, including shares, bonds, precious metals, interest rates and currencies. Derivative instruments may be used to decrease the risk of an investment or to produce greater returns.

What every investor seeks, of course, is a positive return on an investment - that is, an investment that yields a profit, preferably as large as possible. But there is also a risk that the net return of an investment is negative - that is, that the investment generates a loss. The risk of a loss varies with the financial instrument, as the prospect of a profit is usually correlated with the risk of a loss. The longer the duration of an investment, the greater the prospect of a profit and the risk of a loss. There are varying methods of investing in financial instruments to minimize risks. It is usually considered safer not to invest solely in one or a few financial instruments, but to instead diversify the investment across several or many financial instruments. These instruments should then provide a dispersion of risk, rather than producing a concentration of risks that may be realised simultaneously. When investing in financial instruments listed in a foreign denomination, there is also a foreign exchange risk.

Investments in specific financial instruments carry specific financial risks, as described in more detail below. The risk is assumed by the client, which must therefore seek advice from its financial service provider or asset manager in relation to the properties, risks, terms and conditions applicable to specific investments. The client must also continuously monitor its investments in financial instruments regardless of whether it received relevant advice before entering into the investment. Information required to monitor holdings of investments, such as prevailing market prices, are published in most major newspapers, teletext and at various websites maintained by market operators, financial services firms and other public media. Furthermore, the client should, with its own best interests in mind, be prepared to take swift action, where necessary, to close positions which unexpectedly develop negatively, or to provide additional collateral for investments that

have been financed by the use of loans if the collateral has depreciated in value.

The buying and selling of shares on regulated markets and other market venues constitutes a secondary market in the shares issued by a company. Efficient secondary markets - that is, markets in which it is easy to find buyers and sellers and where bids and prices of concluded transactions are continuously published in an environment of open information - are also beneficial to the listed companies on them, since it as a result will be easier for them to issue new shares to raise new capital.

1.1 Different market venues

There are several kinds of market venues in which to buy and sell financial instruments. A market venue is normally a regulated market, a multilateral trading platform (MTF) or a systematic internaliser; in addition, OTC-trading facilities are provided by many investment services firms.

1.1.1 Regulated Markets

Various financial instruments can be traded on each regulated market. For shares, only shares of limited companies may be listed and traded on a regulated market, and strict requirements are imposed on the companies listed on such markets, including obligations relating, among other things, to the company's size, distribution of ownership, business history and financial disclosures. A list of regulated markets in the European Union is maintained by the European Commission and can be found at <http://mifidatabase.cesr.eu>.

1.1.2 Multilateral Trading Facilities (MTF)

An MTF is a regulated trading system that is provided by a market or a financial services company. Generally, the requirements imposed on issuers of financial instruments listed at a MTF are lower than the requirements imposed by regulated markets.

1.1.3 Systematic Internalisers

A systematic internaliser is a financial services firm that, on an organized, frequent and systematic basis, matches clients' orders against the firm's internal orders book outside a regulated market or MTF. A systematic internaliser is obliged to continuously provide quotes to buy and sell liquid shares listed on a regulated market or MTF in which the firm is a systematic internaliser.

1.2 Different kinds and sources of risk

Whenever clients make an investment in a financial instrument, they should always undertake a risk evaluation, both in advance and continuously for as long as the position is held. There are many different kinds and sources of risks and other factors that should be taken into account in such an assessment, the most common of which are as follows:

Market risk – the risk that the market as a whole, or the relevant part in which the client has invested, depreciates.

Credit risk – the risk of default of payment of the issuer of a financial instrument or other counterparty.

Price volatility risk – the risk that large fluctuations in the market value of a financial instrument negatively affect the value of the investment over the period it is held.

Price risk – the risk that the market value of a specific instrument has fallen at the time it matures or is sold

Foreign exchange risk – the risk that a foreign currency related to a financial instrument depreciates.

Tax risk – the risk that tax legislation or levels are uncertain or may change.

Leverage risk – the risk that the construction of a specific derivative instrument multiplies the impact of changes in the market value of its underlying asset.

Legal risk – the risk that relevant laws and regulations are unclear or may change.

Company specific risk – the risk that a specific company performs worse than anticipated or suffers set backs, which negatively affects the value of financial instruments related to that company.

Industry specific risk – the risk that a specific industry performs worse than anticipated or suffers set backs, which negatively affects the value of financial instruments related to that industry.

Liquidity risk – the risk that the client cannot sell a financial instrument at a particular point in time due to lack of demand.

Interest risk – the risk that a financial instrument in which a client has invested depreciates in value due to changes to prevailing interest rates. In the case of a bond, the longer its duration, the greater the exposure to fluctuations in interest rates. In case of increasing interest rates, the bond will reduce in market value.

System risk – the risk due to (mainly) technical errors in systems, accounting systems or communication channels of depositories, stock exchanges, payment or other institutions, as a result of which transactions are cancelled, settlements are delayed after transactions, and inaccurate transaction occur etc.

2 SHARES AND SHARE RELATED INSTRUMENTS

2.1 Share and limited companies

Shares of limited companies entitle the holder to a share of the company's share-capital. Generally, if the company makes a profit, it will pay dividends to its shareholders out of its profits. Shares also entitle the holder to vote at shareholders' meetings – the highest decision-making body of the company. Generally, the more shares in the company the holder has, the greater its entitlement to the company's share-capital, votes and dividends. However, depending on the kind of share, the entitlement to votes may vary.

2.2 Share price

A share's price is to a large degree a reflection of the collective assessment of the market regarding the company's prospects for future profits. Movements in the price of a share are primarily the consequence of changes in investors' perception of such prospects. The impact of market developments, economic trends, technology, legislation, competition and other factors determine the demand for a company's products and services, and are therefore a fundamental cause of changes in the price of its shares.

Prevailing market interest rates also have an effect on the price of a company's shares. Rising interest rates will result in higher yields on new issues of interest-bearing securities, and this will normally put downward pressure on the price of publicly traded shares and previously issued interest-bearing instruments. That is because the yield on new issues of interest-bearing instruments is

proportionately higher, and because the cost of a company's debt will increase with rising interest rates, decreasing its profit margin.

Other factors relevant to the company, such as changes to its board, organization, supply of, and demand for, its factors of production etc. may have a material impact on the company's prospects of producing profits in both the short and long term, and thus on its share price. In a worst case scenario, the company may perform so poorly that it has to be declared bankrupt, in which case its share-capital, i.e. the shareholders' joint capital, is the first resource used to cover the company's debts. This could very well consume the entire share-capital, rendering the company's shares without value.

A company's shares may be listed on more than one market venue, in more than one country, with the share price at each market affecting the other through arbitrage activities. Price movements in a share may also result from price movements in other companies' shares, whether these are in the same sector, listed on the same or on another market venue, within the same country or abroad.

Market participants have varying demand for shares and differing opinions of how a share's price should be moving. These differences, which also include differences of opinion of how the company's value should be determined, contribute to the simultaneous existence of both buyers and sellers of financial instruments. However, if market participants generally agree on how a share's price is expected to move, there will be pressure from many market participants to either buy or sell the share. A large number of market participants selling a share will cause a fall in its price, while a large number of market participants buying a share will cause its price to increase.

A share's turnover (that is, the number of shares bought and sold in a particular period), also has an effect on its price. A high turnover will decrease the difference, also known as the spread, between financial intermediaries' bid / ask prices for a particular share. A share with a high turnover is often highly liquid, and is therefore easy to buy and sell; large positions can be bought and sold in such shares without affecting their price. Companies listed by regulated markets as having the highest turnover are generally perceived to be highly liquid. During the course of a day, or for longer periods of time, shares may experience varying price stability, as measured by the share's volatility - that is, the magnitude and frequency of changes to the share's price in relation to its average price over the period.

The prices at which a share has been bought and sold, such as the high/low/last price paid during the day, together with details of the final purchase/sale quotes and the cash turnover, are published in most major newspapers, teletexts and at various websites maintained by the market operators, financial services firms and other public media. The freshness of such data may vary with the channel and the manner of publication.

2.3 Different lists

Regulated markets and other market venues often list shares in different lists. The list on which a company's shares appear will depend upon its share capital, distribution of ownership, business history and amount of information on its financial strength and business. The shares with the highest turnover may also be included on a separate list. Shares on lists with high requirements and high turnover are generally perceived to entail a lower risk than shares on other lists.

2.4 Kinds and class of shares

Shares may be either preferred shares or common shares. In the case of a company's bankruptcy, the holders of its preferred shares are entitled to reimbursement after the holders of bonds and other debt instruments have been reimbursed, and before the holders of its common shares.

Shares may also be issued in classes, denoted by a letter, starting with A. A share's class is often related to the voting rights tied to that share, where shares of class A entitle the holder to more votes than a holder of a class B share, and so on. The purpose of issuing

shares of different classes is usually to preserve the influence of the original, founding, shareholders by entitling them to more votes than shareholders who acquired their shares in subsequent issues of other classes.

2.5 Nominal price, splits and reverse splits

A share's nominal price represents its share of the company's share capital. The sum of all of a company's shares multiplied by the share's nominal price is the company's share capital. At times, the company may wish to alter the nominal price, for example because the share's market price has risen sharply. By dividing each share into two or more parts, a process known as a split, the nominal price and the market price is lowered proportionately. The shareholders' assets, however, remain the same, but are distributed over a larger number of shares of a lower nominal value and with a reduced market price.

Conversely, a reverse-split may be performed if a share's price has sharply dropped. In such an instance, two or more shares are combined into one share. A shareholder's assets remain unaffected however, although distributed over a smaller number of shares of higher nominal value and with an increased market price.

2.6 Market introduction, privatization and takeovers

A market introduction occurs when a company's shares are listed on a regulated market or other market venue for the first time. The public is then usually offered the opportunity to purchase shares in the company in what is known as its initial public offering. This is usually involves the sale of shares in a pre-existing company, which has not previously been traded publicly and which wants to increase the distribution of its ownership and ease the purchase and sale of its shares. If the company is owned by the government, the market introduction is called a privatization of the company.

A takeover is when an investor, group of investors or another company makes an offer to buy the shares owned by the existing shareholders in a company. If the party making the offer receives 90% or more of the share capital of the company subject to the takeover, the investor may (depending on the law in the relevant jurisdiction) "squeeze-out" the remaining shareholders which have not accepted the offer – that is, force them to sell their shares, although they are entitled to adequate compensation.

2.7 Issues of new shares

A company that wants its business to grow often requires additional share capital. Additional capital may be acquired through an issue of new shares. Often, existing shareholders are issued with rights to purchase such newly issued shares before they are offered to the market. The amount of such rights issued to each existing shareholder is relative to its current shareholding in the company. Buyers of new issues of shares must pay a set price, often lower than the market price, for the new issue. As soon as the rights, which often command a value in the market, have been exercised, the market price of the share will often fall to an average of the market price before the rights expired and the price at which the shares were issued under the new issue. At the same time, each shareholder's number of shares held will increase according to the number of rights it exercised. Shareholders not wishing to exercise their rights may often sell their rights on the market venue where the company is listed, during the period (usually a week or two), during which the rights may be exercised. At the expiration of that exercise period, the rights expire and become obsolete and without value – accordingly, any shareholder that fails to either sell or exercise its rights has lost the opportunity to benefit, and ends up with a lower proportionate ownership of the company.

If the assets of a company have appreciated in value, this will be reflected by an increase in its reserves, in which case it may transfer some of the increase to its share capital by issuing bonus shares. When bonus shares are issued, they are distributed to each existing shareholder in proportion to the number of shares held. Through the issuing of bonus shares, the shareholder's number of shares increase, but the shareholder's share of the company's share capital remains unchanged. The market price of a company's share decreases after an issue of bonus shares, but the value of the

shareholder's holding is unchanged due to the increase in the number of shares. Another manner of a company increasing its share capital is by using its reserves to increase the nominal value of its shares, following which shareholders hold an unchanged number of shares with an unchanged market price.

A company may also make a targeted issue of new shares - that is, offer newly issued shares to a targeted group of investors without offering them by way of rights to existing shareholders. A company may also issue new shares to acquire other companies, businesses or other non-monetary assets. Both of these issues result in the dilution of current shareholders' voting rights and their share of the company's share capital, but neither the number nor market value of their shares changes as a result of this exercise alone. It must be borne in mind, however, that the motivation behind such an issue may impact the share price for other reasons.

2.8 General information regarding equity-related instruments

Closely related to shares are equity index-linked bonds, custody certificates (or depositary receipts), warrants, stock and stock index options, forwards, swaps and other futures.

2.8.1 Equity index-linked bonds are bonds the yield of which is tied to a stock index or even the value of a specific share. If the index increases, the yield on the bond does too. If the index decreases, the yield on the bond may drop to zero. Being a bond, however, the initial nominal amount of the investment is repaid at the end of the bond's maturity, provided the issuer is solvent.

2.8.2 Custody certificates (sometimes known as Depositary Receipts; the most popular types: Global Depositary Receipts – GDR, American Depositary Receipts – ADR) are a substitute for foreign shares, entitling the holder to the same rights as it would have if it held the actual share. Custody certificates are traded, just as shares, and their price movements normally follow the price movements on the foreign market venue where the underlying share is listed.

2.8.3 Convertible bonds are interest bearing financial instruments which, during a specified time period, may be converted into shares or other securities, sometimes for a fee. The yield of the convertible, that is its coupon, is usually higher than the dividend yield on the alternate share for which it may be exchanged. The price of the convertible follows movements in the price of the underlying share, but is expressed as a percentage of the nominal value of the convertible.

2.8.4 There are many kinds of **stock options**. Call options entitle the holder to, within a specified period of time, purchase a previously issued share at a pre-defined price. Put options, on the other hand, entitle the holder to sell shares at a pre-defined price, within a specified period of time. For each acquired option there is an issued option; the risk to the acquiring party is that the option will decrease in value, or reach maturity without value – and in the latter case, the premium which has been paid for the option will be lost without generating any return. The issuer of an uncovered call option is, unless other measures are made, exposed to a risk which may be unlimited.

The difference between issuing an uncovered and a covered call option is that in the latter case, the issuer holds the underlying instrument for the duration of the contract. By doing so, the issuer converts the financial risk into an opportunity cost. The potential monetary loss of the issuer is then limited to the difference between the cost of the underlying asset at the time of issuing the option, and the price stipulated in the contract reduced by the premium paid for the option.

The most extensive trading in stock options takes place on market venues. There, trading with equity index options also occurs. These index options result in profits and losses settled in cash as dictated by movements in the underlying index.

The market prices for options normally follow the price movements of the underlying asset.

2.8.5 An **equity forward** is an agreement between two parties where both parties are obliged to buy respectively sell, or otherwise settle in cash, a share at an agreed price at a future date. **Future contracts** are similar in their set-up, but are continuously settled in cash between issuer and holder.

2.9 Short sale

An investor which expects a particular share's price to drop and which is seeking a positive return may perform a short sale. Selling short involves selling a financial instrument, such as a share, which one does not own at the time; this is done by borrowing the instrument from a holder of the relevant instrument. This loan of the security will then be repaid at a specific date by buying the same instrument in the market and returning it to the lender. The return on the transaction depends on the development of the price of the security involved: if it falls below the price at the outset of the transaction, the return is positive; if it rises, the return is negative.

2.10 Securities Lending

By entering into a securities lending transaction, the lender forgoes any and all rights associated with ownership of the securities lent, including but not limited to any right to dividends, voting rights and similar, for the period during which the securities are lent.

In settling a securities lending transaction, the lender is entitled to reacquire the securities lent, alternatively receive their cash equivalent or the proceeds of redemption. Upon the borrower's insolvency or other cause of default, the lender's right to return of the securities is limited to any collateral the borrower has provided.

2.11 Suspension of trading

A situation may occur in which a position held by an investor can not be closed due to the suspension of trading in response to rapid price movements, in either direction, in an instrument. Events such as the suspension of trading limit the effectiveness of providing stop-loss instructions and similar arrangement which are designed to limit the adverse impact of aforementioned rapid price movements, which may, in such an event, not be possible to execute.

2.12 Stabilization:

From time to time we may enter into transactions with you in securities which are the subject of stabilization. In the interests of ensuring that markets for newly issued securities do not fluctuate heavily in the first days after their introduction, financial regulators have passed certain regulations which, provided the prescribed requirements are observed, permit the manager(s) of an issue to stabilize the price of the securities involved by repurchasing them in the market. This activity can result in the price of the relevant security being temporarily higher than it might otherwise be at that moment. However, given the nature of new issue markets, the fact of stabilization does not indicate the true underlying demand for a share – which may only become apparent once the period immediately after the introduction has passed and any stabilization activity has ended.

Further information relating to options is provided in the section relating to derivatives below.

3 MUTUAL FUNDS

When investing in a fund, an investor places capital with a fund management company (which in turn invests the capital in various financial instruments), and is in turn issued with shares in the fund proportionally the invested capital. The exact composition of the fund – that is, the nature of the instruments in which it invests, such as shares, bonds or a mix thereof – is determined by the fund's constituent rules, which are set out in its prospectus and management by-laws. Usually, the investor may exchange its shares in the fund for a cash amount reflecting the value of the fund's holdings. The terms on which this may be done are set out in the fund's prospectus.

Before investing in a fund, clients are strongly recommended to carefully review the fund's prospectus and annual report.

When investing in financial instruments, risk diversification theory requires that the investment be spread over several instruments. The fact that a particular share decreases in market value is not uncommon. By investing in several companies in several markets, the risk associated with a single company or market may be mitigated by diversification.

The number of shares required to effectively mitigate risks associated with individual instruments varies by market. It may require substantial investments to create a portfolio sufficiently diversified across both companies and markets. Funds, by investing in either or both bonds and shares, lower the capital requirements to the individual investor to achieve diversification. Many funds have limits on the relative portion of its capital that may be invested in a single company – and, as a result, it follows that funds generally achieve risk diversification. There are however many kinds of funds with varying associated risks. For example, some funds invest solely in particular markets, geographic areas and so forth. In order to understand an individual fund's investment strategy, the investor must carefully study the fund's prospectus and annual statements, in which the fund's investment strategy and composition are specified. These documents are available from the fund's management company or its custodian.

3.1 UCITS and non-UCITS funds

Funds can also be divided into UCITS and non-UCITS funds. UCITS is a EU regulation which has strict requirements on, among other things, a fund's investment strategy and risk diversification. A fund which is authorized under the UCITS Directive anywhere within the EEA may be marketed and sold within all member states of the EEA. Non-UCITS funds, also known as non-traditional funds (e.g. hedge funds), are funds that in some way deviate from the UCITS Directive. It is important that you, prior to making any investment in a fund, acquire information regarding the funds properties and governing regulation. Such information can be obtained in the funds prospectus. The fund's management company is required to proactively offer the prospectus to potential investors.

Hedge funds are free to invest in any asset class, market (including emerging markets) and may leverage their capital through loans and other means such as through investing in derivatives to increase potential yields. They may therefore assume a greater risk than UCITS funds. Unlike many UCITS funds, hedge funds may on the other hand yield a positive return even during sharp declines in the market.

The investment strategies of hedge funds are often high-risk. Due to leverage, a small movement in the market can lead to a major gain, but any losses will also be magnified sharply. The entire amount of you're a client's investment can, under certain circumstances, be lost. It is not uncommon for there to be little information available concerning a non-traditional investment. Moreover, many investment strategies are highly complex and very difficult to understand. Changes in strategy that can lead to a substantial increase in the level of risk are often virtually overlooked by investors, or are accorded too little attention or noticed too late.

The liquidity and tradability of non-traditional investments can vary a great deal. Hedge fund issues and redemptions are often only monthly, quarterly or annually. Fixed holding periods lasting many years are not unusual. Provisions regarding trading frequency and holding periods may change frequently and rapidly. Liquidations of funds can stretch over many years.

3.2 Offshore funds

Many funds in this category have a domicile in a tax advantageous overseas jurisdiction, which earns them the name offshore funds. They are frequently subject to less stringent legislation and supervision, which in turn offers poorer investor protection. Problems or delays may also arise in the settlement of buy and sell orders for units in such funds. There is no guarantee that an investor's legal rights will be enforceable.

4 INTEREST BEARING INSTRUMENTS

4.1 General information related to interest bearing financial instruments

An interest bearing instrument is a claim on the issuer of a loan. The yield is normally an interest rate paid to the holder of the instrument. There are different kinds of interest bearing instruments, depending on the issuer of the instrument, the collateral the issuer has for the loan, its maturity and the details of how and when interest is to be paid.

The interest (coupon) is normally paid on a yearly basis. For some loans, the interest is paid only once, at the end of the loan's maturity.

Another kind of interest payment involves the instrument being sold at a discount instead of, or in addition to, interest being paid. This kind of bond is called a zero-coupon bond. At the time of sale, the issuer sets the price of the instrument by discounting the loan, including the interest payments not being made over the life of the bond, to calculate a net present value. The net present value is less than the nominal amount to be received at the instrument's maturity date, and the difference between the two thus represents aggregate interest paid at the maturity of the bond. The potential purchaser can discount this aggregate terminal interest payment over the life of the bond, and thus calculate its equivalent compound interest rate – enabling the investor to compare its investment merits with non-discounted instruments. Bank certificates and government bonds are typically discounted in this way.

Yet another form of interest bearing financial instruments are lottery bonds, in which case the interest payments are randomly distributed among the investors, some receiving payments and some not. There are also interest bearing financial instruments and other forms of investment where the interest is protected against inflation and the investment therefore has a guaranteed real interest rate.

4.2 Risks and factors affecting the market value of interest bearing instruments

The risks associated with interest bearing instruments consist of the potential changes to the market value of the instrument due to changing market interest rates before the instruments reaches maturity, and of the risk of default by the issuer. Therefore, instruments on which the repayment at maturity is fully covered by secured collateral are considered less risky than loans without collateral.

The prices at which existing instruments trade in the secondary markets and the demand from investors seeking newly issued instruments are used on a daily basis to determine the interest rates at which newly issued instruments of both short (less than a year) and long duration are brought to market. The prices and interest rates set in the capital market are affected by the investors' perception of the long and short term outlook for inflation, business cycles, interest rate developments (domestic as well as international) and other factors. Central banks also intervene in the market through market operations designed to steer macro economic variables according to a set agenda, which may include attempting to meet targets for inflation, money growth, or other indicators. The financial instruments traded in capital markets (government bonds, government and corporate debt certificates and real estate bonds) are often traded in very large denominations (multiples of millions).

If market interest rates are rising, the market price for issued financial instruments which carry a fixed interest rate will fall, since new instruments will be issued at a higher interest rate than is paid on instruments already in issue. Conversely, if market interest rates fall, issued interest bearing instruments with fixed interest rates will appreciate in value. Instruments on which interest rates are reset will not be affected in the same way, although there may be a marginal effect depending on the length of time to the next interest-rate reset.

Loans issued by governments and municipalities are often perceived as risk free in terms of default, although there is always some risk; the same is true of bonds which they issue. Other issuers of bonds must often either provide collateral in the form of other financial instruments or assets, or offer a yield that is at a premium above the notional "risk-free" government yield, in order to offset the higher risk involved.

Some bonds, such as debentures, have a lower priority of repayment. These instruments are therefore associated with a higher risk should the issuer have difficulties repaying the loan.

Additional risks may be associated with certain types of bond, e.g., floating rate notes, reverse floating rate notes, zero bonds, foreign currency bonds, convertible bonds, indexed bonds, subordinated bonds, etc. For such bonds, the investor is advised to consider carefully the risks referred to in the issuance prospectus and not to purchase such instruments before being certain that all risks are fully understood.

In the case of subordinated bonds, investors are advised to enquire about the ranking of the debenture compared to the issuer's other debentures. Indeed, if the issuer becomes bankrupt, those bonds will only be redeemed after repayment of all higher ranked creditors.

In the case of reverse convertible notes, there is a risk that the investor will not be entirely reimbursed, but will receive only an amount equivalent to the underlying securities at maturity.

5 STRUCTURED PRODUCTS

Structured products combine different kinds of financial instrument, of which at least one is a derivative, which are provided to clients in the form of a single product to produce specific investment characteristics. Common characteristics of structured products are caps and floors to potential losses and yields. They are also used to separate market related yield from industry and company specific yield, giving investors the opportunity to narrow their risk exposure. There is a multitude of structured products available on the market today. Some structured products are produced to accommodate risk adversity, whereas others entail a higher risk than the underlying instruments individually. More detailed information regarding the risks associated with a specific product can normally be found in the product's prospectus. An investor purchasing such a security in the primary market is normally given the product's prospectus when the product is issued. Investors in secondary markets – that is, regulated markets and other venues trading previously issued financial products - are not automatically provided with the product's prospectus, and should therefore be sure to obtain it before taking an investment decision.

With structured products, buyers can only assert their rights against the issuer. Hence, in addition to the market risk, particular attention needs to be paid to issuer risk. Clients therefore need to be aware that, as well as any potential loss they may incur due to a fall in the market value of the underlying, a total loss of their investment is possible if the issuer should default. Market makers, who in most cases are the issuers themselves, normally guarantee that structured products are tradable, although liquidity risks cannot be excluded.

6 DERIVATIVE AND SHORT SALES – POTENTIAL HIGH YIELDS BUT ALSO HIGH RISKS

Derivative instruments, such as options, forwards, futures etc., are issued with many different kinds of underlying asset, including shares, bonds, precious metals and currencies. Although short sales are not a kind of financial instrument but a particular kind of investment in a financial instrument, they are included here, since the associated risks are similar to the risks associated with investing in derivative instruments.

6.1 General information regarding derivatives

Investing in derivative instruments and the short sale of financial

instruments involves assuming a particular risk, unlike “at sight” investments made directly in the underlying asset. Investing directly in the underlying instruments, may, in a worst case scenario, result in a loss of no more than the entire investment. In the case of some investments in derivatives and short sales, the investor could potentially lose the entire investment and take on additional obligations (i.e. the equivalent of debt) as well. Another characteristic of derivative instruments is that changes in the instrument's market value are generally swifter and sharper than changes in the case of at sight instruments. It is therefore necessary that investors in derivative instruments not only fully understand the risks involved, but that they are also constantly prepared to take action to avoid severe losses if the market develops unfavourably.

6.2 Different purposes and uses of derivative instruments

Derivative instruments are contracts (agreements) which are tied to underlying assets or indicators, such as financial instruments, currencies, precious metals or price indexes. Such instruments may be used to counter an unfavourable movement in the price of an asset (also known as hedging). They may also be used to boost the yield of an investment, using less capital than would be required to produce the same yield in an investment in the underlying asset (also known as highly-g geared investment). Last but not least, derivative instruments may be used to take advantage of price discrepancies between different markets (arbitrage).

The basis of an investment decision in derivatives instruments is the expectation of a specific future development in the price of the underlying asset over a certain period of time. The investor should therefore have a clear picture of the expected market movement. In addition, the investor must have a clear understanding of the purpose of the investment (that is hedging, highly-g geared investing or arbitrage). Only when these preconditions are fulfilled is it possible for the investor to choose the derivative instrument or combination of instruments with the appropriate risk profile.

6.3 Different kinds of derivative instruments

6.3.1 An option is an agreement between two parties under which the issuer is obliged to buy (put option) or sell (call option) the underlying asset at a pre-agreed price, to the purchaser of the option. The holder pays a fee (premium) to the issuer upon concluding the agreement, and thereby acquires a right, but not an obligation, to call on the exercise of the option under the agreement. On an option being exercised, the exercising party will either by pay for, and take delivery of, the underlying asset(s) in question, or (which is the usually case where an index is involved) will be involved in a net cash settlement. In a net cash settlement, if the market price of the underlying asset at the end date is higher than the price stipulated in a call option, the holder of the call option receives the difference between the stipulated price and the market price. If the market price of the underlying asset is equal to or less than the price stipulated in a call option, the call option expires without value. The reverse is true for a put option. There are two kinds of options. An American option entitles its holder to exercise the option at any time of its duration, whereas a European option may only be exercised at the end of its duration.

6.3.2 Forwards and futures are agreements under which the parties involved conclude an agreement involving the right and obligation to buy, and respectively sell, the underlying asset at a predetermined price. In the case of a forward, the underlying asset is either delivered physically, or any profits and losses are settled in cash. In the case of futures, profits and losses are monitored on a daily basis for the duration of the contract period, which may have consequences for any collateral which has been given as security under the contract (for which see further below). Forwards can only be settled on the end date, whereas futures may normally be settled (i.e. “closed out” with the counterparty) at any time before the end date.

6.3.3 A swap agreement is an agreement between parties to swap streams of payments, such as a fixed interest rate for a floating interest rate (interest rate swap) or interest payments in different currencies (currency swap), for a duration of time. There are different combinations of interest rate and currency swaps.

6.3.4 Selling short means selling a financial instrument, such as a share, which one does not own at the time; this is done by borrowing the instrument from a holder of the relevant instrument. This loan of the instrument will then be repaid at a specific date by buying the same instrument in the market and returning it to the lender. The return on the transaction depends on the development of the price of the security involved: if it falls below the price at the outset of the transaction, the return is positive; if it rises, the return is negative.

6.4 Standardized instruments and OTC-derivatives

Derivative instruments can be both standardized and non-standardized. The distinguishing characteristic of standardized instruments is that the terms of the contract are always the same, and the instrument is normally traded on a market venue on which prices are continuously published.

Non-standardized contracts are those which are individually negotiated between two parties. Such contracts are usually referred to as OTC-instruments (over the counter). Banks and other financial intermediaries may provide “tailored” swap agreements and other OTC-derivatives, such as options and futures, to their customers.

6.5 Characteristic properties of derivative instruments

6.5.1 Leverage

The value of a derivative instrument is dependent on both movements in the underlying asset's price, as well as on the remaining duration of the contract. Depending on the characteristics of the instrument, a movement in the price of the underlying asset will often result in a larger movement in the price of the derivative contract. The relative change in price of the derivative is therefore often larger than the change of the underlying asset. This is known as the leveraged effect, and it may lead to higher yields on the invested capital than the same amount invested in the underlying asset would have produced. A successful investment may quickly multiply the invested capital several times. Conversely, the leveraging effect may work to the investor's disadvantage, resulting in a larger loss on the derivative instrument than would have been the case for an investment in the underlying asset. If the price of the underlying asset develops differently than expected, the entire invested capital may be lost. The potential for profit and loss varies with the derivative contract's set-up and use.

The duration of derivative instruments may vary from very short to several years. This affects the leverage effect, and therefore also the risk associated with the investment. For example, price movements are most often the largest for instruments when only a short period of their duration remains.

6.5.2 Risks of losing more than the invested capital

There are basically two types of investment: those with limited and those with unlimited risk. The purchase of equities or options involves limited risk. At worst the entire amount of the capital invested is lost. On the other hand, there are certain types of derivatives that can require an additional outlay of capital over and above the original investment, in the form of margin payments (for which see further below). The amounts involved in this obligation can be many times the original level of the investment. Unlimited risk is particularly associated with:

- writing an unlimited uncovered call option,
- swaps, or
- forwards and futures.

If, in such cases, an investor wishes to limit or reduce the level of risk, it is recommend to take special precautions at the time you make the investment (especially by hedging against potential losses using forwards or futures).

In the case of options, the amount of risk is determined by whether the investor buys or issues the option. The holder, that is the buyer, can elect to buy or sell the underlying asset at a certain price. The issuer, on the other hand, has an obligation to buy or sell the underlying asset if the holder makes such an election. This implies that the holder of the option will, at most, lose the premium paid for the contract. In other words, if the price of the underlying asset is less (more) than that stipulated in a call (put) option at the end of

the contract's duration, the holder will not exercise the option and will thus forfeit only what was paid for the contract at the outset. The holder could not however, in any situation, make a loss greater than the premium paid at the outset of the contract.

The situation is different for the issuer of an option, future or forward. The issuer of such a contract is obligated to buy or sell the underlying asset at the agreed price. This implies that an issuer of a call option is obligated to sell the underlying asset at the agreed price, regardless of the market price of the underlying asset at the time when the option is exercised. Equally, the issuer of a put option is obligated to buy the underlying asset regardless of the market price, should the holder choose to exercise the option. The issuer therefore stands to lose much more than the premium received at the outset of the contract. Since, theoretically, there is no upper limit for the market price of an asset, the issuer of an uncovered call option is taking a risk of loss that is, theoretically, unlimited.

An investor making a short sale assumes the same risk as the issuer of an uncovered call option. The investor who has sold the borrowed shares is obliged to return them regardless of the market price of the share at the agreed date. The potential loss is therefore unlimited in this case too.

6.5.3 Margin requirements related to derivative contracts and short selling shares

An investor assuming an obligation by issuing an option, entering a futures or forward contract or short selling shares is normally obliged, when entering into such a business agreement, to provide collateral to cover the obligation. As the underlying asset appreciates or depreciates in value, the collateral requirement to cover the position also changes. Additional collateral may therefore be required on short notice. The leveraging effect therefore also applies to the collateral requirement.

In the case of failure by a party to provide collateral, the counterparty normally has the right to terminate the agreement (i.e. close the position) immediately, to limit its potential losses. Pursuant to the contract, the counterparty normally seizes the collateral provided, such as pledged financial instruments, and sells it on the market, normally without consulting the owner, using the proceeds of the sale to cover any losses it has incurred. An investor

must therefore carefully monitor the effect of price movements on its collateral obligations, in order to avoid an involuntary closing of the position.

7. REPO AND REVERSE-REPO

Reverse repo transaction is an agreement on sell of financial instrument with an obligation to repurchase it at the maturity date for fixed price. This service available form clients that own financial instruments with high liquidity, usually bonds, and that need to borrow money for short term. Repo is an agreement to purchase financial instrument with an obligation to resell it at the maturity for fixed price.

Both of these transactions contain two stages:

- 1) Seller agrees to sell and buyer agrees to buy certain financial instruments for an agreed price. Buyer pays the seller amount of money that has been agreed only after financial instruments are transferred to securities account of the buyer.
- 2) in the same time the buyer agrees to sell and seller agrees to buy back the same financial instrument, by paying the seller an agreed amount of money at an agreed date. Buyer transfers financial instrument to securities account of the seller only after the seller has paid the agreed price.

In both cases rights to financial instruments are transferred to the buyer. The repurchase price is calculated using an agreed interest rate. Repurchase price is higher than the purchase price because it compensates the buyer for the provided financial resources. Interest rate, which is indirectly incorporated into repurchase price, is called a repo rate and usually is close interbank money market rates in the respective currency with added premium for the buyer. Reverse repo transactions allows client to borrow funds for a lower interest rate and keep rights to financial instruments if they are repurchased from the buyer at the maturity date.

In prices of financial instrument develops unfavourably for the seller (price of financial instrument decreases relatively to the repurchase price), the seller might be obliged to provide additional collateral. In case it is not provided, the buyer can realize (sell) financial instruments. Risks of the reverse repo transaction are equivalent to risks of the underlying financial instrument.