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# **EUROBANK PRIVATE BANK LUXEMBOURG S.A.**

## **RISK DISCLOSURE**

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## FINANCIAL INSTRUMENTS AND RELATED INVESTMENT RISKS

This document contains information about some Financial Instruments, including guidance on and warnings of the risks associated with those Financial Instruments. It is provided herein so that the Customer is able to understand the nature and risks of the service and of the specific type of Financial Instrument being offered and, consequently take investment decisions on an informed basis. This document cannot and does not disclose all the risks and other significant aspects of Financial Instruments.

A Customer shall not deal in Financial Instruments unless he understands their nature and the extent of his exposure to risk and potential loss. A Customer should also be satisfied that the product and/or service is suitable for him in light of his circumstances and financial position and, where necessary, he should seek appropriate independent advice in advance of any investment decisions.

Risk factors may occur simultaneously and/or may compound each other resulting in an unpredictable effect on the value of any investment. In any of the situations described below, the use of leverage (which has the effect of magnifying potential positive or negative outcomes) may significantly increase the impact on any of the risks described.

All Financial Instruments carry a certain degree of risk and even low risk investment strategies contain an element of uncertainty. The types of risk that might be of concern will depend on various matters, including how the instrument is created, structured or drafted. The specific risks of a particular Financial Instrument or transaction will depend upon the terms of the product or transaction and the particular circumstances of, and relationships between, the relevant parties involved in such product or transaction. Different Financial Instruments involve different levels of exposure to risk.

Set out below in Section 1 is an outline of the major generic categories of Financial Instruments and their associated risks, which should be read in conjunction with Section 2 of this document.

## 1. GENERIC DESCRIPTION OF FINANCIAL INSTRUMENTS

The Bank trades on behalf of its customers, on transferable securities and derivatives in regulated international markets. In addition, the Bank offers other financial instruments that are not traded in regulated markets. Overall, the vast variety of financial instruments provided by the Bank may cover most investor's needs, be it capital preservation, income, capital growth, hedging or speculation.

### 1.1 Money Market Instruments

Money market instruments are short term instruments with maturity that is typically one year or less. These instruments offer a high degree of liquidity to investors and pay interest on the invested principal. Indicatively, money market instruments include the following:

- (i) Certificates of Deposit: Certificates of Deposit are instruments that are typically issued by commercial banks and have maturity that ranges from one month to five years. These instruments have a specific, predetermined maturity and typically a fixed interest rate. Certificates of Deposit are intended to be held by the investors until maturity, upon which the invested principal is returned to the investor along with the accrued interest.
- (ii) Treasury Bills: Short term debt instruments issued by governments, usually on discount basis, guaranteed by the country's government and mature at par in one year or less (e.g. Greek Government Notes or U.S. T-Bills). Their interest rate usually depends on their maturity as well as the credit rating of the issuing state.
- (iii) Commercial Paper: Issued by states and private corporations at a discount or at par in order to finance their working capital needs, with maturity of typically up to 365 days. They have a specific principal and maturity; they are transferable and traded in secondary markets. These instruments are usually issued by large corporations which maintain a high enough credit rating by Credit Rating Agencies.
- (iv) Bankers' Acceptance Notes: Short term money market instruments issued by

corporations whose principal and interest payments are guaranteed by a banking institution.

- (v) Repos/Reverse Repos: Repurchase Agreements are agreements to borrow (Repos) or lend money (Reverse Repos) at an implied rate, via entering into sale and repurchase transactions (or vice versa) of bonds at pre-determined prices. In other words, Repos and Reverse Repos are money market instruments that use bonds as collateral.
- (vi) Promissory Notes: A promissory note is a financial instrument that contains a written promise by one party (the note's issuer) to pay another party (the note's payee) a definite sum of money, either on demand or at a specified future date. A promissory note typically contains all the terms pertaining to the indebtedness, such as the principal amount, interest rate, maturity date, date and place of issuance, and issuer's signature.

In case these instruments are not held until maturity the investor may lose part of the invested principal.

**Investment Risks:** Like other debt instruments, money market instruments may be exposed to the major risk types in Section 2 below, in particular credit, interest rate, inflation and liquidity risk.

## 1.2 Time deposits

These are cash deposits remunerated at a fixed maturity date and rate, determined in advance.

### Characteristics:

- Yield: payment of interest;
- Duration: short-term (up to 1 year), medium-term (1-8 years) or long-term (more than 8 years);
- Interest rate: the interest rate depends on the terms and conditions of the deposit; e.g. a fixed interest rate for the entire duration or a variable (floating) interest rate often linked to a financial market reference interest rate (e.g. LIBOR or EURIBOR).

### Advantages:

Depending on market conditions, these products may provide a higher return than other money

market instruments and their duration can be tailored to clients' specific needs.

### Risks:

Like other debt instruments, time deposits may be exposed to the major risk types in Section 2 below, in particular credit, interest rate, inflation and liquidity risk.

## 1.3 Fiduciary Time deposits

An arrangement wherein a depositor instructs the bank to deposit all or part of his liquid assets with another bank. The depositor chooses the degree of risk he wishes to take by choosing the bank (from available options) where his liquid assets will be deposited and by predetermining the amount and period of such deposit.

### Advantages:

As per 1.2 plus the investor has the flexibility to choose which bank he wants to deposit his liquid assets with, while maintaining a high level of confidentiality.

**Investment Risks:** Like other debt instruments, fiduciary time deposits may be exposed to the major risk types in Section 2 below, in particular credit, interest rate, inflation and liquidity risk.

## 1.4 Shares and Other Types of Equity Instruments

- (i) Common Shares: Securities representing equity ownership in a corporation, providing voting rights, and entitling the holder to a share of the company's success through dividends and/or capital appreciation. In the event of liquidation, common shareholders have rights to a company's assets only after bondholders, other debt holders, and preferred shareholders have been satisfied. Typically, common shareholders receive one vote per share to elect the company's board of directors (although the number of votes is not always directly proportional to the number of shares owned).

Preference shares: Securities which provide a specific dividend that is paid before any dividends are paid to common shareholders, and which takes precedence over common stock in the event of a liquidation. Like common shares, preference shares represent partial ownership in a company,

although shareholders do not enjoy any of the voting rights of common shareholders. Also unlike common shares, preference shares pay a fixed dividend that does not fluctuate, although the company does not have to pay this dividend if it lacks the financial ability to do so.

Depository Receipts (ADRs, GDRs, etc.):

Are negotiable certificates, typically issued by a bank, which represent a specific number of shares in a company, traded on a stock exchange which is local or overseas to the issuer of the receipt. They may facilitate investment in the companies due to the widespread availability of price information, lower transaction costs and timely dividend distributions. The risks involved relate both to the underlying share and to the bank issuing the receipt. In addition, there are important differences between the rights of holders of ADRs and GDRs, (together, **Depository Receipts**) and the rights of holders of the shares of the underlying share issuer represented by such Depository Receipts. The relevant deposit agreement for the Depository Receipt sets out the rights and responsibilities of the depository (being the issuer of the Depository Receipt), the underlying share issuer and holders of the Depository Receipt which may be different from the rights of holders of the underlying shares. For example, the underlying share issuer may make distributions in respect of its underlying shares that are not passed on to the holders of its Depository Receipts. Any such differences between the rights of holders of the Depository Receipts and holders of the underlying shares of the underlying share issuer may be significant and may materially and adversely affect the value of the relevant instruments. Depository Receipts representing underlying shares in a foreign jurisdiction (in particular an emerging market jurisdiction) also involve additional risks associated with the securities markets in such jurisdictions.

**Investment Risks:** Shares and other types of Equity investments may be subject to some of the following risks: market risk, liquidity risk, issuer risk, exchange rate risk, systemic and non-systemic risk. Therefore this type of instruments must be

regarded as high-risk investments without having a guaranteed performance and can lead to significant losses in the investor's invested principal.

If the share price (or other type of equity instrument price) of a listed company falls due to company-specific reasons (bad financial performance, problematic business model, sub-standard corporate governance, dividend-payout ability/policy, etc) the company may then find it difficult to raise further capital to finance its business, and the company's performance may deteriorate vis à vis its competitors, leading to further reductions in the share price. Ultimately the company may weaken substantially or even fail (bankruptcy). Additionally, apart from idiosyncratic risks, there is a risk that there could be significant price declines and elevated volatility in the price of an equity instrument due to problems in the sector or the geographical region that the particular company operates in or due to broader turbulence in global financial markets. If the company is private (i.e. not listed) or is listed but only traded infrequently, there may also be liquidity risk, whereby shares could become very difficult to dispose of, especially during periods of significant price declines.

## 1.5 Warrants/Rights

A warrant or a right is a security-linked (usually equity-linked) instrument that confers the right, but not the obligation, to buy or sell a security – usually a stock – at a certain price before expiration. The price at which the underlying security can be bought or sold is referred to as the exercise price or strike price. An American warrant can be exercised at any time on or before the expiration date, while European warrants can only be exercised on the expiration date. Warrants that confer the right to buy a security are known as call warrants; those that confer the right to sell are known as put warrants. Rights usually expire within a short period (30 to 45 days) and usually allow for a discounted purchase of the issuer's shares.

Warrants and rights are in essence derivative instruments (as their price depends on the price of another underlying security) and therefore often involve a high degree of gearing, in the sense that a relatively small movement in the price of the underlying security results in a disproportionately large movement, favourable or unfavourable, in the

price of the warrant/right. Their prices can therefore be highly volatile.

It is essential for anyone who is considering purchasing warrants or rights or is granted rights in the process of a share capital increase of a company, to understand that the conferred right is invariably limited in time (expires), with the consequence that if the investor fails to exercise this right within the predetermined time period then the investment becomes worthless. Some other instruments are also called warrants but are actually options (for example, a right to acquire securities which are exercisable against someone other than the original issuer of the securities, often called a covered warrant).

**Investment Risks:** A warrant or right is potentially subject to all of the major risk types referred to in Section 2. A Customer should not buy a warrant or right unless he/she is prepared to sustain a significant or even total loss of the invested capital plus any commission or other related transaction cost.

## 1.6 Bonds

Bonds are negotiable debt instruments issued in bearer or registered form by a company, a government or a supranational body to creditors and whose par value at issuance represents a fraction of the total amount of the issued debt. The duration of the debt as well as the terms and conditions of repayment are determined in advance. Unless stipulated otherwise, the bond is repaid either at the maturity date, or by means of annual payments. The interest payments on bonds may be either (i) fixed for the entire duration or (ii) variable or often linked to reference rates (e.g. Euribor or LIBOR). The purchaser of a bond (the creditor) has a claim against the issuer (the debtor). They are typically traded over-the-counter (not in an organised exchange market). With respect to the issuing entity, bonds may be classified in the following categories:

- **Government Bonds:** bonds which are issued by governments or their respective debt management organizations (e.g. German Government, U.S. Government). In this way, governments cover part of their borrowing needs.

- **Supranational Bonds:** Bonds issued by supranational organizations (e.g. the European Investment Bank, EBRD, etc).
- **Corporate Bonds:** Bonds issued by corporations.
- **Municipal Bonds:** Bonds issued by local government bodies (e.g. municipalities).

Besides the issuer, the main characteristics of bonds are:

- **Face Value / Nominal Value:** the initial amount of the security that the issuer promises to pay back to the investor at maturity. The interest payments are based on the face value of the bond.
- **Price:** The price of a bond is quoted based on 100, which corresponds to its face value. When the price of a bond is higher than its nominal value, i.e. above par (or above 100), the bond is traded at a premium. When the price of a bond is less than its nominal value, i.e. below par (or below 100), the bond is traded at a discount. Based on the above, the following prices can be identified:
  - (i) **Issue Price:** The price at which investors buy the bond from the bond's issuer at its issue date.
  - (ii) **Buying Price:** The price at which the investor buys the bond.
  - (iii) **Selling Price:** The price at which the bond holder sells the bond.
  - (iv) **Redemption Price:** The amount which the investor receives by the issuer at maturity.
- **Issue Date:** The date the bond is issued.
- **Maturity Date:** The date at which the bond matures.
- **Interest Rate/ Coupon:** It is the interest rate based on which the bond's interest payment is calculated for a specific period of time (usually a month, quarter, semester, or year), using a predefined day-count convention (e.g. ACT/ACT, 30/360, etc). It is expressed as a percentage over the bond's nominal value. The coupon, which is specified when the bond is issued, may be fixed or floating.
- **Accrued Interest:** This is the interest that has been accumulated since the previous coupon payment, which is owed by the issuer but not yet payable to the bond holder.
- **Fair Value:** This is the total sum of the present values of all future cash flows of the

bond (coupons plus face value at maturity), discounted using an appropriate rate that reflects the levels of prevailing interest rate for the currency of denomination of the bond and the credit risk (spread) of the issuer.

- Yield to Maturity: The return the investor will enjoy if he/she buys and holds the bond until maturity. It is expressed as a percentage and is equal to the rate used to discount all future cash flows of the bond so that the sum of present values of these cash flows is equal to the purchase price of the bond.
- Quoted Margin (this is a feature of floating rate bonds): The Quoted Margin is the fixed percentage by which the bond's coupon exceeds the reference rate. For instance, if a floating rate bond has a coupon rate of LIBOR + 2%, the 2% is the bond's quoted margin, specified when the bond is issued and is usually fixed to maturity. The Quoted Margin may also be expressed in basis points and not as a percentage rate, where 100 basis points correspond to 1%.
- Discount Margin: In floating rate bonds, the discount margin expresses the margin of the bond with respect to the reference interest rate, based on the bond's current price, the quoted margin and the bond's remaining time to maturity. The discount margin varies throughout the bond's lifetime based on the aforementioned factors.
- Status of the bonds: The priority (ranking) by which the claims of the bond holders are satisfied in case the issuing company is liquidated:
  - (i) Senior Secured Debt Instruments
  - (ii) Senior Unsecured Debt Instruments
  - (iii) Non-preferred Senior Unsecured Debt Instruments
  - (iv) Subordinated Debt Instruments, which are distinguished in the following categories:
    - Tier 2 Capital comprising of: (i) Lower Tier 2 Capital; and (ii) Upper Tier 2 Capital.
    - Tier 1 Capital comprising of: (i) Lower Tier 1 Capital; and (ii) Upper Tier 1 Capital.
- Credit Rating: It refers to the rating of the bonds according to the credit risk that they represent, which is basically associated with their issuer. Credit Rating Agencies estimate

the credit risk of bond issuers such as governments, financial institutions and corporations. In particular, Credit Rating Agencies collect and analyse information from various sources which relate to the issuer of the securities, the market segment and geographical region in which the issuer operates, the issuer's overall financial situation, the nature and status (ranking) of the bond and in general the ability of the issuer to meet the undertaken obligations towards the bond holder. The ratings have to be assessed by the investors, who have to weigh the potential risks of default or a potential decline in the bond's market price.

Due to the large variety of bond types, for instance short-term or long-term bonds representing senior or subordinated debt, different bond issues by the same issuer may have a different rating.

The three best known Credit Rating Agencies that are active at an international level are Standard & Poor's (S&P), Fitch and Moody's and they use the following ratings:

(i) **Standard & Poor's and Fitch:**

Long term credit ratings: AAA, AA+, AA, AA-, A+, A, A-, BBB+, BBB, BBB-, BB+, BB, BB-, B+, B, B-, CCC+, CCC, CCC-, CC, C, RD, D.  
Short term credit ratings: F1+, F1, F1-, F2, F3, B, C, D.

(ii) **Moody's:**

Long term credit ratings: Aaa, Aa1, Aa2, Aa3, A1, A2, A3, Baa1, Baa2, Baa3, Ba1, Ba2, Ba3, B1, B2, B3, Caa1, Caa2, Caa3, Ca, C.

Short term credit ratings: P-1, P-2, P-3, NP.

*It should be noted that the price of a bond is affected to a large extent by its credit rating and by any changes in its credit rating which occurs before the maturity of the bond.*

Indicatively, bonds include the following types:

- (i) Zero-Coupon Bonds: These bonds are issued at a discount and do not provide interim interest payments, but only the payment of their face value at maturity.
- (ii) Fixed Coupon Bonds: In this case, the interest rate is specified at a fixed rate when the bond is issued and remains fixed until maturity.
- (iii) Floating Rate Bonds / Notes - FRN: FRNs have a coupon that is reset periodically with respect to the reference interest rate (e.g.

Euribor, Libor). The reference rate as well as any possible spread, which is added to or subtracted to/from the reference rate, is specified when the bond is issued. The interest that the investor receives in each interest period depends on the fluctuation of the reference rate. If at the coupon reset date the index has decreased, then the coupon will decrease accordingly.

- (iv) Callable Bonds: When a callable bond is issued, it is specified in its issue terms that the issuer has the right to redeem it (or “call” it) on specific future dates, i.e. repay it prior to its maturity. For instance, if interest rates are significantly decreased with respect to the bond’s coupon, then the issuer can exercise the call right at the price and date specified by the issue terms of the bond.
- (v) Puttable Bonds: When a puttable bond is issued, it is specified in its issue terms that the bond holder has the right to demand that the issuer repays it at a predetermined price and on dates prior to its maturity date. For example, if interest rates are significantly increased with respect to the bond’s coupon, then the bond holder can exercise the put right at the price and date specified when the bond was issued.
- (vi) Convertible Bonds: Convertible bonds offer the investor the right to convert them to other securities of the same issuer, usually common shares. The conversion right may be exercisable on specified future dates and at a predefined conversion ratio between the bond and the other underlying security, according to the issue terms of the bonds.
- (vii) Hybrid Notes: Securities that combine the characteristics of other financial instruments. The investor may receive dividend, like owning a share, but the note may behave in the secondary market like a fixed income security. These notes are subordinated debt securities and belong to the category of Basic Own Funds (Tier 1 Capital). One very common type of Hybrid Bond is Contingent Convertible Securities/ Bonds (CoCos). These hybrid bonds expose investors to the risks associated with both equity investments and fixed income investments. The conversion of the bonds into equity is ‘contingent’ on a specified or pre-determined trigger event, such as a capital adequacy metric (e.g. CET1 ratio) falling below a

particular level. One key risk is the occurrence of a trigger event described in the terms and conditions of the issue. This can result in a partial – or even total – loss of the capital invested since the bond would have to be converted into common shares or be written down, either permanently or temporarily. CoCos are typically issued in the form of subordinated debt instruments in order to provide the issuer with the appropriate favourable regulatory capital treatment prior to a conversion. Accordingly, in the event of liquidation, dissolution or winding –up of an issuer prior to a conversion having occurred, the rights and claims of the holders of the CoCos against the issuer in respect of or arising under the terms of the CoCos shall generally rank junior to the claims of all holders of unsubordinated obligations of the issuer.

- (viii) Structured Bonds (see also 1.9 Structured Products): Bonds, whose return and/ or the capital payment at maturity are not predefined but depend on certain underlying securities, indices or other factors. Structured/ complex bonds can be classified according to the following characteristics:
  - Capital Guarantee at Maturity: (a) 100% capital guarantee at maturity, (b) Partial capital guarantee at maturity and, (c) No capital guarantee at maturity.
  - Type of underlying financial instrument: (a) Equities or indices, (b) Interest rates, (c) Exchange Rates, (d) Commodities, (e) Mutual funds or hedge funds, (f) Other instruments (freight rates, indices relating to climate changes, emission allowances, inflation rates or other official economic statistics etc.) and (g) Combination of two or more underlying financial instruments.
  - Maturity: (a) Up to 1 year, (b) 1 – 2 years, (c) 3 – 5 years and (d) Over 5 years.

**Investment Risks:** Other than the risks described in Section 2 below, some particular risks are associated with Bonds issues such as:

- a) The possibility that an issuer will not be able to pay the investor the initial principal and/or the coupons (credit risk), which is the case when the issuer becomes insolvent
- b) Usually when interest rates and/or the relevant credit spreads of the issuer

increase, the price of fixed-coupon bonds decreases. Additionally, fixed-coupon bonds with long maturities are more sensitive to interest rate and credit spread variations

- c) Bond investments may lead to the loss of a portion of the invested capital amount, when the investor sells them prior to their maturity date in the secondary market
- d) The prices of structured bonds in the secondary market are affected also by fluctuations in the underlying securities, which may lead to the loss of up to 100% of the invested principal (in case of a structured bonds with no capital guarantee) as well as that of the targeted return. Additionally structured bonds can have limited liquidity in the secondary market, especially in cases where they were issued under a private placement arrangement, where typically the issues are of relatively small size (usually below EUR 50mio).
- e) Hybrid Bonds entail an increased risk for capital loss and/or yield loss, apart from the risks mentioned for all other bonds.

## 1.7 Collective Investments (Mutual Funds)

A Mutual Fund is a pool of assets that includes transferable securities, money market instruments and cash whose individual assets belong indivisibly to more than one unit holders, according to the number of units each one holds. Mutual Funds are not legal entities, have no maturity and the unit holders are represented in and out of court by the manager (the Mutual Fund's Management Company) in relation to their legal dealings arising from management of the fund and their rights in the fund's assets.

The Management Company is responsible for managing the fund according to the fund's investment objectives and policy. The mutual fund's future performance cannot be determined in advance. The value of the fund's portfolio may increase or decrease depending each time on the characteristics of its selected investment positions and the chosen allocation in the various investment categories, versus prevailing current market conditions. The mutual fund's net assets, the number of units, the net value of each unit, and its sale and redemption price are calculated every business day and are typically published in the

daily press two business days later by the Management Company.

There are various categories of mutual funds. The most common are:

- (i) Money Market Funds: Money Market Funds primarily invest in money market instruments and secondarily in debt instruments.
- (ii) Bond Funds: Bond Funds invest mainly in government and corporate bonds and secondarily in money market instruments.
- (iii) Equity Funds: Equity Funds invest mainly in shares listed in domestic or foreign regulated markets.
- (iv) Balanced Funds: Balanced Funds combine investments in debt instruments and stocks.
- (v) Funds of Funds: Funds of Funds invest in units of other funds. Funds of Funds are "baskets" of funds whose main objective is high diversification in terms of investment instruments (e.g. bonds, stocks), geographical dispersion, as well as asset managers.
- (vi) Special Type Funds: Special Type Funds are long-term funds which are characterized by the use of derivatives. These type of funds could offer capital and yield protection or guarantee at maturity by utilizing derivatives on an underlying instrument (e.g. basket of stocks/bonds, index or basket of indices). Due to their exposure to derivatives they are considered to entail high risk.
- (vii) Absolute Return Funds: This type of Fund follows no benchmark other than the interbank market interest rates and aims at achieving a return higher than the money market instruments' return while targeting a certain level of volatility. Usually, these Funds employ long-short or market-neutral strategies by utilizing stocks, debt instruments, money market instruments and derivatives.
- (viii) Exchange Traded Funds (ETFs): An ETF, or exchange-traded fund, is a marketable security that tracks an index, a commodity, bonds, or a basket of assets like an index fund. Unlike mutual funds, an ETF trades like a common stock on a stock exchange. ETFs experience price changes throughout the day as they are bought and sold. ETFs typically have higher daily liquidity and lower fees than mutual fund shares. Because it trades



like a stock, an ETF does not have its net asset value (NAV) calculated once at the end of every day like a mutual fund does.

- (ix) **Commodity Funds:** This type of Fund is active in the commodities market by using derivatives which have commodities or commodities indices as their underlying assets. Their performance depends on the course of the underlying financial instruments.
- (x) **UCITS Funds:** UCITS stands for Undertakings for Collective Investments in Transferable Securities. UCITS provides a single European regulatory framework for an investment vehicle which means it is possible to market the vehicle across the EU without worrying which country it is domiciled in. UCITS funds are governed by the EU UCITS Directive. A UCITS Fund may take the form of any of the funds described hereinabove and subject to compliance with the UCITS Directive. An issuer of a UCITS Fund issues a prospectus and the disclosures made therein for a particular UCITS funds should be considered prior to making an investment.

**Investment Risks:** According to their Investor Profile, **investors should carefully select the funds** they decide to invest in. It is the Fund's Management Company responsibility to decide and choose the financial instruments in which a Fund invests. The mutual fund's objective, category, investments restrictions, degree of portfolio risk exposure as well as charges are described in the fund's investment policy and regulations. These investments are generally intended for experienced and financially knowledgeable investors who are willing to bear the risks associated with such investments, which can include: loss of all or a substantial portion of the investment; increased risk of loss due to leveraging, short-selling or other speculative investment practices; delays in tax reporting; prohibitions and/or material restrictions on transferring interests in the fund; and high fees. There is no assurance that the liquidity of the investment funds will always be sufficient to meet redemption requests as and when made.

Diversification does not assure profit nor protect against loss in a declining market. The risk of any particular fund will vary according to its strategy. In the case of Fund of Funds there can be no

assurance that the selection of the managers of the underlying investment funds will result in an effective diversification of investment styles and that positions taken by the underlying investment funds will always be consistent.

### 1.8 Hedge Funds or other alternative investment funds(AIFs)

- (i) **Hedge funds:** are alternative investments using pooled funds that employ numerous different strategies aiming to achieve positive active returns (alpha) or absolute returns, for their investors. Hedge funds may be aggressively managed or make use of derivatives and leverage in both domestic and international markets with the goal of generating high returns (either in an absolute sense or over a specified market benchmark).

**Investment risks:** These products can be highly speculative and may not be suitable for all clients. Investors should ensure that they understand the features of the products and fund strategies and the risks involved, before deciding whether or not to invest in such products. Hedge funds operate in a less regulated environment. Hedge funds are less liquid, and have imperfect transparency and less frequent pricing and reporting and this makes investor due diligence, monitoring, performance tracking and reporting more complicated; some hedge funds may take leveraged positions or large positions in risky or less liquid investments which may be subject to significant market volatility. The client may also face lockup periods or other restrictions when attempting to sell the Fund.

- (ii) **Private Equity Funds:** A private equity fund is a collective investment scheme used for making investments in various equity (and to a lesser extent debt) securities according to one of the investment strategies associated with private equity. Private equity funds more closely resemble venture capital firms in that they invest directly in companies, primarily by purchasing private companies, although they sometimes seek to acquire controlling interest in publicly traded companies through stock purchases. They frequently use leveraged buyouts to acquire financially distressed companies. Unlike hedge funds focused on short-term profits, private equity

funds are focused on the long-term potential of the portfolio of companies they hold an interest in or acquire. Once they acquire or control interest in a company, private equity funds look to improve the company through management changes, streamlining operations or expansion, with the eventual goal of selling the company for a profit, either privately or through an initial public offering in a stock market. To achieve their aims, private equity funds usually have, in addition to the fund manager, a group of corporate experts who can be assigned to manage the acquired companies. The very nature of their investments requires their more long-term focus, looking for profits on investments to mature in a few years rather having the short-term quick profit focus of hedge funds.

**Investment risks:** The value of investments can fall. It is important to note that the capital value of, and income from, any investment may go down as well as up and you may not get back the full amount invested. There is Limited marketability and transferability and illiquidity (lockup periods of 5-12 years or even longer). In such market there is limited regulatory oversight and protection and valuation information can be delayed or limited. As with all types of investment instruments, past performance is not a reliable indicator of future performance.

- (iii) **Property/Real Estate Funds:** A real estate fund is a type of mutual fund that primarily focuses on investing in securities offered by public real estate companies. The majority of real estate funds are invested in commercial, and corporate properties, although they also may include investments in land, apartments complexes and agricultural space. This type of fund can invest in properties directly or indirectly through REITs. A REIT is a corporation, trust or association that owns or finances income-producing real estate.

**Investment risks:** There are, other than the general risks, special risks associated with investing in the securities of companies principally engaged in the real estate industry. These risks include the cyclical nature of real estate prices, risks related to general and local economic

conditions, changes in regulation and tax systems, and other real estate or capital markets influences.

## 1.9 Structured Products

A Structured Product consists of two or more financial instruments that have different payment terms and risk characteristics and comprise a single structure. It is a single and indivisible package typically consisting of a debt instrument combined with one or more financial derivatives. Structured products can be indicatively classified according to the following characteristics:

- (i) Capital guarantee/protection at maturity: (a) 100% capital guarantee at maturity, (b) Partial capital guarantee at maturity and (c) No capital guarantee at maturity.
- (ii) Type of underlying financial instrument: (a) Equities or Equity indices, (b) Interest rates, (c) Exchange Rates, (d) Commodities, (e) Mutual funds, ETFs or hedge funds, (f) Debt Instruments or Bond or Bond indices or Credit derivatives (g) Other financial instruments (freight rates, indices relating to climate changes, emission allowances, inflation rates or other official economic statistics etc.) and (g) Combination of two or more underlying instruments.
- (iii) Maturity: (a) Up to 1 year, (b) 1 – 2 years, (c) 3 – 5 years and (d) Over 5 years.
- (iv) Structured/ complex products may take the form of a bond (note) or a deposit or a certificate.

### **Example: Dual Currency Deposits (DCDs)**

*A dual currency deposit is a structured product where a fixed deposit, made in one currency, is combined with a bank held option to repay the principal at maturity in a different currency. It effectively “packages” a time deposit together with a foreign exchange (FX) option. Because of the currency risk, dual currency deposits offer higher interest rates.*

*A Dual Currency Deposit is an investment product that typically has a short maturity and consists of:*

- i. A time deposit or a fiduciary time deposit*

- ii. *An option on a foreign exchange rate (e.g. on EUR/USD), which the investor sells to the Bank.*

*At maturity, the investor collects a higher interest on the invested capital in the initial currency ("investment currency") compared to a simple time deposit, but simultaneously the Bank maintains the right to repay at maturity the initial investment amount converted in the second currency ("alternative currency") at a predefined exchange rate (strike price). The Dual Currency deposit guarantees the interest on the investment currency, but does not guarantee that the invested capital will be repaid to the investor in the initial investment currency at maturity.*

*The currency in which the invested capital is repaid at maturity depends on the level of the exchange rate (e.g. EUR/USD), one business day prior to maturity - as specified by a predefined publically available fixing rate - versus the predefined exercise exchange rate (strike price) of the transaction. The Bank will exercise the foreign exchange (FX) option that it bought from the investor accordingly or not.*

*This product entails the risk of a significant loss in terms of valuation in the initial investment currency, if the invested capital is repaid at maturity in the alternative currency (i.e. if the Bank exercises its FX option at the agreed pre-defined exchange rate – strike price).*

#### Investment risks of structured products:

<b>Price/Market Risk</b>	Aside from the typical risks associated with debt instruments in general, the prices of structured products are also affected by price fluctuations in the underlying securities/rates/indices etc, which can lead to a loss of up to 100% of the initial investment capital, in cases of structured products without capital protection and especially in cases where leverage is utilized via the use of derivative instruments, hence accelerating losses during adverse price fluctuations in the underlying.
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<b>Default/Credit Risk</b>	The issuer or the guarantor of a structured product, which typically is a financial institution, may be unable to pay the coupons or repay the invested capital or to generally honor the agreed terms of the product, due to financial distress. In case of insolvency, if the issuing or guarantor bank falls within the scope of the BRRD directive, these products could be exposed to bail-in risk.
<b>Interest Rate Risk</b>	As with all debt instruments, structured products are affected by fluctuations in interest rates in case of liquidation before maturity.
<b>Exchange Rate Risk</b>	In cases where there are exposures to other currencies than the investor's base currency, adverse exchange rate fluctuations may have a significant negative impact on these investments (e.g. DCDs).
<b>Liquidity Risk</b>	Usually liquidity in structured products is limited, depending on the size of the issued product, the size of the transactions, the issuer, the liquidity of the underlying and the currency of the product.

An investor should refer to the term sheets for official details on all offerings, including risks involved, before investing in structured products. Investing in structured products which typically include derivatives entails a higher degree of risk and/or complexity that may not be suitable for all investors. Such risks include risk of adverse or unanticipated market developments, issuer credit quality risk, risk of counterparty or issuer default, risk of lack of uniform standard pricing, risk of adverse events involving any underlying reference obligations, entity or other measure, risk of high volatility, and risk of illiquidity/ little to no secondary market. In certain transactions, investors may lose their entire investment, i.e., incur an unlimited loss.

#### 1.10 Derivatives including Futures, Forwards, Options, Swaps, Contracts in Differences (CFDs)

##### 1.10.1 General Information

Derivatives are financial instruments whose value is based on, derived from or follows the value of other underlying assets, the so-called “underlying instrument”. Indicative underlying instruments may be exchange rates, interest rates, equities, bonds, stock exchange indices, commodities, other instruments (e.g. freight rates, climate variables, emission allowances, inflation rates or other official economic statistics etc.), assets or credits. The derivative contract specifies the rights and obligations of the transacting parties with respect to their mutual debts, which are calculated on the basis of the value of the underlying instrument(s) at a predetermined future date or at regular intervals. The main types of derivatives are futures, forwards, options and swaps. The main uses of derivatives are:

- **Hedging:** Those who invest in derivatives may aim at hedging existing or future risks, which may arise from other investments or other undertaken obligations.
- **Speculation:** Derivatives investors may aim at generating outright profit from such derivatives transactions, by expressing either a directional view on the price evolution of the underlying asset or by targeting a non-linear pay-off by engaging in a combination of different derivatives transactions on the same underlying asset. A significant characteristic of derivative instruments is that they allow investors to hold positions whose value is a multiple of the amount invested (leverage) accompanied by the corresponding increase in the undertaken risks.
- **Arbitrage:** Derivatives investors may aim at generating profit without taking any risk, by taking advantage of short-term discrepancies in market prices, i.e. possible differences in prices of the same financial instrument in two or more different markets (arbitrage). Arbitrage requires the execution of several transactions within a limited timeframe, and therefore only investors who have a deep knowledge of the markets and have direct access to high-tech trading systems and extremely low or zero transaction costs can engage in efficient Portfolio Management.

**Investment Risks:** All derivatives are potentially subject to the major risk types described in Section 2 below, especially market risk, credit risk, margin risk and any specific sector risks connected with the underlying asset.

Descriptions of different types of derivatives are shown further below.

### 1.10.2 Futures

Futures are bilateral contracts whereby the purchase or sale of a security at a specific quantity at a specific future date for a specific price is agreed. Futures are exchange traded derivatives instruments, i.e. products with standard terms that are listed in regulated markets. They are used for hedging, speculation or arbitrage.

Every regulated derivatives market has a clearing house, whose mission is the clearing of derivative transactions and the assurance that both counterparties will fulfil the obligations that derive from those transactions.

The risk associated with these instruments is considerably high. Some fundamental terms relating to futures are:

- **Contract Size:** The quantity of the underlying instrument covered by a futures contract.
- **Expiration Date:** The date on which the contract expires.
- **Price of the contract:** The trading price of the contract, i.e. the price at which the future is bought / sold.
- **Settlement price:** The price published by the clearing house at the close of each trading session.

With respect to the underlying instrument, futures can be classified into the following types:

- **Index futures:** futures whose underlying instrument is a financial index (e.g. a stock market index).
- **Equity futures:** futures whose underlying instrument is a listed stock.
- **Currency futures:** futures whose underlying instrument is a currency exchange rate (currency pair).
- **Bond futures:** futures whose underlying instrument is a bond (e.g. US Treasury Notes).
- **Interest rate futures:** futures whose underlying is an interest rate.
- **Commodity Futures:** futures whose underlying instrument is a commodity, such as oil, copper etc.

A futures contract involves the following margins:

- Margin: The Margin constitutes the amount the clearing house demands as collateral in case the investor cannot meet his/ her obligations derived from the daily settlement.
- Initial margin: The amount demanded by the clearing house when a transaction takes place.
- Variation Margin: In case the value of the assets used as initial margin is under a predetermined limit, the derivative contract holder is obliged to deposit the amount of the short-fall (margin call); otherwise the clearing house will proceed to the liquidation of the contract.
- Mark-to-Market and Daily Settlement Process: to minimize losses due to breaches of obligations by the investors, futures contracts are marked-to-market daily. The daily profits or losses are credited or debited to the investor's margin account.

As far as futures traded on the Derivatives Market are concerned, the corresponding Clearing House calculates the investors' initial margins and the additional margins that arise from daily settlement which may include using a RIVA (Risk Valuation) calculation algorithm. Clearing Houses may define a minimum (independent from the valuation of the outstanding positions) account balance per final customer (transaction/settlement code).

### 1.10.3 Forwards

Forwards are bilateral contracts which relate to the purchase / sale of a specified quantity of a security at a specified time in the future and at a specified price. Forwards are similar to futures, their main difference being that forwards are not traded on regulated markets but are over-the-counter instruments.

As a result, forwards, unlike futures, do not have standardised features, but are flexible instruments that can be customized to meet the investors' needs. Forwards do not have a standard contract size, maturity, margin account or daily mark-to-market. The price at which the underlying instrument is bought/ sold is the forward rate of the instrument at the time the contract is drawn. When the forward is created it has a zero value and therefore there is no monetary exchange between the seller and the buyer.

Forwards are used for hedging, speculation or arbitrage purposes and have the same risks as futures with the addition of counterparty risk due to the fact that they are traded outside a regulated market and there is no clearing house. With respect to the underlying Financial Instrument, forwards are classified into the following types:

- Index forwards: forwards whose underlying instrument is a financial index (e.g. a stock market index).
- Equity forwards: forwards whose underlying instrument is a listed stock.
- Currency forwards: forwards whose underlying instrument is a currency exchange rate (pair of currencies).
- Bond forwards: forwards whose underlying instrument is a Bond.
- Forward Rate Agreements (FRAs): forwards whose underlying instrument is a reference interest rate, such as EURIBOR, LIBOR.
- Commodity forwards: forwards whose underlying instrument is a commodity, such as oil, copper etc..

Currency forwards are typically used by investors that need to manage exchange rate risk, such as corporations that borrow in foreign currency or have capital inflows/outflows from/to abroad in foreign currency (e.g. import-export companies) or have expenses in one currency and revenues in another (e.g. shipping companies).

The most widely used currency forwards are:

- Forward: An agreement that secures a fixed exchange rate on a predetermined future date.
- Flexible Forward: A forward whose execution date is open.

### 1.10.4 Options

Options are bilateral contracts that convey to one of the contracting parties the right (but not the obligation) to purchase or sell the agreed underlying security at a specified price (strike price) at a future point in time within a specific hour or deadline in exchange for a premium. Indicatively, the underlying instruments may be commodities, foreign exchange rates, interest rates, stocks, stock exchange indices etc. Options are used for hedging, speculation or arbitrage purposes.

The risk that is undertaken by the buyer is limited to the loss of the premium. The seller of the option on the other hand, undertakes significantly high risk (unlimited loss potential).

Options are derivatives that may be exchange traded (listed), i.e. financial instruments that have standardised terms (standardised contracts) and are traded in a Trading Venue; or, over-the-counter (OTC), i.e. instruments that are traded outside regulated markets and are designed by a financial institution to match the particular needs of a customer. Some of the fundamental terms relating to options are the following:

- **Strike Price:** The price at which the buyer of a call or put option may choose to exercise his/her right to buy or sell the underlying financial instrument, respectively.
- **Expiration Date:** The date when the option expires (i.e. the last date on which the option can be exercised).
- **Style:** European style options can only be exercised on Expiration Date, while American style options can be exercised on any day till Expiration Date.
- **Settlement Date:** The date on which the contract is settled if an option contract is exercised, either via physical delivery (i.e. by exchange of the underlying instrument for cash) or via cash settlement (i.e. a cash transfer to the options buyer). Settlement Date is usually set two business days after the option expiration date.
- **Contract Size:** The quantity of the underlying instrument which the contract relates to.
- **Premium:** The cost of acquiring the call or put option.

Depending on the type of the underlying financial instrument, options may be classified into the following categories:

- **Index option:** An option whose underlying instrument is a financial index (e.g. a stock market index).
- **Equity option:** An option whose underlying instrument is a listed stock.
- **Currency option:** An option whose underlying instrument is an exchange rate (pair of currencies).

- **Interest rate option:** An option whose underlying instrument is a reference rate, such as EURIBOR, LIBOR, etc.
- **Commodity option:** An option whose underlying instrument is a commodity, such as oil, copper etc.
- **Swaption:** A **swaption** is an option granting its owner the right but not the obligation to enter into an underlying swap (see 1.10.5). Although options can be traded on a variety of swaps, the term "**swaption**" typically refers to options on interest rate swaps.

The Bank may also offer financial instruments that are composed of a combination of positions in Options. These instruments address companies' needs for managing foreign exchange risk (or other type of risks). Examples of companies that may have such foreign exchange management needs are companies with loan obligations in foreign currency, import-export companies with capital flows in foreign currency and shipping companies that typically have expenses in Euro and revenues in Dollars. The most widely used are the following:

- Forward Plus
- Knock-out Forward
- Knock-out Forward Plus
- Zero Cost Collar
- Target Profit Forward
- Accumulator Forward
- Cancellable Forward

Additionally, the Bank may offer financial instruments that are composed of several positions in options that cover companies' needs for managing interest rate risk. Companies with loan obligations may have an interest in these products. Some examples of such products are the following:

- Interest Rate Cap
- Interest Rate Collar
- Interest Rate Knock-out Collar
- Swaption

### 1.10.5 Swaps

A Swap is a bilateral contract by which the parties agree to exchange one stream of cash flows against another stream of cash flows calculated by reference to an "underlying" (such as financial indices, bonds, currencies, interest rates or

commodities, or even other intangible underlyings). Swaps are OTC instruments and are usually used for hedging, speculation or arbitrage. The risk associated with these instruments is significantly high. Swaps are distinguished in the following main categories:

- Interest Rate Swaps: Swaps involving the exchange of interest rates used for interest rate risk hedging (typically fixed versus floating rates).
- FX Swaps: An FX swap agreement is a contract, in which one party simultaneously borrows one currency and lends another currency to a second party. The repayment obligation is used as collateral and the amount of repayment is fixed at the FX forward rate.
- Cross-currency Swaps: Swaps involving an agreement to exchange the principal and/or interest payments on a loan in one currency for an equivalent loan and interest payment in another currency.
- Commodity Swaps: Swaps whose payments are based on the return of indices on commodities and are offered for hedging from commodities' price volatility.
- Freight Rate Swap: Swaps whose payments are based on freight rate indices for transporting goods by sea.
- Total Return Swaps: Swap agreements in which one party makes payments based on a set interest rate, either fixed or variable, while the other party makes payments based on the return of one or more underlying asset(s) (financial index, security, etc).

This document cannot and does not disclose or explain all of the risks and other significant aspects involved in trading in financial derivative products. Engaging in derivative transactions can carry a high risk to your capital. There is a feature of 'leveraged' or 'margin' trading embedded in derivative transactions and an investor can lose more than his initial investment. An investor should not engage in financial derivative products unless he/she understands fully the risks involved and has the suitable risk appetite and investment profile to undertake such risks (including the risk of total loss of capital).

Trading in Derivatives, carries significant risks, and the Bank cannot guarantee financial performance by engaging in such investments. In case of trading in Derivatives investors are unsecured creditors to the Bank in respect of moneys owed to them by the Bank, and should be aware of this in the unlikely event that the Bank becomes insolvent.

As described in this Section 1.10 different derivative products involve different levels of exposure to risk. It is recommended that investors carefully consider the characteristics of any such product and additionally seek independent financial, legal, tax or other professional advice before they enter into a derivative transaction.

**PLEASE ALSO REFER TO SECTION 2 FOR FURTHER GENERAL RELATED INVESTMENT RISKS TO BE CONSIDERED WHEN INVESTING IN FINANCIAL INSTRUMENTS.**

**Any information provided in this document is only general and it has been provided to enable a Customer to understand the nature and risks of the Services and of the specific types of some Financial Instruments. It does not constitute financial or legal or investment advice or research material and is not intended as such. A Customer prior to making a decision to invest or trade in any Financial Instrument it is recommended to obtain independent legal, tax or other professional financial advice based on his/her individual objectives, his/her financial situation and in consideration of the significant risks of possible loss inherent in any investment product.**

## 2. INVESTMENT RISKS NOTICE DISCLOSURES

### 2.1 General Information on Investment Risks and Warnings

The price or value of an investment will depend on fluctuations in the financial markets. Past performance is no reliable indicator or guarantee of future performance. The nature and extent of investment risks varies between types of investment, countries, sectors and market segments.

These investment risks will vary with, amongst other things, the type of investment being made, including how these financial products have been created and their terms, the needs and objectives of particular investors, the manner in which a particular investment is made or offered, if it is sold or bought, the location or domicile of the issuer, the liquidity conditions, the diversification or concentration in a portfolio (e.g. the amount invested in any one currency, security, country or issuer), the complexity of the transaction and the use of leverage. Furthermore the markets in which the various Financial Instruments are traded are subject to considerable fluctuations and the Bank cannot guarantee specific returns.

Every investment on any Financial Instrument is exposed to one degree or another, to all or some of the following risks:

- **Basis Risk:** The risk of deviation between the prices of derivatives and the prices of their underlying financial instruments due to the exchange market conditions or rules imposed by the derivatives' or underlying instruments' market regulators.
- **Credit Risk:** It is the risk of loss due to the possibility that a counterparty or issuer of a security will not meet his/her contractual obligations.
- **Commodities Risk:** The prices of commodities may be volatile, and, for example, may fluctuate substantially if natural disasters or catastrophes, such as hurricanes, fires or earthquakes, or weather conditions affect the supply or production of such commodities. The prices of commodities may also fluctuate substantially if conflict or war affects the supply or

production of such commodities. If any interest and/or the redemption amount payable in respect of any product is linked to the price of a commodity, any change in the price of such commodity may result in the reduction of the amount of interest and/or the redemption amount payable to the investor. The reduction in the amount payable on the redemption of an investment may result, in some cases, in the investor receiving a smaller sum on redemption of a product than the amount originally invested in such product.

- **Counterparty Risk:** the risk that the person or institution with whom an investor has entered into a financial transaction or contractual agreement, will default on his/her/its obligations arising from such transaction or contractual agreement (i.e. credit risk).
- **Currency Risk (also known as Foreign Exchange Risk):** Financial Instruments, Funds or assets denominated in a foreign currency (i.e. a different currency from the base currency of the investor) are subject to adverse movements if the relative value of that currency falls vs the base currency of the investor. Currency movements may also impact the value of underlying assets of a security, if such security maintains investments in foreign currencies (e.g. Mutual Funds, Hedge Funds, Structured Products, etc), regardless of the currency denomination of the securities. Fluctuations in currencies via foreign exchange markets may influence the performance of a broader range of investments related to specific geographic regions (e.g. US, Eurozone, Japan or Emerging markets, etc), as they can significantly affect the dynamics of the macro and micro-economy of such regions (GDP growth, trade competitiveness, fiscal performance, inflation, consumption, corporate earnings, etc).
- **Default Risk:** The risk that an issuer of a bond may be unable to make timely principal and interest payments.
- **Dividend Risk:** It refers to the risk that has to do with the incorrect valuation of a security due to the fact that there is a change in the original assumptions made relating to the dividend (or other payments) the security is expected to pay (make). Other than the



possibility of ceasing the dividend payment (either temporarily or permanently), changes may also occur in the time the dividend is paid or the payment frequency etc., that can affect the valuation of the security and thus the value of the position of the investor.

- **Early Redemption Risk:** Some types of bonds give the issuer the right to recall and redeem them before their maturity date. The risk originates either from the possibility that the bonds will be recalled at an unfavourable price for the investor or from the opportunity cost that will arise from the need to re-invest the early-redeemed capital (similar yields with a comparable risk/return profile might be difficult to find at the time of early-redemption).
- **Emerging Markets Risk:** Such markets typically lack the level of transparency, liquidity, efficiency, legal framework and regulation found in more developed markets. Price volatility in emerging markets can be extreme and price discrepancies and market dislocation can be common.
- **Foreign Market Risk:** Foreign markets involve different risks each subject to their regulatory operational system. Foreign markets entail different risks from Luxembourg markets. The potential for profit or loss from transactions on foreign markets or in foreign currency denominated markets will also be affected by fluctuations in foreign exchange rates.
- **Inflation Risk:** The loss of the real value (buying power) of capital due to a larger than expected increase in the level of inflation.
- **Insolvency Risk:** The issuer of an instrument may become temporarily or permanently insolvent, resulting in its incapacity to repay the interest or redeem the bond. Usually insolvency has a heavy adverse effect on the valuation of the securities issued by such issuer (shares, bonds, etc). The solvency of an issuer may change due to one or more factors relating to the issuing company, the issuer's business sector and/or the political and economic status of the country or countries concerned. The deterioration of the issuer's solvency prospects will adversely influence the price of the securities issued by such issuer.

- **Interest Rate Risk:** The risk derived from unfavourable changes in interest rates and their consequent effect on the present value of an investment's future cash flows. Uncertainty concerning interest rate movements means that purchasers of fixed-rate securities carry the risk of a fall in the prices of the securities if interest rates rise. Interest rates can rise as well as fall. The value of a security, especially of a fixed coupon paying security (e.g. fixed-rate bonds), will worsen due to an interest rate increase everything else being equal, as the present value of all future cash flows of the security will be calculated using higher discounting rates (lower discounting factors). There are additional interest rate related risks in relation to floating rate instruments; future interest income on floating rate instruments (with coupons linked to reference interest rate, e.g. 3-month Euribor) are unknown. However if interest rates rise, the future coupons of these instruments will rise too and vice versa. If the terms and conditions of the relevant instruments provide for frequent interest payment dates, investors are also exposed to the reinvestment risk. That is, investors may reinvest the interest income paid to them only at the prevailing relevant interest rates at the time of such payment, which could be lower.
- **Legal Risk:** The risk that contracts of financial instruments do not include detailed and clear information on the financial instruments' characteristics and/or the obligations of the counterparties. In cases of ambiguity where arbitration is needed, the applicable legal framework will be utilized as determined by the relevant contractual terms. Legal risk arises in over-the-counter transactions, whereas in transactions in regulated markets the legal risk is almost eliminated.
- **Liquidity Risk:** The risk of not being able to liquidate a financial instrument within a reasonable time at a price close to its current 'perceived' market price. The liquidity of an instrument is directly affected by the supply and demand for that instrument and also indirectly by other factors, including market disruptions (for example a disruption on the relevant exchange) or infrastructure issues,

such as a lack of sophistication or disruption in the securities settlement process. Under certain trading conditions it may be difficult or impossible to liquidate or acquire a position.

- **Margin Risk:** Margin is collateral that the holder of a derivative instrument has to deposit with a counterparty (most often their broker or an exchange), in the form of cash or securities, to cover some or all of the credit risk the holder poses for the counterparty.

When entering into financial derivative transactions an investor must maintain a minimum required margin on his/her margin account at all times. Usually derivatives positions are valued with a pre-determined frequency (mark-to-market) and any adverse move is reflected by an equivalent reduction in the funds sitting in the investor's margin account. If at any time the minimum sufficient margin is not maintained in such margin account, the investor is asked to provide additional funds within the time required so that the minimum margin is restored. Failure to provide such additional funds may result to open positions being closed at a loss without the consent of the investor (forced stop-out). The investor will be liable for any potential deficit resulting from such 'forced' liquidation of his derivative position.

- **Market Risk:** It is the risk of unfavourable changes in market conditions that affect the prices of financial assets. Market conditions can be affected by various factors such as various macro-economic, corporate and central bank announcements, geopolitical events/news, general market sentiment, changes in the broader level of interest rates/credit spreads/financial indices/exchange rates/commodity prices or generally changes in market volatility. The price of financial assets fluctuates depending on market supply and demand, investor perception and the prices of any underlying or related financial instruments or, indeed, sector, political and economic factors. The evolution of all above factors in the future is unknown and hence very difficult to predict. Hence the performance of investments in financial instruments always entails a great level of uncertainty.
- **Nationalisation/Expropriation Risk:** It is the risk associated with the probability that

the government of a country will nationalize or expropriate the company (or the underlying assets) associated with a particular financial instrument. In most cases of nationalisation or expropriation the investors are exposed to losses that could reach the total value of their invested capital.

- **Non-Systemic / Idiosyncratic Risk:** Non-systemic or idiosyncratic risk is the risk of a change in the value of a financial instrument due to specific factors that influence the issuer of the instrument (e.g issuer's financial results, corporate governance, etc).
- **Operational Risk:** The risk originating from factors such as people, systems and processes. For example, the risks of an investor's order being executed incorrectly or not in a timely manner by the broker, or the risk of the broker's order execution system (OTC trading platforms, trade – matching system, derivatives settlement system, etc) breaking down.
- **Political Risk:** The risk an investment's returns could suffer as a result of political changes or instability in a country or region. Instability affecting investment returns could stem from a change in government, legislative bodies, international or regional disputes, military actions or other geopolitical events.
- **Portfolio Management Risk:** It is the risk that arises from the chosen investment strategy that is being followed by the investor or from the ability of a portfolio manager who is mandated by an investor to follow a specific investment strategy, to act according to the best portfolio management practices.
- **Settlement Risk:** The risk that one counterparty (or intermediary agent) involved in a financial instrument transaction fails to deliver a security or its value in cash as per the agreed terms at the time of the financial instrument transaction (trade).
- **Venue Risk:** This risk is related to the specific characteristics of the market (regulated or not) where the financial instrument is traded.

#### **Additional specialised general risks for certain types of Financial Instruments**

- **Risks specific to certain types of bond:** Additional risks may be associated with certain types of bond, for example floating rate notes, reverse floating rate notes, zero coupon bonds, foreign currency bonds, convertible bonds, reverse convertible notes, indexed bonds, structured bonds, and subordinated bonds. For such bonds, you are advised to make inquiries about the risks referred to in the issuance prospectus and not to purchase such securities before being certain that all risks are fully understood. In the case of subordinated bonds, you are advised to enquire about the ranking of the debenture compared to the issuer's other debentures. Indeed, if the issuer becomes bankrupt, bonds will only be redeemed after repayment of all higher ranked creditors and as such there is a risk that investors of subordinated bonds will not be reimbursed at maturity. In the case of reverse convertible notes or other non-capital protected structured products, there is a risk that investors will suffer a partial or full loss of their invested capital at maturity.
- **Hedge Funds general risks:** These products can be highly speculative and may not be suitable for all investors. Investors should ensure that they understand the features of the products, the investment strategies employed and the risks they involve, before deciding whether or not to invest in such products. These investments are generally intended for experienced and financially sophisticated investors who are willing to bear the risks associated with such investments, which can include: loss of all or a substantial portion of the investment due to increased risk of loss due to leveraging, short-selling or other speculative investment practices; delays in tax reporting; prohibitions and/or material restrictions on transferring interests to/from the fund; and higher fees than traditional simple mutual funds. Diversification in various different hedge funds does not ensure positive performance, nor does it necessarily protect against losses in adverse market conditions.

## 2.2 Transaction and Services Risks

In addition some general technical and operational services risks should always be considered when engaging in transactions in Financial Instruments.

- **Cash and Property:** Customers should familiarise themselves with the protections granted in respect of money or other property they deposit for domestic and foreign transactions, particularly in the event of insolvency or bankruptcy of an issuer or third party involved in financial instruments.
- **Charges and commissions:** Before customers begin to trade, they should obtain details of all commissions and other charges which they will be incurring. When products are purchased or sold, several types of incidental costs (including transaction fees and commissions) are incurred in addition to the current price of the security. These incidental costs may significantly reduce or even eliminate the profit potential of the products. Where additional domestic or foreign parties are involved in the execution of an order, including but not limited to domestic dealers or brokers in foreign markets, it must be taken into account that brokerage fees, commissions and other fees and expenses of such parties (third party costs) may be charged including any follow-up costs (e.g. custody fees for securities, management fees for mutual funds, etc).
- **Clearing House protections:** On many exchanges, the settlement of a transaction by the Bank (or third party with whom it is dealing on your behalf) is 'guaranteed' by the exchange or clearing house. However, this guarantee is unlikely in most circumstances to cover the Customer and may not protect the Customer if the Bank or another party defaults on its obligations to the customer. On request, the Bank will explain any protection provided to Customers under the clearing guarantee applicable to any exchange-traded derivatives in which a customer is dealing.
- **Collateral:** If collateral is deposited as security with the Bank, the way in which it will be treated will vary according to the type of transaction and where it is traded. Deposited collateral may lose its identity as your property once transactions on behalf of the Customer are undertaken. Even if such dealings should ultimately prove profitable,

the Customer may not get back the same assets that he/she deposited, and may have to accept payment in cash. If collateral is deposited as security with the Bank, additional terms and conditions may apply. It is the Customers' responsibility to ascertain how such collateral will be dealt with by the Bank.

- **Insolvency:** In the event of the Bank's insolvency or default, or that of any other brokers involved with Customers' transaction, positions may be liquidated or closed out without your consent. In certain circumstances, Customers may not get back the actual assets which they lodged as collateral and may have to accept any available payments in cash.
- **Off-Exchange Derivative Transactions:** It may not always be apparent whether or not a particular derivative is effected on an exchange or in an off-exchange, over-the-counter (OTC) transaction. While some off-exchange markets are highly liquid, transactions in off-exchange or 'non-transferable' derivatives may involve greater risk than investing in exchange-traded derivatives because there is no exchange market on which to close out an open position. It may be impossible to liquidate an existing position, to assess the value of the position arising from an off-exchange transaction or to assess the risk exposures. Bid and offer prices need not be quoted, and, even where they are, they will be established by dealers in these instruments and consequently it may be difficult to establish what is the fair price.
- **Illiquid market or suspension of trading:** Under certain trading conditions it may be difficult or impossible to liquidate a position. For example this may occur at times of rapid price movement which might lead to trading in an instrument being suspended or restricted. This might also lead to a restriction in trading of a derivative instrument, when trading in the underlying is affected in such a way.
- **Market 'gapping':** Placing a stop-loss order will not necessarily limit your losses to the intended amounts, because market conditions may make it impossible to execute such an order at the specified price. In these cases the orders may be actually

executed at more adverse levels than the ones specified by the investor.

- **Technical Risks:** Breakdowns or malfunctioning of essential systems and controls, including IT systems, can impact financial products. There is a risk that also external circumstances may prevent the Bank from executing orders, or prevent any participant in the relevant markets from accessing any electronic trading platform. These include, for example, system errors and outages, maintenance periods, internet connectivity issues and failures of third party entities on whom the Customer or the Bank is dependent (for example, internet service providers or electricity companies). There may be circumstances beyond the Bank's control that can affect its ability to support your ability to trade in financial instruments.