DESCRIPTION OF FINANCIAL INSTRUMENT TYPES AND THEIR INHERENT RISKS

The customer should be fully aware:

- that he is responsible for making the decision to invest in one or another financial instrument and he himself shall assume the risks related to the investment

- of the need to investigate the documents related to the investment services (including the Bank’s rules, policies, List of Conditions), as well as other information related to the respective services, for example, the information on the country of the investment, the issuer of the financial instrument, etc.

- of the need to check the instructions for transactions before submitting them for execution and immediately inform the bank on mistakes made therein, if any

- of the need to constantly follow the value of his investment (using the information publicly available, DNB Internet bank or requesting such information from DNB banka specialists) and act without delay for example, selling the financial instruments, in which he has invested), to reduce the risk of possible loss.

The Bank, to comply with the legal requirements and to help customers make an investment decision, hereby offers the summarised description of certain types of financial instruments and their inherent risks. This description is designed so as to be understandable to investors who are non-professional customers (i.e. customers who have been granted the status of a private customer) with minimum knowledge of investment products.

General information about the risks

Please note that the current list of risks is not exhaustive and includes only the most important of them, and other risks may occur to the investor in the course of the transaction.

The investor's primary goal is to get a positive return on the investments. However, every investment is related to market risk, because the financial instrument transaction gains may be less than expected or even negative. Usually the probability of profit is directly related to the probability of loss - the higher the expected return, the greater the risk. Investments made in the long term, reduce the possibility of receiving a negative yield result, because the increase in the value in the short term offset value reductions.

The most significant risks that the investor should take into account:

- Liquidity risk - the risk that the investor may incur losses if within the certain period the financial instruments cannot be sold at the desired price. Liquidity risk is topical, if in the market the number of buyers of the specific financial instrument is not sufficient.

- Counterparty credit risk - the risk that the investor may incur losses if a counterparty who has obligations to the investor or to the bank for the benefit of the investor is unable meet its obligations.

- Issuer risk - the risk that the investor may suffer a loss if the bond value varies depending on the creditworthiness of the issuer: if the ability to pay deteriorates, the security's price decreases, and vice versa. If the issuer of the financial instruments, in which the investor has invested funds, fails to meet its obligations, there is a risk of full loss of investment.

- Interest rate risk - the risk that an investor may suffer a loss if because of changes in market interest rates the value of a financial instrument changes as well. The value of debt securities decreases when interest rates rise, and vice versa.

- Currency risk - the risk that an investor may incur losses if investments in financial instruments are denominated in foreign currencies. The customer should be aware that the value of investments may fall as a result of unfavourable fluctuations of exchange rates.
- Other risks - risks related to force majeure (natural calamities and disasters, acts of war, strikes, and disturbances of communication and information systems), the risks associated with legal and/or tax regime changes, cash flow risk, information risk, foreign law enforcement risk, etc.

There are several ways to limit the risk - for example, it is advisable to invest in several financial instruments different in terms of risk, not just in one or some financial instruments of the same or similar risk. In this way, the risk is spread more evenly to avoid simultaneous and equal negative impact on all financial instruments owned by an investor.

Financial instruments by their structure and inherent risks can be divided into non-complex and complex financial instruments. Non-complex financial instruments are, for example, common shares, bonds with no embedded derivatives, as well as separate investment funds, such as UCITS. All financial instruments that are not non-complex financial instruments are considered to be complex financial instruments (including non-complex financial instruments that are purchased on credit or borrowed funds).

If the investor is using borrowed funds (also those from credit institutions) for the purchase of financial instruments, and the financial instruments purchased for borrowed funds have not brought down the amount of profit the investor has expected, the investor in any case will have to repay the borrowed funds to the creditor under the loan agreement between the parties. Investors should be aware that the yield on financial instruments purchased for borrowed funds may not be sufficient for the investor to cover the loan costs (including the loan interest and front-end fees, if any).

Non-complex financial instruments

1. SHARES

Shares are capital share securities. Owner of shares or the shareholder is the company co-owner. If the company makes a profit, in certain cases, a portion of it shall be paid out to shareholders in the form of dividends. The more shares are owned by the shareholder, the greater the stake it owns, and the higher the portion of the distributable profits is due. It should be remembered that when the company's operation brings a loss, its equity should be reduced, resulting in a decrease in the value of shareholders' investment. If the company goes bankrupt, there is a possibility for a partial or complete loss of investments in its shares.

There are common and preferred shares. Holder of common shares is entitled to participate in the company's administration, by exercising the right to vote at shareholders' meetings. In turn, preferred shares give to its owner the prior right to receive dividends, but usually do not give the voting rights. Shares are most often traded in regulated market i.e. at a stock exchange. Particular company's stock price depends on the supply and demand interaction determined by a number of various factors, such as:

1) the company's current situation (including sales, organisational structure, productivity, etc.), as well as future prospects. As it is not possible to accurately predict how successfully the company will operate in the future (it depends on, for example, technology, applicable legal requirements, competition), the stock price is largely determined by investors' estimates of the company's operations in the future.

2) market interest rates. First, higher interest rates mean higher debt service costs for the company, thus reducing its profits and growth opportunities. Second, an increase in interest rates will increase the yield on debt securities and investors' demand for shares decreases, thus negatively affecting the stock price.

3) stock turnover, or total number of shares to be bought or sold at a stock exchange. If the company's stock turnover is high, the difference between the price that the buyers are willing to pay and the price demanded by the seller decreases. Such shares are easy to buy and sell. Conversely, if the turnover is low, the customer may have difficulties with the purchase or sale of shares at the desired price.

Market players often have different opinions about the company's prospects, resulting in a balanced market, because some market players may want to sell the shares, the others - to buy. If the majority of market players have a common viewpoint on the share price in future, the situation leading to more rapid changes in stock prices occurs, because the demand for shares increases or decreases. Declines in stock prices have a negative impact on the investor's returns.
2. DEBT SECURITIES

Debt securities, such as bonds, confirm one party's (the issuer's) debt obligations to the other party (the holder of the bond). The bond issuer's obligations to the bond holders are set forth in the bond prospectus. Usually the issuer is obliged to repay to bondholders the face value of bonds acquired on a certain date (the bond maturity date), and to pay the interest (make coupon payments) from time to time (for example, once or twice a year). However, there are bonds with no fixed maturity and bonds, the issuer of which is not required to pay coupons to bond holders (known as T-bills, zero or zero-coupon bonds). The bond coupon is expressed as an annual percentage of the face value of bonds. It can be either fixed or variable (floating). Bond issuers may be national governments, banks, companies and other market players.

The bond holder may sell their bonds before their maturity date. In this case one should expect that the bond price may be higher or lower than the purchase price of the bond. Bond prices are affected by several factors, and the bondholders have to take account of the following ones:

1) the issuer's creditworthiness. The better the issuer's financial results, the lower its borrowing costs. Consequently, the price of such issuer's bonds is higher. If the issuer's creditworthiness deteriorates, the price of bonds decreases, so the bond holders may suffer a loss. If the issuer becomes insolvent, the holders of its bonds may partially or even completely lose their investment, despite the fact that they have held their investment in bonds until maturity.

2) market interest rates. When the market interest rates grow, the prices of bonds decline, so their holders may incur a loss, if they want to sell the bonds before their maturity date. The fluctuations of market interest rates will mostly affect the long-term bond prices.

3) bond trade turnover. If the number of buyers is not sufficient in the market, the sale of bonds at the desired price may be difficult.

3. CERTIFICATES OF CERTAIN INVESTMENT FUNDS

Investment funds can be both non-complex (such as UCITS, an open-end fund "DNB Reserve Fund" certificates), and complex financial instruments.

An investment fund is a combination of many investors’ monetary funds, which is managed by a professional specialist (fund manager) with the aim to get a profit from the growth of the investment value. In order to ensure the growth of investment value, the fund manager invests in various assets, such as stocks, bonds, term deposits and real estate. The fund manager's right to invest in one or another asset class is defined in the investment fund's prospectus. The prospectus also covers the remuneration that the fund manager receives for his work. It is from time to time charged on the fund's assets.

Investment fund certificates are securities that confirm the investor's participation in the fund and the resulting investor's rights. When buying fund certificates, the investor becomes a fund participant and is entitled to claim the appropriate share of the fund profits. However, investors must take into account that the investment fund shares neither have a guaranteed nominal value, nor guaranteed yield. This means that the investor may lose partially or entirely the money invested in the fund. It should also be noted that the investment fund has the same risks that are inherent to assets, in which the fund existing resources are deployed.

The most common types of investment funds:
- Money market funds - investors' funds are placed in term deposits and short-term bonds. These funds have the lowest risk.
- Bond funds - investors' funds are placed in debt securities.
- Balanced funds - investors' assets are placed in both bonds and equities.
- Equity funds - investors' funds are deployed in equities.
- Hedge funds - in addition to traditional investments in stocks and / or bonds the investments in derivative instruments are used, thus increasing the investment risk degree, but at the same time also increasing the expected profitability. Investments in hedge funds are subject to considerable fluctuations, and at the same time it ought to be taken into account that hedge funds may have certain trade and settlement dates, as a result, it is possible that selling the fund certificates the investor will receive the returns from the sale on its account over time. Hedge funds can be both non-complex and complex financial instruments.
Investment funds are grouped into close-end (the fund has a certain expiry date and restricted number of certificates) and open-end (the fund expiry date is not determined and the number of fund certificates is not limited).

A separate sub-type of investment funds is exchange-traded funds (ETFs). Its certificates are traded at stock exchanges (like shares). Exchange-traded fund's share value may be linked to a variety of assets such as stock or bond indices, commodities, currencies and more. Exchange-traded funds can be both non-complex and complex financial instruments.

**COMPLEX FINANCIAL INSTRUMENTS**

1. **NON-COMPLEX FINANCIAL INSTRUMENTS ACQUIRED FOR BORROWED FUNDS**

   The customer may have an opportunity to increase the size of its investment with the funds borrowed from the Bank. In such cases, the customer's own capital investment may be significantly less than the total face value of the investment. However, the customer must understand that purchasing financial instruments for borrowed funds he may lose not only his own investment, but also the borrowed funds and stay indebted if the financial asset price developments will be unfavourable.

2. **STRUCTURED FINANCIAL INSTRUMENTS**

   Structured financial instruments include, for example, index-linked bonds. Index-linked bonds typically offer a yield that is dependent on the development of a stock index or an index basket. If the index value grows, the value of the bond grows as well. Conversely, if the index decreases in value, the investor may lose not only the face value of the bond. Index-linked bond issuer guarantees the face value of bonds at maturity date, so the investor may suffer a loss if he chooses to sell the bond before the maturity date.

   Index-linked bonds have a risk of the issuer, i.e. if the bond issuer (usually a bank) goes bankrupt, the investor may lose some or all funds invested in the bonds, including borrowed funds, if such have been used for the purchase of the bonds.

3. **CERTIFICATES OF CERTAIN INVESTMENT FUNDS**

   Investment funds may be both a non-complex (such as UCITS business certificates, an open-end fund "DNB Reserve Fund" certificates), and a complex financial instrument.

   If the investing in investment fund is related to certain difficulties (e.g. investment fund units cannot be easily and quickly sold or information comprehensible to the average customer is not available), this type of fund units are considered to be complex financial instruments. The principal risk, contributing to such financial instruments is the risk of a total loss of the invested funds.

   A separate sub-type of investment funds is exchange-traded funds (ETFs). Their certificates are traded at stock exchanges (like shares). The value of exchange-traded fund shares may be linked to a variety of assets, such as stock or bond indices, commodities, currencies and more. Exchange-traded funds can be both non-complex and complex financial instruments.

4. **DERIVATIVE FINANCIAL INSTRUMENTS**

   Derivatives are financial and commodity instruments, whose price is dependent on the value of the underlying asset. The underlying assets of derivatives can be interest rates, exchange rates, stocks, bonds, stock indices, oil, gold, cotton, and other commodities.

   Derivatives may be used to reduce the risks associated with the underlying asset price fluctuations, as well as to profit from the price fluctuations of derivatives themselves. Before making a deal with derivatives, the customer should clearly understand how the underlying asset’s prices fluctuate, which financial and other risks are associated with these instruments, what the aims of using derivatives are and which alternative instruments are available for reducing the risks in question.
When trading derivatives is conducted for risk reduction purposes, they may be useful for the reduction of underlying asset price volatility effect. However, note that the fluctuations of prices of derivatives and their underlying assets may be different.

When trading in derivatives is conducted for profit purposes, the customer should be aware that such a trade entails high risks. Certain derivatives are characterised by large price fluctuations. Consequently, even small changes in the market may have a significant negative impact on the customer’s financial position.

Most settlements for derivatives are made in the future. In order to purchase or sell derivatives, it is not always necessary to deliver funds in the full amount of the transaction at the moment of the transaction. In certain cases, when making transactions with derivatives, the customer must provide a guarantee or collateral in the amount required by the bank. In case of adverse changes in the market prices the Bank shall be entitled to request the customer to increase the amount of the guarantee or collateral provided earlier. If the client does not make the supplement mentioned above, the Bank has the right to terminate the derivative transaction before due date.

The customer who wants to make derivative transactions should have adequate knowledge of the derivative instruments nature, principles and associated risks. Each derivative type is characterised by specific risks, and the customer’s knowledge and experience in making transactions with one type of derivatives derivative do not guarantee the understanding of other derivatives.

The term to maturity of derivative transactions may be different - ranging from a few days to several years. The most common derivatives are as follows: forwards, options, swaps.

**Foreign exchange forward contracts (FX forwards) and currency swaps (FX swaps)**

*General Information*

Forward exchange contracts (forwards) are agreements to conduct foreign exchange transactions at a fixed price at a future date.

Currency swaps are the agreements to make two currency exchange transactions simultaneously, one of which is a transaction of currency purchase / sale at the settlement date in accordance with the rate fixed as of the date of the transaction and the other is the opposite deal for the sale / purchase of the same amount of currency in future. The exchange rates for both transactions are fixed at the moment of the transaction and depend on the difference in the interest rates of the respective currencies.

*Related risks.*

To make the foreign exchange forward contracts or currency swaps, it is not always required to reserve the full cash value of the concluded transaction at the time of the transaction. In certain cases, when making the transaction, the customer must provide a guarantee or collateral in the amount required by the bank. In case of adverse changes in the market prices the Bank shall be entitled to require the increase of the guarantee or collateral provided by the customer earlier. If the client does not make the increase specified above, the Bank has the right to terminate the respective transaction before due date. If the transaction is terminated prior to maturity, the customer may incur losses and other additional expenses. If the transactions with FX derivative financial instruments are carried out for the purposes of gaining profit, the customer should be aware that such transactions are subject to high risk. The client may incur unlimited losses as the result of unfavourable exchange rate fluctuations.

**Options**

*General Information*

Options are derivatives, which create an obligation for the seller of an option and give a right (but not an obligation) to the buyer of the option to buy (call option) or sell (put option) the contractual amount of underlying assets at a specified price at any date from the contract date to the maturity date (American option) or on the maturity date (European option).

The option buyer pays a premium to acquire an option. The amount of premium paid depends on the volatility of the underlying asset (exchange rate, interest rate, equity or equity index price, commodity price), time till maturity of the option, the option’s agreement strike price, as well as on other factors.
Related Risks
The seller of an option contract assumes the financial risks in order to provide to the buyer the right to request the execution of the contract.

Risks assumed by the customer in case of entering into the options agreement can vary considerably, depending on whether the customer is the buyer or the seller of the option. When buying a call or put option the option buyer pays the seller a premium, and his costs do not exceed the premium paid.

The option seller receives the payment i.e. the option premium from the buyer, and his income is limited to the amount of premiums received. In certain cases, when making the option sale transaction, the customer must provide a guarantee or collateral in the amount required by the bank. In case of unfavourable changes in the market prices the Bank shall be entitled to request the customer to increase the guarantee or collateral provided earlier. If the client does not make the increase mentioned above, the Bank has the right to terminate the transaction before due date. If the transaction is terminated prior to maturity, the customer may incur losses and other additional expenses.

If option sale transactions are carried out for the purposes of gaining profit, the customer should be aware that such transactions are subject to high risk. In case of adverse fluctuations of exchange rates the customer may incur substantial losses.

Interest rate swaps

General Information
Interest rate swaps are agreements, according to which the cash flow based on a fixed interest rate, for the calculation of which the notional principal amount is used, is being replaced by cash flows based on a floating interest rate, for the calculation of which the same notional principal is used, or vice versa.

Related Risks
To make the interest rate swaps, it is not always required to reserve the full cash value of the concluded transaction at the time of the transaction. In certain cases, when making the transaction, the customer must provide a guarantee or collateral in the amount required by the bank. In case of adverse changes in the market prices the Bank shall be entitled to require the increase of the guarantee or collateral provided by the customer earlier. If the client does not make the increase specified above, the Bank has the right to terminate the respective transaction before due date.

If the transaction is terminated before due date, it is revaluated at market rates. If the customer is a fixed-rate payer and the interest rate market has come down, then the transaction will have a negative value in most cases, and the customer upon the bank's request will have to cover the full amount on the transaction early termination date. Consequently, if the transaction is terminated before the due date, the customer may incur losses and other additional expenses.

Commodity swaps

General Information
Commodity swaps are agreements, under which the cash flow based on a fixed price, for the calculation of which the notional value of the goods is used, is being replaced by cash flows based on a floating price, for the calculation of which the same notional value of the goods is used, or vice versa.

Related Risks
If the transactions are concluded for the purpose of making a profit, the price at the moment of execution may differ from the price fixed at the transaction date, and the customer may incur substantial losses.

Entering into commodity swaps the customer has to pay attention to the underlying commodity prices, which can fluctuate differently than commodity derivative’s prices. The funds equal to the total value of the deal made do not necessarily have to be reserved at the moment of closing the transaction. In certain cases, when entering into the transaction the customer must provide a guarantee or collateral in the amount required by the bank. In case of adverse changes in the market prices the Bank shall be entitled to require the increase of the guarantee or collateral provided by the customer earlier. If the client does not make the increase specified above, the Bank has the right to terminate the respective transaction before due date. If the transaction is terminated prior to maturity, the customer may incur losses and other additional expenses.