

## REVIEW OF RISKS OF INVESTMENT IN FINANCIAL INSTRUMENTS

### I. GENERAL PROVISIONS

1. Nordea Bank Finland Plc Lithuanian Branch (hereinafter referred to as the “Bank“) is obligated, according to the provisions of the Markets in Financial Instruments Directive (MiFID), the Republic of Lithuania Law on Markets in Financial Instruments and other legal acts, to make its clients and potential clients (“the Client/Clients“) conversant with risks inherent to financial instruments so that the Clients are able to adopt reasonable investment solutions.
2. This document contains a brief overview of the risks related to investment in financial instruments, however, such risks may differ from case to case, therefore, prior to deciding on a transaction, the Client should assess potential risks based on the Client’s experience, objectives, financial position and other circumstances.
3. The terms used in this document are consistent with the terms defined in the Lithuanian legislation unless the document states otherwise.

### II. MAIN RISKS

4. **Issuer risk** - a risk to incur losses as a result of decrease in the value of financial instruments due to the issuer's failure to discharge its obligations.
5. **Information risk** – a risk that the Client will incur losses due to the fact that, at the time of adopting a decision on investments in certain financial instruments, complete information on the issuer is not available or the information is erroneous.
6. **Inflation risk** – a risk that the purchasing power will decrease due to the rise in prices for consumer goods and services, i. e. ability to purchase a smaller quantity for the same amount of money.
7. **Price risk** – a risk that the Client will incur losses due to unfavourable changes in the market price for securities.
8. **Liquidity risk** – a risk that the Client will incur losses due to the failure to sell a financial instrument at a desired time and at an appropriate price.
9. **Credit risk** – a risk that losses may be incurred if the issuer’s counterparties fail to discharge their obligations and no securities/guarantees are sufficient to satisfy the claims of the Bank’s issuer.
10. **Interest rate risk** – a risk that the Client will incur losses or lose profit due to changes in market interest rates.
11. **Market risk** – a risk that the Client will incur losses due to the effects of price, currency, interest rate, raw materials’ price and liquidity risks.
12. **Counterparty risk** – a risk to incur losses due to the failure of the counterparty to duly discharge its obligations.
13. **System risk** – a risk that cannot be avoided by the investor through diversification of its portfolio. Diversification of portfolio minimises the risk related to specific sectors or companies. System risk arises when the value of securities is dependent on market sentiments or circumstances of investment.
14. **Country/political risk** – a risk arising from political or economic instability, lower market development levels or other social, economic and political factors prevailing in a country of operation or registration of the issuer in whose securities the Client has invested.

**Risks related to investments in emerging and underdeveloped markets (e.g. East European states, China, Brazil, Russia etc.)**

Legal and regulatory infrastructure of emerging and underdeveloped markets is still under formation, which gives rise to legal uncertainty for both local market players and their foreign partners. Some markets may be characterised by increased risk for investors, therefore, prior to investing, they should clarify the relevant risks and make sure that the investment concerned suits them. The risks may include political or economic risk, legal risk, accounting practices, insufficient protection of shareholders or inexistence of such protection, market and settlement risk, unclear taxation rules, execution and counterparty risk, or unclear representation status. This list is not complete and other risks may arise. Investors should take into account that currency exchange rates may fluctuate considerably and a currency may become non-convertible. Therefore, emerging and underdeveloped markets should be selected only by knowledgeable investors or professionals having independent knowledge of the relevant markets, able to consider and assess different risks related to such investments, and having financial resources to cover potential losses arising from such investments.

15. **Legal risk** – a risk that, as a result of change in legal regulation, liquidity or price of financial instruments can decrease or additional obligations can be imposed upon investors.
16. **Currency risk** – a risk that the value of investments will decrease due to currency exchange rate fluctuations.
17. **Other risks** such as war, strike, natural disaster, sanctions upon the issuer or other counterparties imposed by government authorities, communications failures etc., as a result of which the value of the Client's investments can decrease considerably.
18. *The list of risks is not complete.* It includes only the key risks related to investments.

### III. RISKS INHERENT TO CERTAIN FINANCIAL INSTRUMENTS

19. Risks inherent to specific financial instruments are described below.
  - 19.1. **Mutual fund** – assets owned by a number of investments, transferred to an investment management company on trusteeship basis. A person's right to a share in the mutual fund is evidenced by units of the fund held by the person. Managers of the fund invest the assets entrusted to them in various securities such as equities, bonds, money market instruments. The mix of securities (e.g. larger share of equities or of bonds) determines the return on investments and the risks assumed (the higher the risk, the higher potential return). The return on investments is allocated to the holders of the fund's units in proportion to the number of units, in the form of the unit whose price has gone up.
    - 19.1.1. Upon investment in a mutual fund, the risks assumed and their forms depend on the strategies selected by the fund managers (e.g. investment regions; types of securities etc.).
    - 19.1.2. The value of investments in mutual funds can vary within a wide range. The following factors, inter alia, may cause variations in value and affect the variations' scope:
      - changes taking place in Nordea Investment Funds S.A.;
      - competence of the fund managers;
      - interest rate fluctuations;
      - currency exchange rate fluctuations;
      - changes affecting macroeconomic indicators such as employment level, public spending and public debt, inflation;
      - changes in legal environment;
      - changes in investors' trust in certain investments (e.g. in equities as compared with bonds or cash), markets, countries, industries and sectors;
      - liquidity risk.

- 19.1.3. By diversification of investments, the fund manager seeks to mitigate the effect of the risks upon the value of the fund.
- 19.1.4. It is recommended that the Client, prior to adopting a decision on investments in funds, carefully reads the prospectus, strategies and regulations of the fund and assesses competence of the investment fund manager.
- 19.2. **Debt securities (bonds).** Debt securities may be issued by governments or companies. Debt securities are documents promising to repay money borrowed from their holder by a company or by a government. The amount for which bonds are acquired is equal to the amount borrowed. The party issuing debt securities undertakes to pay interest (usually fixed-rate interest) and to repay the borrowed amount upon expiration of the loan term. Thus interest represents the return on investment in this case. The rate of interest depends on the issuer's ability to repay the debt; this ability is assessed by credit rating. The greater the doubt over the ability to repay the debt, the higher the interest rate.
- 19.2.1. Yield on these securities is mainly affected by the interest rate risk. This means that the bond price (the price at which debt securities were acquired) is influenced by the fluctuations of market interest rates – the bond price falls along with rising interest rates. Yield is also affected by other risks such as credit risk and currency risk.
- 19.2.2. Interest on bonds is normally paid by one of the following methods:
- 19.2.2.1. over the bond term, coupon payments are made at the set frequency or at maturity;
- 19.2.2.2. bonds are sold at a discount (discounted bonds) and redeemed at minimal value.
- 19.2.3. If the Client intends to hold the bonds until redemption, the return on the bonds is predetermined. If the bonds are sold prior to redemption, potential gain or loss depends on the *bond yield* at that time. Bond yield represents the bond market price in percentage terms at a certain time and depends on the interest rates, investor expectations, overall economic situation etc.
- 19.2.4. When bonds are purchased, a thorough assessment of the risk related to the issue should be made as if shares in that company were bought. Government bonds are an exception because states go bankrupt much more rarely than companies. Price (yield) of both shares and secondary market bonds depends also on their liquidity.
- 19.2.5. *Risks related to investments in high-yield debt securities.* Certain very high-yield securities with the rating Ba1 or BB+ or lower (Moody or Standard & Poor's) are highly speculative; they are characterised by increased risk compared with the higher quality securities and their prices can vary considerably and problems of payment of nominal principal amount or interest may arise. Compared with securities having high rating, the high-yield bonds are more susceptible to economic or legal factors and changes in the issuers' financial position; violation of obligations is more likely to occur in the use of such bonds. Furthermore, such bonds are characterised by lower liquidity. Companies may issue debt securities with a fixed-interest coupon, with fixed and notional interest coupon, or with variable interest coupon. Such securities may have some characteristics of equities such as the right to convert or exchange them, guaranteed acquisition of equities of same issuer or another issuer (e.g. synthetic convertible securities), or the right to part of income, sales or profit.
- 19.2.6. *Risks related to investments in debt securities with lower ratings.* Securities which have a lower than investment grade rating or to which an equivalent rating has been given by management company are considered to be speculative grade securities. Therefore,

problems of payment of nominal principal amount or interest may arise. Such securities are characterised by increased credit risk or liquidity risk. High credit risk: debt securities with low rating are also called junk bonds, with the credit risk much higher than that of investment grade debt securities. During recession, a large share of issuers of low-rating debt securities may be unable to repay the amount invested and interest. Therefore, the price for low rating debt securities may vary dramatically when unfavourable information about an issuer or economic situation as a whole becomes available. High liquidity risk: during recession or periods of considerable market fall, liquidity of low rating debt securities may be lower, which means that their valuation or selling at acceptable price may be difficult.

- 19.2.7. *Index-linked bonds*. Index-linked bonds consist of bonds and other financial assets, thus they are different from ordinary bonds in that interest paid on index-linked bonds depends on return on other financial assets (equities, commodities and other markets). Index-linked bonds risk is also related to issuer's risk.
- 19.2.8. Higher risk is inherent to index-linked bonds compared with ordinary bonds because, if a decision to sell them prior to redemption is adopted and market situation changes, interest may be lost and losses may be incurred. Still, the risk is lower than that related to the part of reference assets (e.g. oil), as the amount invested is regained if the index-linked bonds are held until redemption.
- 19.2.9. Risks related to banking operations include, first of all, credit risk and market risk. However, other risks such as operating risk and liquidity risk may also be present. Liquidity risk means that it may be possible to fulfil the liquidity obligations only after increasing costs or, eventually, the obligations will not be fulfilled in due time; operating risk is defined by the issuing bank as the risk of incurring losses, including damage to reputation, due to inappropriate internal processes and control or errors or due to external events affecting operations. The bond holder will receive payment for the bond if the issuing bank is able to fulfil its obligation to pay interest on the bond and to repay the nominal principal amount, which, on its turn, depends on the results of operations of the bank.
- 19.2.10. Risks inherent to bonds is also related to changes in interest rates and currency exchange rates, the banks' right to redeem the bonds prior to the set term, complexity of bonds, changes in relevant indexes, other underlying assets or financial markets, as well as to whether redemption amount depends on any factors other than credit ratings of banks.
- 19.2.11. Some risks are related to circumstances beyond control of banks, e.g., presence of an active secondary market, stability of relevant clearing and settlements system, and global macroeconomic situation.
- 19.3. **Equity securities (shares)** – are securities entitling their holder to part of the assets of the company that has issued these securities. Apart from the right to assets, equity securities grant the holder the right to take part in the company's management in a certain defined manner (depending also on the size of the shareholding). Investment in equities provides return from two sources. If the company is profitable, its shareholders are entitled to part of the profit, which is paid out in the form of dividend. In addition, the market value of the shares may rise (e.g., due to favourable evaluation of the company's operations), which augments the shareholder's wealth.
  - 19.3.1. Preference shares may be issued either with cumulative dividend or non-cumulative dividend, and either with the voting right or without the voting right. This is established in the description of the share classes in the Articles of Association. The holder of preference shares with cumulative dividend is guaranteed the right to a dividend of

preset size. Ordinary registered shares grant the voting right and the right to dividend provided that the dividend is declared and paid. The holders of ordinary registered shares may exercise their rights only after the relevant property rights of the preference shareholders have been exercised.

19.3.2. Equity securities are related, in one form or another, to many types of risks such as liquidity, credit, currency or country risk. However, market risk is inherent to all equity securities. It is related to the circumstances of investing in a company, sentiments of financial markets and other abstract market factors that may affect the value of investments rather to the financial position of the company.

19.3.3. *Risks related to investments in shares of smaller companies.* Performance of shares in smaller and medium-size companies may differ from that of larger, widely-known companies and is often characterised by stronger fluctuations. Fluctuations of share prices may also be increased by the lower liquidity of these securities, greater sensitivity to changes in economic situation or interest rate, and uncertainty with respect to growth aspects. In addition, smaller companies may experience difficulties in earning money for growth and development and may lack stronger management; such companies may develop their products in new and unstable markets. All these risks have to be assessed prior to investing in the said companies.

19.3.4. Two notions should be distinguished in assessing investments in equities and return on such investments: share value and share price. The share value represents the value of the company's assets excluding the value of the company's liabilities and including the value of expected profit. Share price includes the value of the shares, investors' expectations, general economic trends etc. It is important to note that the share price determined/forecast by analysts is not indicative of the share market price. The risk inherent to investments in equities is high – the investor/shareholder may lose the whole amount invested if the company goes bankrupt.

19.4 **Derivative financial instruments.** Derivative financial instruments include such instruments as futures, forward contracts, swaps, and options. The purpose of their use is hedging against fluctuations in asset prices. All these financial instruments have one thing in common – their prices depend on variations in the value of other securities, indexes, currency exchange rates, commodities or other assets. Market prices of underlying assets instruments (interest rates, currencies, commodities etc.) are influenced by numerous factors such as country's or global economic situation and growth expectations, supply and demand of/for relevant underlying assets, actions taken by central banks, economic and borrowing policies of governments, political events, conflicts etc. Therefore, key risks related to derivative financial instruments arise from fluctuations in the value of the said financial assets. In case of over-the-counter contracts, there is a risk that the counterparty will not be able to fulfil its obligations and/or the contract will be cancelled, e.g. due to bankruptcy, subsequent unlawfulness or change in taxation/accounting legislation after the date of conclusion of the contract for derivative instruments.

19.4.1. Forward contract is an agreement that, upon expiration of a defined period, one party to the contract will buy and the other party will sell a financial assets or a material assets (depending on subject of contract) at the price agreed on the agreement date. At maturity of such contract, one of the counterparties may earn profit and the other one may incur losses depending on the actual price of the subject of the contract. For example, a forward currency contract gives an opportunity of hedging against currency exchange rate fluctuations, without potential loss or potential profit due to such fluctuations. Forward currency contracts do not eliminate the risk that, as a result of unfavourable

change in future exchange rates, the party will still has the obligation to conclude the transaction at a rate which is worse than market rate, leading to losses.

- 19.4.2. Swap contract is an agreement between the parties to exchange, upon expiration of a defined period, cash flows which may depend e.g. on differences in interest rates, currency exchange rates, or prices for exchange-traded commodities in different countries. Two parties may agree on the payment (receipt) of fixed interest rates or fixed cash flows on exchange-trade commodities during the agreed period and on the receipt (payment) of variable interest rates or variable cash flows on exchange-trade commodities in the same currency and during the same period. For example, a currency swap transaction is an agreement between two parties to exchange, during a defined period, cash flows in some currency for cash flows in another currency. Such agreement is equal to a combination of a spot contract and a forward currency contract where a currency bought via spot transaction is sold via forward transaction, and vice versa. The contract is binding upon the parties until an agreed date. As market value of the contract may change during the term of the contract, in case of early termination the party normally pays present market value to the other party.
- 19.4.3. Future contracts are very similar to forward contracts but differ from the latter in standardised characteristics: futures are traded on stock exchanges and have secondary markets; i. e. a future contract may be bought or sold in the market prior to its maturity. For example, a future contract for agricultural products is a standardised agreement to buy or sell a set quantity of an agricultural product on an agreed future date. On the last date of the contract term, either the physical delivery of the product takes place, or a difference between the spot price and the contract is calculated and paid in cash. No cash flows are exchanged between the buyer and the seller at the time of entering into a future contract.
- 19.4.4. Option is a more complicated form of a future contract, whereby at due date one of the parties may opt to fulfil or not fulfil the terms of the contract. Options may involve buying or selling tangible or financial assets at a set time and at a set price. For example, a currency option grants the buyer the right, but does not obligate him, to buy or sell currency at an agreed rate during the term of the contract. The buyer pays the seller a premium at conclusion of a currency option. An option gives the buyer an opportunity to hedge against changes in currency exchange rates, with the losses being limited to the premium paid and with the opportunity for earning unlimited profit. The buyer only risks to lose the premium paid in case of unfavourable future changes in currency exchange rates. In case of such changes, the seller in a currency option risks to incur losses higher than the premium received. The size of the premium depends on the rate of exchange between the selected currencies, variability of the rate, and the term of contract.
- 19.4.5. Investments in derivative financial instruments can potentially lead to earning a very large profit or to incurring very high losses. *In case of an extremely unfavourable market situation, in particular if borrowed funds were used for investments in derivative financial instruments, losses can very high.*
- 19.5. **Investments using borrowed funds.** Leveraged contract is concluded when the investor borrows financial instruments from a third party, promising to return them upon expiration of an agreed term. Investors do this in an expectation that the price of the borrowed instrument will be lower on the agreed date, then returning of the borrowed instrument will be cheaper and profit will be earned on the difference in prices. The investor should also consider the possibility that the price of the borrowed instrument will go up during the agreed period. In such a case, the investor will have to buy the instrument dearer in the

market in order to return it to the lender, thus incurring a loss rather than earning a profit. Normally, investors also pay lenders interest on the borrowed instruments.

- 19.5.1. Repurchase contract is one of the ways to borrow funds for a short time. The lender makes a loan, receiving financial instruments as collateral. For example, if you have bonds and intend to hold them until maturity but you need money, you may enter into a repurchase contract, i.e. may borrow money from the bank by pledging your bonds to the bank. Just as in case of the leveraged contract, interest at the agreed paid is paid on the borrowed financial instruments.
- 19.5.2. If, in case of a repurchase contract, the investor continues borrowing and investing the borrowed funds in the same financial instruments, a financial structure may be created whereby even the smallest fluctuations of the financial instruments' prices can lead to the loss of all the assets invested. The investor using borrowed funds or financial instruments risks both own and borrowed money – and he will have to repay the latter anyway. Prior to concluding a repurchase contract, the Client should examine all the terms and conditions of the contract and assess his ability to assume the risks described above.
- 19.5.3. Difference contract is an agreement between two parties to pay the difference between the present asset price and the future asset price upon expiration of the set term. In this way investors can speculate in the differences in prices of a financial instrument without buying it.

#### **IV. FINAL PROVISIONS**

20. This document is for information only and the Bank may amend it on a unilateral basis without further notice.
21. The document is published in the website of the Bank [www.nordea.lt](http://www.nordea.lt) and may be presented to the Clients, at their request, at the client service units.

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