

# **Description of financial instruments and services**



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## General Information About Financial Instruments/Services and Inherent Risks

The purpose of this description is to provide clients with information about Bank-offered financial instruments, investment services and related risks and illustrative examples of real investments with different outcomes.

To its clients, Bank offers transactions in the following financial instruments and services: stocks, UCITS ETF, UCITS funds, non-UCITS, debt instruments, money market instruments, derivatives (futures, stock options, and options on futures), FX forwards, margin loan. In the description, Bank informs its clients about risks that an investor may encounter when carrying out transactions in financial instruments. Bank warns the clients about potential loss that may arise while receiving investment services. Bank informs that the list of the risk types is not exhaustive and encompasses only the most significant material risks associated with transactions in financial instruments. Transactions in financial instruments can expose an investor to additional risks.

**Systematic risk** is the risk associated with financial instruments market functioning as a system. The risk manifests itself a potential inability of the system or any part thereof (bank's system, deposit system, market system, setoff system and any other system affecting financial-instrument market) to function properly.

**Idiosyncratic risk** (also known as unsystematic risk) is the risk associated with a specific participant of the financial-instrument market, i.e., a risk inherent to client, Bank, protector, trading platform, depository, issuer, and regulators of the financial-instrument market.

**Information risk** is the risk resulting from unavailability or a lack of information about the issuer and/or financial instruments.

**Price risk** is the risk that market price of client's investment portfolio declines, and client will lose money (fully or partially) invested in the financial instruments because of unfavorable price movements on the financial-instrument markets.

**Currency risk** is the risk stemming from unfavourable swings of exchange rates because of which client's assets are affected by inflation.

**Risk of liquidity squeeze** is the risk stemming from a situation on the financial-instrument market and resulting in a potential difficulty or impossibility to close out client's open position.

**Default risk** is the risk of loss of assets stemming from default (failure to honour obligations), insolvency or illegal involvement of the financial-instrument market's participant which owes obligations to client.

**Tax risk** is the risk that changes in the tax legislation can reduce profitability of client's assets. Bank does not act as client's advisor on tax, legal and/or investment issues.

**Risk of interest rate fluctuations** is the risk of incurring loss because of fluctuating interest rates on the financial market.

**Interest rate risk** is the risk of incurring a drop in the price of a fixed-rate security (e.g., bond) in a situation where interest rates rise, or interest rate hikes are on the whole anticipated by markets.

**Counterparty risk** is the risk of incurring loss if a counterparty, with which Bank has sealed client's transaction in financial instrument(s), fails to honour the contractual obligations arising out of the transaction.

**Political risk** is the risk associated with unfavorable changes in the political landscape in the country of domicile of the security's issuer, in the country of domicile of any other participant of the financial-instrument market (counterparty to the transaction) where those unfavorable changes can affect the price of the financial instruments, the amount of payable income, and the conditions of the pay-out.

**Margin trading risk** – margin trading carries a high level of risk. The use of leverage is the reason why even minor market changes substantially affect client's account. If market moves in the opposite direction to client's position (a market reversal), the client is required to deposit, within a short timeframe, additional money. Otherwise, the client's position may be closed out, leaving the client with losses. The client may fully lose initially invested funds and any other additional funds paid in to retain the open position.

**Legal risk** is the risk of incurring loss or additional expenses because of legislative changes in the Republic of Latvia and/or foreign jurisdictions.

**Other risks** is the risk that client may suffer losses caused by force majeure events (such as natural disasters, military operations, strikes, and others), possession of inaccurate, misleading or incomplete information about the issuer, sanctions implemented by public authorities, court judgments against the issuer or any other of the counterparties, and other similar events that can substantially reduce the value of the invested funds.

## Shares

Shares are equity securities that represent the company's share capital. By buying the securities, the owner of the shares (shareholder) acquires a share (a unit of ownership) in the company's own funds which entitles the shareholder to a part of the company profits in the form of dividends, indirect participation in the management of the company, and part of the assets when company is liquidated; any remaining assets are distributed pro-rata, i.e., in proportion to the number of shares owned, after satisfaction of all the claims of the creditors).

**Ordinary shares** give the right to participate in the voting of shareholders according to the **one-share-one-vote** rule. There are cases when the right of vote attached to ordinary shares can be transferred to a third party for participation in the voting. Furthermore, the company may give the current shareholders the right to purchase more company's shares at a price below the market price, by issuing additional shares. In this case, the right to purchase the new shares will be traded on the market together with the shares.

**Preferred shares** are non-voting shares or with limited voting rights (depending on the joint stock company's articles of association). The absence or restriction of rights is compensated by additional privileges received by the owner of shares of this type. Usually, these privileges include the ability to receive a guaranteed income (dividends), seniority to the holders of common stock in the case of the company's liquidation, and others.

**Depository receipt** is a bank-issued financial instrument that denotes and guarantees the ownership of shares in a foreign company. The main purpose of depository receipts is to raise foreign capital and increase the liquidity of the stock. The most popular types of depository receipts are ADR (American Depository Receipt) and GDR (Global Depository Receipt).

**ADR (American Depository Receipt)** is a certificate issued by a U.S. depository bank for trading in the capital markets in the United States.

**GDR (Global Depository Receipt)** is a receipt issued by any other depository bank. Both ADRs and GDRs are usually denominated in U.S. Dollar but can also be denominated in euro (less frequently). It should also be mentioned that the face value of the depository receipt may not correlate to the share in the ratio of 1:1 (one receipt equals one share) and can be either more or less than that.

It should be added that the investor (the owner of the depository receipts) may be charged an additional fee. As the issuing bank bears costs when issuing and maintaining the receipts, the issuing bank therefore charges an additional fee, i.e., DR service fee. The fee is debited directly by the issuing bank. The fee is debited once a month on a certain date set by the issuing bank, and the amount of the fee may vary. Fees charged by the issuing bank and the amounts of the fees are unique for each depository receipt.

### Example of calculation of DR service fee:

On the 20<sup>th</sup> day of each month, the issuing bank deducts, in its favour, \$0.02 for each receipt owned by the client. Investor bought 1 000 receipts. On the next day, the investor had to pay \$20 (1,000 × \$0.02 = \$20).

- 1) In addition to DR service fee, the issuing bank may set also other fees (the fees are calculated according to the same principle as DR service fee), for example:
- 2) Inspectional fee: charged for inspecting the local stock register. The commission is debited once a year to cover the costs of the issuing bank.
- 3) Conversion fee: written off at the conversion of receipts.
- 4) Insurance fee: written off by the agent for insurance of the depository receipts.
- 5) Dividend fee: written off when dividends are paid on the depository receipts.

### Complexity of the instrument:

**Non-complex:** shares admitted to trading on a regulated market of a EU Member State or on an equivalent non-EU market, or on a multilateral trading facility (MTF).

**Complex:** shares that do not have characteristics of the abovementioned non-complex financial instrument.

### Risks specific to the financial instrument:

Clients must familiarise themselves with the description of the most typical risks (please read General information about financial instruments/services and inherent risks), in particular, price risk, legal risk, risk of liquidity squeeze, tax risk, interest rate risk, systematic risk, idiosyncratic risk and political risk.

While investing in shares, please keep the following points in mind. It is quite possible that the respective shares will not earn the anticipated profit. You can also lose the invested funds if the company/enterprise

goes out of business. Shareholders have the right to receive a share of the company's assets. But the last group to receive payment when a company goes into liquidation are the shareholders. Risk sharing is a widely-spread method of reducing risk associated with one company/enterprise when building a portfolio comprised of different shares. However, risk sharing does not prevent general market risk as prices of shares can fluctuate wildly due to the reasons that are not directly connected with the company's economic performance.

**Important information:**

On Bank's website, client can read complete information about costs and expenses, the list of order execution venues, description of the target market for financial instruments/services, and key information documents (KID) containing information on the characteristics of financial instruments.

**Examples of investments in shares:****Investment with subsequent profit:**

An investor purchased 1,000 shares of U.S. company for \$133.11 per share. The purchase costs are as follows:

- 1)  $1,000 \times \$133.11 = \$133,110$  (for the shares).
- 2) \$50 – the minimum Bank's fee charged for purchase of the shares in the U.S. stock exchange. With the fee of 2.50 cents per share, you'll get \$25. As the minimum fee is \$50, the client will be charged the minimum fee in any event.

Total purchase costs:  $133,110 + 50 = \$133,160$ .

After 52 days, the company's shares have risen to \$151.12 per share.

The investors decides to sell the shares. Income from the sale and attributable costs:

- 1)  $1,000 \times \$151.12 = \$151,120$ .
- 2) \$50 – Bank's minimum fee for the sale of the shares in the U.S. stock exchange.
- 3) \$50.96 – custody fee (0.25% per annum from the value of the assets held in the financial instruments account; in this example, the portfolio comprises only one asset). The calculation uses a constant increase in the portfolio's value of \$392.35 per day during the holding of the asset. The calculation formula:  $V \times 0.25\% / 360$ , where V is the value of the asset on a specific date (for the calculation purposes, the settlement date (which usually is the next day after the transaction date for US companies) will be regarded as the first date and the last date.

Total income from the sale:  $151,120 - 50 - 50.96 = \$151,019.04$ .

**Net profit** from the deal, including all commissions (fees) and custodial fees:  $151,019.04 - 133,160 = \mathbf{\$17,859.04}$ .

**Investments with subsequent loss:**

The investor purchased 10,000 shares of a German company at €6.78 per share. The purchase costs are as follows:

- 1)  $10,000 \times €6.78 = €67,800$  (for the shares).
- 2) €135.60 – Bank's fee for the purchase of the shares on Xetra Frankfurt, a trading venue operated by the Frankfurt Stock Exchange, Germany. In this case, the fee is 0.2% of the transaction amount ( $€67,800 \times 0.2\%$ ).

Total purchase costs:  $67,800 + 135.60 = €67,935.60$ .

After 70 days, the price of the company's shares fell to €5.31 per share.

The investor decides to sell the shares. Income from the sale and attributable costs:

- 3)  $10,000 \times €5.31 = €53,100$  (for the shares).
- 4) €106.20 – Bank's fee for the sale of the shares on Xetra Frankfurt, a trading venue operated by the Frankfurt Stock Exchange, Germany.
- 5) €29.39 – custody fee. The calculation uses a constant decrease in the portfolio's value of – €213.04 per day during the holding of the asset.

Total income from the sale:  $53,100 - 106.20 - 29.39 = €52,964.41$ .

**Net loss** from the deal, including all commissions (fees) and custodial fees:  $52,964.41 - 67,935.60 = \mathbf{-€14,971.19}$ .

**Examples of investments in depositary receipts:****Investment with subsequent profit:**

The investor purchased 1,000 depositary receipts (ADR) at \$50.42 per receipt. The purchase costs are as follows:

- 1)  $1,000 \times \$50.42 = \$50,420$  (for the depositary receipts).
- 2) \$50 – Bank’s minimum fee for the purchase of the depositary receipts in the U.S. stock exchange.

Total purchase costs:  $50,420 + 50 = \$50,470$ .

After 22 days, the price of the depositary receipts surged to \$53.91 per receipt. The investor decides to sell the depositary receipts. Income from the sale and attributable costs:

- 3)  $1,000 \times \$53.91 = \$53,910$ .
- 4) \$50 – Bank’s minimum fee for the sale of the depositary receipts in the U.S. stock exchange.
- 5) \$7.97 – custody fee (0.25% per annum from the value of the assets held in the financial instruments account; in this example, the portfolio comprises only one asset). The calculation uses a constant increase in the portfolio’s value of \$166.19 per day during the holding of the asset. The calculation formula:  $V \times 0.25\% / 360$ , where V is the value of the asset on a specific date.
- 6)  $1,000 \times \$0.02 = \$20$  – depositary receipt service fee.

Total income from the sale:  $53,910 - 50 - 7.97 - 20 = \$53,832.03$ .

**Net profit** from the deal, including all commissions (fees) and custodial fees:  $53,832.03 - 50,470 = \mathbf{\$3,362.03}$ .

**Investments with subsequent loss:**

The investor purchased 1 000 depositary receipts (ADR) at \$53.80 per receipt. The purchase costs are as follows:

- 1)  $1,000 \times \$53.80 = \$53,800$  (for the depositary receipts).
- 2) \$50 – Bank’s minimum fee for the purchase of the depositary receipts in the U.S. stock exchange.

Total purchase costs:  $53,800 + 50 = \$53,850$ .

After 12 days, the price of the depositary receipts fell to \$52.08 per receipt. The investor decides to sell the depositary receipts. Income from the sale and attributable costs:

- 3)  $1,000 \times \$52.08 = \$52,080$ .
- 4) \$50 – Bank’s minimum fee for the sale of the receipts in the U.S. stock exchange.
- 5) \$4.41 – custody fee. The calculation uses a constant decrease in the portfolio’s value of – \$156.36 per day during the holding of the assets.
- 6)  $1,000 \times \$0.02 = \$20$  – depositary receipt service fee.

Total income from the sale:  $52,080 - 50 - 4.41 - 20 = \$52,005.59$ .

**Net loss** from the deal, including all commissions (fees) and custodial fees:  $52,005.59 - 53,850 = -\mathbf{\$1,844.41}$ .

## Exchange-Traded Funds (ETFs)

**Exchange-traded funds (ETFs)** are investment funds whose securities (shares) are freely traded on an exchange. The ETFs are structured so that the correlation between the fund and the underlying index (or asset) is positive or negative (if the fund is the opposite of its underlying index or benchmark). Investors can conduct transactions involving ETF's shares in the same manner as transactions involving ordinary shares (i.e., purchase / sale). Apart from regular ETFs, there are also **leveraged ETFs** (funds with the 'built-in' leverage). The difference between these funds is the presence of the so-called "lever". The presence of the financial leverage allows an ETF to generate a larger profit or loss than the index it is based on. This is achieved through the use of various financial derivatives and debt instruments. The use of the derivatives in the structure of the fund also adds the need to transfer the derivative position to the next active month upon the expiry of the contract. This can lead to a situation where the value of the ETF's shares decreases, even on a stable market. It is worth mentioning that leveraged ETFs **tend** to correlate with the underlying index (or asset) as accurately as possible (given the declared multiplier) but **do not guarantee** it.

As structured deposits or structured products work similarly to how ETFs do, investors can use also structured deposits or structured products to achieve their investment objectives and to diversify their portfolios. Structured deposits are a popular type of investment in countries with a highly developed financial system. The deposits guarantee safety of the principal amount (capital-protection feature) and offer a chance to have gains substantially higher than standard interest rate on traditional deposits. The gains are possible due to the structure of the deposit. A major portion of the principal is invested in low-yield but especially safe money market instruments (such as treasury bills, inland bills, etc.). The rest of the principal is invested in high-risk instruments offering the potential for higher returns (options, futures, etc.). The structure of the deposits allows the investors to preserve initially invested money and enables them to gain high profit under favourable conditions.

It should also be taken into account that ETFs carry management fee (indicated in the description of the instrument and usually ranges from 0.5% to 1.5% per annum of the total value of the fund's assets) which affects the potential amount of profit or loss. The ability of retail investors to invest in ETFs is restricted unless the ETFs supply the retail investors with a 'key information document' (KID) to help them better understand the investment product.

### **Complexity of the instrument:**

Complex, except for (UCITS ETF)\*.

\*Undertakings for collective investment in transferable securities (UCITS) are investment funds regulated at a European Union level. UCITS are stringently regulated by Directive 2014/91/Eu of the European Parliament and of the Council of 23 July 2014 amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions. The Directive sets forth requirements in relation to the funds-pursued investment strategy, risk diversification and other relevant aspects.

### **Risks specific to the financial instrument:**

Clients must familiarise themselves with the description of the most typical risks (please read General information about financial instruments/services and inherent risks), in particular, risk of liquidity squeeze, political risk, information risk, systematic risk, idiosyncratic risk, tax risk, price risk, currency risk and legal risk

There is a risk that the investment can lose its partial or entire value. Depending on the chosen ETF's underlying index and the ETF's structure, the risk levels may vary. Double-leveraged ETFs (leveraged 2X ETFs) and triple-leveraged ETFs (leveraged 3X ETFs) and inverse/short ETFs are much riskier than regular ETFs due to their complex structure.

### **Important information:**

On Bank's website, client can read complete information about costs and expenses, the list of order execution venues, description of the target market for financial instruments/services, and key information documents (KID) containing information on the characteristics of financial instruments.

### Examples of investments in ETFs:

#### Investment with subsequent profit:

An investor purchased 1 000 ETF's shares at €44.70 per share. The purchase costs are as follows:

- 1)  $1,000 \times €44.70 = €44,700$  (for the shares).
- 2) €89.40 – fee for the purchase of ETF's shares if the rate is 0.2% of the transaction amount.  
( $€44,700 \times 0.2\% = €89.40$ ).

Total purchase costs:  $44,700 + 89.40 = €44,789,40$ .

After 17 days, the price of ETF's shares surged to €45.63 per share. The investor decides to sell the shares.

Income from the sale and attributable costs:

- 3)  $1,000 \times €45.63 = €45,630$ .
- 4) €91.26 – fee for the sale of ETF's shares if the rate is 0.2% of the transaction amount ( $€45,630 \times 0.2\% = €91.26$ ).
- 5) €5.33 – custody fee (0.25% per annum from the value of the assets held in the financial instruments account, the portfolio comprises only one asset). The calculation uses a constant increase in the portfolio's value of €58.13 per day during the holding of the asset. The calculation formula:  $V \times 0,25\% / 360$ , where V is the value of the asset on a specific date.

Total income from the sale:  $45,630 - 91.26 - 5.33 = €45,533.41$ .

**Net profit** from the deal, including all commissions (fees) and custodial fees:  
 $45,533.41 - 44,789.40 = \mathbf{€744.01}$ .

#### Investments with subsequent loss:

An investor purchased 1,000 ETF's shares at €45.68 per share. The purchase costs are as follows:

- 1)  $1,000 \times €45.68 = €45,680$  (for ETF's shares).
- 2) €91.36 – fee for the purchase of ETF's shares if the rate is 0.2% of the transaction amount  
( $€45,680 \times 0.2\% = €91.36$ ).

Total purchase costs:  $45,680 + 91.36 = €45,771.36$ .

After 4 days, the price of ETF's shares dropped to €44.04 per share. The investor decides to sell the shares.

Income from the sale and attributable costs:

- 3)  $1,000 \times €44.04 = €44,040$  (for ETF's shares).
- 4) €88.08 – fee for the sale of ETF's shares if the rate is 0.2% of the transaction amount ( $€44,040 \times 0.2\% = €88.08$ ).
- 5) €1.56 - custody fee. The calculation uses a constant decrease in the portfolio's value of – €410 per day during the holding of the assets.

Total income from the sale:  $44,040 - 88.08 - 1.56 = €4,950.36$ .

**Net loss** from the deal, including all commissions (fees) and custodial fees:  
 $43,950.36 - 45,771.36 = - \mathbf{€1,821}$ .

## Fund Shares

An investment fund is a set (pool) of money from many investors combined or pooled together for investment purposes. An investment fund is established to collectively invest in certain assets, depending on a pre-determined strategy. The investors (private individuals or legal entities) are holders of fund shares (units).

Individual investors are not obligated to make decisions concerning the investments (allocation of the fund's money). The investors only choose a particular fund after considering its objectives, risks, costs and other relevant factors. The fund's manager is responsible for asset allocation and the strategy. An investor receives an amplified and professionally managed portfolio. The aggregation of money enables investors to minimise risks by distributing the assets across securities and hence optimise costs.

The funds can take one of the two forms: open-end investment funds (their shares can be sold at any point in time) and closed-end investment funds (the money can be received only when the fund goes into liquidation (the investors will know about the liquidation in advance)). There are two broad categories of investment funds: UCITS funds and non-UCITS funds (categorised as alternative investment funds under EU regulation).

UCITS fund is an investment fund regulated by the Directive 2009/65/EC of the European Parliament And of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS), as amended. The UCITS standard offers additional benefits for fund managers and investors. One of the most important advantages of these funds is a high degree of awareness, transparency and high standards of risk management (limitations on the range of instruments in which investment can be made, etc.). Each UCITS fund has a "passport" that allows the fund to sell its shares in different EU Member States. It should be taken into consideration that many funds have the entry threshold, the minimum amount of investment.

Non-UCITS are funds that do not possess the so called "UCITS passport". Overall, they are not as transparent as UCITS are. The EU regulatory authority does not stringently regulate the funds. However, the funds have much more possibilities in respect of the structure and financial instruments that the funds can buy. The local supervisory bodies regulate the funds in their domicile (country where the respective fund is incorporated), depending on the fund's legal structure (SICAV, SICAF, FCP, etc.). A non-UCITS can be converted to a UCITS as long as it meets UCITS requirements.

Like non-UCITS, UCITS offer different share classes (Class A, Class B, etc.). Each fund individually determines the classes and the number of the classes, depending on various factors. For example, class A may have a higher entry threshold and is intended for institutional investors, and class B for private ones with a lower entry threshold for private clients. However, it should be taken into consideration that, despite the division into classes, the investors of the fund own the same financial instrument (the same ISIN, profits earned by the shares).

### **Complexity of the instrument:**

UCITS funds: non-complex; non-UCITS funds: complex.

### **Risks specific to the financial instrument:**

Clients must familiarise themselves with the description of the most typical risks (please read General information about financial instruments/services and inherent risks), in particular, price risk, information risk, legal risk, risk of liquidity squeeze, tax risk, systematic risk, idiosyncratic risk, political risk and currency risk. Different investment funds are exposed to risks of different levels, depending on segments of financial market and types of financial instruments. Money market funds (MMF) and bond funds are perceived as the safest ones (offer the least volatile types of investment).

Balanced funds carry higher risk (offer more volatile investment). A fund's prospectus and/or the funds management rules contain the description of investments-related restrictions/limitations and risks.

### **Important information:**

On Bank's website, client can read complete information about costs and expenses, the list of order execution venues, description of the target market for financial instruments/services, and key information documents (KID) containing information on the characteristics of financial instruments.

**Examples of investments in UCITS:****Investment with subsequent profit:**

An investor purchases 1,000 UCITS shares at €1,110.75 per share. The purchase costs are as follows:

- 1)  $1,000 \times €1,110.75 = €1,110,750$  (for UCITS shares).
- 2) The purchase fee (1.5% min. €500) =  $€1,110,750 \times 1.5\% = €16,661.25$ .

Total purchase costs:  $1,110,750 + 16,661.25 = €1,127,411.25$ .

After 17 days, the price of UCITS shares surged to €1,200. The investor decided to close the deal at profit. Income from the sale and attributable costs:

- 3)  $1,000 \times €1,200 = €1,200,000$  (for UCITS shares).
- 4) €136.71 – custody fee (0.25% per annum from the value of the assets held in the financial instruments account). The calculation uses a constant increase in the portfolio's value of \$5,250.71 per day during the holding of the shares. The calculation formula:  $V \times 0.25\% / 360$ , where V is the value of the asset on a specific date.
- 5) €328.10 – management fee (0.6% per annum of the market value of all UCITS shares mentioned in this example). The calculation uses a constant increase in the portfolio's value of €5,250.71 per day during the holding of the shares. The calculation formula:  $V \times 0.6\% / 360$ , where V is the value of the asset on a specific date.
- 6) The sale fee:  $1,200,000 \times 1\% = €12,000$  (1% of the transaction amount, min. €500).

Total income from the sale:  $1,200,000 - 136.71 - 328.10 - 12,000 = €1,187,535.19$

**Net profit** from the deal, including all commissions (fees), custodial fees and management fees:  $1,187,535.19 - 1,127,411.25 = \mathbf{€60,123.94}$ .

**Investments with subsequent loss:**

An investors purchased 1,000 UCITS shares at €1,110.75 per share. The purchase costs are as follows:

- 1)  $1,000 \times €1,110.75 = €1,110,750$  (for UCITS shares).
- 2) The purchase fee (1.5% min €500) =  $€1,110,750 \times 1.5\% = €16,661.25$ .

Total purchase costs:  $1,110,750 + 16,661.25 = €1,127,411.25$ .

After 17 days, the price of UCITS shares slid to €1,105. The investor decides to sell the shares. Income from the sale and attributable costs:

- 3)  $1,000 \times €1,105 = €1,105,000$  (for UCITS shares).
- 4) €130.77 – custody fee. The calculation uses a constant decrease in the portfolio's value of – €338.24 per day during the holding of the shares.
- 5) €313.85 – management fee (0.6% per annum of the market value of all UCITS shares mentioned in this example). The calculation uses a constant decrease in the portfolio's value of – €338.24 per day during the holding of the shares.
- 6) The sale fee:  $1,105,000 \times 1\% = €11,050$  (1% of the transaction amount, min. €500).

Total income from the sale:  $1,105,000 - 130.77 - 313.85 - 11,050 = €1,093,505.38$ .

**Net loss** from the deal, including all commissions (fees), custodial fees and management fees:  $1,093,505.38 - 1,127,411.25 = \mathbf{-€33,906.06}$ .

## Debt Instruments

A debt instrument is a documented (paper or electronic format) financial liability between a borrower and a creditor. The instrument can be traded between one or more legal entities. Debt instruments include bonds, depositary receipts and commercial paper.

A bond is a debt security whereby a borrower (issuer) undertakes to pay the lender (investor) the debt (the loan principal together with the interest accrued over a certain period of time).

There are coupon bonds and zero-coupon bonds (discount bonds). **Coupon bonds** are interest-bearing bonds for which the issuer pays interest (coupon) until maturity. **Zero-coupon bonds** do not pay coupon. Zero-coupon bonds are sold at a price below their face value (initial price set by the issuer), i.e., the discount. The discount is the difference between the issue price and the face value (if the bond is held until maturity). The discount makes the bondholder's income. Bonds are classified by the type of issuer and fall into the following categories: government, municipal and corporate bonds. Most investors prefer bonds carrying the highest credit rating assigned by a rating agency (a company that rates the creditworthiness/assesses financial strength of enterprises). Despite the large number of credit agencies, Standard & Poor's, Moody's and Fitch are the three most significant rating agencies (The Big Three credit rating agencies).

### **Complexity of the instrument:**

**Non-complex:** debt securities admitted to trading on an EU regulated market or a third-country market considered as equivalent to a regulated market in the Union, or multilateral trading facility (MTF)

**Complex:** debt securities that are not defined as / do not qualify for treating as non-complex financial instruments.

### **Risks specific to the financial instrument:**

Clients must familiarise themselves with the description of the most typical risks (please read General information about financial instruments/services and inherent risks), in particular, price risk, information risk, risk of liquidity squeeze, tax risk, systematic risk, idiosyncratic risk, political risk, currency risk and default risk.

There is a risk that the investment can lose its partial or entire value, including the circumstances under which the issuer unable to honour its obligations (e.g., in the event of case of insolvency) or its ability to honour its obligations diminishes. There is also the risk of not receiving part or all of the interest income. The probability of the issuer's insolvency is assessed by independent credit rating agencies. Rating changes significantly affect the bond's market value. Smaller companies do not always request a rating for their bonds, which makes it difficult for the investor to assess the risk of such securities. An abnormally high interest rate on a bond means that the issuer is facing financing problems, and such bonds are considered risky in the market. Considerable fluctuations in the market value of the bond can also be caused by circumstances that are not directly related to the issuer of the bond, but to changes in interest rates in general (interest rate risk). In general, the prices of longer-term bonds are more exposed to changes in interest rates.

### **Important information:**

On Bank's website, client can read complete information about costs and expenses, the list of order execution venues, description of the target market for financial instruments/services, and key information documents (KID) containing information on the characteristics of financial instruments.

### **Examples of investments in bonds:**

#### **Bond parameters:**

Each bond has certain parameters. The transaction is carried out based on the parameters. Despite a large number of nuances, each bond has the following key parameters:

The international securities identification number (ISIN) is a 12-digit alphanumeric code that uniquely identifies a specific security (stock, bond, etc.). At the same time, ISIN is not the only identifier (although the most common one). There are other identifiers usually assigned by national regulators (for example, VALOR).

The minimum transaction amount is the minimum amount (at face value) required to conduct the transaction.

Increment is the step after the minimum transaction amount. With the minimum transaction amount equal to 100,000 (at face value) and with an increment of 1,000, the investor can buy bonds at face value of 100,000, 101,000, 102,000, 103,000, etc.

NAME	POLAND 5 ¾ 11/16/32
ISIN	US857524AE20
COUPON	5.75%
PERIODICITY OF COUPON PAYMENT	Twice a year
CURRENCY	USD
MATURITY DATE	16.11.2032.
MINIMUM TRANSACTION AMOUNT	1 000
INCREMENT	1 000

### Investment with subsequent profit:

An investor decides to purchase 230,000 Poland Government Bonds paying a coupon rate of 5.75% per annum. The purchase price is 105% of the face value. The purchase costs are as follows:

- 1)  $230,000 \times 105\% = \$241,500$  (market value).
- 2) \$1,873.54 – the accrued coupon from the date of the previous payment (51 days\*).

\* The accrued coupon income is paid to the previous bondholder and is calculated based on the settlement date for the transaction. The last coupon date was 51 days ago (*coupon date is the date when the coupon is due to be paid*). For 230,000 bonds, coupon per day totals \$36,736.11. Respectively, for 51 days:  $36,736.11 \times 51 = \$1,873.54$ .

- 3) \$243.37 – Bank's fee for transaction in government bonds denominated in US dollars. The fee is calculated at the rate of 0.10% the transaction amount (purchase price + accrued coupon).

Total purchase costs:  $241,500 + 1,873.54 + 243.37 = \$243,616.91$ .

After 41 days, the price of the bond surged to 111% of the face value, and the investor decided to close the deal at profit. Income from the sale and attributable costs:

- 4)  $230,000 \times 111\% = \$255,300$  (market value).
- 5) \$3,379.72 – the accrued coupon from the date of the previous payment (92 days).
- 6) \$258.68 – Bank's fee for the transaction involving government bonds denominated in US dollars.
- 7) \$72.45 – custody fee (0.25% per annum from the value of the assets held in the financial instruments account; in this example, the portfolio comprises only one asset). The calculation uses a constant increase in the portfolio's value of \$336.59 per day during the holding of the assets. The calculation formula:  $V \times 0.25\% / 360$ , where V is the value of the asset on a specific date.

Total income from the sale:  $255,300 + 3,379.72 - 258.68 - 72.45 = \$258,348.59$ .

**Net profit** from the deal, including all commissions (fees) and custodial fees:  $258,348.59 - 243,616.91 = \mathbf{\$14,731.68}$ .

### Investments with subsequent loss:

The investor decided to purchase 230,000 Poland Government Bonds paying a coupon rate of 5.75% per annum. The purchase price is 105% of the face value. The purchase costs are as follows:

- 1)  $230,000 \times 105\% = \$241,500$  (market value).
- 2) \$1,873.54 – the accrued coupon from the date of the previous payment (51 days).
- 3) \$243.37 – Bank's fee for transaction in government bonds denominated in US dollars.

Total purchase costs:  $241,500 + 1,873.54 + 243.37 = \$243,616.91$ .

After 41 days, the price of the bond fell to 102% of the face value, and the investor decided to record the loss. Income from the sale and attributable costs:

- 4)  $230,000 \times 102\% = \$234,600$  (market value).
- 5) \$3,379.72 – the accrued coupon from the date of the previous payment (92 days).
- 6) \$237.98 – Bank's fee for transaction in government bonds denominated in US dollars.
- 7) \$69.43 – custody fee. The calculation uses a constant decrease in the portfolio's value of – \$168.29 per day during the holding of the asset.

Total income from the sale:  $234,600 + 3,379.72 - 237.98 - 69.43 = \$237,672.31$ .

**Net loss** from the deal, including all commissions (fees) and custodial fees:  $237,672.31 - 243,473 = -\mathbf{\$5,800.69}$ .

In addition to bonds with simple methodology of calculation, instruments with various variables are also common on the debt market. These variables can be both external and internal factors affecting the company or the economic situation as a whole; as well as additional conditions that the company establishes by itself (at the time of issuance). The most common variables include instruments with:

- 1) Early redemption of bonds (CALL) – the company has the right to redeem the bond prior to the maturity date, at a predetermined price, if the market price at the date of possible redemption is lower.
- 2) Early sell right (PUT) – the investor has the right to demand early repayment of the principal. This type of bond is typical for emerging markets, e.g., Brazil.
- 3) Variable coupon rate – the bond rate may be floating, dependent on specific parameter (i.e., central bank rate, LIBOR, indexes and other indicators).
- 4) Amortization of the principal amount of debt – often the company will pay a part of the face value along with the coupon in order to avoid paying the full amount at maturity. This can be done if the bond considers amortization.
- 5) Extension of the maturity period – the maturity of the bond may be extended to a later date.
- 6) Conversion to another financial instrument – the bond can be converted into another instrument, both into shares and into a debt instrument with an increased maturity.

Bonds with variables are considered complex bonds as they require investors to have thorough knowledge of financial markets and greater awareness of higher risks.

### Examples of investments in bonds:

#### Bond parameters:

NAME	NSANY 4.81 09/17/30
ISIN	USJ57160DZ32
COUPON	4.81%
PERIODICITY OF COUPON PAYMENT	Twice a year
CURRENCY	USD
MATURITY DATE	17.09.2030.
MINIMUM TRANSACTION AMOUNT	200,000
INCREMENT	1,000

The given bond has the following variables: Possibility of early redemption at 100% of the face value.

#### Investment with subsequent profit:

An investor decided to purchase 500,000 corporate bonds paying a coupon rate of 4.81% per annum. The purchase price is 110% of the face value. The purchase costs are as follows:

- 1)  $500,000 \times 110\% = \$550,000$ .
- 2) \$1,202.50 – the accrued coupon from the date of the previous payment (18 days\*).

\*The accrued coupon income is paid to the previous bondholder and is calculated based on the settlement date for the transaction. The last coupon date was 18 days ago (*coupon date is the date when the coupon is due to be paid*). Coupon per day totals  $500,000 \times 4.81\% / 360 = \$66,8055555$ . Respectively, for 18 days:  $66,8055555 \times 18 = \$1,202.50$ .

- 3) \$826.80 – Bank's fee for transaction in corporate bonds denominated in US dollars. The fee is calculated at the rate of 0.15% of the transaction amount (face value + accrued coupon).

Total purchase costs:  $550,000 + 1,202.50 + 826.80 = \$552,029.30$ .

After 17 days, the bond's price rose up to 115% of face value, and the investor decided to close the position at profit. Income from the sale and attributable costs:

- 4)  $500,000 \times 115\% = \$575,000$  (market value).
- 5) \$2,338.19 – the accrued coupon (for 35 days).
- 6) \$866.01 – Bank's fee for transaction in corporate bonds denominated in US dollars.
- 7) \$74.36 custody fee (0.25% per annum from the value of the assets held in the financial instruments account; in this example, the portfolio comprises only one asset). calculation uses a constant increase in the portfolio's value of \$1,537.39 per day during the holding of the asset. The calculation formula:  $V \times 0.25\% / 360$ , where V is the value of the asset on a specific date.

Total income from the sale:  $575,000 + 2,338.19 - 866.01 - 74.36 = \$576,397.82$ .

**Net profit** from the deal, including all commissions (fees) and custodial fees:  $576,397.82 - 552,029.30 = \$24,368.52$ .

#### Investments with subsequent loss:

The investor decided to purchase (at face value) 500,000 corporate bonds paying a coupon rate of 4.81% per annum. The purchase price is 110% of the face value. The purchase costs are as follows:

- 1)  $500,000 \times 110\% = \$550,000$  (market value).
- 2) \$1,202.50 – the accrued coupon from the date of the previous payment (18 days\*).

- 3) \$826.80 – Bank’s fee for transaction in corporate bonds denominated in US dollars. The fee is calculated at the rate of 0.15% of the transaction amount (face value + the accrued coupon).

Total purchase costs:  $550,000 + 1,202.50 + 826.80 = \$552,029.30$ .

After 17 days, the bond’s price surged to 115% of its face value, and the issuer decided to redeem the bond early (prior to the bond’s maturity date) resulting in that the client gained 100% of the face value.

Income from the bond redemption:

- 1)  $500,000 \times 100\% = \$500,000$  (face value).
- 2) \$2,338.19 – the accrued coupon from the date of the previous payment (35 days\*).
- 3) \$53.98 – custody fee. The calculation uses a constant decrease in the portfolio’s value of – \$1764.06 per day during the holding of the assets until the early redemption date (on the call date, the calculations are based the early redemption price).

Total income:  $500,000 + 2,338.19 - 53.98 = \$502,284.21$ .

**Net loss** from the deal, including all commissions (fees) and custodial fees:  $502,284.21 - 552,029.30 = -\$49,475.09$ .

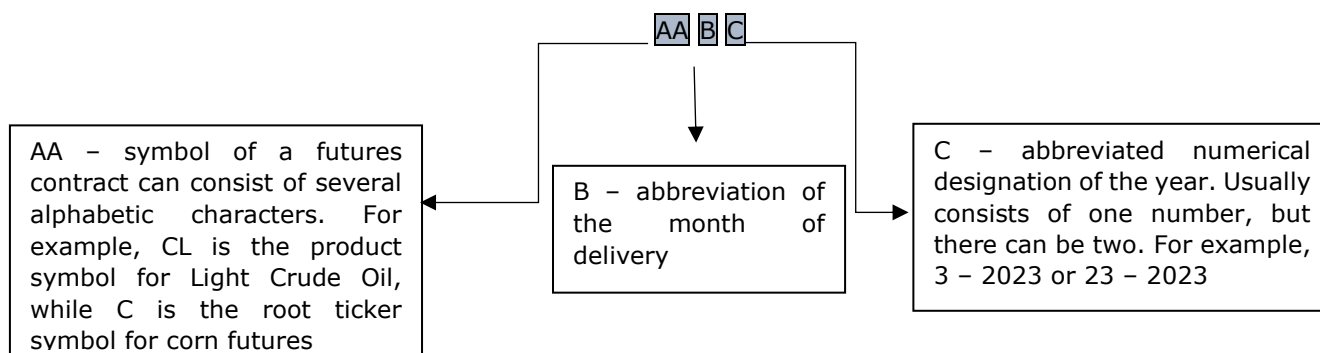
**N.B.** Please consider the following aspect: depending on the bond prospectus, the bond can be redeemed partially or left unredeemed as the company has the right, but not the obligation, to redeem the bond. In the event of partial redemption, the money is paid out, most often, on a pro rata basis, i.e., the received sums are distributed proportionally between the bondholders according to a certain covenant.

## Futures Contracts

Exchange-traded futures contract. The essence of the transaction is the delivery of a certain asset in a certain place on a specific date in the future. When buying futures, neither the transfer of this asset nor the payment for it occurs. The price of the contract at a particular point in time is the current value of the asset plus the interest for the time remaining until payment, that is, until the contract is realized. Thus, futures markets are a kind of auction, trade on which reflects the latest data on the correlation of demand and offers for specific assets. There are two types of futures contracts – delivery and settlement (non-delivery). At the expiration of delivery futures, raw materials (oil, grain, gasoline, etc.) are delivered, while a settlement future does not imply physical delivery, and a settlement takes place instead, where the contractual parties settle the difference between the price under the opening of the contract and the official price at the contract’s expiration. By buying and selling futures, investors tend to predict the direction of price movements of certain underlying assets and thus to receive profit. Futures contracts are traded by month of delivery. The corresponding month is mentioned in the contract name and may have the following abbreviations:

ABBREVIATION	FULL WORD
F	January
G	February
H	March
J	April
K	May
M	June
N	July
Q	August
U	September
V	Octobers
X	November
Z	Decembers

According to generally accepted standards, the abbreviated name of the futures contract is based on the following principle:



Futures contracts are characterized by a high degree of standardization – according to the specification, quantity, place and time of delivery of the goods. Due to standardization, contracts are similar not only in the calculation methodology and structure, but also in the terminology used to describe the main parameters. The main terms include:

- 1) Contract size – the number of units of weight or volume in one contract. Can be measured in different mass / volume units (troy ounces, bushels, barrels, etc.)
- 2) Value of 1.0 pt – the cost of changing the contract price by one point (for example, from 15.4 to 16.4, etc.)
- 3) Tick size – the minimum change in the price of the contract. Also called the minimum step.
- 4) Tick value – the price of the price change in the currency of the contract (US dollar, euro, yen, etc.) with a minimum price change.
- 5) Contract price – the current market price of the futures contract.
- 6) Contract value – contract price multiplied by the size of the contract.
- 7) Up Limit and Down Limit:

- Up Limit – the maximum value of the contract price during the day. The upper limit is set by the exchange and serves as a kind of restrictor, above which the price cannot go. This limitation exists to control panic states and excessive volatility. When the upper limit is reached, the trade under the contract can be suspended. The exchange revises the upper limit daily, based on the closing price of the contract.
- Down Limit – the minimum value of the contract price during the day. The Lower Limit is set by the exchange and serves as a sort of restrictor, below which the price cannot go. This limitation exists to control panic moods and excessive volatility. When the Lower Limit is reached, trade under the contract can be suspended. The exchange revises the Lower Limit daily, based on the closing price of the contract.

**N.B.** It should be noted that many exchanges set restrictive limits also for other classes of financial instruments, as well as for the whole stock exchange trade. Thus, exchanges can stop trading in case of significant (10 or more percent) changes in stock indices.

- 1) Initial margin – the required amount of money to open a futures position.
- 2) Notification dates under the contract:
  - Last trade – the last day when a futures contract is traded or may be closed before the delivery of the underlying asset or cash settlement. This parameter is present for all futures contracts.
  - First notice – on this day the holder of the contract can receive a notice of the need to receive delivery of the underlying asset. In order to avoid the risk of delivery, clients close or transfer positions to the next active month on the day before the first day of the delivery notification. This parameter is present only for contracts for which the physical delivery of the underlying assets is provided.
  - First delivery date – the beginning date of the physical delivery under the futures contract. This parameter is present only for contracts for which the physical delivery of the underlying assets is provided.

**N.B.** Brokers can independently set the end dates until which they are willing to hold the position of their clients, without fear of the risk of delivery and related administrative costs and cancellation formalization difficulties. In this case, they can force the client to close the position ahead of schedule on such instrument.

As not all underlying assets undergo standardization, futures exist only for the primary assets, in particular, futures on stock indices, stocks, currencies, agricultural commodities, metals, oil products, etc. are widespread. The counterparty is not known to the investor, nor is it needed, since there exists a system of security deposits that operates to provide for the mechanism of bidding. When opening a long (purchase) or short (sale) position, the client must provide a guarantee that usually ranges from 2% to 10% of the current market value of the asset. Thus, in the futures market there are a lot of bilateral deals.

**Complexity of the instrument:** Complex.

**Risks specific to the financial instrument:**

Clients must familiarise themselves with the description of the most typical risks (please read General information about financial instruments/services and inherent risks), in particular, price risk, information risk, legal risk, risk of liquidity squeeze, tax risk, systematic risk, idiosyncratic risk, margin trading risk, political risk and currency risk.

Client take into consideration that the amount of loss is unlimited. Bank can use client's other assets (held with Bank) to settle the client's obligations. There is a risk of suffering significant losses if the transaction's market the value changes in an unfavourable direction for the client, including the risk of losing part or all of the collateral, as well as there is a risk that the amount of losses may exceed the amount of the provided collateral.

If the client is unable to provide initial collateral or top-up (additional) collateral upon Bank's request, Bank may close the client's position and use the collateral to discharge the client's obligations.

**Important information:**

On Bank's website, client can read complete information about costs and expenses, the list of order execution venues, description of the target market for financial instruments/services, and key information documents (KID) containing information on the characteristics of financial instruments.

**Examples of trading in futures contracts:**
**Description of the contract:**

CLQX – WTI CRUDE OIL 202X, AUGUST	
CONTRACT SIZE	1,000 barrels
VALUE OF 1.0PT	\$1,000
TICK SIZE	0.01
TICK VALUE	\$10
PRICE	\$76.81/bbl. (US dollars per barrel)
CONTRACT VALUE	\$76,810
INITIAL MARGIN	\$6,380
UP LIMIT	N/A
DOWN LIMIT	N/A

**Purchase of futures:**

% P/L	OPENING PRICE	CLOSING PRICE	COMMISSION (\$19 PER PARTY)	PROFIT/LOSS (INCLUDING COMMISSIONS PAID)
+ 3%	76.81	79.11	\$38*	$= (79.11 - 76.81) \times 1,000 - 38 = \$2,262$
- 3%	76.81	74.51	\$38*	$= (74.51 - 76.81) \times 1,000 - 38 = -\$2,338$

\* commission of \$19 for the contract per party means that by buying and reselling one contract, the client pays \$38.

**Sale of futures:**

% P/L	OPENING PRICE	CLOSING PRICE	COMMISSION (\$19 PER PARTY)	PROFIT/LOSS (INCL. COMMISSIONS PAID)
+ 3%	76.81	74.51	\$38*	$= (76.81 - 74.51) \times 1,000 - 38 = \$2,262$
- 3%	76.81	79.11	\$38*	$= (76.81 - 79.11) \times 1,000 - 38 = -\$2,338$

\* commission of \$19 for the contract per party means that by buying and reselling one contract, the client pays \$38.

Trading in margin instruments, including futures, is associated with the need to maintain a certain level of margin. In case of insufficient coverage of margin requirements, a margin call may occur on the account, in case of occurrence of which the investor needs to refill the account to fully cover all of the margin requirements. With further deterioration of the situation, a stop-loss situation may also arise. It should be considered that when the situation of margin calls arises, Bank has the right to close out the client's position, without waiting for the onset of a stop-loss situation.

**N.B.** Often, the opening price of trading of financial instruments can be lower (opening with a gap down) or higher (opening with a gap up) in comparison with closing price of the previous day. When trading starts with a gap, there may be a situation in which the requirements to the client may exceed the security deposit. In this case, the client will be required to provide additional funds to cover the difference between loss and security deposit.

**Example of determining the level of margin call un stop loss:**

AVAILABLE FUNDS PRIOR TO THE OPENING OF THE POSITION	\$15,000
THE OPEN POSITION	Purchase of 1 lot of WTI CRUDE OIL 202X, AUGUST
PURCHASE PRICE	75
INITIAL MARGIN REQUIREMENT	\$6,380
COMMISSION FOR OPENING THE CONTRACT	\$19
AVAILABLE FUNDS AFTER THE OPENING OF THE CONTRACT	$= 15,000 - 6,380 - 19 = \$8,601$
MARGIN CALL LEVEL IN POINTS FROM THE POSITION ENTRY PRICE	$= 8,601 / 1,000 / 1 = 8.60$
MARGIN CALL LEVEL	$= 75 - 8.60 = 66.40^*$
STOP LOSS LEVEL IN POINTS FROM THE POSITION ENTRY PRICE	$= (8,601 + 0.70 \times 6,380) / 1,000 / 1 = 13.067$
STOP LOSS LEVEL	$= 75 - 13.067 = 61.93^{**}$

\* because the minimum movement (tick) under the contract is 0.01; the margin call will occur at a price 66.40.

\*\* since the minimum movement (tick) under the contract is 0.01; stop-loss will occur at a price of 61.93.

## Stock Options and Options on Futures

An option is a derivative that allows the option buyer (the owner or holder of a long position of the option) the right, but not the obligation, to buy or sell the underlying asset or financial instrument at the strike price of the option, depending on the option type (European or American). It should be considered that when buying an option, a premium is received by the counterparty (the seller of the option). In regard to this, the maximum loss of the holder of a long position can be equal only to the premium paid for the option. For a holder of a short position on an option (the seller), the loss is unlimited (except for the sale of PUT options, since the underlying asset cannot be below zero), but profit is limited to the initial amount of premium received for the sale.

In addition to being either CALL or PUT, options can also be divided by their duration – weekly and monthly, where weekly options expire each week, and monthly options expire each month. For liquid stock and futures contracts, three weekly options and one monthly expire per month (totalling four working weeks or one month). Some options for the underlying asset do not provide for the trading of weekly options – in most cases this is due to the demand for the underlying asset (the availability of options for the base contract is determined by the issuer of the contract, in most cases it is the exchange).

A holder of a long position in American-type options during the option may request for the underlying asset to be delivered (CALL option), or sell the underlying asset at the strike price (PUT option). For European-type options, delivery can only occur on the maturity date of the option. The holder of the short position (the seller) is, on the contrary, obliged to fulfil the requirements of the other party either to sell the asset (CALL option) or buy the option (PUT option). When delivering the underlying asset by option, it is imperative to satisfy an initial margin requirement for a futures contract or to provide cash to pay for the shares to be delivered.

It should be noted that a standard stock option on the exchange contains 100 shares, while a futures option contains one contract. However, the number of shares/futures may vary depending on the specification of the option.

**Complexity of the instrument:** Complex

**Risks specific to the financial instrument:**

Clients must familiarise themselves with the description of the most typical risks (please read General information about financial instruments/services and inherent risks), in particular, price risk, information risk, legal risk, risk of liquidity squeeze, tax risk, systematic risk, idiosyncratic risk, margin trading risk, political risk and currency risk.

Client must take into account that the option's price (premium) is affected by changes in the price of the underlying asset and the volatility of these prices. The stock option's price may change until the option expiration date. Options the buyer's potential total loss is limited to the amount of the premium paid, while retaining the opportunity to profit as a result of favourable changes in the price of the security. The maximum profit of the option seller is the premium received. The option's seller has unlimited losses, which can exceed the amount of the premium received and the amount of collateral provided. Unexercised options after expiry of the validity period expire and lose value accordingly. Financial instruments serving as collateral for an option may be written off without prior notice. In some cases, if options are sold without collateral, the amount of loss may be unlimited.

**Important information:**

On Bank's website, client can read complete information about costs and expenses, the list of order execution venues, description of the target markets for financial instruments/services, and key information documents (KID) containing information on the characteristics of financial instruments.

**Examples of trading in stock options and futures options:**
**Example of futures option:**

CLUX P77 – CRUDE OIL OPTION SEPTEMBER OF 202X 77 PUT

BASE CONTRACT	CLUX
NUMBER OF CONTRACTS	1 CRUDE OIL OPTION SEPTEMBER OF 202X contract
SIZE OF THE CONTRACTS	1,000 barrels
PRICE OF 1.0 POINT	\$1,000
TICK SIZE	0.01
TICK VALUE	\$10
PRICE	3.10
CONTRACT VALUE	\$3,100
INITIAL MARGIN REQUIREMENT	\$6,000 (collected only at sale)
OPTION TYPE	American
PARTY TO THE OPTION CONTRACT	PUT
STRIKE PRICE	77

**Purchase of options on futures:**

Profit/Loss calculation using option price

% P/L	OPENING PRICE	CLOSING PRICE	COMMISSION (\$19 PER PARTY)	PROFIT/LOSS (INCLUDING COMMISSIONS PAID)
+ 30%	3.10	4.03	\$38	$= (4.03 - 3.10) \times 1,000 - 38 = \$892$
- 30%	3.10	2.17	\$38	$= (2.17 - 3.10) \times 1,000 - 38 = -\$968$

Profit/Loss calculation using option premium

% P/L	PREMIUM PAID UPON OPENING OF THE POSITION	PREMIUM RECEIVED UPON THE SALE	COMMISSION (\$19 PER PARTY)	PROFIT/LOSS (INCLUDING COMMISSIONS PAID)
+ 30%	$= 3.10 \times 1,000 = \$3,100$	$= 4.03 \times 1,000 = \$4,030$	\$38	$= 4,030 - 3,100 - 38 = \$892$
- 30%	$= 3.10 \times 1,000 = \$3,100$	$= 2.17 \times 1,000 = \$2,170$	\$38	$= 2,170 - 3,100 - 38 = -\$968$

**Sale of option on futures:**

Profit/Loss calculation using option price

% P/L	OPENING PRICE	CLOSING PRICE	COMMISSION (\$19 PER PARTY)	PROFIT/LOSS (INCLUDING COMMISSIONS PAID)
+ 30%	3.10	2.17	\$38	$= (3.10 - 2.17) \times 1,000 - 38 = \$892$
- 30%	3.10	4.03	\$38	$= (3.10 - 4.03) \times 1,000 - 38 = -\$968$

Profit/Loss calculation using option premium

% P/L	PREMIUM RECEIVED UPON OPENING OF THE POSITION	PREMIUM PAID UPON THE SALE	COMMISSION (\$19 PER PARTY)	PROFIT/LOSS (INCLUDING COMMISSIONS PAID)
+ 30%	$= 3.10 \times 1,000 = \$3,100$	$= 2.17 \times 1,000 = \$2,170$	\$38	$= 3,100 - 2,170 - 38 = \$892$
- 30%	$= 3.10 \times 1,000 = \$3,100$	$= 4.03 \times 1,000 = \$4,030$	\$38	$= 3,100 - 4,030 - 38 = -\$968$

### Example of stock option:

AAPL US 09.15.202X. C195 APPLE STOCKS 15 SEPTEMBER 202X 195 CALL

BASE CONTRACT	Stocks of Apple Inc.
BASE NUMBER OF SHARES	100 stocks of Apple Inc.
VALUE OF 1.OPT	\$100
TICK SIZE	0.05
TICK VALUE	\$5
PRICE	5.00
INITIAL MARGIN REQUIREMENT (INDICATIVE)	\$5,000 (collected only at sale)
OPTION TYPE	American
OPTION CONTRACT'S PARTY	CALL
STRIKE PRICE	195

### Purchase of stock option:

Profit/Loss calculation using option price

% P/L	OPENING PRICE	CLOSING PRICE	COMMISSION (\$35 PER PARTY)*	PROFIT/LOSS (INCLUDING COMMISSIONS PAID)
+ 30%	5.00	6.50	\$70	= (6.50 - 5.00) × 100 - 70 = \$80
- 30%	5.00	3.50	\$70	= (3.50 - 5.00) × 100 - 70 = - \$220

\* the minimum commission is \$35. When exceeding the minimum threshold, the commission is \$3.5 per option.

Profit/Loss calculation using option premium

% P/L	PREMIUM PAID UPON OPENING OF THE POSITION	PREMIUM RECEIVED UPON THE SALE	COMMISSION (\$35 PER PARTY)*	PROFIT/LOSS (INCLUDING COMMISSIONS PAID)
+ 30%	= 5.00 × 100 = \$500	= 6.50 × 100 = \$757	\$70	= 650 - 500 - 70 = \$80
- 30%	= 5.00 × 100 = \$500	= 3.50 × 100 = \$243	\$70	= 350 - 500 - 70 = - \$220

\*the minimum commission is \$35. When exceeding the minimum threshold, the commission is \$3.5 per option.

### Sale of stock option:

Profit/Loss calculation using option price

% P/L	OPENING PRICE	CLOSING PRICE	COMMISSION (\$35 PER PARTY) *	PROFIT/LOSS (INCLUDING COMMISSIONS PAID)
+ 30%	5.00	3.50	\$70	= (5.00 - 3.50) × 100 - 70 = \$80
- 30%	5.00	6.50	\$70	= (5.00 - 6.50) × 100 - 70 = - \$220

\* the minimum commission is \$35. When exceeding the minimum threshold, the commission is \$3.5 per option.

Profit/Loss calculation using option premium

% P/L	PREMIUM RECEIVED UPON OPENING OF THE POSITION	PREMIUM PAID UPON THE SALE	COMMISSION (\$35 PER PARTY) *	PROFIT/LOSS (INCLUDING COMMISSIONS PAID)
+ 30%	= 5.00 × 100 = \$500	= 3.50 × 100 = \$350	\$70	= 500 - 350 - 70 = \$80
- 30%	= 5.00 × 100 = \$500	= 6.50 × 100 = \$650	\$70	= 500 - 650 - 70 = - \$220

\* the minimum fee is \$35. When exceeding the minimum threshold, the commission is \$3.5 per option.

## Option Strategies

An option strategy is a combination of various options, which can either be paired with an underlying asset of the option, or without it. An option strategy is determined by the investor, based on his goals and aims, which can include increasing profit of the position (with market growth) or limiting losses (hedging). Since option strategies are related to the movement of the market, they can be divided into two types – Bull and Bear. The main principle of the Bull strategy is to increase the value of the underlying asset, while a Bear strategy bets on the reduction of an underlying asset's value. For effective use of option strategies, you need to understand where the payback point is (the price level at which the income and expense for the option position, including commission costs, is 0). Despite a large number of optional strategies, the most common ones are:

- 1) Bull (CALL) Spread – this strategy involves the purchase of a CALL option with the simultaneous sale of a CALL option, but with a higher strike. The premium received from the sale will partially offset the premium paid for the purchase. Using this strategy, the investor assumes that the price for the underlying asset will go up (above the strike of the long position), but not above a certain level (strike of the short position).
- 2) Bear (PUT) Spread – this strategy is the opposite of a bull spread. The strategy involves the purchase of a PUT option with the simultaneous sale of a PUT option, but with a lower strike. As in the above paragraph, the sales premium partially covers the premium paid. Using this strategy, the investor assumes that the price for the underlying asset will go down (below the strike of the long position), but not below a certain level (strike of the short position).
- 3) Covered CALL/PUT options: the main idea of this strategy is either the sale of a CALL option against a long position on the underlying asset, or the sale of a PUT option against a short position of the underlying asset. When an option is sold, the investor receives a premium. Due to this premium, a kind of a buffer is created that reduces the risk of a price fall on the underlying asset (for a long position on the underlying asset) or growth (for a short position on the underlying asset), and also increases the yield on the position if the price of the underlying asset remains within certain limits.

For example, an investor has 100 shares in his portfolio, bought at \$300 apiece. To increase his profit, he sells CALL options at an exercise price of \$305. The premium received is \$2. In this case, the lowest limit at which the investor will suffer a loss will be \$298 per share (the price of entry into the underlying asset minus the premium). However, the maximum profit will also be limited to \$7 per share (if the share price is equal to or above \$305 at the expiration date of the option, the investor will have to allocate the shares with the counterparty).

- 1) Straddle refers to an options strategy based on the purchase or sell of the same number of CALL and PUT options with the same strike price and the same maturity date for one underlying asset. There are 2 types of straddles: a long straddle (purchase of options) and a short straddle (sale of options). A long straddle pays off when high price volatility is expected due to which the profit on options will exceed the premium paid for the purchase. Profit potential (the maximum profit) is unlimited and the loss does not exceed the premium paid. A short straddle pays off when there is low volatility. Therefore, a premium will be received from the sale of the contracts and the buyer of the option will not exercise its rights. Profit potential (the maximum profit) is limited to the amount of premium collected from the sale of the options. Potential loss is unlimited.

For example, a company's shares currently trade at \$1,265 per share. The investor expects high price volatility after the release of quarterly financial reports. The investor therefore buys a CALL option and a PUT option with a strike price of 1,265 for \$40.50 per share. In total, the investor pays \$81 for both options. If at the maturity date the share will be traded below \$1,184 or higher than \$1,346, the option strategy will generate a profit.

- 2) Strangle: the strategy uses the same principle as straddle but is used instead with options that are "out of the money" (options whose strike price is distanced from the current market price). The option is "out of the money", when there is no sense to make a delivery, because to buy or sell the underlying asset at a market price is more profitable. Options that are "out of the money" are, as a rule, cheaper. The main advantage of strangle option strategies is the presence of a smaller premium. However, with a decrease in costs, the profitability margins increase (the upper and lower levels of the strategy payback).

An example of using a strangle strategy would be a purchase of a CALL option with a strike of 270 for \$3 each and a PUT option with a strike of 260 for \$5 each, when the market offer is 265. The maturity date of both options must be the same, just like the underlying asset. The aggregate premium will be equal to \$8. If the price of the underlying asset at maturity date will be lower than \$252 ( $260 - 8$ ) or higher \$278 ( $270 + 8$ ) the strategy will generate a profit.

## Currency Forwards

Currency forwards (or forward exchange contracts) are OTC contracts. A currency forward is a contract whereby one party (the seller) must exchange for the other party (the buyer) a certain amount of money at a predetermined exchange rate on a certain day in the future (unilaterally). Unlike a futures contract, a forward contract is a non-standardized contract between two parties. This means that a currency forward can be tailored to precisely fit the parties's respective needs regarding a monetary amount and the timeframe the contract covers. Unfavourable exchange rate fluctuations can give rise to currency risk. Currency forwards are concluded to reduce currency risk and to be able to plan the future cash flow more precisely. For instance, currency forwards can protect the buyer or the seller against unfavourable exchange rate occurrences that may arise between when a sale is contracted and when the sale is actually made. Currency forward pricing is calculated on the spot rate and the interest rate differentials between the two currencies for the tenor of the forward.

**Complexity of the instrument:** Complex

**Risks specific to the financial instrument:**

Clients must familiarise themselves with the description of the most typical risks (please read General information about financial instruments/services and inherent risks), in particular, price risk, information risk, legal risk, risk of liquidity squeeze (where there are certain transaction volumes or the respective market conditions prevail), tax risk, systematic risk, idiosyncratic risk, margin trading risk and political risk.

Foreign exchange (spot) transactions are less suitable for future cash flow hedging because settlement takes place only two business days after the conclusion of the transaction and thus requires quick availability of funds. Therefore, forward contracts are more suitable for this purpose. There is a risk of suffering significant losses if the market value of the transaction changes in an unfavourable direction for the client, including the risk of losing part or all of the collateral if the settlement day of the transaction does not coincide with the day of conclusion of the transaction. The amount of loss can also exceed the value of the underlying collateral. Currency forwards cannot be ordinarily terminated unilaterally. The forward is intended to be held (the position remains open) until the maturity date. You may have to bear extra costs to end the product early (prematurely).

**Important information:**

On Bank's website, client can read complete information about costs and expenses, the list of order execution venues, description of the target market for financial instruments/services, and key information documents (KID) containing information on the characteristics of financial instruments.

**Examples of a forward transaction:**

In one month, a client needs to purchase (for US Dollars) business equipment. Since the company operates in the eurozone, the company earns its main income in euro. If currency conversion is carried out at the time of the transaction (in a month), it is unclear how much money will be needed as the exchange rate may change.

In order to protect the company from foreign exchange risk and allocate the necessary amount of money for the transaction, the client decides to fix the exchange rate (for the transaction that will take place in a month) by using a forward transaction.

**Transaction parameters:**

- 1) The amount required to purchase the equipment is \$1,000,000.
- 2) Security deposit of \$70,000 – 7% of the forward amount to be collected in one of the forward contract currencies and calculated individually.
- 3) The fixed exchange rate is 1.17.
- 4) Amount (EUR) required for converting in a month:  $1,000,000 / 1.17 = €854,700.86$ .

If in a month the market exchange rate is equal to \$1.15 per euro, the client will earn \$17,094.01 on the deal (the forward rate is better than the market rate). With a market rate of \$1.19 per euro, the client will lose \$17,094.01 on the deal (the market exchange rate is better than the forward rate). It should be noted that even with an, exchange rate loss, the forward contract allows you to plan future costs, which has a positive effect on the company's activity as a whole.

## Money Market Instruments

A financial market consists of two major segments: money market (MM) and capital market. The key features of money market are as follows: money market instruments are short-term financing instruments that are issued with a maturity of one year or less; there is little risk associated with MM funds. Basically, the transactions involve lending or investing for a short term, MM instruments generate lower returns.

Common MM instruments:

- 1) Short-term securities (Treasury bills, bank checks, certificates of deposits /CD/);
- 2) Short-term loans (commercial and interbank);
- 3) Repurchase transactions (repos).

Short-term U.S. Treasury bills or T-bills (with a maturity of less than one year, inclusive) are the simplest and most popular instruments. The T-bills are considered highly liquid and widely regarded to be the safest financial instruments. How do U.S. T-bills differ from other treasury bills? The T-bills are zero-coupon bonds usually sold at a discount to the face value, and the difference between the purchase price and the face value is your accrued interest. As U.S. T-bills are zero-coupon bonds priced at a discount, the T-bill's current price makes its yield on paper.

**Complexity of the instrument:** non-complex instruments, excluding those instruments which embed a derivative or incorporate a structure which makes it difficult for the client to understand the risk involved in the respective financial instruments.

**Risks specific to the financial instrument:**

Clients must familiarise themselves with the description of the most typical risks (please read General information about financial instruments/services and inherent risks), in particular, price risk, information risk, legal risk, risk of liquidity squeeze, default risk, tax risk, systematic risk, idiosyncratic risk and political risk.

The value of debt security depends on the annual interest rate prevailing in the relevant market. As the interest rate increases, the price of the debt security decreases, while as the interest rate decreases, the price of the debt security increases.

**Important information:**

On Bank's website, client can read complete information about costs and expenses, the list of order execution venues, description of the target market for financial instruments/services, and key information documents (KID) containing information on the characteristics of financial instruments.

**Examples of investments in US T-bills:**

**Investment with subsequent profit:**

An investor purchased 100,000 short-term US T-bills maturing in 27 days. At the time of the purchase, the T-bill was traded with a yield of 1.2625% (price 99,7475% of face value). The purchase costs are as follows:

- 1)  $100,000 \times 99.7475\% = \$99,747.50$  (for the T-bill).
- 2) \$99.75 – Bank's fee for the purchase of the specific T-bills (0.1% of the transaction amount).

Total purchase costs:  $99,747.50 + 99.75 = \$99,847.25$ .

The investor decides to hold the T-bills until maturity. As the T-bills are redeemed at 100% of face value, the income from the redemption and attributable costs are as follows:

- 3)  $100,000 \times 100\% = \$100,000$  (for the T-bill at the face value).
- 4) \$0 – Bank's fee for the redemption of the T-bill (the redemption fee is not charged).
- 5) \$18.73– custody fee (0.25% per annum from the value of the assets held in the financial instruments account; in this example, the portfolio comprises only one asset). The calculation uses a constant increase in the portfolio's value of \$9.71 per day during the holding of the asset. The calculation formula:  $V \times 0.25\% / 360$ , where V is the value of the asset on a specific date.

Total income from the redemption:  $100,000 - 18.73 = \$99,981.27$ .

**Net profit** from the deal, including all commissions (fees) and custodial fees:  $99,981.27 - 99,847.25 =$   
**\$134.02**

**Investments with subsequent loss:**

The investor purchased 100 000 short-term US T-bills, maturing in 28 days. At the time of the purchase, the T-bill was traded with a yield of 1.895% (price 99.621% of face value). The purchase costs are as follows:

- 1)  $100,000 \times 99.621\% = \$99,621$  (for the T-bill).
- 2) \$99.62 – Bank's fee for the purchase of the specific T-bills (0.1% of the transaction amount).

Total purchase costs:  $99,621 + 99.62 = \$99,720.62$ .

After 21 days, the yield on the T-bills surged to 2.15% (price 99.57% of face value). The investor decides to record the loss and to sell the position. Income from the sale and attributable costs:

- 3)  $100,000 \times 99.57\% = \$99,570$  (the T-bill's face value).
- 4) \$99.57 – Bank's fee for the sale of specific T-bills.
- 5) \$14.53 – custody fee. The calculation uses a constant decrease in the portfolio's value of – \$2.55 per day during the holding of the asset.

Total income from the sale:  $99,570 - 99.57 - 14.53 = \$99,455.90$ .

**Net loss** from the deal, including all commissions (fees) and custodial fees:  $99,455.90 - 99,720.62 = -$   
**\$264.72.**

## Use of Margin Loans

Margin loans secured by pledged securities allow an investor to increase the profitability of his portfolio by increasing the number of assets that are available to the client for acquisition. Also, such a loan allows you to get quick access to funds. Margin loans can be issued against a pledge for a portfolio of securities consisting of shares, bonds, ETF-funds, UCITS-funds, etc., which meet the criteria for granting a loan.

With the presence of borrowed funds, the portfolio becomes marginal. When buying securities using a margin loan, the investor must provide a deposit that will serve as collateral for the transaction. The relationship is as follows: "The market value of a security = margin loan + security deposit". A decrease in the asset's price entails a situation where the amount of money required maintain marginal parameters falls below a certain level, known as the maintenance margin, and hence triggers margin call. When a margin call occurs, the investor must restore the balance between the margin loan and the client's deposit by adding money/financial instruments to the account or by selling a portion of the asset. If margin call occurs, Bank has the right, but not the obligation, to close out the position.

### Specific risks:

Clients must familiarise themselves with the description of the most typical risks (please read General information about financial instruments/services and inherent risks), in particular, price risk, information risk, legal risk, risk of liquidity squeeze (where there are certain transaction volumes or the respective market conditions prevail), tax risk, systematic risk, idiosyncratic risk, margin trading risk and political risk.

The amount of loss is unlimited. Bank may use the client's other assets held with Bank to settle the client's liabilities. There is a risk of suffering significant losses if the market value of the transaction changes in an unfavourable direction for the client, including the risk of losing part or all of the collateral, as well as there is a risk that the amount of loss may exceed the amount of the provided collateral.

### Important information:

On Bank's website, client can read complete information about costs and expenses, the list of order execution venues, description of the target market for financial instruments/services, and key information documents (KID) containing information on the characteristics of financial instruments.

### Investment (by using margin loan) with subsequent profit:

An investor decided to purchase shares of U.S. company for \$200 050 with his own money and by using a margin loan. The company's shares are financed in the proportion of 80% / 20%, where 80% is Bank's financing and 20% is the client's deposit. Bank's maximum financing will total \$800 000, interest rate of 7%\* per annum.

\* The rate may vary depending on the amount of funding, the assets used as collateral, the interest rate situation on the markets and other various factors.

The price per share is \$500. The purchase costs are as follows:

- 1)  $2,000 \times \$500 = \$1,000,000$  (for the shares).
- 2)  $2,000 \times 0.025 = \$50$  (Bank's minimum fee for the purchase of the shares in the U.S. stock exchange).

Total purchase costs:  $1,000,000 + 50 = \$1,000,050$ .

After 102 days, the price of the shares rose to \$680 per share. The investor decides to sell the shares (close at profit). Income from the sale and attributable costs:

- 3)  $2,000 \times \$680 = \$1,360,000$  (for the shares).
- 4)  $2,000 \times 0.025 = \$50$  (Bank's minimum fee for the sale of the shares in the U.S. stock exchange).
- 5) \$844.03 – custody fee (0.25% per annum from the value of the assets held in the financial instruments account; in this example, the portfolio comprises only one asset). The calculation uses a constant increase in the portfolio's value of \$3,529.41 per day during the holding of the asset. The calculation formula:  $V \times 0.25\% / 360$ , where V is the value of the asset on a specific date.
- 6) \$15,866.67 – interest on the issued loan for the loan usage period (7% per annum of margin loan amount – \$800 000). The calculation formula:  $K \times 7\% / 360 \times D$ , where K is the amount of the margin loan on the specific date and D is the number of days of using the margin loan.

Total income from the sale:  $1,360,000 - 50 - 844.03 - 15,866.67 = \$1,343,239.30$ .

**Net profit** from the deal, including all commissions (fees) and custodial fees:  $1,343,239.30 - 1,000,050 = \$343,189.30$ .

**Investments (while using margin loan) with subsequent loss:**

An investor decided to purchase shares of U.S. company for \$200,050 with his own money and by using a margin loan. The company's shares are financed in the proportion of 80% / 20%, where 80% is Bank's financing and 20% is the client's deposit. Bank's financing will total \$800,000, interest rate of 7% per annum. Price per share is \$500. The purchase costs are as follows:

- 1)  $2,000 \times \$500 = \$1,000,000$  (for the shares).
- 2)  $2,000 \times 0,025 = \$50$  (Bank's minimum fee for the purchase of the shares in the U.S. stock exchange).

Total purchase costs:  $1,000,000 + 50 = \$1,000,050$ .

After 71 days, the price of the shares fell to \$420 per share. The investors decides to sell the shares (record the loss). Income from the sale and attributable costs:

- 3)  $2,000 \times \$420 = \$840,000$  (for the shares).
- 4)  $2,000 \times 0.025 = \$50$  (Bank's minimum fee for the purchase of the shares in the U.S. stock exchange).
- 5) \$460 – custody fee. The calculation uses a constant decrease in the portfolio's value of – \$2,253.52 per day during the holding of the asset.
- 6) \$11,044.44 – interest on the issued loan for the loan usage period (7% per annum of the margin loan amount).

Total income from the sale:  $840,000 - 50 - 460 - 11,044.44 = \$828,445.56$ .

**Net loss** from the deal, including all commissions (fees) and custodial fees:  $828,445.56 - 1,000,050 = -\$171,604.44$ .

## Portfolio Management Service (PMS)

Portfolio Management Service (management of individual financial-instrument portfolio) is a professional financial service where a portfolio manager (here referred to as the manager) manages, on your behalf, your cash funds and financial instruments, and you rely on the manager's decisions and choices. The manager will not contact you every time he invests on your behalf. However, the manager regularly reports to you on the activities that he has taken on your behalf. This service is most suitable for investors who prefer to delegate their investment decisions to a knowledgeable and competent professional.

When you choose to receive PMS, you rely on the manager to a greater extent than if you choose to invest without receiving such support. Therefore, you and the manager must be sure that you both have understood and agreed on your individual wishes and circumstances in order to be able to buy and sell products that are most suitable for you in your goals. It is important for the manager to obtain complete and accurate information from you so that he can choose products that suit your goals most accurately. It is in your interest to provide the manager with correct, up-to-date and complete information. You should also inform the manager about any significant changes in your financial situation. The manager has a duty to maintain confidentiality of the information.

The manager will ask you more questions that are part of the so-called suitability assessment. These questions are focused on your investment goals, your financial situation, knowledge and experience in relation to financial instruments and your sustainability preferences. In order to understand your investment objectives, questions will be asked on the following topics:

- 1) investment goal;
- 2) investment amount;
- 3) investment horizon;
- 4) risk tolerance.

To assess your **financial situation**, the manager will ask questions about:

- 1) income;
- 2) assets;
- 3) liabilities;
- 4) expected expenditures.

To assess your **knowledge and experience** in relation to financial instruments, you will be asked questions about

- 1) investment services that are well known to you;
- 2) investment transactions and types of products;
- 3) the nature of the transactions previously carried out;
- 4) volume and frequency;
- 5) level of education;
- 6) occupation.

To determine your **sustainability preferences**, questions are asked about:

- 1) General Sustainability preferences;
- 2) The minimum proportion of the Portfolio to be invested in Environmentally Sustainable Investments;
- 3) The minimum proportion of the Portfolio to be invested in Sustainable Investments;
- 4) The restrictions related to investments in companies that have a negative human rights impact and/or that have significant greenhouse gas emissions and/or whose business activities involve controversial weapons.

Always remember that it is in your interest to provide the manager with the information as complete as possible about your financial situation and investment goals. This is required in order for the manager to have all the necessary information to compile an individual portfolio that is right for you. If the manager managing the individual portfolio does not obtain or cannot obtain the information necessary to assess suitability, he cannot manage your assets and make decisions on your behalf. If you provide incomplete or misleading information, this will affect the type of services that the manager may provide.

PMS is designed for clients **categorised** as follows:

- 1) retail clients;
- 2) professional clients.

Each specific client, who receives the service of individual portfolio management suitable for oneself, will at the same time be the object of the **target market for such service**. The risk level of an individual portfolio can range from 1 to 5, and for the clients of a portfolio created, their risk profile is determined. The risk profile of these clients is determined individually according to their individual and unique

circumstances. In order to assess which financial instruments may be included in the portfolios of these clients, the level of clients' knowledge and experience with financial instruments is assessed. If the client has a high level of knowledge and extensive experience in working with complex tools, these tools can be included in the client's portfolio. In order for derivatives, for example, to be included in clients' portfolio, a client besides the experience in working with these instruments needs to understand concepts such as leverage as well as the risks associated with margin trading. By assessing the financial condition of the client, it is determined whether the client is able to suffer losses from those funds that he/she transfers for Portfolio Management. In order to avoid situations where the client's funds are invested in instruments or portfolios that may incur losses for the client, it is assessed whether the client is able to financially tolerate losses in his/her individual portfolio.

In order to assess whether the **client is aware of the risk** to which his/her portfolio will be exposed, the client is offered to choose the price fluctuations that he/she is ready to see in his/her portfolio, as well as the amount of losses that may be at such a level of risk that the client wants to see in his/her portfolio.

In addition to all the criteria described above, the client's investment **goals and needs** are determined, which are agreed upon with the client by signing an Investment declaration, where all guidelines and all criteria for how the client's portfolio will be managed are reflected. The list with all available financial instruments for the further management of the investment portfolio would be included in the Investment declaration as well. Client has a possibility to exclude any type of available financial instruments from the portfolio. In the Investment declaration is also specified the amount of fees for this service, which is negotiated on an individual basis.

After an initial assessment of the portfolio structure's suitability for the client, the signing of the Agreement on the provision of portfolio management service and the Investment declaration by both the client and the Bank, the Manager can start forming and managing the client's portfolio of financial instruments in full accordance with the client's risk profile and provisions stated in the Investment declaration. When managing a portfolio, the main task of managers is to determine an optimal approach to achieving client's investment goal within the acceptable risk boundaries and effectively adapt the portfolio to the changing realities of financial markets, using all the capabilities of financial instruments to increase the invested capital.

When assessing the investment potential and the worthwhileness of adding a particular financial asset to the portfolio, Managers use both of the main approaches: Top-down and Bottom-up. The Top-down approach is based on an assessment of the current macroeconomic environment and its impact on specific sectors of the economy and financial markets. Such an assessment helps determine which asset classes have higher growth potential for given risk parameters in certain macroeconomic conditions. The Bottom-up approach focuses on evaluating specific issuers. Managers pay special attention to the prospects and sustainability of the company's business model, as well as its key financial metrics to determine the profitability and creditworthiness of the issuer. A deep understanding of the competitive advantages of specific companies and the dynamics in various sectors of the economy helps Managers more effectively assess the long-term prospects of companies, as well as the risks associated with investments in these companies.

Another important factor in portfolio management is effective risk management. Every day, Managers monitor and evaluate various economic and financial indicators, as well as the financial performance of individual companies. This approach allows one to better control systematic market risks and risks related to individual issuers, which allows one to make timely decisions regarding reduction, increase or complete abandonment of various types of risk associated with investing. The frequency of transactions with financial instruments in a client's portfolio depends on many factors, including those listed above, and is not limited to a particular number or execution period.

## Corporate Actions

Corporate action is an event of corporate governance that can affect the material condition of the company, shareholders or debt holders. These actions are usually approved by the board of directors of the company and in many corporate events shareholders have the right to participate and vote. Some corporate events require mandatory participation of shareholders. The absence of a shareholder in a corporate action has consequences, e.g., the shareholders meeting may consider his vote to be abstained or in favour of the motion. Separately, it must be noted that an investment firm (in our case – a bank) is not obliged to notify its clients of the coming corporate event - the tracking of such events is entirely the prerogative of the shareholders (investors). In addition, due to the fact that the client shares are held by a custodian (depository) on omnibus accounts, rather than on personal ones, the bank may not have the opportunity to vote on behalf of the client since the stock custody format may not provide for a separate voting, whilst the shareholder register indicates the bank as the nominal owner. In turn, the bank sends out notices received by the depository about the occurrence of corporate events, if possible. Such notifications in most cases come in the form of standardized messages on the SWIFT system, which include basic information about the corporate event, voting aspects among others. The language of the notification is English in most cases. In case the client wishes to receive a further explanation regarding the nature of the notification sent, the bank is ready to provide a summary of such notice.

The most common corporate actions include:

- 1) stock split happens when a company increases the number of its shares; during a stock split, the price per share falls
- 2) stock consolidation, also known as reverse stock split, stock merge, or share rollback is the opposite transaction, in which a company lowers, instead of increasing, the number of shares outstanding, raising the share price accordingly

**Example:** A company announces a stock split, in 2:1 ratio. In a 2-for-1 stock split, each existing share splits into two new shares. As a result, the total number of shares outstanding is doubled, but the value of each share is halved. Therefore, if a client had 1,000 shares traded at \$100 per share, then after the stock split the number of shares will increase to 2,000 while the price will fall to \$50. During stock consolidation, which is the opposite of a stock split, the number of shares decreases while the price increases.

**Dividends** are payments of income from securities. Payments can be made at the expense of the received profit or of an additional issue of shares.

**Example:** When dividends are paid out at the expense of the received profit, the company announces the amount of funds to be paid to each shareholder. If an investor's portfolio holds 1,000 shares and the declared dividend per shares is \$0.50 per share, the investor will receive \$500.

**Example:** When dividends are paid in the form of company shares, the company declares the number of shares to be received by the investor. If the company pays 0.1 share for each share owned by the investor and the investor has 1,000 shares, then after the payment the number of the investor's shares will increase to 1,100.

**A rights issue is a type of corporate action.** A company may offer its existing shareholders the right to buy additional shares on preferential terms. Each shareholder receives the right to purchase a pro-rata allocation of additional shares at a discounted price. The shareholders not willing to subscribe to their rights issue can sell their rights in the open market.

**Example:** An investor's portfolio holds 2,000 shares. The company announces a rights issue for its existing shareholders at a certain date. Furthermore, 10 rights can be used to purchase 1 share at a predetermined price. Accordingly, the investor will receive 2,000 rights. The investor can use the rights to purchase 200 shares at a discounted price.

**Mergers and acquisitions (M&A)** have become a common phenomenon in today's economy. A merger is a contractual process whereby two or more individual businesses consolidate to form a new entity by mutual agreement. An acquisition, on the contrary, implies a buy-out of a controlling stake, with the establishment of control over the company, but without the merger of stocks.

**Example:** An investor owns 100,000 shares of company X. The management of companies X and Z decides to merge together and form a new company U. According to the merger agreement, holders of shares of the company X will receive shares of the new company U with a coefficient of 1 to 4. At the date of the merger, the investor will receive 25,000 shares of the new company U.

**Corporate spin-off** is a separation of a subsidiary from the parent company. In a spin-off, shares of the new company are issued, while holders of shares of the parent company receive new shares in proportion to their original holdings.

**Example:** An investor owns 250,000 shares (2.5% of the total number of shares) of the parent company X, the total number of shares issued is 10,000,000. A new company Z will be separated from the parent company. At the separation, the company Z issues 1 million shares. Proportionally, the investor gets a 2.5% stake in the new company Z or 25,000 shares.

**Bond restructuring** is a process that modifies the terms of an existing bond to facilitate debt repayment and prevent default. This can include extending the maturity date, reducing the interest rate, partially cancelling the debt or replacing the securities with other securities.

**Example:** An investor owns 100,000 corporate bonds. The company is having difficulty making its bond payments, so it agrees with its creditors to change the terms. This extends the maturity of the bonds by 5 years and lowers the coupon from 6% p.a. to 4% p.a., thereby reducing the financial burden and helping to stabilise the company's cash flow.

The expenses incurred by the clients while participating in a corporate action depend on the type of corporate action. Most corporate actions do not involve additional costs; however, some actions may increase custodial fees (i.e., exercise of rights to purchase shares at a discount, etc.). In a number of cases (rarely) companies provide compensation for participation or a certain action at the voting, which depends on the amount of the asset (the number of shares or the par value of the debt).

However, account must be taken of the fact that there are many other corporate actions that can affect not only the number and price of shares / bonds, but also the future of the company and hence the success of investments. Therefore, these corporate actions are essential for market participants.