DESCRIPTION OF FINANCIAL INSTRUMENTS AND RELATED RISKS

This description of the risks associated with securities and securities investments is general information. The investor should not make decisions, based to only this information. Investors can find additional information about a particular issuer or product on the internet. Investment activities always **involve the risk** that the desired result may not be achieved or that the investment may result in a loss. It is necessary to remember that past performance is not a reliable criterion and does not guarantee future profits. The risk levels and potential returns of financial instruments is variable. The higher the potential return, the higher the risk that a large part of the investment may be lost.

As the risks and rewards of different types of securities differ and investors are exposed to different risks, the Bank generally divides securities into two categories — non-complex and complex securities. When purchasing a specific financial instrument, if necessary, the suitability and relevance of the instrument to the client shall be assessed.

1. EQUITIES

Intended to *private* customers and *professionals*.

Equity is a security that indicates that the owner of the share owns a part of the company. Holding of equities gives rise to certain rights and obligations, such as the right to receive a share of the profits distributed by the operator and voting rights at the general meeting of shareholders. The articles of association and legislation of the joint-stock company determine the rights and obligations of the investor. Equities are ordinary and privileged. Ordinary shareholders have the right to receive dividends from the company's profits; voting rights at the general meeting of shareholders; part of the property in the event of liquidation of the company.

Privileged shareholders do not have vote rights at the general meeting of shareholders; but such kind of shareholders have the right to receive dividends. For example. After receiving the annual report, the general meeting of shareholders may decide not to pay dividends, but to invest all profits in the development of the company. In this case, the holders of ordinary equity do not receive dividends, but the holders of the preferred shares are entitled to dividends in any event, but if the shareholders decide to liquidate the undertaking, the interests of the privileged shareholders are satisfied at first.

Equities may be private companies that are not traded on a stock exchange but are distributed or allotted on other terms. (*Orkla, Conexus Baltic Grid*).

The equities price reflects the market assessment of the company's expected future profits, but the investor must also take into account other circumstances, speculation. Before investing, the investor has to consider many aspects (industry, region, currency, specialization, governance, historical price dynamics, dividend policy, etc.)

Equities price changes can happen in a very short time and unexpectedly. For example, equities price in a few minutes can change by more than 10%. It means, that equities are with very high-risk securities level. It is important to be aware that an investor may lose all his investment because if a company goes out of business, shareholders are among the last to be compensated from the company's assets.

<u>The main risks</u> in relation to equity investments: market risk, issuer risk.

Investments in equities may also include: liquidity risk, especially for investments in small companies; currency risk for investments in shares outside the euro area, where changes in the value of the investor's base currency may affect the profit or loss from the investment; political risk, especially with regard to investment in some emerging markets; tax risk arising from the tax collection procedures for securities transactions and account holding for investments abroad and in the home country.

2. EXCHANGE TRADED FUNDS (ETF)

Intended to *private* customers and *professionals*.

Exchange traded funds (ETF) is collective investment schemes, which are traded on stock exchange. ETF managed by professional investment management companies. With ETF can trade throughout the day and can be bought and sold in the same way as ordinary shares during the business hours of the relevant exchange. ETF has **risks**, that are similar to equities. ETF have a variety of portfolio creation and investment strategies, from non-complex index-linking to more complex exposures.

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For example, investment in goods, or using borrowed funds (*levereged*). It is important for the investor to read the **ETF prospectus** and understand the risks before entering into any transaction. In case of ETF liquidation, the investor receives an amount equivalent to the value of the fund's assets at the time of liquidation (this may not be the final closing price on the last trading day) in proportion to the number of units held by the investor in this fund. There is a **risk** that, as the markets for the underlying assets are very different, the price volatility of the relevant ETF may also be different. Depending on the base asset instrument, the price volatility range can be insignificant or very large. An ETF can sold on an open stock exchange in the same way as ordinary shares. If the price has fallen since their purchase, the investor suffers a loss. However, if the price is higher than the purchase price, the investor will make a profit. The investor, who purchased a part of an ETF fund, does not incur any additional financial obligations and other liabilities, including contingent liabilities, other than acquisition costs and management fees. EU investors are protected. One of the limits for an ETF to be traded to a private client must be KIID (*Key Investor Information Document*), where the investment product is described.

3. EXCHANGE-TRADED NOTES (ETN)

Intended to *professionals.*

Exchange-traded note (ETN) is a type of unsecured and unsubordinated debt security based on the yield of a basket of base assets or base assets, but for which no periodic coupon payments are made. Like exchange-traded funds (ETF), also ETN is traded on exchanges. Unlike ETF, ETN has no real investment portfolio, so no assets are purchased or sold. ETN is simply an issuer's promise to pay an investor a return on an investment that reflects the yield of a given basket of base assets or base assets.

ETN usually has lower liquidity than ETF. Redemption of some ETN before maturity is possible for the issuer only for a specific minimum amount. **Issuer credit risk** — As ETN is unsecured debt normally issued by banks, credit risk is a key factor that distinguishes ETN from ETF. Price volatility depends on the return on the underlying assets, the demand for ETN certificates, and the issuer's creditworthiness An ETN can sold on an open stock exchange in the same way as ordinary shares. Redemption of some ETN before maturity is possible for the issuer only for a specific minimum amount.

4. Exchange traded commodity (ETC)

Exchange-traded commodity (ETC) is exposure to relevant commodities such as oil, gold, cereals, etc. ETC may be linked to individual goods and/or to a basket of goods. Although the ETC transaction depends on the price of the commodity, it is in fact a debt called a promissory note. Reversed ETC is a much more sophisticated tool whose value increases when the price of the commodity falls or opposite. Borrowed capital ETC transactions are structured in such a way that changes in commodity prices are multiplied by a certain factor, such as two or three, resulting in twice or three times the price volatility of the underlying commodity. ETC usually has lower liquidity than base product. Redemption of some ETC before maturity is possible for the issuer only for a specific minimum amount. **Issuer credit risk** — As ETC is unsecured debt normally issued by banks, credit risk is a key factor that distinguishes ETC from ETF. Price volatility depends on the return on the underlying assets, the demand for ETC certificates, and the issuer's creditworthiness An ETC position can sold on an open stock exchange in the same way as ordinary shares. Redemption of some ETC before maturity is possible for the issuer only for a specific minimum amount.

5. THE BONDS

A bond is a security on the basis of which the issuer of the bond is obliged to repay the nominal value of the bond and interest on the specified maturity date (the investor lends money to the issuer of the bond)

There are bonds with **fixed percent rates** (the most common group), bonds with **variable interest rates** (interest payable is related to EURIBOR or LIBOR) and non-residential bonds (**no coupon** payments: the yield is derived from the difference between the issue or purchase price of the bond and the nominal price paid when the bond is redeemed). The bonds usually are traded over-the-counter (*OTC – over-the counter*). In ordinary market conditions, the bond may be sold before maturity. At the time of the bond sale, the yield may be higher or lower than the yield at the time of their purchase. Also the yield may be negative. For example, The yield on 5-year Latvian government bonds is minus 0.2%. Most bonds are traded over-the-counter (*OTC*), negative market trends or low liquidity can make it difficult to find bond buyers.

Bonds can have different levels of risk. Ratings assigned by rating agencies provide an opportunity to navigate risk levels. If the bonds are rated are rated with an **investment grade** (BBB- to AAA), the risk level is lower. In turn, the risk of **speculative bonds** (BB + and lower rating) is higher. Rating agencies shall update their risk assessment and rating with a specified

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frequency. Depending on the changes in the economic and operating environment and the development of the company, the country, the assessment may be both more positive and more negative, and this may also affect the bond price.

There are two types of investment returns from bonds: interest payments, which are calculated on the basis of the nominal value of the bond; gains or losses from bond trading, which depend on the purchase and sale price of the bond, which in turn is affected by changes in market percent rates.

For bonds with a **fixed coupon** rate, the price changes in contrast to percent rates, i.e. if percent rates rise, bond prices fall (and opposite). The longer the remaining maturity of the bond, the greater the price change per unit of percent rate change. For example, if the market percent rate increased by 1%, 2% the coupon bond with a residual maturity of 1 year would decrease by about 2% and the price of a bond with a residual maturity of 6 years would decrease by about 7%. If percent rates fall, the price of the bond rises at the same amount.

Thus **long term bonds have a higher percent risk than short term bonds.**

The main risks, which connected with investing in bonds: **percent risk; credit risk; issuer risk.**

Investing in bonds can also be related to more other aspects. For example, **currency risk**, if eurozone companies mainly issue bonds in euro, then the most commonly used currency in the international bond market is the USA dollar. The investor must study the bond issue prospectus to capture the risks of the particular bond. For example, **secured** bonds give the investor more confidence that the invested funds will be recoverable. In the case of subordinated bonds, investors are more exposed to investment risk than in the case of covered or standard unsecured bonds. In the event of a bankruptcy of an issuer, an investor who has invested in subordinated bonds may only recover part of the invested funds after investors who have invested in standard bonds.

In the case of structured bonds, the amount and time of the redemption fee and the payment of the coupon may depend, for example, on changes in the price of an underlying asset or the occurrence of an event. In the case of standard bonds, for example, may be added useful additional provision to the issuer. In turn, in the case of another type of bond, the issuer has the right to delete the bond earlier after some time. However, the right to request early redemption of the bond may arise for the investor after a certain period of time, depending on the terms of the bond.

6. INVESTMENT FUND CERTIFICATES OR INVESTMENTS IN SECURITIES PORTFOLIO

Investment fund activity may vary by country. The European Union basically recognizes the agreement's investment funds and funds established as public limited liability companies, but it also recognizes funds that acting as trust funds.

UCITS or "undertaking for collective investment in transferable securities" means a fund recognized in an EEA Member State which complies with the requirements of Directive 85/611/EEC of the Council of the European Union (consolidated). UCITS investment certificates can be offered to the public in all Member States and they protect investors more. An investment fund is a set of funds received from investors for the purpose of investing them in equity, bonds, money market instruments or other financial instruments and combinations thereof. When you choose to invest in an investment fund, you entrust your funds to a financial institution, which invests them in various financial instruments. The fund's investment strategy determines where the entrusted funds will be invested. It should be noted that the funds are segregated from the financial institution that manages it, so that, even in the event of its possible insolvency, investors recover the investment. UCITS funds activity are regulated by the European Union Directive UCITS IV, therefore these funds are subject to strict regulatory supervision.

The risk of investment funds **is usually lower compared to a purchase of equity**, as investment funds are diversified by asset class, sector, region, as well as other aspects. Investment fund assets can be invested in shares of various companies, thus reducing the risk of an individual company. If an investment fund invests in companies from different countries and sectors, that risk will fall even further. If the same fund were to complement its investment strategy and invest in bonds or other types of financial instruments, the risk would also be reduced in terms of classes aspect. Before making an investment decision, the investor must familiarize himself with the investment fund's strategy and rules. Investment funds are typical **system risk**. It is important to note that investment funds with low risk, such as money markets or bond funds, may also lose some of their value when market conditions change, resulting in less than you have invested (**market risk**). Before purchasing investment fund certificate, it is important to assess their liquidity (**liquidity risk**). Other significant risks related to investment funds (UCITS): capital risk, investment choice risk.

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An alternative fund is mainly an investment fund other than PVKIU (undertakings for collective investment in transferable securities) or a pension fund intended for individual investors. Alternative investment funds may include, for example risk capital funds for qualified investors, private equity funds, commodity funds, and real estate funds. An investment fund is a set of jointly invested assets owned by fund unit holders according to the value of the units they hold. As a Law, investment funds are well-diversified securities investment portfolios, so the issuer's risk and credit risk associated with them are significantly lower than for direct investments in individual equity or bonds. Unlike investment funds, AIF investments do not have statutory investment limits. AIF funds may invest not only in financial instruments traded on a regulated market but also in other assets, such as real estate and in the capital shares of commercial companies, in accordance with the investment policy and investment restrictions of the AIF rules. The AIF has a high level of investment risk due to its extensive and unlimited performance, and therefore it should be taken into account that the investor has not only the possibility of earning more than investing in an investment fund, but also the possibility of losing part or even the entire investment of AIF.

The risks of the funds may differ depending on the structure of the invested assets in the fund (the fund may invest money, for example, in various shares, bonds or other funds). Risk descriptions are included in the fund prospectuses. The main risks of securities portfolios are the same as for the securities that make up the respective portfolio. For example, the return of the invested equity fund is affected by the fall of the equity price.

The diversification of investment funds as well as securities portfolios aims to reduce the issuer's risk and/or credit risk. As different markets develop differently, diversification also aims to reduce market risk and/or percent risk. If diversification is limited to select issuers operating in the same economic sector or geographical area, operating in an identical investment style or limited by some other similar parameter, diversification may not mitigate the above mentioned risks.

7. DERIVATIVE FINANCIAL INSTRUMENTS

Derivative financial instruments are contracts for a future purchase/sale transaction or for the purpose of offsetting a change in the price of a particular underlying asset. Few derivative financial instrument contracts may impose an obligation to physically deliver the goods to a specified location at a specified price, in turn others involve settlement by offsetting to the extent that the price has changed.

Derivative financial instruments are instruments, which initially formed in relation to the need to limit risks, but they are now also used for investment purposes. Derivative financial instruments may relate to, for example, *equity prices, equity indices, percent rates, bonds and debt indices, currencies, minerals,* as well as *agricultural products.*

Derivative financial instruments are used, for example, to protect themselves from price changes in an undesirable direction; increase return on investment; take a certain position on some underlying assets (the investor expects, for example, that the equity price will remain moderate for some time or that the price of short-term futures for oil will increase compared to the price of long-term futures). Derivative financial instruments may be standard and non-standard. In case of standard instrument main contract terms are always the same. Usually such instruments are traded on fund exchanges.

Terms of non-standard instruments shall be negotiated separately by the parties to the transaction. As the terms of such instruments take into account certain needs and agreements between the parties, this precludes the development of an active secondary market. As these instruments are not traded on a regulated market, they are also commonly referred as (*over-the-counter — OTC*) financial instruments.

7.1. Option contract *(options)*

An option contract is a security of which the owner has a right, not an obligation to purchase (purchase option) or sell (sale option) certain underlying assets at a pre-agreed price on a pre-agreed date. Receiving an option contract, the holder of the option shall make a payment to the issuer (option contract premium). If the market price of the underlying asset has changed in an unfavorable direction during the previously agreed time, the amount of loss shall not exceed the option premium paid for the option contract. This is also the highest risk, which is associated with buying option contract.

When selling option contracts:

Option contract orders, which are executable in a purchase/sale transaction involve the trade risk that the transaction price at which the underlying security must be traded and the price at which the underlying securities can be purchased (*Call option - buying option*) or sell (*Put option - selling option*) on the market. In both cases **the loss may exceed the option premium** received by the seller. With a Cash-settled option contract involves the risk that the option will be paid at a price less than the

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market price at which the security is traded at the moment the debt is settled. In both cases the loss may exceed the option premium received by the seller. During the term of the option contract, the market price of the option is affected by the price of the underlying assets, expected price fluctuations of the underlying assets, dividends and money market percent rates. The impact depends on the type of option agreement. In the case of early payment, the seller may suffer a loss equal to the absolute value of the negative market value.

Buying option contracts:

The risk of purchasing options does not exceed the amount of the paid premium.

7.2. Standardized future contracts (*futures*)

Standardized **future contracts** are traded securities on a fund exchange. The holder of a futures contract has an obligation to buy or sell certain financial assets or commodities (the underlying assets) at a pre-agreed price and on a pre-agreed date. These contracts differ from options in that the holder of the option has the right to decide whether he wishes to transact at a previously agreed time, but the holder of a standardized futures contract must complete the transaction within a specified time in any case. If there is no desire to physically receive / deliver the assets underlying the standardized futures contract, the standardized futures position must be closed on the last trading day with a transaction that is the opposite of the original transaction. Standardized future contract trading involves several risks: the risk of leverage; liquidity risk, especially in cases where the position cannot be realized; the risk that loss fixing orders cannot be executed at the desired time; this can lead to large losses, especially if is used the leverage effect.

7.3. Non-standardized future contracts (*futures*)

A non-standardized **future contract** is contract between two parts, which requires the contract holder to sell certain financial assets or raw materials (the underlying asset) at a pre-agreed price and on a pre-agreed date. Unlike standardized futures contracts, a unstandardized futures contract cannot be sold and, if the holder owns a unstandardized contract, the parties must be prepared to settle the obligation within the specified time. With unstandardized and standardized future contracts involved risks are similar, except for the risks that arise directly from the fact that standardized future contracts are tradable securities, but unstandardized future contracts are not.

With unstandardized future contracts involved risks:risk of financial leverage; the risk of insufficient collateral, i.e. the risk that in the event of a major market change, the security deposit or collateral may not cover changes in the value of the underlying assets due to those market changes and the investor must find additional collateral in the short term; otherwise there is a risk that the position will be closed; counterparty risk, which may also be directed against the investor, i.e. a situation may arise where the investor is not ready to meet its obligations in a timely manner and therefore the other party to the transaction may impose sanctions on the investor.

7.4. Swap contracts

A Swap contract is an agreement between two parties to exchange certain payment flows, for example, to exchange a fixed percent rate for a variable percent rate (percent rate swap) or to exchange different currencies (*currency swap SWAPS*). Risk of swap contract is high, and as they are also exposed to the financial leverage effect, small changes in the prices of underlying assets can lead to big profit or losses for an investor. Theoretically, the amount of losses is not limited. To cover possible losses, the investor may have to pay additional collateral on a daily basis, and if the investor is unable to provide it in the event of a negative price change, the other party to the transaction will be able to request contract termination.

7.5. Structured promissory notes

Structured promissory note is instrument, which usually consists of a bond and a number of derivative financial instruments or underlying assets. Structured promissory notes risk level affects the instruments of which it is composed. This aspect can both enable the owner to make a profit and cause losses due to changes in the prices of financial instruments and underlying assets. As the formation of instruments in several existing active conditions, it allows investors to diversify the investment risk in one instrument. Profit generation for structured notes is complicated sometimes, which can make it difficult to compare the return on bond investments with other investment options. Sometimes profits can be leveraged, thus even the smallest change in the value of the underlying assets can have a significant impact on the value and yield of a bond. Structured promissory notes can be with and without capital protection. If the product has capital protection, the issuer pays the bonds at their nominal value on the redemption date. If the signing fee for the product is higher than the nominal price or the signing

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includes a commission, the said price difference or commission are irrecoverable expenses related to the purchase of the product. In this case the total investment profit can be negative.

If the product does not have capital protection, there is no guarantee that the bond will be repurchased at its original value. If in the market changes unfavorably, the bond may be repurchased for less than the nominal value and in the worst case the investor may lose all the money invested.

Structured promissory are **complex** instruments that may involve increased investment risk. Thus we encourage investors to study the related product and additional information very carefully to obtain complete information about the circumstances that may affect the investment. It is important to remember that a structured promissory is a "buy and hold" type of product and is suitable for investors who can invest for as long as the bond deletion due date.

8. DESCRIPTION OF MAIN RISKS ASSOCIATED WITH SECURITIES INVESTMENTS

Market risk

The risk that the prices of securities or other assets may rise and fall due to circumstances beyond the control of the issuer of the security in question, thereby affecting the value of the security. The redemption price of a bond depends on the relevant terms, but its value at the maturity of the bond is also affected by other several factors that are not related to the underlying assets. The general price level in the market is influenced by, among other things, economic indicators, significant conditions, instability of the economic or political environment, etc.

Credit risk

The risk that the issuer of securities fails to fulfill its obligations or fulfills them only partially and therefore the price of the security may move in an unfavorable direction or the security may become worthless. Credit risk can be minimized by diversifying investments between several issuers by analyzing information about issuers during and before investments. The credit ratings of many issuers are set by independent rating agencies.

Settlement system risk

The risk that settlement in a securities or other asset settlement system will not take place at the specified time or amount because the other party to the transaction will not fulfill its obligations on time or in full amount. To reduce the risk of the settlement system, it is recommended to trade on regulated markets, for example, at stock exchange.

Liquidity risk

The risk that securities will not be able to be sold in time at a reasonable price or may not be sold at all, because there is no counterparty in the market willing to transact. To minimize liquidity risk, it is advisable to diversify investments between different issuers and markets.

Currency risk

The risk that the value of the investment or the return on the investment changes in an unfavorable direction due to changes in the exchange rate. Currency risk can be minimized by diversifying investments between different geographical areas or by using financial instruments designed to hedge currency risk.

Depositary risk

Risk of loss or destruction of assets held in the depositary due to insolvency, bankruptcy, negligence or willful misconduct. To minimize the risk of the depositary, the depositary is selected very carefully and is constantly monitored while providing the depositary services.

Issuer risk

The risk that the price of a particular security may move in an unfavorable direction due to unfavorable circumstances depending on the issuer (for example, due to management mistakes). Issuers risk can be minimized by diversifying investments between several issuers by analyzing information about issuers before and during investments.

Issuance risk

In case, if the interest of investors in the product during the subscription period is not sufficient or the market situation is not suitable to start offering the product in the specified conditions, the issuer is entitled to cancel the issue. Whereas, if too many investors have signed on the product, the customer can only receive a part which is proportional to the signed amount.

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Percent risk

The risk that in a situation where percent rates rise or are generally expected to rise, the price of a fixed-income security (such as a bond) will fall. Percent risk can be diversified by investing in different markets with unrelated interest rates and by diversifying investments between percent rate instruments with different term.

Counterparty risk

The risk that a securities counterparty will default in part or in full. Counterparty risk can be minimized by choosing recognized and trusted partners for the transaction.

Political risk

The risk that changes in national legislation, public administration structures, general political stability in a country or region will reduce the value of the issuer's securities operating in that country or region. To minimize the political risk, investments are diversified between different regions and countries of the world.

Concentration risk

The risk that the value of an investment may decrease due to asset or market concentration.

Risk of legislation

The risk that legislation relating to securities activities, including legislation governing the tax system, may change and adversely affect the value of an investor's assets or reduce investor expectations regarding the result of the investment.

Risk of leveraged effect

Leveraged effect is situation, when the value of the invested assets changes significantly more than the market price of the assets. The value of assets subject to the leverage effect may unexpectedly become invaluable and, depending on the terms of the collateral agreement, an investor may be required to meet financial obligations to contractors, despite the loss of invested assets .

Tax risk

Depending on the regulation, practice or service in force in a particular market and provided by a depositary operating in that market, the customer may not benefit from the double taxation convention signed by the State of residence and the State of securities. owner. The application of taxes may also be affected by the fact that the securities held by the client are held with the consent of the depositary in an account opened in the name of the bank. As a result, the client's securities are taxed as bank securities.

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