GENERAL DESCRIPTION OF THE NATURE AND RISK OF FINANCIAL INSTRUMENTS

1. Introduction

In this document, we provide per type of Financial Instrument an introduction to the main characteristics and risks of the Financial Instruments. Erste Securities Polska S.A. (hereinafter referred to as “Erste”) advises its Clients to read this information with care, so that they are aware of their actions and the risks related thereto.

2. General risks of investment

Every investment involves risk to some extent. In addition to the specific risks of a Financial Instrument, investing also involves general risks. Usually, the higher the expected return, the higher the risks will be. The main (general) risks for investors are described below.

2.1 Currency risk

The currency risk is the (additional) risk that the value of investments denominated in Foreign Currencies, is sensitive to changes in the exchange rate of those Foreign Currencies against the Local Currency. If you have a position in Foreign Currency with Erste, you run a currency risk on this position. Currency risk also arises with investments in Financial Instruments denominated in Foreign Currencies or in Financial Instruments that are sensitive to currency rate movements.

2.2 Interest risk

Changes in both short and long-term interest rates can affect the value of Financial Instruments. A change in the interest rate can affect all types of investments in your portfolio. Generally speaking, fixed-interest securities with a long maturity react strongly to interest rate fluctuations.

2.3 Liquidity risk

The liquidity risk depends on the volume of both the transactions in the Financial Instrument and the free float (the outstanding securities available for trade). If the market is not sufficiently liquid, the investor runs the risk of being unable to sell the securities, or being unable to do so directly at the market price.

2.4 Bankruptcy risk/counter-party risk

Securities are issued by companies or governments that may go bankrupt during the period in which you invest in these instruments. The risk of bankruptcy depends on the creditworthiness of the issuing institution. If a bankruptcy occurs, the situation may arise that you become a creditor of the estate of the bankrupt party. In order to make an estimate of the bankruptcy risk, you need to have insight into the creditworthiness of the issuing institution and your rights in the event of any bankruptcy.

2.5 Specific market risks

Via the Erste it is possible to trade on different exchanges. Bear in mind that different exchanges may have different rules for e.g. the permitted order types, order limits, opening hours and the trading system used.

It is wise to ensure that you are well-informed about these specific rules before you start trading on a new exchange or market. These rules may change from time to time. If you are trading in Securities that are not listed in the main indices, it is advisable to be extra cautious. On some markets lower requirements apply to such Securities. Securities outside the main indices may also be traded less frequently, as a result of which pricing may be more volatile and the risk of problems higher. This guide primarily contains general information. If you need more information, you can always contact the Sales Department. We advise you to obtain information from the different exchanges from time to time, which can often be found on the websites of the exchanges.

2.6 Risks of interruptions of trade and malfunctions

There is a possibility that trading in a particular Financial Instrument may be temporarily impossible, be seriously delayed or that you cannot invest via a certain communication channel. Certain information may also be unavailable (such as price information or executed order reports), which can lead to substantial damage in cases arising. However hard the market parties concerned may try to arm themselves against such failures, they cannot be eliminated entirely. Think, for instance of a situation in which technical infrastructure is damaged by third parties, for example in the course of construction work. Depending on the different exchange regulations, there may also be interruptions of trade, often to prevent or cure irregular pricing.

Be aware that the various market parties have excluded their liability for malfunctions, interruptions of trade and the like. As a result, any damages will be borne by you, as a client.

Erste does everything possible to avoid this kind of situations. Erste only deploys third parties with a good reputation for their services. Also Erste itself may face a malfunction. This could be a malfunction Erste’s trading system , for example, or a malfunction in the connections with exchanges. In the event of a malfunction, Erste may decide to temporarily halt the acceptance of orders. Erste will try to notify you of a malfunction through a message on the Website or otherwise. During a malfunction you can always place your order via other agreed communication channels. The Sales Department will be happy to assist you with information on placing orders, your current orders, other questions and comments or complaints about the services of Erste. If you have a complaint or have observed any irregularities, you should follow rules of complaints handling as indicated in Information about Erste Securities Polska S.A..

2.7 Other risks

The risk for the investor of negative price movements is not only determined by the results of the company in which you invest, but also by the overall market sentiment. Various other factors can also influence the general price movements of Financial Instruments. Examples of these include:

- liquidity risk (the risk of limited marketability);
- political risks (amendments of laws and regulations and other government measures that have adverse effects for the investor);
- fiscal risks (changes in the fiscal treatment of your investments through changes in the applicable fiscal laws or their interpretation);
- inflation risk (the risk that the spending power of your Local Currency will diminish);
- reinvestment risk (the risk that there is no equivalent reinvestment possibility at the time of repayment);
- et cetera.

3. Characteristics and risks of Financial Instruments

The purpose of this chapter is to provide you with a picture, in outline, of the key characteristics of the different types of Financial Instruments in which you can invest via Erste and the risks associated with those investments. This chapter cannot describe all characteristics and risks. The information in this chapter does not refer to your personal situation, but provides general information on the Financial Instruments concerned.
Risks are associated with all forms of investment and trading. These risks are dependent on the nature of the product in which you trade or invest. An investment can be speculative to a greater or lesser degree. Sometimes, you can only lose your initial investment and sometimes you can lose more than your investment, for example, if you invest in futures or written options, or if you use short sales technique. Usually, an investment with a higher expected return carries higher risks.
If the characteristics of the category of Financial Instruments in which you wish to invest are not described in this chapter, you should inform yourself of the investment risks associated with these Financial Instruments.
The relevant issuing institutions provide information on many Financial Instruments, for example in the form of Key Investor Information Documents, prospectuses, financial statements, reports on corporate actions (dividends, coupon payments, rights etc.), and so on. Erste advises you to use this information when taking your investment decisions. Erste investment service is limited to 'Execution Only'. This means that you decide for yourself, at your own initiative, which Orders you want to place. Erste confines itself to executing those Orders and provides no advice in that regard.

3.1 Shares

Shares are participating interests in the share capital of a company. A shareholder acquires voting rights in the company and possibly an entitlement to dividends.

Risks of shares

The price of the share will fluctuate sharply as the profit expectations of the company become more uncertain. The price depends mainly on macro-economic developments, news on the company and/or the sector and the dividend policy. The returns on shares will vary sharply from one (type of) company to another. With shares, too, you run the risk of losing your entire investment. As a rule, if a company goes bankrupt the shares will no longer have any value.

3.2 Futures

A futures contract is a term contract in which the vendor sells the buyer a fixed amount of the underlying assets (shares, index, bonds, commodities, etc.) 'in advance' for a fixed prices. Attention: other than with options, with a future obligations arise for both the seller (who must deliver in due course) and the buyer (who must pay in due course). Futures contracts are settled either on the basis of delivery of the underlying assets or on the basis of settlement in money ('cash settlement'). In the event of settlement on the basis of delivery, the parties are required to actually deliver or take delivery of the underlying asset against payment of the fixed price (Securities through transfer, commodities usually through physical delivery). In the case of cash settlement, settlement takes place on the basis of the price of the underlying security on the expiry date.

Security must also be provided for the obligations that arise from a futures position. Because with futures, both the buyer and the seller have obligations, both the buyer and the seller must provide security. Other than with options, price movements in the underlying security do not lead to changes in the amount of the security, but to daily payments between the buyer and the seller of the future. Unlike an option, therefore, a future does not build up any value.

This complex product is suitable for investors who actively monitor their positions on a daily basis and have enough knowledge of Derivatives and of trading in the underlying security and who can afford high fluctuations in the price.

Risks of futures

When entering into a future, only a small amount of security must be provided in relation to the underlying assets to which the future relates. However, limited price fluctuations of the underlying assets, can lead to high losses (or profits), through the leverage effect. The security that an investor in futures must hold provides some cover for the price losses but does not rule out the possibility of a loss that is higher than the amount of the security. The loss on a future can be substantial. As an investor in futures, you should carefully consider whether this complex product is suitable for you, partly in view of your knowledge and experience, your financial position and the purpose of your investments.

3.3 Bonds

A bond is a debt instrument issued by a government agency or a company. The buyer of a bond lends the issuer an amount for a period agreed in advance, often at a fixed rate of interest. The zero-coupon bond forms an exception to this. This bond does not pay interest during its term. The return on bonds of this kind is obtained from the difference between the purchase price and the later redemption price.

There is a wide range of different types of bonds, with very large differences in terms of risks and returns. You should therefore take care when investing in bonds and study the documents issued for the relevant bond. In addition to the more conventional bonds, there are special forms of bonds with a complex character (complex bonds). This character may relate to the interest payment method, the redemption method, the issuing method and special lending conditions. For example, the return on a bond may be made (partly) dependent on current interest rates (examples include surplus bonds and interest index bonds) or on the profit of the institution that issued the bond (such as profit-sharing bonds and income bonds). In view of the special risks of complex bonds, they cannot generally be regarded as fixed-interest securities.

Risks of bonds

An investment in bonds entails risks. The risk of the bond is reflected partly in current market interest rates and the creditworthiness of the issuing institution. Rising market interest rates will usually lead to a fall in the price of the bond, and vice versa. With a reduction in thecreditworthiness of the issuing institution, you run a greater risk that it will be unable to pay the interest and to redeem the bond. This also results in a fall in the price. In the event of bankruptcy, bond-holders usually take precedence over shareholders for any payments to creditors. Nevertheless, also with an investment in bonds, there is a risk that you will lose your entire investment.

Complex bonds generally offer higher (coupon) yields than conventional bonds, but complex bonds also carry higher risks than conventional bonds.

A perpetual bond is a perpetual loan that can be redeemed. As such, the redemption of the loan is uncertain. There is a risk that the coupon interest of a perpetual bond will be temporarily or structurally lower than that of conventional bonds of the same or similar issuing institutions. If the price of existing bonds falls because new bonds offer a higher coupon interest, the price loss that this causes for a perpetual bond will be higher than the price loss for a conventional bond, because with the perpetual bond, there is no prospect that the loan will be redeemed, and the received amount reinvested for a better return. In addition, the perpetual nature of perpetual bonds means that the duration may be longer than for conventional bonds, resulting in a higher debtor risk.

Subordinated bonds carry a high debtor risk because if the issuing institution goes bankrupt, the holder of a subordinated bond is in a far worse position than the holder of a conventional bond, who will be a normal unsecured creditor. As a holder of a subordinated bond, you accept that your loan will not be repaid until after all other creditors of the issuing institution have been paid.

Bonds with a variable interest rate (immediately or commencing at a later date), such as 'floating rate notes'], carry a risk that the coupon interest will be lower than expected at a certain point, which not only leads to a lower yield but also to a price loss.

3.4 Convertible bonds

A convertible bond is a bond that at the request of the investor or the issuer, or at a predefined trigger, can or will be converted into shares. An important distinction is that between convertibles and reverse convertibles. A convertible affords the investor the right to exchange the bond for a predetermined number of shares during the conversion period. With a reverse convertible, the issuing institution has this right and the investor therefore has an obligation, if the issuing institution exercises that right, to accept a predetermined number of shares in exchange for the bonds.

3.5 Options

An option is a contract in which the party granting the option (the 'writer') grants its counter-party (the 'buyer') the right to buy underlying assets, such as a package of shares, during or at the end of an agreed term (we then refer to a 'call option'), or to sell the underlying assets (we then refer to a 'put option') for a price determined in advance or of which the determination method is agreed in advance. The buyer usually pays the writer a price for this right. The price of the option is often a fraction of the value of the underlying assets. As a result, price fluctuations in the underlying assets lead to higher profits or losses for the holder of an option. This is known as the 'leverage effect'.
Options are suitable for investors who have enough knowledge of Derivatives and of trading in the underlying assets and who can afford high fluctuations in the price.

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Bought (long) options

The buyer of an option contract has a right (not an obligation) to buy a certain number of the underlying assets during or at the end of a particular period (call option) or to sell these (put option) for a pre-agreed price. The buyer of an option pays a price for the right that the buyer acquires.

Risks of bought options

The potential loss for the buyer of an option is limited to the price paid (the premium). Due to the leverage of the option, however, its value will fluctuate sharply. The risk of losing your investment is higher than with an investment in the same underlying assets. The risk of losing the entire investment increases as the exercise price rises in the case of a call option, or falls in the case of a put option. Because options have a limited term, the chance that you will actually lose your investment is higher.

Written (short) options

The writer of an option accepts an obligation (not a right) to sell the underlying assets (call option) or to buy it (put option) for the agreed price. The writer has therefore accepted an obligation for which it receives a price (the premium). The writer of the option must provide security ('collateral' or 'margin') for the obligations that can arise from a written option position, in the Netherlands usually in the form of a right of pledge on money and/or Securities. The required security fluctuates with the price of the underlying security and is calculated on a daily basis. If the security provided by the writer is no longer sufficient, the writer must provide additional security, for example by transferring money, or close positions.
Risks of written options

The security that the writer of an option must provide, provides cover for part of the price losses, but does not rule out the possibility of a loss that is higher than the value of the security. The writer of an option may face (unlimited) losses which can be many times higher than the price that the writer has received. As alternative to writing an option with the accompanying security as cover, it is also possible to write (partially) hedged call options, for example by writing call options for shares that are present in the portfolio. The risk is then limited.

3.6 Investment funds

Investing in an investment fund (a contractual fund or an investment company created under corporate law) is a simple way to achieve a spread of your investment portfolio. With the aid of an investment fund, you also have the possibility of investing (indirectly) in assets that are not available to private investors in other ways. The way in which the fund manager compiles the investment portfolio is described in detail in the relevant prospectus. The fund manager of an investment fund compiles a portfolio within a predetermined spread over the various investment categories, such as money, shares, bonds, property and commodities.
Investment funds are offered via exchanges and outside the exchanges. This distinction is described as listed and unlisted investment funds. A distinction can also be made between open-ended and closed-ended investment funds. An open-ended investment fund has the possibility of issuing new units when new money flows into the investment fund and to withdraw units when the money flows out of the fund again. The value of the units in an open-ended investment fund trade around the net asset value (the total of all that fund’s investments per unit). A closed-end investment fund does not have the possibility of issuing new units, as a result of which the price depends on the supply of and demand for units in that fund in the financial market. For all investments, but in particular for closed-end investment funds, it is important to make use of Limit Orders. This avoids a transaction being realised at an unexpectedly high or low price.

Risks of investment funds

Investment funds can invest in almost anything. As a result, little can be said about the risk of investment funds without information on the investment policy of the specific fund. An investment fund may or may not make use of borrowed money and borrowed Securities or trade in Derivatives to finance investments and/or to increase the exposure to certain asset categories.

Such a construction usually increases the price fluctuations of the investment fund. You will find this information in the prospectus. If you wish to invest in an investment fund, it is therefore essential that you study the investment policy and the investment objectives of the relevant fund.

Investment funds are offered by fund managers from all over the world. Some in more and some in less regulated jurisdictions. Although this does not say anything about the investments or investment risk of the fund in question, investment funds from less regulated countries may bear additional risks that you should take into account when making your decision.

Often, positions in unlisted investment funds can only be acquired through pre-subscription, in which you have to deposit money in advance, for example with the manager of that fund or the party that performs the client administration for that investment fund. This means that no direct delivery of units or shares takes place for your payment. Investors that pre-subscribe to an unlisted investment fund should bear in mind that an increased credit risk is associated with this because no direct delivery takes place for payment. There is a risk that the institution that has received your money will go bankrupt in the period between the pre-subscription and the payment of the amount to the investment fund. The amount that is reserved for the pre-subscription to pay for the delivery of the units that you wish to buy will then be included in the bankruptcy estate of that institution. In that case, no units in the investment fund can be delivered to the investor and the investor's payment obligation may still exist.

All regulated investment funds within the EU that offer units to non-professional investors must provide a Key Investor Information Document (KIID). The KIID provides a brief description of the investment proposition that the investment institution offers, in non-technical terms. The KIID will be available on the website of the relevant investment fund.

3.7 Warrants

A warrant has similar characteristics to an option contract, the main difference being that a warrant is not - like is the case with a Derivative - created as a contract with an (unknown) counter-party, but is always issued by and contracted with, the company or (government) institution that fixed the conditions for the warrant.

Risks of warrants

The risks associated with a warrant are similar to the risks associated with buying call options. An extra risk of a warrant is that the value of the warrant depends on the prosperity of the issuing institution.