

INFORMATION ON RISKS AND INVESTMENT INSTRUMENTS

1. Introductory Provisions

- (a) This document describes the principal risks associated with Investment Services and Investment Instruments and provides a general description of the nature of the individual classes of Investment Instruments. This is by no means an exhaustive description of the risks or functionalities of all existing products.
- (b) Capitalised terms and expressions used in this document have the meaning specified in the Business Conditions of PPF banka a.s. for Investment Services. The rules of interpretation under the Conditions also apply to the provisions of this document. This document is an Investment Document.

2. Information on Risks

2.1 General Information on Risks

- (a) This information on risks cannot be regarded as complete and exhaustive advice on all risk aspects associated with dealing in Investment Instruments. Clients shall learn as much as possible about the risks associated with the Transaction or Derivative Transaction they are considering, and in case of ambiguities or queries, they shall consult such Transaction or Derivative Transaction with their financial, legal, accounting and/or tax advisers, and may also request additional required information from the Bank. The Bank is only authorised to provide Clients with objective information that does not include the Bank's assessment of the Investment Instrument or the Investment Service.
- (b) Every Transaction and Derivative Transaction with Investment Instruments involves risks. In general, the higher the expected return and/or the longer the duration of the Transaction or Derivative Transaction, the higher the potential risk of loss. The returns of the various Investment Instruments achieved in the past are not a guarantee of returns achieved by the same Investment Instrument in the future.
- (c) Dealing in Investment Instruments is associated with the risk that the expected return is not achieved, or the risk of loss. Where a Client does not fully understand the conditions of the execution of Transactions or Derivative Transactions and the extent of the potential loss of invested funds or, in certain cases, even a loss exceeding invested funds, the Client should not engage in such Transactions or Derivative Transactions. Clients should be aware that in the case of dealing in derivatives and instruments that use the leverage effect (such as futures and options) the risk of loss is not limited by the value of the invested funds, but can even exceed this value (i.e. the loss can be greater than the amount of the invested funds). Dealing in derivative Investment Instruments therefore requires specific knowledge and experience.
- (d) The amount of risk expressed as a ratio of the potential loss and the nominal value or current price of an Investment Instrument also differs depending on the type of the Investment Instrument. The riskiest Investment Instruments generally include financial derivatives where a minor change in the market conditions or in the market price of the underlying asset may trigger a major change in the market value of the derivative. High risk instruments are also deemed to include shares and similar securities and commodity instruments. Relatively less risky Investment Instruments include bonds and similar securities constituting the right to receive a repayment of an owed amount, in particular sovereign bonds and debt securities issued by central banks.

2.2 Overview of Risks

- (a) The main types of risks associated with Investment Instruments and Investment Services on the capital market include the credit risk, the market risk, the concentration risk, the liquidity risk and the operational risk. The market risk includes, without limitation, the interest rate risk, the currency risk, the equity risk and the commodity risk, but the inflation risk, the correlation risk and the volatility risk can also be identified within the market risk. A detailed description of the various types of risk, including examples of reducing such risks, is provided below.

- (b) Besides the above risks, which influence all Investment Instruments to a varying degree, it is also possible to identify risks specific to the individual Investment Instruments arising from the specific form of and method of trading in the respective Investment Instruments.

2.3 Credit Risk

- (a) Credit risk is one of the basic financial risks. Credit risk consists in the debtor not being able to honour their obligations (failing to repay their debts), whether due to insolvency or due to a lack of will to pay. Credit risk may also stem from mere impairment of the debtor's creditworthiness (quality).
- (b) Debtors' insolvency or unwillingness to pay their debts may stem from mature loans or interest, securities, guarantees provided, foreign exchange transactions, money market transactions and other contractual relationships. Whenever a Client concludes a Derivative Transaction with the Bank the Client faces the credit risk of the Bank.
- (c) The causes of debtors' insolvency or unwillingness to pay may be internal on the debtor's part, or due to the debtor's credit rating, as well as external, i.e. due to external factors such as an economic or a sector's crisis.
- (d) Credit risk may be mitigated, in particular, through a detailed credit rating of the debtor and their ability to repay debts, and also through reducing exposure to one debtor.

2.4 Concentration Risk

Concentration risk is a risk of loss resulting from a significant concentration of exposures to counterparties or groups of counterparties where the likelihood of their default is affected by a common risk factor such as counterparties operating in the same industry or geographic area, conducting the same business, trading in the same commodity or being part of the same economic group, or from the application of credit risk reducing techniques, in particular a risk related to a high indirect exposure to, e.g., the same collateral issuer.

2.5 Market Risk

- (a) Market risk is a risk of loss resulting from a change in market conditions (in particular market prices, interest rates, exchange rates or commodity prices) and leading to a change in the value of the Investment Instrument or to an imbalance of a certain nature between the Investment Instrument and the source of its financing. All Investment Instruments are exposed to market risk. Market risk involves a number of factors – not only the economic development of the company (security issuer) but also, e.g., expectations of a recession, structural changes in the economy, political shocks and consumer preferences.
- (b) Depending on the specification of the market factor that may induce a change in the value of an Investment Instrument, market risk means primarily interest, currency, equities and commodity risks. From the perspective of the current market situation and the method of trading in the particular market, other market risks can be identified as well.
- (c) Interest risk affects the fluctuation of the rate of return on Investment Instruments through the changing level of interest rates. These changes affect debt Investment Instruments inversely, i.e., they respond to an interest rate hike by a fall of market prices and vice versa. The risk level depends on the specific Investment Instrument, its sensitivity to interest rates and other factors.
- (d) Currency risk: With investments in Investment Instruments denominated in foreign currencies the risk and the potential profit or loss depend on the overall development of the market price of the respective Investment Instrument as well as on the exchange rate trend. An unfavourable exchange rate trend may adversely affect the overall development of the investment even if the Investment Instrument itself develops positively.
- (e) Equities risk is a risk of an adverse change in the market price of equity Investment Instruments, or financial derivatives derived from those instruments. Trading in equity Instruments is the principal source of this risk.
- (f) Commodity risk expresses a change in the price or yield from an Investment Instrument due to a change in the price of a commodity (e.g. raw materials, precious metals or energy). Commodity risk is typical of Investment Instruments whose underlying asset is a commodity, although commodity risk affects all Investment Instruments to a certain degree depending on the sensitivity of the economy or the Investment Instrument issuer to the trend in the prices of that commodity.
- (g) Inflation risk affects the real rate of return on Investment Instruments. Inflation (decline in the purchasing power of money) reduces the real return on an investment. High inflation may cause a Client to achieve a negative real rate of return due to the return on the Investment Instrument being consumed by inflation.

2.6 Market Liquidity Risk

Market liquidity risk is a risk of loss due to an insufficient market depth or breadth. This situation is marked by a lower number of sellers or buyers, greater differences between the best buy and sell prices, greater differences between individual quotes and insufficient liquidity at the individual price levels of quotes. These adverse factors may result in an Order or Investment Instrument transaction being executed at a price very distant from the mean quote or the best buy/sell quote, or in the execution of an Order or Transaction being impossible due to illiquidity. OTC-traded Investment Instruments typically entail higher market liquidity risk. Nonetheless, Investment Instruments traded on Trading Venue (including regulated markets) also contain significant risks of counterparty finding or quote discovery substantially different from the independent valuation of Investment Instrument. The risk of Order execution at a price substantially different from the independent valuation of such Investment Instrument is increased with the Orders without any price limit (i.e. at best). The final price can reach zero with sell Orders and infinite with buy Orders.

Operational Risk

Operational risk means the possibility of loss due to the insufficiency or failure of the internal processes, human factor and the systems of the Investment Instrument issuer, the Bank or a third party or due to external factors, including information technology and legal risks. To illustrate operational risk, examples of factors causing a loss include sending money to a wrong account, losing a business contract, incorrect calculation of the interest amount, destruction of electronic data due to a voltage sag in the grid or fire, etc.

2.7 Risks Specific to Derivative Investment Instruments

- (a) The value of derivative Investment Instruments depends on or derives from the value of the underlying asset such as, without limitation, equities, equity indices, equity baskets, currency pairs, interest rates or commodities. The various names of derivative Investment Instruments may be imprecise or misleading, which is why it is always necessary to study the document on the conditions for the respective Investment Instrument, describing its structure and its behaviour during varying market conditions.
- (b) Leverage. Investing in derivative Investment Instruments involves a high of risk due to leverage. Leverage is the situation where the profit or loss upon a change in the price of the leverage instrument is higher than the profit or loss would be upon acquiring the respective underlying asset. The result of this mechanism is that even a minor change in the price of the underlying asset may induce a major change in the value of the Investment Instrument.
- (c) Options. Investing in option transactions usually involves a high risk. Clients should familiarise themselves with the type of the option Transaction they intend to conclude and with the specific risks related to such type of Transaction. With options bought by the Client, the maximum loss is limited by the amount of the premium paid and the transaction costs. In option transactions where the Client sells a call option the Client's loss is theoretically unlimited.

3. Risks Related to Multi-tier Records of Investment Instruments

3.1 Governing Law, Registers and Authorised Administrators

- (a) Every country's law defines the legal owner of an Investment Instrument issued under the respective law. As regards certificated securities, the ownership of an Investment Instrument is usually associated with the ownership of the relevant certificate, while the ownership of dematerialised or immobilised Investment Instruments is usually associated with an entry in a 'constitutive' (constituting a right) Register. In line with the customary practice on international capital markets, certificated Investment Instruments are usually held by Authorised Administrators, established in the country whose law governs the Investment Instruments in question (for example, Italian certificated bonds are usually held by Authorised Administrators established in Italy). By the same token, Registers are usually kept by Authorised Administrators established in the country whose law governs the Investment Instruments in question.
- (b) Authorised Administrators that keep constitutive Registers or hold certificated securities are usually called central securities depositories. More detailed information about the systems for registering Investment Instruments and about the working of central securities depositories in various countries can be obtained from the website of the International Securities Services Association (www.issanet.org).

3.2 Multi-tier Records

- (a) Most Authorised Administrators (including Authorised Administrators whose services the Bank is using) do not keep constitutive Registers, nor do they directly hold certificated Investment Instruments, but use the services of central securities depositories or those of other Authorised Administrators as

intermediaries. Thus, multi-tier systems for keeping records of Investment Instruments, composed of several “tiers” of Authorised Administrators, exist on international or foreign capital markets.

- (b) Where Investment Instruments administered by the Bank are kept in omnibus accounts with Authorised Administrators, such Authorised Administrators keep all Investment Instruments of the Bank’s Clients in such omnibus accounts open for the Bank. Any other Authorised Administrator that may potentially keep the omnibus accounts for the Authorised Administrator whose services the Bank is using may also keep a Register in the same way (for example, the Bank keeps its Clients’ Asset Accounts and at the same time has an omnibus account open with Authorised Administrator A, in which Investment Instruments are registered collectively for the Bank’s Clients; further, Authorised Administrator A has an omnibus account open with Authorised Administrator B, in which Investment Instruments are registered collectively for the clients of Authorised Administrator A; and so forth, down the line to a custodian (administrator) who is a central securities depository that keeps the ultimate, constitutive Register or physically holds the respective certificated securities).
- (c) Multi-tier systems of omnibus accounts, maintained by Authorised Administrators, have been spawned by the needs of capital market development in other countries, chiefly to reduce the costs and risks incurred in the actual possession of Investment Instruments and because of the need to provide for the safe and effective settlement of Investment Instruments transactions. Omnibus account systems significantly reduce the costs and risks that would otherwise be incurred in the actual possession of Investment Instruments and in the settlement of transactions with them. In addition, without omnibus accounts it would frequently not be possible at all to make investments in Investment Instruments on capital markets in other countries.
- (d) Due to the existence of the multi-tier systems of omnibus accounts and in line with the customary practice on international or foreign capital markets, the Investment Instruments administered by the Bank are recorded in the Client’s name solely in the Register kept by the Bank but not in the omnibus accounts kept by the other Authorised Administrators. For Clients, this fact increases the risk in the case of any of the Authorised Administrators failing (for example, it cannot be completely ruled out that the consequences of a breach of the due professional care obligation, committed by an Authorised Administrator in relation to another client, are transferred to the Client; in other countries, Authorised Administrators sometimes establish security (lien) rights to Investment Instruments registered in omnibus accounts, on the basis of which an Authorised Administrator can, for example, sell the Investment Instruments in question in the case that their contracting partner for whom it keeps a register of the Investment Instruments in an omnibus account defaults on their obligation to this Authorised Administrator, etc.).

3.3 Risks of Multi-tier Records

- (a) In addition, in the case of omnibus accounts a Client’s individual claims may not be identifiable through certificates or other documents or other records, and in the case of permanent shortfalls (losses) following an Authorised Administrator’s failure, Clients can share the loss jointly in proportion to their respective share of the Investment Instruments collectively registered in the omnibus account.
- (b) Multi-tier records of Investment Instruments in omnibus accounts increase the risk for Clients primarily in the case of insolvency of an Authorised Administrator involved in the registration of the Client’s Investment Instruments. In such a case the national law that would govern the insolvency or similar proceedings against the insolvent Authorised Administrator would be the governing law for protecting and exercising the Client’s property rights. In such cases, the various countries’ legal systems do not always provide sufficient protection for the property rights of Authorised Administrators’ Clients who are the end investors.

3.4 The Bank’s Liability

The Bank shall not be held accountable or liable for any Authorised Administrator’s insolvency and shall not be held accountable or liable for any Authorised Administrator’s performance of their obligations. The Bank is accountable for breaches of its legal obligations, *inter alia* for applying professional care in selecting the Authorised Administrators whose services it is using.

4. Investment Instruments

4.1 Shares (Equities)

4.1.1. Description

A share is a security certifying that its owner is a shareholder, i.e., holds a certain ownership interest (capital) in a public limited company (public company limited by shares, joint-stock company). A shareholder enjoys various rights, including, for example, the right to share in the company’s profit in the form of dividends and the right to take part in the management of the company by, *inter alia*, voting at the General Meeting, and,

possibly, to share in the surplus assets after liquidation if the company goes into liquidation. Shareholder rights are governed by the relevant regulations of the country under which the public limited company was founded or whose law governs it, and other internal regulations of the company such as Articles of Association.

Selected classes of shares:

Ordinary shares give their holder the right to share in profit, to take part in the General Meeting, to make motions and counter-motions, and the right to share in the surplus assets after liquidation.

Preference shares carry the priority right to dividends and/or priority in liquidation, or both, usually with a limited right to vote.

4.1.2 Return and yield

The return from holding shares includes dividends and capital gain or loss on the sale of shares. The yield obtained from dividends relative to the price per share is called the dividend yield. In comparison with other Investment Instruments, it is possible to achieve a higher return in the form of dividends or capital gain as opposed to other, more conservative assets. The return is compensated by a higher risk. Shares mostly exhibit a high degree of volatility in comparison with more conservative assets and their prices can fluctuate strongly on a short-term scale.

4.1.3 Risks Associated with Investments in Equities

Market risk:

Share prices depend on the issuer's economic activity. If the issuer's business develops positively, the profit on an investment may be unlimited. If the issuer is insolvent, the investor incurs a loss of the invested capital at up to 100% of the amount of the investment. Other factors that affect share prices are the overall development of the economy, its economic cycle and the development in the respective industry.

Currency risk:

If a stock is denominated in a currency other than the principal currency of the investor's income and expenses, there is a risk of an unfavourable development in the exchange rate of the foreign currency in respect of the investor's principal currency.

Liquidity risk:

If a stock is traded on regulated markets the liquidity risk is eliminated by the greater number of market participants. Shares admitted for trading in several regulated markets or shares in a narrow market may face problems with the tradability of the share in the required amount.

Credit risk:

The share owner is also a shareholder. If the issuer's business develops positively the profit on an investment may be unlimited. If the issuer is insolvent the investor incurs a loss of the invested capital up to 100% of the amount of the investment.

Specific risk hedging options:

Market risk can be mitigated to an extent by diversifying investment and selecting a suitable portfolio. A Czech investor may avoid currency risk by investing only in shares denominated in the Czech currency (crown) and/or by using currency hedging. Portfolio liquidity can be influenced by investing primarily in shares publicly traded on regulated markets with a high liquidity. Even publicly traded shares are exposed to various market factors which may affect their liquidity. Credit risk can be mitigated to an extent by diversifying investment and a thorough analysis of the company's performance.

4.2 Bonds

4.2.1 Description

A bond is a debt security representing the issuer's obligation to the creditor. It is a substitutable security which gives the investor the right to receive repayment of the owed (principal) amount and payment of the set yields, and the issuer's obligation to satisfy all liabilities. The rights and obligations of the bond issuer and the bond holder (investor) are usually defined in the bond issue conditions. Bond holders are not liable for the company's liabilities.

The payment of the principal amount of and yield on bonds is not legally guaranteed. Banks and investment firms that issue bonds are involved in a statutory guarantee system, which partly satisfies bond holders' investments if issuers face financial problems.

Selected types of bonds:

By issuer:

Government bonds – government bonds are issued by governments or government agencies – in the Czech Republic the issuer is the Ministry of Finance.

Municipal bonds – municipal bonds are issued by self-governing administrative units.

Corporate bonds – corporate bonds are issued by commercial companies in order to raise capital. The varying level of risk involved in corporate bonds influences the coupon.

Bank bonds – bank bonds are issued by financial institutions.

Treasury bills – treasury bills are short-term bonds issued by the sovereign or by the central bank.

By coupon:

Fixed coupon bonds – the coupon agreed at the time of issue of the bond remains unchanged over the life of the bond. The advantage is that it is easy to calculate the yield to maturity; the weakness is that the client does not gain higher yields when interest rates grow.

Floating coupon bonds – the coupon of these bonds depends on a reference rate – often an interbank rate such as the PRIBOR, LIBOR or EURIBOR. A certain percentage is added to the reference rate to compensate for the higher risks, compared with the interbank market. The advantage is that the client gains higher yields when interest rates grow. The weakness is the fact that when interest rates decrease the yield for the client is lower.

Zero coupon bonds – no coupon payments are made during the life of these bonds. The yield is generated through creditors buying this security at a discount on its nominal value. The debtor then pays the nominal value of the bond at maturity.

4.2.2 Bond yield

Coupon yield from bonds results from collecting a fixed or floating coupon. Another possibility for bond holders to grow their investment is making a profit on the difference in price when buying and when selling the bond.

4.2.3 Risks Associated with Investments in Bonds

Credit risk:

The risk stems from the debtor's inability to meet their obligations, i.e., pay interest and repay the principal amount of the bond. Where commercial companies are involved this risk can be significant; conversely, bonds of governments with a high rating or of international organisations exhibit a markedly lower level of this risk.

Interest risk:

This risk stems from a change in interest rates depending on bond maturity and coupon type. The more interest rates grow, the more the market price of fixed-coupon bonds decreases, in order for the current bond yield to maturity to be identical to the market interest rate.

Currency risk:

If a bond is denominated in a foreign currency there is a risk of a movement in the exchange rate between the foreign currency and the Czech crown. If the Czech crown weakens the investment may appreciate. If the Czech crown strengthens the investment may be partly impaired.

Liquidity risk:

To a great extent, bonds are traded in OTC markets that do not guarantee sufficient sizes for transactions to take place. Liquidity risk is individual with bonds. The liquidity of bonds depends on the issuer, the issuer's rating, the size of the issue of the particular bond, and on other specific factors.

Specific risk hedging options:

Generally, market risk is lower with bonds than it is with shares. An investor may influence the credit risk by selecting bonds of an issuer with a high rating. Liquidity risk can be mitigated by investing in bonds tradable on secondary markets. Currency risk can, similarly to shares, be avoided by buying bonds solely in the investor's home currency. Interest rate swaps can be used for hedging against interest risk with floating coupon bonds.

Generally, the higher the yield from a bond the greater the risk that the investment represents.

4.3 Repo Transactions, Reverse Repo Transactions, Sell/Buy and Buy/Sell Transactions

4.3.1 Description

Repo operations, Reverse Repo operations, and Sell/Buy and Buy/Sell operations (hereinafter collectively "Repo Transactions") are purchase agreements with agreed repurchase. For Repo operations and Reverse

Repo operations there is one purchase agreement. For Sell/Buy and Buy/Sell there are two purchase agreements made at a single moment.

In a Repo Transaction one party – the buyer – buys an agreed amount of securities at an agreed price from the other party – the seller – and also agrees to sell the same amount of securities back to the seller for the purchase price plus the agreed return.

Repo Transactions serve as deposits or loans of funds. Interest is expressed as the difference between the price of the security at the beginning and at the end of the Repo Transaction.

These operations may involve e.g. treasury bills, government bonds, equities, etc. Where securities with markedly fluctuating prices are involved (typically equities) the loan is not provided for the entire amount (current market price * number of shares), but just for a percentage, e.g., 80%, the percentage being referred to as the 'hair cut'.

The benefit of Repo operations for the client is that the client can obtain funds in a relatively short time. The quality and liquidity of the securities heavily affect interest and the amount of securities that have to be pledged.

4.3.2 Return

The return on these transactions is known in advance. The interest rate is the difference between the initial and the final price.

4.3.3 Risks

Liquidity risk:

Transactions are predominantly illiquid, meaning that they cannot be ended early. In effect, the original owner reacquires the ownership of the originally owned securities only on the date of maturity. By the same token, the provider of the funds for the transaction gets the funds back only on the date of maturity. A potential early termination may involve additional costs.

Credit risk:

Both the buyer and the seller may fail to deliver on their obligations to sell (buy) back in the event of the counterparty default. In addition, the value of the securities subject to transfer may decrease due to lowered rating of the security issuer or due to other market factors.

Specific risk hedging options:

The options for hedging are rather limited due to the very nature of such transactions and the nature of the purpose for which the transactions are made. The only way to mitigate the risks mentioned is the good quality of the securities used for the pledge of the ownership title.

4.4 Derivatives (general)

4.4.1 Description

A derivative is an Investment Instrument whose value is derived from the underlying asset. The underlying assets may be securities, currencies, interest rates, commodities, indices etc. Being linked to conditions at a later time, meaning that the transaction will be settled in the future, and the related leverage effect are important features of derivatives. Only a relatively small initial investment or none at all is involved in the arrangement for a transaction. Therefore, unlike ordinary spot Investment Instruments, derivatives offer opportunities to achieve much higher returns and, of course, also to suffer higher losses.

Derivatives can be used for various purposes in practice:

Hedging – derivatives can be used to fix a price of the underlying asset at an agreed future date. In other words, for a particular position a transaction is arranged in the futures market whereby the profit or loss will develop as a mirror reflection of the position. It can thus be said that the profit or loss arising from the market revaluation of the underlying asset is eliminated by the loss or profit from the market revaluation of the agreed derivative.

Speculations – a speculator buys a derivative in an attempt to profit from price developments of the underlying asset. Simply speaking, he speculates that the price of the underlying asset will be lower or higher than the prompt price of the underlying asset on the maturity date, for which he can sell or buy this instrument in the prompt market.

Arbitrage – this is taking advantage of price differences that can occur in terms of geographies and/or time.

Selected types of derivatives:

Forward Rate Agreement (FRA), FX forward, FX swap, Interest Rate Swap (IRS), FX option.

4.4.2 Risks Associated with Investing in Derivative Transactions

Market risk:

Risk of a decrease in the fair value of a derivative due to a change in the value of the underlying asset. This risk is especially significant in speculative transactions, but it may also occur in hedging transactions, especially where the initial assumption under which the hedging was agreed proves to be wrong. In extreme cases, the potential loss from this risk may even exceed the face value of the contract.

Liquidity risk of the underlying asset:

Most derivatives are not traded in regulated markets, so the investor may lack the possibility to close or change their position. For more on this refer to section 2.6 of this document.

Credit risk:

Risk of insolvency of the counterparty that cannot meet its obligations (default) at the time of the settlement of the derivative.

4.5 Forward Rate Agreement (FRA)

4.5.1 Description

An FRA is a fixed agreement between two parties, enabling the parties to fix the rate of interest for a loan or deposit in a future period, or to “switch” from a floating interest rate for a receivable or debt to a fixed interest rate, or vice versa. It is a derivative interest rate contract, negotiated as an individual non-standardised contract on the OTC market. Delivery under the FRA involves only settlement of the balance resulting from the difference between the two interest rates. The FRA is not associated with any additional costs or commissions.

These transactions take place on the interbank market and there are no standardised conditions for them. Unlike with interest rate futures transactions, the FRA are tailor-made Investment Instruments in terms of the principal, currency and interest period.

Entities negotiating the FRA:

FRA buyer – ensuring a fixed interest rate for the FRA buyer’s future obligations, which are subject to a floating interest rate, i.e. hedging against increases in interest rates in the future (speculating on market interest rates rising).

FRA seller – ensuring a fixed interest rate for the FRA seller’s future claims, which are subject to a floating interest rate, i.e. hedging against decreases in interest rates in the future (speculating on market interest rates declining).

Possible uses of the FRA:

FRA seller – hedging the capital invested in interest rate instruments sensitive to changes in the market interest rate against decreases in the interest rates.

FRA buyer – hedging the FRA buyer’s expected future capital needs against increases in the market interest rates.

4.5.2 Return

The FRA buyer/seller obtains a fixed interest rate through buying/selling. If the reference interest rate is higher than the agreed interest rate (FRA price) on the date of maturity, the buyer receives compensation for the movement of the interest rates. If the reference interest rate is lower than the agreed interest rate (FRA price) on the date of maturity, the seller receives the compensation.

4.5.3 Risks Associated with Investing in FRA

Market risk:

Market risk arises from the uncertainty as to the future changes in the level of market interest rates. The more volatile the interest rates, the higher the risk.

Credit risk:

The FRA credit risk is the possibility of the counterparty’s default, resulting in a loss of the positive value of the FRA over the market situation, and in the necessity to cover the transaction by buying on the market at a less favourable price.

4.6 Interest Rate Swap (IRS)

4.6.1 Description

Interest rate swap (IRS) is an agreement between two parties to exchange their money flows in a specified period of time, usually based on a floating interest rate and fixed interest rate. Only interest is exchanged and not the nominal value (i.e. there is no capital flow). The nominal value of the IRS serves only to derive the

amount of interest payments. The fixed rate is an interest rate serving to determine the fixed interest payment. The floating interest rate serves to determine the floating interest payment and is expressed by reference to the PRIBOR, LIBOR etc. In non-standardised contracts the nominal value may change during the life of the contract.

IRS are not standardised. The details for the transaction must be defined by a contract in advance. These are tailor made products, and so it is exceptionally important to obtain precise information on the conditions of a specific IRS, in particular as regards the nominal amount, maturity, agreed interest rates and other parameters.

4.6.2 Return

IRS buyer (fixed interest payer) benefits from an increase of interest rates. IRS seller (fixed interest recipient) profits from a decrease in interest rates. The income from the IRS cannot be determined in advance.

4.6.3 Risks Associated with Investing in IRS

Market risk:

Market risk arises from the uncertainty as to the future changes in the level of market interest rates. IRS buyer/seller is exposed to a risk of loss if market interest rates are decreasing/increasing.

Credit risk:

The credit risk is in the possibility that the Derivative Transaction counterparty will fail to meet its obligations as a result of its default. The lower the credit rating of the counterparty, the higher the risk.

4.7 Foreign Exchange Forward (FX Forward)

4.7.1 Description

FX Forward is an agreement between the parties under which one party sells the other party a pre-agreed amount of foreign currency at a fixed future date and at a fixed exchange rate (forward rate).

Contract counterparties:

Buyer – has the obligation to buy an agreed amount of a currency at a fixed future date and at an agreed forward rate.

Seller – has the obligation to sell an agreed amount of a currency at a fixed future date and at an agreed forward rate.

Example of use:

An importer wants to hedge their obligation against a future appreciation of the euro versus the local currency, the Czech crown. For this purpose the importer enters today into an FX Forward contract as at the maturity date of their future obligations, where they have both the right and the obligation to buy the euro for CZK at a pre-agreed rate. On the maturity date, the contract is settled at the pre-agreed forward rate.

An exporter expects a euro-denominated payment from their foreign customer. The exporter is concerned that the local currency (CZK) is going to be stronger and therefore it enters today into an FX Forward contract as at the maturity date of their receivable, where they have both the right and the obligation to sell the euro for CZK at a pre-agreed rate. On the maturity date, the contract is settled at the pre-agreed forward rate.

4.7.2 Return

The return is defined by the difference between the price agreed in the contract and the current price of the underlying asset. The buyer makes a profit if the current FX rate is less favourable than the exercise price. The potential profit/loss is not limited.

4.7.3 Risks Associated with Investing in FX Forward

Market risk:

The value of the FX Forward is influenced by the spot FX rate, interest rates in both currencies and other market factors. In effect, the forward rate fluctuates depending on the market parameters of the above variables.

Credit risk:

Credit risk is in the possibility that the Derivative Transaction counterparty will fail to meet its obligations as a result of its default. The lower the credit rating of the counterparty, the higher the risk.

4.8 Foreign Exchange Swap (FX SWAP)

4.8.1 Description

FX Swap is a contract between two parties, under which one party sells the other party a pre-agreed amount of a foreign currency at a specific fixed date (usually within two days from transaction closing) at the current rate (spot rate) while the buyer sells the seller the same agreed amount of a foreign currency at a specific fixed date in the future and at a fixed rate (forward rate).

The transaction takes place in two separate conversions: the client first sells the funds to the counterparty at the current market (spot) rate and in the future the client buys the funds back at a forward rate.

4.8.3 Risks Associated with Investing in FX Swap

Market risk:

If an FX swap is agreed for speculative purposes, the market risk is linked to the movement of exchange rates and interest rates.

Credit risk:

Credit risk consists in the risk of insolvency, i.e. the possibility of a temporary or lasting inability to meet the obligations under the swap, resulting in the necessity of covering the transaction through the market.

4.9 Foreign Exchange Options (FX Options)

4.9.1 Description

FX Option is a contract between parties, under which the option holder (buyer) has the right (but not the obligation) to buy (call option) or to sell (put option) an agreed currency at a pre-agreed strike price at a pre-agreed date(s) or period.

Basic option positions:

	Call option (buy)	Put option (sell)
Option buyer (Long)	<ul style="list-style-type: none"> • Right to buy a currency at the strike price • Obligation to pay option premium 	<ul style="list-style-type: none"> • Right to sell a currency at the strike price • Obligation to pay option premium
Option seller (Short)	<ul style="list-style-type: none"> • Obligation to sell a currency at the strike price • Right to collect the option premium 	<ul style="list-style-type: none"> • Obligation to buy a currency at the strike price • Right to collect the option premium

Possible uses of currency options:

- Hedging against currency risk
- Speculation aiming to profit from expected future market developments

4.9.2 Return

The exercise price of the underlying asset is pre-defined at the moment of negotiating the option. With call options, the buyer achieves a return if the agreed price of the underlying asset is higher than the price on the option exercise day. With put options, to achieve a return the price of the underlying asset on the exercise day must be lower than the agreed price. If the difference between the pre-agreed price and the current price is unfavourable for the option holder, the option holder need not exercise the option. The option holder will incur a loss not exceeding the amount of the paid option premium. Return can also be achieved by selling the option itself. If the underlying asset price is changing on the market, the value of the call/put option grows or falls depending on the type of the option (call/put) and the exercise price.

4.9.3 Risks Associated with Investing in FX Options

Market risk:

The market price of the option is linked to the changes in currency rates, interest rates, time value and, in particular, the volatility of these variables.

Credit risk:

See the Derivatives section.

4.10 Investment Certificates

4.10.1 Description

Investment certificates are securities that carry rights specified in their issue conditions. The issuer promises to pay the value of the certificate at a certain time. The value received by the investor at the end of the agreed period depends on the development of the value of the underlying assets such as individual shares, equity indices, bond indices, equity baskets, credit instruments, currencies or even commodities.

The term of an investment certificate is individual and ranges from several days to an unlimited period. "Endless" or open-end certificates exist as well. An investor may sell investment certificates at any time on the secondary market or directly to the issuer depending on the liquidity of the product. Another option for the investor is to hold investment certificates to maturity and then request the issuer to pay the value of the investment certificate.

Transparency and versatility – details on an investment certificate including its maturity, the way it is constructed and the underlying asset can be found in the issue conditions of the respective instrument.

Liquidity – the possibility to convert certificates back to money. Liquidity of individual investment certificates may be limited, depending on the current market conditions.

Diversity – currently there is a vast number of certificates with different attributes and characteristics.

Selected types of investment certificates:

Guaranteed certificates – these certificates provide up to 100% protection from a decrease in the underlying asset price to investors. The price for the protection is giving up a part of the return for the benefit of the issuer. During the term of such certificates they are exposed to a number of factors such as the volatility of the underlying asset, time to maturity, changes in interest rates etc.

Index certificates – the index certificate participation is 1:1 to the underlying asset. Increase or decrease of the underlying asset in percentage terms results in the same change on the index certificate side. The same percentage change upwards or downwards is the main reason for the creation of index certificates.

4.10.2 Return

The return from investment certificates is determined by the development in the price of the underlying asset. The value of an investment certificate depends directly on the value of the underlying asset. In principle, the price of investment certificates is not determined by the interaction between the supply of and demand for such an investment certificate.

4.10.3 Risks Associated with Investing in Investment Certificates

Credit risk:

The investor is exposed to the risk of the certificate issuer being unable to meet their obligations. The issuer's insolvency may stem e.g. from unfavourable market developments, incorrect decisions of the management team, natural disaster, crime and other unexpected circumstances. The investor's loss may be up to 100% of the invested amount. The investor is exposed to the risk of insolvency of the underlying instrument issuers. The losses are passed through to the investor in full or in part under the conditions of the certificate.

Market risk:

This is a risk of loss due to a change of the market prices of the underlying instruments. Market risk means primarily interest, equity, currency and commodity risks.

(Foreign exchange) currency risk:

This risk exists if a certificate is denominated in a foreign currency or is a financial product sensitive to changes in the exchange rate.

4.11 Structured Deposit

4.11.1 Description

Structured deposit is a type of transaction that combines a deposit with an Investment Instrument. The yield from the structured deposit may depend on the performance of the underlying asset (one or more currencies, equities, bonds, market index, commodity or any combination thereof). Such yield may be even several times greater than the performance of the underlying assets. With some types of structured deposits the return of the principal may not be guaranteed, and/or the deposit may be paid out in a currency other than the currency in which the deposit was agreed.

Selected types of Structured Deposit:

Dual term deposit – this is a term deposit that is initially negotiated for a specific principal and interest that can be higher than with similar standard term deposits. Under certain conditions defined in advance, the principal may be paid out in a currency other than the currency in which the term deposit was agreed.

4.11.2 Return

The return is higher compared with similar standard term deposits.

4.11.3 Risks Associated with Investing in Structured Deposits

Market risk:

The yield (and sometimes even the value of the principal) may vary with the prices of the embedded investment instruments or underlying assets (equities, bonds, market index, commodities, exchange rates etc.).

Credit risk:

The primary credit risk for the client is a default of the structured deposit recipient. This risk is mostly low, but not zero.

Compensation from the Deposit Insurance Fund may not apply to some types of structured deposits or their yields. Hence, if the recipient of the deposit (the bank) goes bankrupt, the deposit owner may even lose the entire principal.

Liquidity risk:

Structured deposits are very illiquid financial instruments and their early termination (prior to maturity) may require high costs or may even be unfeasible.

Currency risk:

Where the currency of a structured deposit, or an alternative currency, is not at the same time the basic currency of the structured deposit owner's income and expenses, currency risk may occur when the exchange rate changes.

Specific risk hedging options:

A client arranges a structured deposit primarily for the purpose of achieving a greater yield. Risk hedging would reduce the yield to the level of standard term deposits. If the client wants to reduce the risks they should use one of the above instruments (derivatives).

This document is effective as of 1 October 2020.