



DESCRIPTION OF FINANCIAL INSTRUMENTS AND RELATED RISKS

Pursuant to the requirements of legal acts and in order to enable the Client to make a reasoned investment decision, the Bank hereby presents a generalized description of the character of financial instruments and risks inherent to them. A particular financial instrument may have additional conditions and risk factors inherent to that particular instrument. The Client should review this description prior to making an investment decision.

1. GENERAL PROVISIONS

An investor's main objective is to seek a positive return on his/ her investment. However, any investment is risky. Therefore, an investment may fail to ensure the expected return, or even be loss-making. Normally, there exists a direct relation between the amount of the expected return and the scope of the risk, i.e. the higher the return on investment is expected, the higher the risk of incurring losses. Different financial instruments carry different risks. One of the methods for limiting the risk of losses is to invest in a set of financial instruments rather than in one, or in several similar financial instruments. The purpose of this is to distribute the risk evenly and avoid the same negative impact on all financial instruments at the same time. If an investment is made in financial instruments nominated in a foreign currency, the risk of fluctuations in the exchange rate of foreign currency will also arise. The Client is personally responsible for a decision to invest in one or another financial instrument. The Client is obliged to monitor the status of his investments regularly, irrespective of whether he or she has been given personal recommendations in respect of a certain investment or not. The Client should use all the information accessible to him in order to monitor price changes and to follow the value of his investments, including data provided by the trading system, Reuters, Bloomberg, Internet, and other information facilities, as well as information directly received from the Bank.

2. SECURITIES

2.1. Shares

Shares are ownership securities. If the company that issued the shares (the issuer) earns profit, a portion of the profit may be distributed to the shareholders in the form of dividends. Shares can also grant the voting right at shareholders meetings. The risk faced by an investor when acquiring a share constitutes the price paid by the investor and the dynamics of that price. The price may either increase or decrease in the future.

The risk of the issuer's insolvency: the business success of a company is not guaranteed; therefore, a probability that the company's business will become loss-making for any one of a number of reasons and that the company will go bankrupt always exists. In this case, only that portion of the company's assets which remains after satisfying all requirements of its creditors will be divided to shareholders. Most frequently, no assets remain for shareholders; in this case, the shares become worthless.

The prospects of the issuer's profitability: the price of shares depends on the prospects of the company's profitability. When assessing the company's profitability, market players should take into account the country's overall economic situation, its prospects, the possible demand for the goods produced or the services provided by the company, as well as its management, organizational structure, and operating efficiency. Market players often have different opinions on the prospects for the company's share price. Therefore, some purchase shares, while others sell them.

Changes in the number of shares: the announcement of the planned increase in a company's capital by means of a new share issue may influence the share price if the shares are to be distributed at a price different from the market price.

The risk of the correlation (interdependence) of shares: share prices of companies within the same industry are frequently interrelated. Share prices are also significantly influenced by global and regional market trends; therefore, even the share price of a company that has favourable market prospects may decrease owing to the aforementioned reasons.

The risk of low turnover: the lower the turnover of shares in the market is, the more the price of those shares may fluctuate. This means that the price of low-turnover (non-liquid) shares may change extremely rapidly and radically.

2.2. Bonds

A bond is a non-ownership security, under which the company, government or other issuing institution (the issuer) becomes the bond holder's debtor.

2.2.1. Fixed-interest bonds

Return on investments is usually paid out in the form of regular interest (a coupon) either one or several times per year. There are some bonds for which regular interest is not paid: the bond is distributed at a price lower than the nominal price and is redeemed at the nominal price (zero-coupon bonds). Bonds can be of different maturity and coupon amounts. They can be issued by governments and financial institutions, as well as by other enterprises and organizations.

2.2.2. Risk factors related to the redemption of shares and payment of interest



The risk of the issuer's insolvency: the issuer is responsible for the payment of interest and redemption of bonds. Distributors of bonds are not liable under the obligations of the issuer; therefore, investors should assume the risk of the inability on the part of the issuer to redeem the bonds and/or to pay interest. On frequent occasions, issuers finance the redemption of bonds while engaging in additionally borrowing on capital markets. In a case where the situation on these markets deteriorates (e.g. in the case of a decrease in the demand for debt securities or an increase in the interest rate), it may be difficult or impossible for the issuer to arrange additional borrowing, as a result of which, the bonds may remain unredeemed.

Warning concerning high-yield bonds: the yield of bonds is related to the risk of the issuer's insolvency. In terms of high-yield bonds, the risk is high on most occasions; therefore, we do not recommend investing a considerable portion of one's savings in such bonds.

The risk of the reinvestment of interest: the actual yield (profitability) of bonds may be lower than that specified in the bond redemption documents if a bond holder fails to reinvest the coupons (interest) received for the bonds at the yield specified in those documents.

2.2.3. Risk factors related to the premature sale of bonds

The yield (profitability) specified in the bond redemption documents is only guaranteed provided that the bonds are held until their maturity. In a case where bonds are sold prematurely, the yield may be either lower or higher than that specified at the time of their acquisition. In case of premature sale, the yield may also be negative, i.e. the investor may recover an amount smaller than that which he or she invested.

The interest rate risk: in a case where the interest rate in the market changes, both the price of bonds and their yield, may increase or decrease. When the interest rate in the market increases, the price of the bond decreases and vice versa. The interest rate risk is not relevant if bonds are held until their redemption date, and the issuer redeems them and pays all amounts payable under those bonds.

Issuer's credit risk: in case of deterioration in the financial condition of the issuer of bonds and/or in case of downgrade of the issuer's credit rating, the demand for, the turnover and the price of the bonds may decrease.

The risk of low turnover: the lower the turnover of bonds is, the more their price fluctuates. This means that the price of low-turnover (non-liquid) bonds may change extremely rapidly and radically. The more time is remaining until redemption of the bonds and/or the higher the yield of the bonds is, the more their price fluctuates. Quite often bonds are only distributed by one intermediary. If this intermediary reduces the price of any given bonds considerably, it may be difficult to find a sale alternative and, if the intermediary stops buying up the bonds, it may become totally impossible to sell them before redemption. It should be noted that the quoting of bonds on a stock exchange does not directly ensure activity in the turnover of those bonds.

2.2.4. Bonds related to financial instruments

Bonds related to financial instruments are those bonds where the interest or redemption price depends on the changes in the value of a given financial instrument. Investors in such bonds assume the same risk as holders of fixed-interest bonds and also face the additional risk of complete failure to receive any interest.

The risk of changes in the value of the financial instrument: in the case of an unfavorable change in the value of the financial instrument to which the bonds are related, investors may fail to receive any interest at all.

Acquisition of bonds at a price higher than the nominal price: most often, the issuer guarantees the redemption of a bond at a price not lower than the nominal price. Investors who have acquired bonds at a price higher than the nominal price run a risk of incurring a loss due to the difference in the acquisition and redemption prices of the bonds. If specific taxes are applicable to the acquisition or sale of the bonds, such taxes increase the acquisition price.

2.2.5. Bonds related to credit risk

Bonds related to credit risk are those bonds where their redemption is related to the credit risk of another issuer (the Reference Entity). Normally, a higher than usual interest is paid on such bonds; however, in case when an established credit event occurs, the bonds are redeemed upon the investor's presentation of the other issuer's (the Reference Entity's) securities, in respect of which the credit event has occurred. The Reference Entity may be a government or an enterprise. Holders of bonds related to the credit risk assume the same risk as fixed-interest bonds and also face the additional risk of the complete loss of all the invested funds if a credit event occurs.

The Reference Entity credit risk: in a case where a credit event in respect of the Reference Entity occurs (e.g. in a case of the Reference Entity's declaring bankruptcy), bonds related to the credit risk are redeemed at the nominal value of the bond with payment in the Reference Entity's securities to the corresponding nominal value. If a credit event occurs, the Reference Entity's securities may have a very low value or be worthless; therefore, in this case, the bond holder may lose either a considerable portion or the whole of the invested funds. Bonds related to a credit risk may be also related to financial instruments. The holders of such bonds also assume the risk of a change in the value of the financial instrument, as described above.

2.3. Investment funds



An investment fund is a collective investment entity, the capital of which is divided into shares or investment units. When acquiring shares/investment units in an investment fund, the investor becomes a participant thereof and is entitled to claim the relevant profit from the fund. On frequent occasions, investment funds invest a major portion of their capital in shares, bonds or derivative financial instruments. Mixed funds invest in various financial instruments in portions. The result of an investment fund depends on changes in the value of the assets in which the fund has invested. Investment funds' results increase as the value of the assets held grows.

The risk to be faced by an investor when acquiring units of an investment fund is close to the risk of investing in shares or bonds; however, fluctuations in their value is decreased concerning diversification of the investments over a number of financial instruments.

The market dynamics risk: although price fluctuations in a financial instrument in which an investment fund's funds are invested do not have a significant impact on the value of the unit, the value of the investment fund's units may also fluctuate significantly in a case of global changes in the finance market as a whole. Should financial market indices fall as a result of regional or global stagnation, or a slump, the result of the investment fund's activity might be negative. The extent of the losses incurred by the investor will depend on the extent of the fall of the financial markets. In the worst case, investors might lose a considerable, or even a major portion of the funds they have invested.

The fund strategy risk: funds' investment strategies are different, ranging from the wholly conservative, when investments are made only in guaranteed yield financial instruments, to the aggressive, when investments are made in the shares of enterprises of developing and rapidly growing countries, or in commodities. The more aggressive a fund's investment strategy, the higher the risk of incurring losses owing to fluctuations in the market is. Hedge funds use complex derivative instruments, which are only comprehensible to people of considerable financial sophistication.

The manager expertise risk: funds that have the same investment strategy may achieve different investment results, considering the varied experience and expertise of their managers. Usually, the results of funds managed by less experienced managers are difficult to forecast; therefore, the risk of incurring losses is higher in a case where investment is made in funds run by such managers and in the case of an unstable market situation.

The liquidity risk: when the funds invested in an investment fund are to be recovered, certain difficulties may be faced if the fund is unable to promptly dispose of the financial instruments held in the fund. This is especially relevant for funds investing in shares in developing countries or in non-liquid financial instruments. It should be noted that the value of financial instruments with lower liquidity fluctuates more considerably, and this, in its turn, influences the fluctuation in the value of a unit of the fund. This fluctuation is further enhanced by the realization of a larger number of units of the fund (in this case, the value of the fund drops) or their acquisition (which may promote growth in the value of the fund).

3. RISKS RELATED TO THE PLEDGE OF FINANCIAL INSTRUMENTS AND INVESTMENT OF BORROWED FUNDS

The market risk: when financing investments, or a portion thereof, using funds borrowed from third parties, the risk emerges of losing not only one's own capital which has been directed to the corresponding investments, but also of incurring additional losses with respect to the borrowed funds, or to amounts related to the borrowed funds, e.g. interest on the loan.

Interest: borrowed funds usually require payment of a given interest. Therefore, an investor may lose a portion of the invested funds and/or incur additional losses if the return on investments is lower than the interest to be paid on the loan.

The security value risk: the market value of pledged financial instruments may fluctuate significantly. In the case of a decrease in the value of the pledged financial instruments, the creditor may require an increase of the security by means of monetary contributions or by financial instruments it deems acceptable. In the case of a failure to increase the security within the stipulated time (which may be 1 working day), the creditor may terminate the credit agreement and cover the loan from the funds raised by selling pledged financial instruments/debiting cash. If the funds received from the sale of the financial instruments/debiting cash are not sufficient to cover the loan, interest, and other amounts payable, the investor is obliged to cover the outstanding debt. Considering aforementioned, in the case of a sharp drop in the market value of the financial instruments, the client may lose not only the pledged financial instruments, but also the additional funds. The pledge value risk is especially relevant in a case where non-liquid financial instruments are pledged, since their market price may fluctuate considerably. In economic and market terms, repo transactions are loans with the pledge of financial instruments, while financial instruments purchased from a client are held as a security.

4. DERIVATIVE FINANCIAL INSTRUMENTS

A derivative financial instrument is an agreement traded in the market. A derivative financial instrument and its price is derived (calculated) from a specific underlying asset, which may take the form of shares, bonds, crude oil, gold, or other commodities, as well as financial instruments including interest rates, currency exchange rates, share indices etc. A derivative financial instrument



may be used for offsetting a possible negative change in the price of the underlying asset. It can also be traded in order to seek profit. The precondition for using a derivative financial instrument is formed by certain expectations in respect of the price dynamics of the underlying asset to which the derivative financial instrument is related. Prior to investing in a derivative financial instrument, an investor should have a clear vision of the possibilities of the underlying asset's price dynamics and the objectives to be achieved by the investment, as well as of the risk, and select an appropriate derivative financial instrument or a combination of several instruments on the basis of this vision. The maturity of derivative financial instruments may range from a week to several years. Derivative financial instruments can be traded in the standardized form in regulated markets (foreign stock exchanges) or in the non-standardized form. The types of derivative financial instruments include the following: forward contracts, futures contracts, options, swaps, and contracts for difference (CFD). The market prices of underlying assets (interest rates, currencies, commodities, etc) are influenced by a number of factors, including the current condition of the national and global economy and its growth expectations, the supply and demand of the corresponding underlying assets, the actions of central banks, governmental economic and lending policy, political events, conflicts and so forth. It is difficult to forecast the aforementioned factors, and some of them cannot be forecasted at all.

Forward contract

A forward contract means an agreement whereby the counterparties agree to purchase and sell a specified underlying asset (share, currency, commodity, etc) at a pre-agreed price; with settlement to be made at a future time, however. Under a forward contract, settlement is obligatory. If the underlying asset is delivered, the entire agreed price is paid. If the underlying asset is not delivered, the difference between the agreed and market prices is paid. The seller of a forward contract undertakes to sell the underlying asset at a future time. The seller faces the risk of an increase in the market price of the underlying asset. Upon the maturity date, the seller is obliged to deliver the underlying asset at the agreed price, which would be lower than the market price, or to pay the difference in price if the underlying asset is not delivered. The buyer of a forward contract undertakes to buy the underlying asset at a future time. The buyer faces the risk of a decrease in the market price of the underlying asset. Upon the maturity date, the buyer is obliged to pay the agreed price in full, which would be higher than the market price, or to pay the difference in price if the underlying asset is not delivered.

A forward contract can be an appropriate financial instrument for investors whose future payments will be made in a foreign currency, who will have to pay for commodities and so forth, and seek to fix their incomes and/or expenses in advance, irrespective of the future price of the underlying asset. A forward contract can also be an appropriate instrument for other investors who have their individual expectations in respect of the price dynamics of the underlying asset and seek trading profit. Sellers of a forward contract anticipate that the market price of the underlying asset will decrease in the future, while buyers anticipate an increase in its price.

Futures contract

A futures contract means a contract in a standardized form for the purchase and sale of a specified underlying asset (share, currency, commodity etc) at a pre-agreed price; with settlement to be made at a future time, however. Futures contracts are traded in regulated markets and multilateral trading systems. The intended purpose and risks of futures contracts, in their essence, correspond to the intended purpose and inherent risk of a forward contract.

Option

An option means an agreement whereby the buyer of the option acquires the right to buy or sell the specified underlying asset (share, currency, commodity etc) at a certain price and at a future time. In return for granting this right, the seller of the option collects a payment, the premium, from the buyer. A distinction must be made between options of the European and American types. With a European-style option, the buyer of the option decides, on the final day of the option's validity, whether it is reasonable to exercise the option or not. If the buyer of the option requires that the option should be exercised, the seller of the option must sell (buy) the underlying asset at the pre-agreed price. If it is not reasonable to exercise the option, the right and obligations automatically expire. In the case of an American-style option, the buyer of such an option has the right to make a decision on any day before its expiration. There are two types of option: a CALL (an option to buy something) and a PUT (an option to sell something). The essential risk falls on the seller of an option, since the seller undertakes to exercise the right of the buyer of the option if the latter so requires. The risk for the buyer of an option is limited to the amount of the premium paid.

Options can be an appropriate financial instrument for investors whose future payments will be made in a foreign currency, who will have to pay for commodities and so forth and seek not only to limit the negative risk of price fluctuation, but also to gain additional earnings. An option can also be an appropriate financial instrument for other investors who have their individual expectations in respect of the price dynamics of the underlying asset and seek trading profits. Buyers of a CALL option anticipate that the market price of the underlying asset will increase in future, while sellers of a CALL option anticipate that the market price of the underlying asset will not increase in future to such an extent that it would be reasonable for the buyer of the option to exercise the option. Buyers of a PUT option anticipate that the market price of the underlying asset will decrease in future, while sellers of a PUT option anticipate that the market price of the underlying asset will not decrease in future to such an extent that it would be reasonable for the buyer of the option to exercise the option.

An interest rate CAP transaction means a transaction whereby the buyer of the CAP acquires the right to a payment if the market interest rate (EURIBOR or LIBOR) exceeds the agreed CAP interest rate on the specified dates. The difference between the market interest rate and the CAP interest rate is paid by the seller of the CAP. A CAP transaction can be an appropriate



financial instrument for investors who wish to counterbalance an increase in interest rates and thus to stabilize the expenses of interest on loans.

An interest rate FLOOR transaction means a transaction whereby the buyer of the FLOOR acquires the right to a payment if the market interest rate (EURIBOR or LIBOR) is lower than the agreed FLOOR interest rate on the specified dates. The difference between the market interest rate and the FLOOR interest rate is paid by the seller of the FLOOR. A FLOOR transaction can be an appropriate financial instrument for investors who wish to counterbalance a decrease in interest rates and thus to stabilize interest income on deposits or investments in bonds.

An interest rate COLLAR transaction means a combination of CAP and FLOOR. An investor simultaneously buys a CAP and sells a FLOOR, or vice versa. A COLLAR allows a reduction of the expenses of paying a premium. When a CAP is bought and a FLOOR is sold, a COLLAR can be an appropriate financial instrument for investors who wish to counterbalance an increase in interest rates and thus to stabilize the expenses of interest on loans. In this case, the main risk is related to the fact that the seller of the FLOOR would incur additional losses if market interest rates drop below the FLOOR level.

Swap

A swap means an agreement whereby the counterparties of the transaction agree to a periodical exchange of payments. Either full amounts or the differences in price alone can be paid under transactions.

A currency swap means an agreement whereby currencies are exchanged temporarily. The counterparties to the transaction pay the full agreed amounts at the beginning and at the end. The risk to be incurred is similar to that in the case of a forward contract. An interest rate swap (IRS) means an agreement whereby fixed interest rate payments, to be calculated on the basis of the virtual amount of the transaction, are exchanged for floating interest rate payments, to be calculated on the basis of the same virtual amount. At the time of the transaction, it is agreed which counterparty is to make the periodical fixed payments, calculated in accordance with the virtual amount of the transaction and the fixed interest rate, and which makes the periodical floating payments, calculated in accordance with the virtual amount of the transaction and the floating interest rate. The payer of the fixed interest rate incurs the risk that the overall level of interest rates on the market would decrease and the payer would incur additional interest expenses. The payer of the floating interest rate incurs the risk that the overall level of interest rates on the market would increase and the payer would incur additional interest expenses. An IRS can be an appropriate financial instrument for investors who wish to fix the interest expenses on floating interest rate loans. It can also be an appropriate financial instrument for investors who wish to exchange fixed interest payments on loans or issued bonds for floating interest payments.

A cross-currency swap (CCSW) means an agreement similar to an IRS, whereby payments of interest in different currencies are periodically exchanged. The types of payments to be exchanged include fixed for fixed, floating for floating, and fixed for floating. At the beginning and at the end of the transaction, the main transaction amounts are exchanged. For a CCSW, the same risk as for an IRS is characteristic; however, the counterparties to the transaction may incur the currency risk in addition. A CCSW is appropriate for investors who wish to exchange expenses or incomes from interest in one currency for those in another currency while assuming a possible currency risk.

A commodity swap means an agreement whereby fixed price payments for a commodity, to be calculated on the basis of the virtual amount of the transaction, are exchanged for floating payments for the commodity, to be calculated on the basis of the same virtual amount, or vice versa. Upon the maturity date, one of the counterparties to the transaction pays the difference in price. The payer of the fixed price incurs the risk that the price of the commodity will decrease, and the payer will incur additional expenses. The payer of the floating price incurs the risk that the price of the commodity will increase, and the payer will incur additional expenses. A commodity swap can be an appropriate financial instrument for investors who wish to fix the purchasing or selling price of a commodity for the future.

Contract for difference (CFD)

A CFD means an agreement between two counterparties, i.e. the buyer and the seller, whereby one of the counterparties pays the difference between the current price of the underlying asset and its initial price on the day on which the transaction is concluded. A CFD is a derivative financial instrument, the price of which can be derived from shares, share indices, and prices of commodities or other financial instruments. A CFD is an appropriate alternative for a direct investment in an underlying asset (shares, commodity futures contracts), since the price of a CFD fluctuates in exactly the same manner as the price of the underlying asset. The investor receives the same result (either positive or negative) as an investor in the corresponding financial instruments. However, unlike shares, a CFD does not provide any equity or voting rights in the share issue. In addition to the aforementioned risks, the risks of a CFD correspond to the risks of shares and futures contracts.

Deposits related to financial instruments

Deposits related to financial instruments (for ex., deposits related to currency, commodity prices, their indices or interest rates) – are the deposits, the return and/ or yield (interest) of which depend on the results of respective financial instrument. These two main risks characteristic to deposits related to financial instruments shall be distinguished: i) risks connected to the market changes of the price of financial instrument, which influences the final result of the investment, including the possible losses on the initial invested amount. Risk factors peculiar to financial instruments are described in detail in chapter 4; ii) insolvency risk of the company (bank, credit union), which accepts the deposit related to financial instruments, that is the possibility of not



regaining of the invested funds in case the credited company becomes insolvent (insolvency risk of the credited company is described in detail in chapter 2). Unlike in case of bonds, deposits are insured under the conditions and following the procedure prescribed in the laws. It shall be noted, that the fluctuation of the price of financial instrument influences the result of the deposit related to financial instruments, which may also be negative, that is the investor undertakes the risk of not regaining the invested funds.

5. MARGIN TRADING (LEVERAGED TRADING)

Margin trading or leveraged trading allows an investor to engage in trading in financial instruments without being in possession of the total sum of money. It is sufficient that the investor provide the Bank with a relatively small security, this being no less than the required margin (margin requirement). The security is held on a special margin account, belonging to the investor and pledged to the Bank. The Bank will return the money from the margin account only after having ascertained that the investor's obligations under the concluded margin transactions have been fulfilled. In margin trading, financial instruments shall not be delivered upon maturity, i.e. the corresponding counterparty to the transaction shall collect the difference in price.

Take, for example, trading in the currency market (FOREX). If the margin requirement for a certain currency pair is 1 per cent, an investor willing to buy/sell 100,000 currency units must hold no less than 1,000 currency units on his or her margin account. In this case, the investor can use a leverage of up to 1/100. Margin trading is possible in the currency market, in CFD and futures.

Margin trading is associated both with the possibility of earning enormous profits and suffering significant losses in comparison with capital investments. Margin trading carries a high degree of risk both for buyers and sellers, irrespective of the underlying asset class. If market prices move in a direction opposite to the investor's positions, the investor may not only lose the original investment but also incur a substantial amount of debt.

Margin trading requires a close and regular monitoring of the market and the use of margin. If the value of the deal changes the investor may receive a margin call. The investor's failure to meet the margin call will cause the deal to be cancelled and the incurrence of losses respectively.

6. RISKS RELATED TO TRADING SYSTEMS

Nowadays, all trading systems are computerized to greater or lesser extent, i.e. the placement, registration, and execution of orders, as well as other necessary operations, is carried out electronically. As with other electronic systems, their operation might be temporarily interrupted owing to causes beyond the control of the Bank. The execution of orders might be temporarily interrupted or they might not be executed to the fullest extent, or an investor may fail to receive essential information on a real time basis. Should an investor incur losses due to interruptions of this nature, he or she can expect to recover only a limited amount of the losses, with the precise amount being determined by the Bank, other market intermediaries, or a clearing house.

7. RISKS RELATED TO TRANSACTIONS IN FOREIGN MARKETS

Foreign markets are regulated by the relevant supervisory institutions, the requirements of which may differ from those applicable in Lithuania. Lithuanian supervisory institutions are not competent to apply the same protection for investors who carry out transactions on regulated foreign markets.

8. WARNING REGARDING THE LIKELY RETURN ON SOME OF THE FINANCIAL INSTRUMENTS

Those financial markets which function based on the principle when the profit of some investors is covered by the same loss of other investors (zero-sum game) are not able to ensure capital gain for all participants. The total value of invested capital does not change, but gets regularly distributed among the participants of the market (excluding the commission fees paid to intermediaries). Such are currency, option and futures markets. The likely return in such markets in long perspective is close to zero.