

**Otkritie Finance (Cyprus) Limited**

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**DECLARATION OF RISK RELATING TO FINANCIAL INSTRUMENTS**

The client fully understands:

- that investments are made or other positions taken in financial instruments at the client's own risk
- the need to carefully study the securities company's general business terms and conditions and other relevant information on the financial instrument in question and its properties and risks before trading in financial instruments
- the need to immediately scrutinize contract notes and submit any complaints regarding any errors
- the need to regularly monitor changes in the value of holdings of financial instruments
- the need to react by selling holdings if required in order to reduce the risk of losses on the client's own investments

**THE RISK RELATING TO TRADING IN FINANCIAL INSTRUMENTS****In general regarding risk**

Financial instruments normally provide a return in the form of a dividend (shares and fund units) or interest (interest-bearing instruments). In addition, the price of the instrument may increase or decrease compared to the price when the investment was made. Naturally, the investor is seeking a total return that is positive, i.e. a profit. However, there is also a risk that the total return will be negative, i.e. that the investor will make a loss on the investment. The risk of loss varies between different instruments. Normally, the chance of making a profit on an investment in a financial instrument is linked to the risk of loss. The longer the investor intends to keep the investment, the greater the chance of making a profit or loss. There are various ways of investing in financial instruments in order to reduce the risk. It is normally better from a risk point of view to invest in several different financial instruments rather than a single one or only a few financial instruments.

These instruments should have properties which mean the risk is spread and should not gather risks that may be triggered simultaneously. Trading in foreign financial instruments also involves a currency risk.

Investments in financial instruments are associated with an economic risk. The client is personally responsible for this risk and must therefore become acquainted with the terms and conditions, prospectuses, etc, governing trading in such instruments and with the instruments' individual risks and characteristics. The client must also regularly monitor his/her investments in such instruments. This is the case even if the client has received personal advice in conjunction with the investment.

Information for use in monitoring prices and thus the change in the value of the client's own investments may be obtained from price lists published in the media, e.g. newspapers, the Internet, teletext and, in certain cases, by the investment firm itself. If necessary the client should, in his/her own interests, react swiftly, for example by selling investments that are developing negatively or by providing additional collateral in conjunction with investments financed through loans where the collateral value has fallen.

**Various risk concepts**

There are many different types of risk and other factors that the client should be aware of.

Below are some of the most important types of risk:

**Market risk:** the risk that the entire market, or certain parts of the market, in which the client has invested declines

**Credit risk:** the risk that the issuer or a contracting party will become unable to pay.

**Price volatility risk:** the risk that major fluctuations in the price of a financial instrument will have a negative effect on the investment.

**Price risk:** the risk of the price of financial instrument falling.

**Tax risk:** the risk that tax rules and/or tax rates are unclear or may be changed.

**Currency risk:** the risk that a foreign currency to which the investment is linked falls in value.

**Leverage/gearing effect risk:** the structure of a derivative instrument which means there is a risk that a change in the price of the underlying asset will have a major negative effect on the price of the derivative instrument.

**Legal risk:** the risk that relevant legislation and rules are unclear or may be amended.

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**Company-specific risk:** the risk that a company does worse than expected or that the company is affected by a negative incident so that the financial instruments which are linked to the company may fall in value.

**Industry-specific risk:** the risk that a specific industry does worse than expected or is affected by a negative incident so that the financial instruments which are linked to the companies in the industry in question may fall in value.

**Liquidity risk:** the risk that the client cannot sell or purchase a financial instrument at a certain time when the client wishes to do so because the turnover in the financial instrument is low.

**Interest-rate risk:** the risk that the financial instrument in which the client invests falls in value due to changes in the market interest rate.

### **Risk Means Many Things**

The risk/reward trade-off is the level of risk one assumes in pursuit of a particular return potential. But there are different kinds of risk. Below, we describe five varieties of risk and suggested ways to deal with each.

#### **Credit Risk**

In the case of bonds, it's likely that the issuer may not be able to meet interest or principal payments when they come due. If this bond is part of a bond fund, it can affect the fund's overall market value. Higher-quality bonds issued by companies with strong financial positions usually pose less credit risk than those issued by companies on less solid footing. For stocks, credit risk is the possibility that the company issuing the stock may have financial problems that could cause it to cut or suspend its dividend payments. This, in turn, often causes the company's stock price to drop.

Option: Consider emphasizing investments in financially sound companies

#### **Market Risk**

This risk arises where the whole markets can decline. An investor can buy the stock of a company whose earnings and financial position are good, only to have its market price drop because overall market sentiment has turned negative. The stock or bond markets as a whole can be influenced by an unexpectedly bad economic report or non-economic developments. And, of course, if the market enters an extended period of declining prices—a bear market—all investments within that market are likely to be affected.

Option: Consider diversifying among a variety of asset classes, including stocks, bonds, and cash equivalents.

#### **Business or Event Risk**

A common hazard in investing is business or event risk, which simply means that unforeseen circumstances may adversely affect the value of your investment. This risk can be either company-specific or industry wide. For example, a firm's profits may be hurt by a lawsuit, a change in management, or a product failure. Or new government regulations (i.e., for drug companies) may cause the price of stocks in a particular industry to drop. In this case, the damage is confined to one industry or one company.

Option: Consider investments that offer diversification across an array of industries.

#### **Interest Rate Risk**

Changing interest rates can have a major effect on fixed-income (bond or bond fund) investments. Bond prices typically fall when interest rates rise, and they increase as rates decline. Rising interest rates depress the value of existing bonds because investors can buy new bonds paying higher prevailing yields. On the other hand, if rates fall, potential buyers will be willing to pay a premium for an older, higher-yielding bond. Either scenario will affect the current value of your investment. Generally speaking, the longer the bond's maturity, the greater its sensitivity to changing interest rates. Rising interest rates can also make stocks less attractive, though any correlation between interest rate changes and stock prices is less clear. A stock's dividend yield may be less appealing, and a company may face higher borrowing costs if money is needed to develop new products or expand operations.

Option: Consider a diversified bond fund holding fixed-income securities of various maturities.

#### **Purchasing Power Risk (inflation)**

In nearly every year, inflation causes a dollar to purchase less than it did the year before. That's because the cost of goods and services tends to rise year to year. The uncertainty over what your dollar will be able to buy in the future is often referred to as purchasing power risk. Even when inflation is relatively low, as

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it has been over the past few years, its cumulative effect over the long term is significant. An inflation rate of just 4% a year will cause your purchasing power to be cut in half in about 18 years.

Option: Consider selecting investments appropriate to your risk tolerance and time horizon that have provided returns that historically have outpaced the long-term rate of inflation.

Stock and bond funds, by their very nature, are diversified, and fund managers invest in securities that they believe will provide good returns at a reasonable risk given the fund's objective. You can also invest in different asset classes and choose investments that can preserve your purchasing power.

### **Liquidity risk**

many forms of investment may not be readily salable on the open market (e.g. commercial property) or the market has a small capacity and may therefore take time to sell. Assets that are easily sold are termed liquid therefore this type of risk is termed

### **Interest Rate Risk**

The risk that an investment's value will change due to a change in the absolute level of interest rates, in the spread between two rates, in the shape of the yield curve or in any other interest rate relationship. Such changes usually affect securities inversely and can be reduced by diversifying (investing in fixed-income securities with different durations) or hedging (e.g. through an interest rate swap).

Interest rate risk affects the value of bonds more directly than stocks, and it is a major risk to all bondholders. As interest rates rise, bond prices fall and vice versa. The rationale is that as interest rates increase, the opportunity cost of holding a bond decreases since investors are able to realize greater yields by switching to other investments that reflect the higher interest rate. For example, a 5% bond is worth more if interest rates decrease since the bondholder receives a fixed rate of return relative to the market, which is offering a lower rate of return as a result of the decrease in rates.

## **SHARES AND SHARE-RELATED INSTRUMENTS**

### **In general regarding shares**

#### **Shares and limited companies**

Shares in limited companies entitle their owner to a proportion of the company's share capital. If the company makes a profit, the company usually distributes dividends on these shares. Shares also entitle the holders to voting rights at the company's general meeting, which is the highest-ranking decision-making body in the company. Normally, the more shares the holder owns, the greater the shareholder's proportion of the capital, dividends and votes is.

### **The share price**

The price of a share is affected to a great extent by the company's prospects. A share price may rise or fall depending on investor analyses and assessments of the company's opportunities to make future profits. Future external developments in the economy, technology, legislation, competition, etc, determine the demand for the company's products or services and, consequently, are also of fundamental importance to developments in the price of the company's shares.

The general interest rate level (the market interest rate) also plays an essential role in the pricing. If the market interest rate increases, interest-bearing financial instruments that are issued at the same time may provide a better return. In such cases, the prices of listed shares normally fall, as will those of already traded interest-bearing instruments with a lower interest rate. The reason for this is that the increasing returns on newly issued interest-bearing instruments may be better, relatively speaking, than the return on shares or on already traded interest-bearing instruments. In addition, share prices are negatively affected by the fact that interest payments on the company's debts increase, since this reduces the company's chances of making profits in the future.

Other factors directly related to the company, such as changes in the company's management and organisation, disruptions to production, etc, may affect the company's future ability to create profits, both in the long- and short-term. In the worst case, a company may perform so poorly that it must be declared bankrupt. The share capital, i.e. the capital invested by the shareholders, is that which is repaid last from the estate in bankruptcy. The company's other debts must first be repaid in their entirety. This often results in there being no assets left in the company after its debts have been paid, so that the shares in the company are worthless.

Players in the finance market often have different opinions on how share prices will develop. These factors, which also include how the company will be valued, contribute to there being both buyers and sellers. If the investors share the same opinion regarding price trends, they will either buy, thereby creating buying pressure from many buyers, or sell, thereby creating selling pressure from many sellers. Prices increase in the event of buying pressure and fall in the event of selling pressure.

The turnover, i.e. the quantity of a certain share that is bought or sold, affects the share price. In the event of a high turnover, the difference, also called the spread, between the prices the buyers are prepared to

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pay (bid price) and the price requested by the sellers (ask price) is reduced. A share with a high turnover, where large amounts can be traded without any major effect on the price, enjoys good liquidity and is thus easy to buy or sell.

The framework conditions for industry, both national and international, may also affect share prices. Changes in tax and duty levels nationally and in other countries affect the companies' cost levels and thus their competitive situation. International agreements between countries regarding customs charges and duties on the import and export of goods and services affect the competition situation that exists between companies and thus also share prices. Major events such as disasters, terrorist acts and wars may have major effects on share prices on stock exchanges worldwide.

### **Share trading – including trading systems**

Only shares issued by public limited companies may be listed on a regulated market. In addition, there are requirements regarding the company's size, the company's operations history, spread of owners and publication of the company's finances and other business.

Trading in shares that are not listed on a regulated market takes place in the so-called OTC market. In this market, trading takes place to a large extent based on information on prices and interests that the stock broking firms state to each other.

The OTC list is divided into an A list and a B list. Only companies that are registered on the A list must pass price-relevant information of significant importance on to the market. If a share is not listed on either a regulated market or a trading support system, trading will normally take place by the stock broking firm trying to assist the client by contacting potential clients who may be interested in becoming a contracting party. Investments in this type of share entail a considerable liquidity risk.

Trading in a regulated market or other trading systems comprises the secondary market for shares, primary capital certificates and bonds that a company has already issued.

In addition, the OTC list functions as a secondary market for shares. If the secondary market functions well, ie, it is easy to find buyers and sellers and offer prices from buyers and sellers and the final prices of completed trades are noted continuously, companies benefit from the fact that it is easier to issue new shares and thus raise more capital for the company's activities.

The primary market is the market where newly issued shares, primary capital certificates and bonds are traded in/subscribed for.

Shares registered in a regulated market or other trading system are normally divided into various lists depending on the company's market value or liquidity. These lists are often published on the trading system's home page, in newspapers and via other media. Different shares may demonstrate various levels of stability in their prices (volatility) during the day or over longer periods, ie, the frequency and size by which the prices change. Shares on lists with high liquidity are normally regarded as entailing a lower risk than shares on lists with lower liquidity.

### **Various classes of shares**

There are various classes of shares, commonly A and B shares, which normally refer to voting rights. Class A shares normally entitle the holder to one vote, while class B shares normally entitle the holder to a restricted voting right or no voting rights at all. The differences in voting rights may, for example, be due to the fact that, in conjunction with a diversification of ownership, the original founders and the owners of the company have wanted to maintain their influence over the company by holding stronger voting rights.

### **Nominal value, splits and reverse share splits**

A share's nominal value is the amount of the company's share capital represented by each share. The sum of all the shares in a company multiplied by the nominal value of each share constitutes the company's share capital. Occasionally, companies wish to change the nominal value, for example because the market price of the share has risen significantly. By dividing the share into two or several shares, a so-called split, the nominal value is reduced at the same time as the price of the shares is reduced. However, after a split the shareholder's capital remains unchanged but is divided into a greater number of shares, each of which has a lower nominal value and a lower price.

Conversely, a reverse share split may be carried out if, for example, the share price has fallen dramatically. In such case, two or more shares are merged to form one share. Following a reverse share split, the shareholder's capital remains unchanged but is divided into fewer shares, each of which has a higher nominal value and a higher price.

### **Stock exchange introduction, privatization and acquisitions**

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A stock exchange introduction means that shares in a limited company are listed in a regulated market (including a stock exchange). The general public may then be invited to subscribe for (buy) shares in the company. This usually involves an existing company that has not previously been listed on a stock exchange, whose owners have decided to increase the number of shareholders and facilitate trading in the company's shares. If a state-owned company is introduced on the stock exchange, this is called privatization or part-privatization, depending on the size of the stake in the company that the state is offering to sell to the general public. An acquisition normally involves an investor or investors inviting the shareholders of a company to sell their shares on certain terms. If the buyer obtains 90% or more of the share capital and votes in the company, the buyer can petition for the compulsory purchase of the remaining shares from those shareholders who have not accepted the acquisition offer.

### **Share issues**

If a company wishes to expand its operations, additional capital is often required. The company raises this by issuing new shares through a share issue. The existing shareholders usually receive subscription rights giving them a pre-emptive right to subscribe for shares in the new issue. The number of shares that may be subscribed for is established in relation to the number of shares previously held by the shareholder. The subscriber must pay a price (issue price) for the newly issued shares that are often lower than the market price. Immediately after the subscription rights - which normally have a certain market value - are detached from the shares, the price of the shares normally declines. Shareholders that have subscription rights but do not subscribe for shares may sell their subscription rights in the marketplace where the shares are listed during the subscription period (which often lasts for a few weeks). Upon the expiry of the subscription period, the subscription rights lapse and thus become useless and worthless.

If the share premium account in a limited company has greatly increased in value, the company can transfer part of the value to its shareholders through what is commonly referred to as a bonus issue. In a bonus issue, consideration is given to the number of shares already held by each shareholder. The number of new shares offered to the shareholders through the bonus issue is established in proportion to the number of shares the shareholder already holds. However the shareholder's proportion of the company's share capital remains unchanged.

A limited company can also carry out a so-called private placement, which is carried out as a share issue but is directed solely at a limited group of investors. In a private placement, the existing shareholders' proportion of the shares and share capital in the company is diluted, but the number of owned shares is not affected and the market value of the invested capital is also not normally affected.

### **In general regarding share-related instruments**

Some instruments such as convertible bonds/debentures, share-index bonds/index bonds, warrants, share options, share-index options and depository receipts are closely connected to shares. These instruments are normally traded in a regulated market (including a stock exchange) but are also traded in the OTC market.

### **Convertible bonds/debentures**

Convertible bonds/debentures are interest-bearing securities which may be exchanged for shares within a certain period of time. The return on the convertible bonds/debentures, ie, the coupon interest, is normally higher than the dividend on the shares to be received in exchange. The price of convertible bonds/debentures normally follows the share price and is expressed as a percentage of the nominal value of the convertible bond/debenture.

### **Share-index bonds/index bonds**

Share-index bonds/index bonds are bonds whose yield normally depends on how a share index develops. If the index develops positively, so does the return. In the event of a decline in the index, there may be no return. However, the nominal value of the bond is always repaid on the maturity date so the risk of loss is limited compared to shares and fund units. Apart from any share premium, the risk of investing in a share-index bond may be defined as the alternative interest income, ie, the interest the investment could have achieved if the amount had been invested differently.

### **Warrants**

Certain call (purchase) and put (sales) options with a longer term to maturity than the standardized call options, normally called warrants, are also traded. Warrants may be used to buy underlying shares or to provide cash settlement if a gain has been achieved as a result of the price of the underlying share being higher than the agreed future purchase price/selling price.

### **Share options and share-index options**

There are various types of share options. Acquired (bought) purchase options (call options) entitle the owner to purchase already issued shares at a predetermined price within a specific period of time.

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Acquired (bought) sales options (put options) entitle the holder to sell shares at a predetermined price within a specific period of time. There is an issued/written (sold) option corresponding to each acquired option. The risk borne by the party that acquires an option is that the option will decline in value or become worthless by the expiry date. Unless special precautionary measures are taken, the issuer (writer) of an option runs a risk which may be unlimited in scope. Index options produce a gain or loss linked to the development of the underlying index. The price of options (premium/price) normally follows the developments in the price of the corresponding underlying shares or index.

### **Depository receipts**

Depository receipts are proof that shares are stored by a depository and give the owner the same rights as if he/she owned the actual share. Depository receipts are traded as shares and their prices normally follow the price trends in the foreign regulated market where the share is traded.

### **INTEREST-BEARING FINANCIAL INSTRUMENTS (BONDS)**

An interest-bearing financial instrument is a right to claim against the issuer of a loan. The return is normally provided in the form of interest (coupon). There are various types of interest-bearing instruments depending on the issuer of the instrument, the security provided for the loan by the issuer, the term until the maturity date, and how interest is paid. The interest (coupon) is normally paid as a fixed or floating rate. For fixed-interest loans, the interest is normally stipulated (fixed) for one year at a time. For floating-interest loans, the interest is normally stipulated (fixed) four times a year for three months. On certain types of loans, no interest is payable and only the nominal amount is repaid on the loan's maturity date (zero coupons). The purchase of zero coupon bonds takes place at a considerable discount, which means that the effective interest rate is the same as for bonds on which a regular coupon interest is paid.

The risk associated with an interest-bearing instrument consists in part of the price changes that may occur during the term of the instrument due to changes in market interest rates, and in part that the issuer may be unable to repay the loan. Loans for which satisfactory security has been provided for repayment are thus less risky than loans without security. However, in purely general terms, it can be stated that the risk of loss associated with interest-bearing instruments may be deemed lower than it is for shares.

Market interest rates are established every day both for instruments with short terms until maturity (less than one year), eg, certificates, and for instruments with longer terms until maturity, such as bonds. This takes place in the money market and bond market. If the market interest rate increases, the price of already issued interest-bearing financial instruments will fall if they provide a fixed interest rate. This is because new bonds are issued bearing rates of interest that follow the current market rate of interest and thereby provide a higher rate of interest than the already issued instruments. Conversely, the price of already issued instruments increases when the market interest rate declines. Bonds issued by the State, county council and municipalities (or guaranteed by such bodies) are deemed to be more or less risk-free with respect to redemption at the predetermined value on the due date.

### **Trading in interest-bearing financial instruments (bonds)**

A number of bonds are listed on a stock exchange, so trading in these financial instruments, like trading in listed shares, takes place in a regulated market. Trading in bonds normally takes place in a different way to trading in shares. In practice, the interest and currency market is regarded as a quoting or price-driven market, unlike the stock market which is an order-driven market. In the case of trading in standardized options, bonds and currency/interest derivatives, the investment firm normally stipulates prices as a market maker and publishes purchase and sales prices based on its own assessments of the market conditions.

### **DERIVATIVE INSTRUMENTS**

Derivative instruments, such as options, forward/futures etc, are issued with various types of underlying assets, such as shares, bonds, commodities and currencies. Derivative instruments may be utilized in order to reduce the risks associated with an investment.

One special risk that investors must be aware of when investing in derivative instruments is that the instrument is put together in a way which means that changes in the price of the underlying asset affect the price of the derivative instrument, the so-called "leverage (gearing) effect". The price effect is often stronger in relation to the amount invested than the change in the value of the underlying asset. The price effect is therefore referred to as the leverage/gearing effect and can lead to a larger profit on the invested capital than if the investment had been made directly in the underlying asset. On the other hand, the leverage/gearing effect may result in a greater loss on the derivative instrument compared to the change in the value of the underlying asset if the price of the underlying asset does not develop as expected. The leverage/gearing effect, ie, the chance of making a profit or risk of suffering a loss, varies depending on the derivative instrument's structure and scope. Monitoring developments in the prices of the derivative

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and underlying asset is therefore of the utmost importance. The client should, in his/her own interests, be prepared to act swiftly, often that same day, should the derivative instrument start developing in an unfavorable direction.

## **MUTUAL FUNDS**

A fund is a "portfolio" of different financial instruments, such as shares and/or bonds. The fund is owned jointly by all those who save in the fund, the unit holders, and is managed by a management company. There are various types of mutual funds with different investment strategies and risk profiles.

Below is a brief description of the most common types of funds

An equity fund invests all or most of the capital paid in by the unit holders in shares.

Combination fund: a mutual fund that is not defined as a pure unit trust/equity fund or interest fund. A combination fund may have a more or less permanent preponderance of shares or interest-bearing securities, but the proportion of various securities may also change during the fund's lifetime.

Interest funds: a mutual fund that is to invest in securities other than shares. These funds are divided into bond funds and money market funds.

Index funds: a mutual fund that is managed relatively passively in relation to the fund's benchmark index.

A fund-in-fund is a fund which invests in other funds; A fund-in-fund can be seen as an alternative to investing in several different funds yourself. Therefore, you may obtain the spreading of risk which a well-considered personal fund portfolio could have. There are fund-in-fund with various investment focuses and risks levels.

Hedge funds (specialist funds): there is no exact definition of the concept of a hedge fund, and individual hedge funds may vary greatly as regards investment choices and risk profiles. A hedge fund normally takes much more risks than a normal mutual fund and is therefore a product for professional investors that are willing to accept a large amount of risk. The fund can usually raise loans and is normally quite free to use various derivatives. A hedge fund can also trade "short" in securities, which means that the fund sells borrowed securities and then buys the borrowed securities at a later date. When they invest in a fund, unit holders receive the number of units in the fund that equals their invested capital's percentage of the fund's total assets under management.

Funds can also be divided into UCITS (Undertakings for Collective Investments In Transferable Securities) and special funds. UCITS are funds which meet the so-called UCITS Directive's requirements (EU directive), mainly in relation to the investment rules and spreading of risk. Special funds (for example, so called hedge funds) are funds which in some manner deviate from the rules in the UCITS Directive and it is therefore particularly important for you as a client to find out which investment rules that apply for a special fund in which you intend to invest. This will be stated in the fund's prospectus and fact sheet.

The units may be bought from and redeemed (sold) to the management company. The units' actual value is calculated daily by the management company and is based on developments in the prices of the financial instruments in which the fund has invested. There are also fund units that can be traded in a regulated market (Exchange Traded Funds ("ETF")). One of the purposes of a unit trust/equity fund is to invest in several different shares and other financial instruments. This means that the risk run by the unit holders is less than the risk run by shareholders who only invest in one share or a few shares. Unit holders do not have to select, buy, sell or monitor the shares or carry out other management work related to this.

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