Baltic International Bank

DESCRIPTION OF FINANCIAL INSTRUMENTS AND INHERENT RISKS

Investments in financial instruments come with exposure to risks as described further herein. In the event of materialisation of the risks, Client may suffer economic loss (including the loss of principal amount originally invested) and /or fail to achieve his/her investment objectives. In individual cases, the loss may substantially exceed the amount originally invested. Client undertakes to pay serious attention to all risks associated with financial instruments and to independently reconcile investment goals with risk tolerance. Client is aware that the risk references are not exhaustive and that engaging in financial transactions can carry also other risks. Client is aware that he/she assumes all risks associated with financial instruments and transactions in financial instruments, and Bank shall not be liable to Client for any loss incurred by Client in the event of materialisation of the above risks.

1. Investment risks

Risks		Description of risks
Credit risk	**Issuer risk**	The risk of loss stemming from the inability or refusal (for certain reasons) of the issuer of the financial instruments to meet its obligations owed to the holder of financial instruments (investor), which may accordingly affect the price of the issuer's financial instruments or hinder the holder's (investor's) ability to receive payments owed and payable to the holder (investor) according to the terms & conditions applicable to the particular financial instrument within timeframes specified in the terms & conditions**.**
	Downgrade risk	Probability of loss arising from a fall in a debt financial instrument's rating and hence a decline in its value as a result of the deterioration of the issuer's credit quality (a measurement of the issuer's ability to pay interest on the financial instrument in a timely manner).
	Credit spread risk	Probability of loss arising from a widening credit spread (credit spread is the yield spread, or difference in yield between the respective financial instrument and a zero-risk/ risk-free financial instrument of similar maturity due to different credit quality (when credit spread gets wider as a result of the deterioration of the issuer's credit quality)); a widening credit spread affects the value of the financial instrument.
Market price risk		The risk of loss arising from adverse changes in the market prices (price volatility) for financial instrument or its underlying asset, which in turn can negatively impact the holder's (investor's) expected rate of return and can cause other losses.
Liquidity risk		The risk of loss arising from the potential necessity to sell financial instruments while applying a discount to their market value whenever the financial instruments need to be sold within the shortest possible time and in special circumstances such as a limited market demand for a certain financial instrument, or loss stemming from the impossibility of selling or buying at the desired specific point in time because of lack of demand of supply in the market.
Interest rate risk		The risk of loss that may be suffered by an investor due to adverse fluctuations in market interest rates, which n turn can adversely affect the value of the financial instruments. Interest-rate changes may cause (1) a decline in the present value of cash flows (expected to be received by customer); (2) a growth in the present value of the customer's future obligations; (3) the use by the counterparty or the issuer of an option in a manner causing loss to the investor.
Currency risk (foreign exchange risk)		The risk of loss stemming from fluctuation of exchange rates (exchange rate movements), which in turn may cause a decline in the value of financial instruments in the investor-stated base currency, an increase in the value of the investor's obligations in the investor-stated base currency, reduce returns anticipated or cause other losses to the holder of the financial instruments (investor).

Systems-related risk	In the event of materialisation of the risk, Client may suffer losses as a result of malfunction in information systems, electronic systems or remote customer service systems or as a result of unauthorised third-party access to any of the systems (by using the investor's personally identifiable information, i.e. identity theft) or as a result of other external circumstances.
Early redemption risk (callability risk)	The risk that investor's financial instrument will be redeemed before maturity (prematurely), i.e. the issuer (counterparty) discharges its obligations prior to maturity (the date/dates originally specified or that the counterparty requests that the holder of the financial instrument / investor discharges his obligations prior to maturity.
Stop-out risk	The risk that Client's open positions will be closed out without first receiving Client's respective order and also without notifying Client thereof in cases envisaged by the agreement or international market practices as described in the terms & conditions applicable to the respective financial instruments.
Leverage (margin trading) risk)	To transact deals, investors use financial leverage to increase revenue. Margin trading (buying or selling financial instruments on a leveraged basis) involves borrowing additional funds. Thus, the amount of Client's obligations substantially exceeds Client-provided margin, and the amount of Client's loss can significantly exceed the amount invested as a result of adverse changes in the financial markets (financial market fluctuations) and, hence, lead the investor into debt.
Country risk	The risk of exposure to losses caused by adverse events in a particular country or the respective region, which has a direct or indirect impact on the performance of issuers operating in the country or the region and, accordingly, on the value of the financial instruments issued in the country and/or on the profits paid to the holder of the financial instruments (investor).
Regulatory/Legislative risk, including tax risk	The risk of exposure to losses because of the unexpected application of a new or amended law or regulation (legislative changes). The risk that a change in laws and regulations will cause losses to the investor, additional expenses, tax burden or will reduce the yield on an investment.
Counterparty risk, also known as 'default risk'	The risk of exposure to loss if the counterparty (a legal person of the Republic of Latvia or of any other foreign country who, pursuant to the applicable laws of the respective jurisdiction wherein it operates, is authorised to provide investment services /core services and ancillary /non-core services or to account for and to record financial instruments, to ensure transactions in financial instruments and cash settlement of the transactions, and with whom Bank needs to partner or whose services needs to use so as to execute client orders for transactions in financial instruments or to hold in custody / to safe-keep clients' financial instruments) will, for certain reasons, not be able or will refuse to discharge its respective obligations owed to Bank in favour of the holder of the financial instruments (investor) and/or the holder of the financial instruments (investor).
Risk of OTC trading	The risk of exposure to losses because over-the-counter (OTC) or off-exchange trading is done directly between two parties and is not subject to mandatory supervision or regulation. Therefore, OTC transactions can be unexpectedly stopped, be conducted on a non-regular basis, or otherwise be hampered. Also, it can be difficult or impossible to determine price for the particular financial instrument, to close out an open position or to set the procedure to identify risks associated with the transactions.
Model risk	Model risk is the risk of loss resulting from using pricing models (used by an investor or in the investor's interests) to estimate the fair value of a financial instrument since the models may turn out to be incomplete, inaccurate or erroneous and therefore there may be inconsistency (discrepancy) between the assessed fundamental value and the fair value of the financial instrument (the assessment may prove to be wrong).
Litigation risk	Litigation risk is the likelihood of loss resulting from legal action initiated by a third party over customer's investment activities and/or activities of the issuers of financial instruments, intermediaries (agents) involved into the investment activities, or other persons directly or indirectly associated with customer's investment activities.

Other risks	An investment services provider's activity can be exposed to a multitude of other various risks which cannot be reasonably foreseen and guarded against. The investment risks described herein are not purported to be exhaustive. Investment services receivers (investors) should take into account other potential risk factors associated with investing in financial instruments.)

2. Description of financial instruments and the list of inherent risks

2.1 Debt financial instruments

Debt financial instruments are financial instruments which, according to the issue terms & conditions, imply (envisage) that the issuer raises funds (obtains a loan) from the buyer of the bonds at the time of issuing the instrument, and subsequent payment of a certain cash flow to the buyers/holders of the bonds according to a predetermined schedule; the cash flow can be fixed (fixed-income bonds), can be linked to a certain market indicator (such as the expected level interbank interest rates / indices, or can depend on the optionality embedded in the instrument and specified in the terms & conditions applicable to the instrument. Normally, a cash flow payable to the investor includes the redemption amount, i.e. the principal amount (the amount initially borrowed) of a debt financial instrument must be redeemed (repaid) on a fixed date (maturity date). However, in certain cases the repayment of the principal amount of a convertible bond and perpetual bond on a fixed date is not specified (no stated maturity). Debt financial instruments can be secured by certain assets owned by the issuer or can be unsecured; also, they can be subordinated to other obligations owed by the issuer.

Brief characteristics	Inherent risks
Bonds	
2.1. Debt financial instruments	credit risk market price risk liquidity risk interest rate risk early redemption risk currency risk systems-related risk country risk regulatory/legislative risk, including tax risk counterparty risk risk of OTC trading litigation risk model risk other risks.
2.1.1. Fixed-income bond redeemable in full on maturity (plain vanilla bond) is a debt security which serves as a legally enforceable evidence of a debt and the issuer's obligation to pay to the bondholder on a fixed date/dates a fixed rate of interest of the bond's face value (called coupon rate, coupon yield) and redeem the bond (to pay out the face value of the bond) at the end of the bond's life. **2.1.2. The terms & conditions of different types of bonds may vary. The possible characteristics are listed below in this paragraph**	
Debt financial instruments (bonds) can be broadly classified as follows:	
By coupon types • with fixed rate • with floating rate	
By issuer types • Sovereign • Corporate • Supranational	
By methods of paying coupons • Periodical • With coupon paid on maturity • Zero-coupon (discount)	
By methods of repaying the principal amount • Periodical payment of portions of the principal amount • Repayment of the principal amount on maturity (bullet)	

By the priority of claims • Secured by assets (collateralised) • Unsecured (non-collateralised) • Subordinated	
By maturity • Short-term (up to 1 year; include commercial paper, treasury bills, treasury promissory notes and others) • Mid-term (1 to5 years) • Long-term (more than 5 years) • Perpetual (with no maturity date)	
By being listed on public trading venues • listed (listed on a stock exchange) • non-listed (private placement)	
By availability of optionality • Without optionality • With a put option (puttable); allows the holder to redeem the bond before maturity; • With a call option (callable); allows the issuer to redeem the bonds before maturity; • Convertible bonds that can be converted into a predetermined amount of the company's equity	
By the ability to provide inflation hedge • Ordinary • Inflation-protected securities (IPS); (the bond's principal amount and coupon payments are indexed according to a certain price index)	
There are also other criteria whereby debt instruments can be classified into categories.	

2.2. Equity financial instruments

Equity financial instruments are financial instruments that represent the evidence of the right of ownership in an undertaking (issuer). The instruments do not imply (stipulate) their mandatory redemption on a fixed date; also, they do not stipulate the payment of a predetermined cash flow to the holder (except for preferred stocks), but give the holder the right to share the undertaking's profits through dividends.

Brief characteristics	Inherent risks
Equity Securities (Shares)	
2.2.1. *Equities* or shares of stock are securities representing a shareholder's rights in a company and participation in the capital of a stock company. They grant the owner the right to receive a share of the stock company's profit (dividend) or liquidation quotas if the stock company is liquidated.	credit risk (issuer risk) market price risk liquidity risk currency risk systems-related risk country risk regulatory/legislative risk, including tax risk counterparty risk (default risk) risk of OTC trading litigation risk model risk other risks.

2.3. Derivative financial instruments

Financial instruments (or contracts), whose value changes in response to a change in the price of the underlying instrument, are known as derivative financial instruments, or derivatives. Common underlying instruments comprise currency pairs, stock market indices, bonds, interest rates, physical commodities (incl. precious metals) and other financial and physical assets. Transactions in derivatives can be concluded through a stock exchange or directly between the counterparties (OTC). To transact in derivative financial instruments, a margin (collateral, cash deposit) is required to be provided to Bank, stock exchange, counterparty. Client is obligated to timely replenish the margin account to bring it up to the required level if the prices or trading rules change. Derivative contracts can require physical delivery of the underlying instrument; sometimes they do not imply physical delivery. Risks inherent in the respective underlying instrument can affect the price of the derivative financial instrument. There are many different types of derivative financial instruments, including:

Brief characteristics	Inherent
Derivative financial	
2.3.1. Futures contract is an exchange-traded contract that gives the buyer or the seller a legally binding obligation to buy or deliver a specific quantity of a certain underlying instrument at a certain date in the future (the delivery date or final settlement date) at a pre-set price (the futures price). When you buy or sell a standardised futures contract, you don't pay the entire value of the contract at the time of sealing the deal.	liquidity risk currency risk systems-related risk market price risk credit risk (issuer risk) leverage (margin trading) risk stop-out risk country risk regulatory/legislative risk, including tax risk litigation risk model risk counterparty risk (default risk) risk of OTC trading other risks.
2.3.2. Forward contract is a non-standardised non-exchange (over-the-counter) traded contract between two parties. A forward contract is a legally binding non- standardised contract which obligates one party to buy and the counterparty to sell a specific quantity of a certain underlying instrument at a certain place at a fixed time in the future for a certain price, or to discharge an alternative financial obligation.	risk of OTC trading credit risk (issuer risk) liquidity risk currency risk market price risk systems-related risk leverage (margin trading) risk stop-out risk country risk regulatory/legislative risk, including tax risk litigation risk model risk counterparty risk (default risk) other risks.
2.3.3. Option contracts are contracts that give the buyer the right - but not the obligation - to buy or sell a fixed amount of the underlying instrument at a certain future date or in a certain time period for a fixed price. The writer (seller) of the option has the obligation to honour the specified feature of the contract. Option buyers pay option sellers a fee (the premium) for the rights conveyed by the option contract.	market price risk stop-out risk liquidity risk currency risk systems-related risk leverage (margin trading) risk country risk regulatory/legislative risk, including tax risk litigation risk model risk counterparty risk (default risk) risk of OTC trading credit risk other risks.

2.3.4. Swap transaction is an arrangement between Bank and Client in which the buyer/seller of currency, financial instruments or other assets assumes the respective obligation to sell/buy (i.e. the obligation to undertake the opposite set of transactions on the maturity date) the said currency, financial instruments or assets for a pre-agreed fixed price.	market price risk stop-out risk liquidity risk currency risk systems-related risk leverage (margin trading) risk country risk regulatory/legislative risk, including tax risk litigation risk model risk counterparty risk (default risk) risk of OTC trading interest rate risk credit risk (issuer risk) other risks.

2.4. Instruments that allow using leverage

Leverage means a loan (directly or indirectly received from a provider of brokerage services) secured by financial instruments, either being purchased or already existing. As a rule, leverage is used for the purpose of buying financial instruments. In certain cases, a margin (collateral, cash deposit) is required to be provided to the creditor to hedge against the change in the market price of the financial instruments purchased. Allows receive exposition in respect of the instrument in the amount that significantly exceeds the amount originally invested. Also, that significantly increases the risk of loss if the instrument's value changes adversely (the amount of the loss may exceed the amount of money originally invested).

2.4.1. Contract for difference (CFD) is an agreement between two counterparties (speculating on the movement of an asset price) to exchange the difference in value of a contract (based on a particular financial instrument) at the time the contract is opened and the time it is closed).	market price risk stop-out risk liquidity risk currency risk systems-related risk leverage (margin trading) risk country risk regulatory/legislative risk, including tax risk litigation risk model risk counterparty risk (default risk) risk of OTC trading other risks.
2.4.2. Repo transaction is the transaction whereby Client, at a specified date, at a specified price and for a specified amount of money, sells to Bank a specific quantity of certain financial instruments for a certain period of time and on certain terms and conditions, and simultaneously commits to repurchase the financial instruments from Bank at a certain date in the future, at a specified price and for a pre-agreed amount of money.	market price risk stop-out risk liquidity risk currency risk systems-related risk leverage (margin trading) risk early redemption risk country risk regulatory/legislative risk, including tax risk litigation risk model risk counterparty risk (default risk) risk of OTC trading interest rate risk credit risk other risks.

2.4.3. FX Margin Transaction means foreign exchange transaction concluded by Client for the purpose of profiting from fluctuating exchange rates, by providing (margin) and making settlements only in respect of the amount of profit or amount of loss, which is calculated on an offsetting (also known as netting) basis and which arises after closing Client's open position by concluding an opposite transaction to the previously concluded transaction (offset deal).	market price risk stop-out risk liquidity risk currency risk systems-related risk leverage (margin trading) risk country risk regulatory/legislative risk, including tax risk litigation risk model risk counterparty risk (default risk) risk of OTC trading interest rate risk other risks.

2.5. Products of UCITS (undertakings for the collective investment)

Brief characteristics	Inherent risks
Certificates of investment funds and Exchange Traded Funds (ETF)	
2.5.1. Investment certificate (participation unit) of open investment fund is a financial instrument /an investment product. It represents an investor's share in an investment fund (a term generally interchangeable with "mutual fund"). If fact, investment funds are collective investment vehicles that invest in the pooled funds (funds from multiple individual investors that are aggregated for the purposes of investment) for a fee. Each investor owns a pro-rata share of the fund's investments and shares in the returns from the fund's portfolio. Investors deposit funds in exchange for investment certificates (participation units) issued by investment funds. Investments funds are typically externally managed by a professional management company which aggregates the funds to buy stocks, bonds or other financial instruments. Investors of the investment funds benefit from professional investment management, diversification opportunities, availability of various market segments, and liquidity.	credit risk (issuer risk) market price risk liquidity risk currency risk systems-related risk country risk regulatory/legislative risk, including tax risk litigation risk model risk counterparty risk (default risk) other risks.

2.5.2. Shares of closed-end funds (CEF), also called publicly traded funds (a collective investment scheme). Distinguishing features of closed-end funds may vary by jurisdiction. Most often closed-end funds differ from typical mutual funds. Generally, closed-end fund shares are not redeemable: in other words, a closed-fund's managing company is prohibited from buying back its shares (or units) from investors and /or a closed-end fund typically issues shares to the public only once -- at the fund's initial public offering, or IPO. A closed-end fund issues a limited (fixed) number of shares. These vehicles include real estate funds, venture capital funds, hedge funds and private equity funds)	credit risk (issuer risk) market price risk liquidity risk currency risk systems-related risk country risk regulatory/legislative risk, including tax risk litigation risk model risk counterparty risk (default risk) other risks. **Comment**: Shares of closed-end funds may be traded outside stock exchanges. Beyond that, closed-end funds are not redeemable (issuers are not obligated to redeem the securities).
2.5.3. ETF shares (known as creation units) represent the set of financial instruments underlying an **exchange traded fund (ETF),** a pooled investment vehicle. Index-based ETFs are designed to track the performance of specified market indices, such as major stock indices. ETF may buy a pool of assets or may ensure an exposition in relation thereof by using derivative financial instruments. As compared to closed-end funds and open investment funds, ETFs have greater liquidity than mutual funds because ETF shares trade on regulated markets the same way as stocks (equities).	credit risk (issuer risk) market price risk liquidity risk currency risk operational risk country risk regulatory/legislative risk, including tax risk litigation risk model risk counterparty risk (default risk) risk of OTC trading other risks, including risks inherent in pooled fund assets.
2.5.4. Structured product is a compound financial instrument made up of simpler components (several financial instruments). Structured products allow ensure certain parameters of financial instruments (for instance, to hedge against specific financial risks). As a rule, the products imply the creation of a pool of assets wherein the participation is sold to investors. Examples of structured products include: structured notes, structured certificates of deposit (CDs), structured bonds), financial instruments featuring 'capital guarantee' or 'principal guarantee' function (capital- guarantee products), and others.	market price risk liquidity risk currency risk systems-related risk leverage (margin trading) risk early redemption risk country risk regulatory/legislative risk, including tax risk litigation risk model risk counterparty risk (default risk) credit risk (issuer risk) risk of OTC trading other risks.