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CHARACTERISTICS AND RISKS OF CERTAIN FINANCIAL OPERATIONS

Union Bancaire Privée (Europe) S.A.

UBP

UNION BANCAIRE PRIVÉE

Sommaire

1. INTRODUCTION

Union Bancaire Privée (hereafter "UBP"), whose registered office is in Geneva, is the principal bank of the UBP Group, with an international network of financial and banking branches and subsidiaries. The UBP Group ensures it complies with the laws of Switzerland and of all countries in which it operates, in particular as regards its duty to provide information on investment risk.

Without claiming to cover every possible situation, this brochure sets out to inform clients of UBP Group entities on the risks of investing in the main types of financial instruments.

Other documents issued by the UBP Group (see below) set out the client's situation as regards applicable local laws and regulations.

The fiscal and legal implications of investing in securities (e.g. the obligation to declare) are not covered by this brochure. If necessary, expert advice should be sought.

Please read this brochure carefully and consult the UBP Group entity which handles your account if you have any further questions.

2. DEFINITIONS

2.1. Financial intermediary

The term "financial intermediary" refers to the UBP Group entity with which you conduct business relations.

2.2. Financial instrument

In this document, the term "financial instrument" covers the following elements:

- The concept of "financial instrument" which, within the meaning of Annex C MiFID II, covers
  - money market instruments,
  - transferable securities (stocks and bonds),
  - units in collective investment undertakings,
  - options, futures, swaps, forward rate agreements and any other derivative contracts relating to securities, currencies, interest rates and yields, emission allowances or other derivative instruments, financial indices or financial measures which may be settled physically or in cash,
  - options, futures, swaps, forwards and any other derivative contracts relating to commodities that must be settled in cash or may be settled in cash at the option of one of the parties (other than by reason of a default or other termination event),
  - options, futures, swaps and any other derivative contracts relating to commodities that may be physically settled provided that they are traded on a regulated market and/or a multilateral trading facility (hereafter: "MTF") or an organised trading facility (hereafter: "OTF"), with the exception of wholesale energy products that are traded on an OTF and that must be physically settled, options, futures, swaps, forwards and any other derivative contracts relating to commodities that may be physically settled, are not for commercial purposes and have the characteristics of other derivative financial instruments,
  - derivative instruments for the transfer of credit risk,
  - financial contracts for differences,
  - options, futures, swaps, forward rate agreements and any other derivative contracts relating to climatic variables, freight rates or inflation rates or other official economic statistics that must be settled in cash or may be settled in cash at the option of one of the parties (otherwise than by reason of a default or other termination event), as well as any other derivative contracts relating to assets, rights, obligations, indices and measures which have the characteristics of other derivative financial instruments, having regard to whether, inter alia, they are traded on a regulated market or an MTF or OTF.
  - emission allowances consisting of any units recognised for compliance with the requirements of Directive 2003/87/EC (Emissions Trading Scheme).

2.3. Derivatives

Derivatives are financial instruments for which the price is derived from that of an underlying or basket of underlyings: assets (equities, bonds, units of mutual funds, precious metals and other commodities), benchmark rates (exchange rates, interest rates, indices), the occurrence of an event (credit incident, natural disaster), or derivatives (notes, certificates, warrants, futures, forwards, options, swaps).

For instance, in the case of an equity option, the equity is the underlying from which the option derives its value.

The following chapters will illustrate the different types of derivatives, including forwards and structured products as well as options and swaps.

3. SPECIFIC LOCAL RULES

3.1. European entities

European Union Member States have been required to transpose into their own legislation the provisions of Directive 2014/65/ EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments "MiFID II". UBP's website (www.ubp.com), under its "Legal" heading, contains information on the effects of the MiFID II on the relations of clients with the European entities of the UBP Group, depending on whether they are classified as "eligible counterparties", "professional clients" or "retail clients".

Clients of the European entities of the UBP Group should consult the documentation provided, and in particular the document "General Information", and contact their relationship manager if they have any further questions.

3.2. Other entities

Clients of entities of the UBP Group that are not in Europe should contact their relationship manager directly to discuss any questions concerning the effects of local regulations on their dealings with the Group. If necessary, additional information will be provided by the entity with which they are dealing.

4. OVERVIEW OF ESSENTIAL RISKS OF INVESTING IN FINANCIAL INSTRUMENTS

The Bank has prepared this document on investment risks for its retail clients, whose level of experience, knowledge and expertise is lower than that of professional clients and eligible counterparties.

4.1. Economic risk

Developments in the economic cycle always have an impact on the prices of securities and, in turn – and with a multiplier effect – on those of derivatives. Prices fluctuate in line with expectations of economic recession or expansion. The length and extent of economic cycles vary over time, as does the impact on the various economic sectors. Moreover, economic cycles are not always synchronised between countries. For investors, failing to take the economic cycle into account or misjudging how an economy will evolve can lead to investment losses. The impact of the economic cycle on interest rates, exchange rates and corporate earnings in particular must be factored into investment decisions.

4.2. Liquidity risk

Liquidity risk is the risk that it is impossible to redeem an investment at the desired time and price. When a market is in this condition, it is said to be 'illiquid'. Liquidity risk occurs especially with shares in unlisted or poorly capitalised companies, investments with sales restrictions, and certain structured products.

4.3. Counterparty risk/insolvency

The debtor (issuer) can encounter financial difficulties and become insolvent (credit and default risks). In the event of issuer insolvency, the creditor may lose income (i.e. non-payment of interest) but also the invested capital.

4.4. Psychological risk

Prices can be affected by irrational factors: trends, opinions and rumours can push prices down significantly even if the financial situation and outlook of the companies in question have not deteriorated.

4.5. Currency risk

Currency risk is the same for all financial assets (money market instruments, bonds, equities and derivatives). Investors who buy a security denominated in a currency other than that of their domestic economy (i.e. their reference currency) are exposed to the risk of the foreign currency losing value relative to the reference currency.

4.6. Settlement risk

Settlement risk occurs when the client is required to pay the purchase price of a security in advance but does not actually receive the security until later. In this event, the risk is that the securities are delivered late or not at all, despite the fact that they have already been paid for. Settlement risk also arises where securities which have been sold are delivered before the sale proceeds are received. Settlement risks mainly occur in emerging markets.

4.7. Custody risk

Financial instruments can be held either in Luxembourg or abroad. Generally, they are held where they are most frequently traded, and are governed by the regulations that apply in the country concerned. Under Luxembourg law, the client remains the owner of the financial instruments held in custody by the Bank; these financial instruments therefore do not represent Bank assets in the event of the Bank's bankruptcy and can be recovered by the client. If a third-party custodian becomes insolvent, the law in many foreign countries provides that the financial instruments deposited with that custodian by the bank are protected. In less advanced economies, however, financial instruments deposited may be included in the bankruptcy assets.

4.8. Inflation risk

Investors may experience a financial loss on investments if the currency in which their investments are denominated declines in value. This loss in value can have an impact on the real value of assets held and on the real return that can be expected to be earned on these assets. Investors must therefore look at the real return, which, for fixed-rate products, is the difference between the interest rate and the inflation rate.

When the inflation rate exceeds the return generated by the financial instruments (capital gain plus interest), the value of the invested capital declines.

4.9. Interest-rate risk

In general, a change in long- or short-term interest rates can have a sharply negative impact on the value of financial instruments.

4.10. Country risk

Country risk arises if a country restricts securities trading, for instance by imposing economic sanctions or currency restrictions.

4.11. Credit risk, for credit-financed financial instruments

Purchasing securities on margin leads to several additional risks. First, additional collateral (guarantees) may be required if the pledged assets lose value and cause a credit overrun. If the investor is not able to produce the additional collateral, the Bank may be forced to sell the securities being held at a loss. Second, the loss caused by an unfavourable price movement is likely to exceed the initial investment. Fluctuations in the prices of pledged securities can limit the investor's ability to repay the borrowed amounts. Investors should also be aware of the leverage effect resulting from buying securities on margin, which makes the investment more sensitive to price fluctuations; such leverage can lead to superior gains but also implies a higher risk of loss. The greater the leverage effect, the greater the risks associated with margin buying.

4.12. Additional risks on emerging markets

Markets in countries with low to middle per capita income, according to the World Bank's classification system, are considered emerging markets. More specifically, these are markets in countries where there is a higher degree of political instability, where the markets and economic growth are relatively uncertain, and where the financial market is still developing and the economy is not strong. This definition applies to a large number of markets in Latin America and Eastern Europe and several Asian countries.

Broadly speaking, the risks described above are even greater on these markets.

Political and economic changes (such as inflation and exchange rates) will have a greater influence on the value of investments in emerging markets than they do in other countries. Emerging markets also often have a stronger and longer-lasting reaction to natural disasters and conflicts.

Furthermore, in many cases emerging markets have less sophisticated rules when it comes to closing and settling transactions. As a result, trade-booking errors or the failure to deliver instruments can be more common.

Finally, prudential supervision and investor-protection rules on these markets are often weak.

4.13. Risks associated with derivatives

Derivatives entail financial risks. Derivatives are often composed of a number of financial instruments, which sometimes makes them difficult to understand. This is particularly true for "exotic" options. This brochure explains these financial instruments and their associated risks. However, it is no substitute for the product descriptions provided by issuers and financial intermediaries. If you have any further questions, please consult your bank.

Can risks be unlimited?

There are basically two distinct types of financial instruments: those with limited risk and those with unlimited risk. The purchase of equities or options involves limited risk. At worst, you will lose the entire amount of your invested capital and not make a profit.

CAUTION: Certain types of derivatives can require an additional outlay of capital over and above the original investment. The obligation to respond to margin calls can amount to several times the purchase price of the securities. Unlimited risk is particularly associated with:

- **selling uncovered call options;**
- **selling forwards and futures.**

When selling a put option, the seller incurs a limited risk equal to the strike price of the underlying.

4.14. Sustainability risk

Sustainability risks are defined as "environmental, social or governance events or conditions that, if they occur, have or may potentially have significant negative impacts on the assets, financial position and earnings of a supervised entity or on its reputation".

Sustainability risks are classified according to three categories: environmental, social and governance:

- Environmental sustainability risks are split into physical risks and transition risks:
  - Physical risks arise both from individual extreme weather events and their consequences (e.g. heatwaves, droughts, floods, storms, hail, forest fires and avalanches), and from long-term changes in climate and environmental conditions (e.g. rainfall frequency and volume, volatile weather conditions, rising sea levels, changes in sea currents and winds, ocean acidification, and global warming with regional extremes).
  - Transition risks exist in connection with the change to a low-carbon economy. Political measures may lead to fossil fuels or emissions certificates becoming more expensive and/or scarce (e.g. fossil fuel phase-out and CO2 taxes), or to high investment costs as a result of the required clean-up of buildings and plants. New technologies may replace existing ones (e.g. electro-mobility) and a change in counterparty preferences and societal expectations may endanger entities that have failed to adjust.
- Sustainability risks in the social and governance areas are events, developments or behaviors associated with social and governance areas which may also lead to negative impacts on the asset, financial and earnings situation of an entity if the probability of their occurrence is not sufficiently priced into the valuation of the affected assets or liabilities. Reputational impacts are also possible. Social risks are characterized inter alia by negative effects on the stakeholders of an entity. E.g.: successful billion-dollar damages claims against cigarette manufacturers; the refusal of approval for a major construction project due to violations of the land rights of indigenous peoples; fines for tax evasion or wrongful tax reimbursements.

As part of its investment advice and portfolio management services, UBP strive to take into account and assess all the main financial risks, including sustainability risks.

SFDR Article 6 disclosure: Transparency of the integration of sustainability risks

- Integration of Sustainability Risks into investment decisions and investment advice

By taking sustainability risks into consideration during its investment decision and advisory processes, the intention of UBP is to manage such sustainability risks in a way that those risks do not have a material impact on the performance of the portfolios.

UBP's approach to responsible investing invokes the following practices integrated to varying degrees in its investment decision process and investment advice:

- Encourages the incorporation of ESG research and analysis throughout our investment processes.
- Negative screening via:
  - Exclusion List
  - Watch List
- Sustainability Champions List that promotes companies that, either through their processes or end products, make a positive contribution to society and / or the environment.

- Likely impact on returns

While sustainability factors are considered by UBP, sustainability risks are currently not likely to have a material impact on the returns of the portfolios considering the integration of the sustainability risks in the investment decision and advisory processes and the nature and diversification of the investments. Assessment of sustainability risks is complex and requires subjective judgments, which may be based on data which is difficult to obtain and/or incomplete, estimated, out of date or otherwise materially inaccurate. Even when identified, there can be no guarantee that the Bank's assessment will correctly determine the impact of sustainability risks on the portfolios' investments.

N.B. UBP also manufactures DPM mandates that are categorized under SFDR as Article.8 products, which promote, among other characteristics, environmental or social characteristics, or a combination of those characteristics, provided that the companies in which the investments are made follow good governance practices, and for which specific sustainability-linked disclosures are available on the UBP website's sustainability-related disclosures section.

4.15. Other risks

4.15.1. Information risk

This risk corresponds to the likelihood that the investor will make poor investment decisions owing to a lack of information or to incomplete or inaccurate information. This may be the result of the investor's use of unreliable sources or misunderstanding of the information received, or it may be caused by communication errors.

4.15.2. Order placement risk

When placing an order, investors must provide the Bank with certain information required for its execution (instrument, order type, volume, execution date, etc.). The more accurate the order, the lower the risk of a mistake.

4.15.3. Transaction cost risk

In addition to the Bank, other domestic and foreign intermediaries (e.g. brokers) may be involved in order execution. Investors must pay the fees and commissions charged by these parties.

5. CHARACTERISTICS AND SPECIFIC RISKS ASSOCIATED WITH CERTAIN FINANCIAL INSTRUMENTS

5.1. Money market instruments

5.1.1. Description and characteristics

The money market is an informal market on which financial institutions like central banks, commercial banks, insurers, fund managers and other large corporations manage their liquidity by investing money on a short-term basis and obtaining short-term financing. Short term refers to less than one year. The main interest rates used on this market are the Eonia, Euribor and Libor.

As borrowers on the money market are finance professionals, both the risk and return on money market instruments are low. These instruments are ideal for highly risk-averse investors.

5.1.2. Associated risks

The money market can only be accessed by professionals investing large amounts of money. Most private investors can only invest in the money market through money-market funds (UCI).

Credit risk refers to the failure of the counterparty to pay interest or to fully reimburse the capital. In addition to publishing long-term ratings on issuers, Standard & Poor's and Moody's also publish ratings for their short-term debt in order to assess this type of credit risk. These ratings distinguish between investment-grade and speculative-grade debt.

The money markets of OECD countries are generally shielded from widespread risks apart from the extreme case of a major banking crisis, such as if a large financial institution were to default and trigger a contagion effect in the international banking system.

Since money market instruments are short term in nature, investors bear the risk of reinvestment, i.e. the risk that at maturity an investment will be reinvested at a lower interest rate.

These products are also exposed to inflation, currency, interest-rate and counterparty risks.

5.2. Bonds

5.2.1. Description and characteristics

Bonds are tradeable securities, in either registered or bearer form, that are issued by a company or a public entity and purchased by investors that are in effect lending capital to the issuer. The face value of a bond represents a fraction of the overall amount of the debt issued. There are both fixed- and floating-interest-rate bonds. The term of the bond and how it is redeemed are defined in advance.

Some structured products are created with the legal structure used for bonds; they are addressed in the section on structured products.

The bond buyer (creditor) holds a claim against the issuer (debtor). Main characteristics:

- **Nominal or face value**

The nominal value of a bond is the total amount of the debt divided by the total number of bonds issued. It is used to calculate the interest payments.

- **Issue/redemption price**

A bond's issue and redemption prices can differ from its nominal (or par) value. If the issue price is above par, the difference is called the "issue premium" (unfavourable for investors). If the redemption price is higher than par, the difference is called the "redemption premium" (favourable for investors).

- **Market price or real value**

The real value of a bond is the market price. Both the theoretical and real value of a bond can differ significantly from its nominal value.

In general, when interest rates rise, the prices of already-issued bonds decline. This is because bonds that were issued at a lower interest rate are less attractive than the newly issued bonds, which pay a higher interest rate. The inverse relationship between interest rates and bond prices is referred to as interest-rate risk.

When buying a bond, investors pay the market price plus the accrued interest, which is the portion of interest earned between when it was issued, or since the previous interest payment was made, up to the value date of the bond purchase. When selling a bond, the investor receives the market price and the accrued interest, which takes into account the interest earned up to the value date of the bond sale.

- **Coupon rate**

This is the interest rate at which the bond was issued and is used to calculate the coupon payments. Bond interest payments are most commonly calculated using the Actual/365 method (where Actual refers to the exact number of days).

- **Yield**

The bond yield, sometimes called the yield to maturity (YTM), is a percentage that measures the amount of income earned by a bond investment over a given time period; the period generally runs to the date on which the bond matures. It takes into account the bond's purchase and redemption prices, its coupon rate, and its residual term. If the bond is purchased at its nominal value, the yield is the same as the coupon.

- **Bond redemption**

Bonds can be redeemed in several ways:

- redemption at maturity;
- early redemption upon the investor's request (put bond) or if the issuer includes a call provision when issuing the bond;
- early redemption by lottery, where the issuer includes a periodic-redemption provision and lots are drawn to determine which bonds are redeemed;
- redemption by conversion into shares.

- **Rating**

Standard & Poor's and Moody's are the two main rating agencies. They assess the quality of issuers of bonds and other medium- and long-term debt and assign a rating to each security.

5.2.2. Associated risks

The main risks associated with bonds are:

- Risk of insolvency
- Interest-rate risk
- Early-redemption risk
- Risks associated with serial bonds
- Risk associated with the issuer's country
- Risks that are specific to certain bonds

Additional risks come into play for certain types of bonds: these include floating rate notes, reverse floating rate notes, zero bonds, foreign-currency bonds, convertible bonds, index bonds, option bonds, subordinated bonds, etc.

5.3. Equities

5.3.1. Description and characteristics

Equities are transferable securities that represent a stake in a company's equity capital (whether or not the company is publicly listed). This ownership right is issued to the shareholder; shares can be registered or bearer. In addition to financial rights, shares include participatory rights that entitle shareholders to attend and vote in annual meetings and to receive a share of the company's profit in the form of dividends.

Shareholders also have a right to receive information from the company (e.g. financial results, profits, annual report, etc.). The returns earned by shareholders may be higher than those earned on time deposits and bonds.

In return, shareholders share fully in the risks faced by the company.

5.3.2. Associated risks

Company risks

Shareholders are not creditors. They provide capital and are therefore co-owners of the company. They have a stake in the company's performance and the related opportunities and risks, which can lead to unexpected fluctuations in the value of their investment. The most extreme case is when a company goes bankrupt, which may lead to the loss of the entire investment.

Share-price risk

Share prices experience unforeseeable fluctuations, with a risk of loss. Prices rise and fall over the short, medium and long term, and there is no way to tell how long these cycles will last.

General market risk must be considered alongside the specific risk associated with the company itself. Both of these risks affect share prices.

Dividend risk

A share's dividend is determined primarily by the profits that the company earns. If the company posts low profits or a loss, the dividend may be reduced or even cancelled.

5.4. Collective investment undertakings (CIU)

5.4.1. Description and characteristics

A CIU is an investment fund whose exclusive purpose is to pool investments from the public and invest the money, in most cases, in transferable securities, such as stocks and bonds or other financial assets, or in real estate, while maintaining appropriate risk diversification.

There are two types of investment fund units (i.e. shares): capitalisation and distribution units. With capitalisation units, the income received by the CIU is reinvested, and no dividends are paid to unit holders. This explains why the net asset value (NAV) per unit of capitalisation units differs from that of distribution units within the same sub-fund. Holders of distribution units receive income in the form of an annual coupon.

A closed-end investment fund issues a fixed number of units set out in the fund regulations. Investors can only acquire units in a closed-end fund from unit holders selling their units or through a capital increase.

Most CIUs are open-ended, which means the number of outstanding units is not fixed or limited by the fund regulations. With these funds, the fund prospectus defines when new units can be subscribed.

Every CIU or CIU sub-fund manages the money invested on behalf and in the interest of its subscribers/unit holders in compliance with applicable law and in keeping with the investment policy defined when the fund was set up. The investment policy defined for each sub-fund is always described in the CIU issue prospectus.

5.4.2. Associated risks Management risk

Since the return on investments in a CIU depends on, among other things, the skills of the fund managers and the quality of their decisions, management errors can lead to losses that may affect the invested capital.

Volatility risk on unit prices

The price of CIU units can decline if, all other things being equal, the value of the securities or currencies held by the fund decline. The greater the level of investment diversification, the lower the risk of loss. Conversely, more specialised and less diversified investments imply higher risks. Special care must be paid to the general and specific risks associated with the financial instruments and currencies held in the funds.

Investors can learn about the specific risks associated with each fund by consulting the fund prospectus.

5.5. Options

5.5.1. Description and characteristics

Options are derivatives whose value depends on the performance of their underlying security. The option buyer pays an option premium to the option seller for the right to buy (call) or sell (put) the underlying security at a set base price for a certain period of time or when the option matures.

Option features can be standardised or defined on a case-by-case basis between the buyer and seller. The commonest underlyings for options are:

- assets such as equities, bonds, precious metals and other commodities;
- benchmark rates such as currencies, interest rates and indices;
- derivatives; or
- any combination of the above.

What are American-style options?

American-style options can normally be exercised on any trading day up to the expiry date.

What are European-style options?

“European-style” options can only be exercised on the expiry date, in other words the date set out in the contract. This does not, however, normally affect their tradability on the secondary market (e.g. on a stock exchange).

What types of options are there?

Warrants are options in securitised form that are traded on an exchange or over the counter (OTC). Traded options are not securitised, but are traded on an exchange.

OTC (over-the-counter) options are neither securitised nor traded on-exchange. They are agreed directly off-exchange between the seller and the buyer. If you wish to cancel an OTC option before the expiry date, you must make a corresponding offsetting trade with your counterparty or with another counterparty. OTC options with precious metals and currencies as their underlying are offered publicly as standardised products. Tailor-made OTC options, by contrast, are specially created for individual investors.

What are exotic options?

Unlike the so-called plain vanilla put and call options described above, exotic options are linked to additional conditions and agreements. Exotic options come in the form of tailor-made OTC options or as warrants.

Given the special composition of exotic options, their price movements can vary markedly from those of their plain vanilla cousins.

CAUTION: You must be aware that larger transactions can trigger price movements even shortly before expiry and that these can render an option worthless. Before buying or selling any exotic options, be sure to seek comprehensive advice about the particular risks involved.

There is no limit to the possible structures for exotic options. We cannot describe in full here the risks involved in any particular case.

The examples of exotic options listed below can be broadly divided into two categories: path-dependent options and options on more than one underlying.

What are path-dependent options?

Unlike plain vanilla options, for path-dependent options, it is not just when the option expires or is exercised that the market value of the underlying is important. You also need to take into account fluctuations in the market value of the underlying during the life of the option when contemplating such an investment.

The following are examples of path-dependent options:

- **Barrier options**

For knock-in barrier options your exercise rights only arise if the market value of the underlying reaches a fixed threshold (barrier) within a specified period.

For knock-out barrier options your exercise rights expire if the market value of the underlying reaches the specified barrier during the given time period.

If this barrier is between the market value of the underlying at the time the option was entered into and its strike price, it is referred to as a kick-in/kick-out barrier option.

Double-barrier options have both an upper and a lower barrier and may take the form of knock-in and knock-out barrier options.

CAUTION: When buying a barrier option, you must be aware that your exercise rights only arise when the market value of the underlying reaches the barrier (knock-in/kick-in option) or that they expire irrevocably when that barrier is reached (knock-out/kick-out option).

- **Payout options**

Payout options accord you the right to the payment of a fixed amount agreed in advance.

In the case of a digital (also known as binary) option, you receive payment if the market value of the underlying reaches a fixed value once during a specified time period (one-touch digital option) or precisely on the day of expiry (all-or-nothing option). For the one-touch digital option, payment occurs either immediately when the barrier is reached or on the date of expiry (lock-in option).

With lock-out options, you only receive the fixed payment if the market value of the underlying does not reach the agreed barrier during a specified time period.

CAUTION: If you sell a payout option you owe the fixed amount if the barrier is reached, regardless of whether or not the option is in the money when exercised or on the expiry date. This means that the amount you owe can be considerably larger than the option's intrinsic value.

- **Asian options**

For Asian options, an average value is derived from the market value of the underlying over a specified time period. This average is used to determine the underlying's value for an average-rate option and to calculate the strike price for an average-strike option.

CAUTION: The calculation of an average value for the underlying in the case of the average-rate option can result in the value of the option on the expiry date being considerably lower for the buyer and considerably higher for the writer than the difference between the strike price and the current market value on expiry.

CAUTION: For an average-strike option, the average strike price of a call option can be considerably higher than the price originally set. For an equivalent put option, the strike price can similarly be much lower than the price originally set.

- **Lookback options**

With a lookback option, the market value of the underlying is recorded periodically over a specified time period.

For a strike-lookback option the lowest value (call option) or the highest value (put option) of the underlying becomes the strike price.

The strike price remains unchanged for a price-lookback option, with the highest value (call option) or the lowest value (put option) being used in calculating the option value of the underlying.

CAUTION: For lookback options, both the calculated strike price and the calculated value of the underlying can vary considerably from the market prices prevailing on the expiry date. If you sell an option of this type, you must be aware that it will always be exercised at the most unfavourable value for you.

- **Contingent options**

When you buy a contingent option you must pay the premium only if the market value of the underlying reaches or exceeds the strike price during the life of the option (American-style option) or on the expiry date (European-style option).

CAUTION: You will have to pay the entire premium even if the option is only just at the money or just in the money.

- **Cliquet and ladder options**

For cliquet options (also known as ratchet options), the strike price is modified for the following period, normally at regular intervals, in line with the market value of the underlying. Any intrinsic value of the option is locked in. All lock-ins arising over the entire life of the option are accumulated.

For ladder options, these modifications take place when the underlying reaches specified market prices, rather than at regular intervals. Normally, only the highest intrinsic value is locked in. In rare cases, all the intrinsic values recorded are added together.

CAUTION: If you sell a cliquet option, you are required on the expiry date to pay the buyer all the accumulated lock-ins in addition to any intrinsic value of the option. If you sell a ladder option you must pay the buyer the highest lock-in amount, which can be considerably higher than the option's intrinsic value on the expiry date.

What are options on more than one underlying?

Examples of options on more than one underlying are:

- **Spread and outperformance options**

Both spread and outperformance options are based on two underlyings. With a spread option, the absolute difference in movement between the two underlyings forms the basis for calculating the option's value. By contrast, the value of an outperformance option is based on the relative difference, i.e. the percentage outperformance of one underlying compared with the other.

CAUTION: Even if the underlying performs positively, the spread between the underlyings may remain constant in absolute as well as relative terms, thus having a negative impact on the value of the option.

- **Compound options**

Compound options have an option as their underlying, i.e. they are options on options.

CAUTION: Compound options can have an especially large leverage effect. If you sell an option of this type, you can be faced with very substantial obligations.

- **Credit default options**

With a credit default option, a credit risk of the original risk-taker (risk seller) is transferred to a third party (risk buyer), who receives a premium in return. If the defined credit event occurs, the risk buyer is obliged to effect a cash settlement or take on the non-performing loan (or another delivery obligation) by way of physical settlement at a previously determined price. Credit default options are a form of credit derivatives.

CAUTION: The risk of chain reactions on the credit market is high and can easily be underestimated.

There is also the risk that lack of liquidity will lead to price distortions when volumes are low. This may mean that the investment can only be sold at a low price, longer term or even not at all.

5.5.2. Associated risks

- **Price risk**

Options are traded both on- and off-exchange and are subject to the law of supply and demand. An important consideration in setting an option's price is knowing if there is a sufficiently liquid market for the option, as well as the real or projected price trend of the corresponding underlying. When the price of the underlying declines, a call option loses value while a put option gains in value. The option's price is not only affected by the price of the underlying, but also by a series of other factors, such as the term of the option and the price volatility (frequency and extent of fluctuations) of the underlying.

As a result, an option can lose value even if the price of the underlying does not change.

- **Leverage effect risk**

Owing to the leverage effect, when the price of the underlying changes, the price of the option changes more. This means that options offer greater upside, but also greater downside. The level of risk when purchasing an option increases with the leverage effect.

- **Risk associated with acquiring the underlying in a short sale**

The seller of an uncovered call option does not own the underlying after entering into the contract (short sale).

For an option with physical delivery, the risk of loss for the investor corresponds to the difference between the strike price at which the underlying will be delivered if the option is exercised and the price that the investor will have to pay to acquire the underlying. For offsetting options, the investor's risk of loss equals the difference between the strike price and the underlying's market value.

Given that the market value of the underlying can be significantly higher than the strike price when the option is exercised, the risk of loss for the option seller cannot be determined in advance and is, in theory, unlimited.

This risk is higher for American-style options, which can be exercised at any time, including at an inconvenient time for the option seller.

An additional risk for the option seller is the inability to procure the underlying required when the option is exercised or the ability to procure it on very unfavourable terms (i.e. at a high price) on the market.

It is important to bear in mind that the eventual loss may also exceed the amount of the option margin paid in by the investor.

- **Special risks associated with over-the-counter (OTC) transactions**

An option bought or sold over the counter can only be closed with the agreement of the counterparty.

- **Special risks associated with combinations**

A combination is when two or more option contracts are created using the same underlying yet have different features or are different types of options.

Numerous combinations are possible. As a result, the risks inherent in every possible combination are not addressed in this document. Investors are responsible for assessing the specific risks inherent in the planned combination.

It should be borne in mind, however, that for all combinations, if one or more options are closed at a certain point, the investor's risk level can be affected significantly.

- **Special risks associated with exotic options**

These options come with conditions or additional clauses. No combination of options can replicate their payout structure.

They include tailor-made OTC options and option certificates.

The range of possible exotic options is unlimited, which makes it impossible to describe the risks inherent in every exotic option in this document.

However, the most common exotic options present the following risks that conventional options do not.

5.6. Swaps

5.6.1. Description and characteristics

A swap is a contract between two counterparties negotiated over the counter to exchange future cash flows over a specified period; it only involves an exchange of the difference in value between a fixed and a variable amount.

The floating amount payer has to pay the variable amount of the swap. The fixed amount payer has to pay the fixed amount of the swap.

The cash flows (variable and fixed amounts) are based on a theoretical principal sum (the notional) on one or several predetermined dates during the life of the contract, or on the expiry date.

For swaps with physical settlement, you can require the swap counterparty to deliver the underlying on expiry, or on the payment dates if there are several of them.

When the swap contract stipulates cash settlement, you merely receive a sum of money equal to the difference between the fixed amount and the floating amount (these amounts being calculated on the notional principal sum).

What are the different types of swaps?

The most common swap contracts are:

- a plain vanilla interest rate swap which exchanges the interest on a notional variable-rate loan or deposit for interest at a fixed rate;
- a currency swap, in which there is an exchange of the interest and principal on the maturity of a loan or deposit in one currency for its value in another;
- a credit default swap, in which there is an exchange of protection on the credit risk of the issuer of a bond for periodic and regular payments over the life of the swap;
- a commodity swap, which exchanges a fixed price, calculated when the swap contract is signed, for a variable price, normally calculated as the average of an index for a future period.

However, there are many other types of swap, including:

- a cross-currency swap, or currency interest rate swap (CIRS) in which there is an exchange of medium- or long- term interest rates in two different currencies;
- a standard basis swap, which exchanges two variable rates indexed to short-term benchmark rates in the same currency or in two different currencies;
- a constant maturity interest rate swap, which allows a variable rate indexed to a short-term interest rate to be exchanged for another variable rate indexed to a medium- or long-term rate with a constant maturity (i.e. the maturity of the interest rate is repeatedly converted into medium or long term);
- an asset swap which is a combination of two products: a fixed-rate bond and a corresponding swap (an over-the-counter contract with an exchange of fixed interest for variable interest between two counterparties in accordance with a predetermined timetable). The fixed leg of the swap replicates the precise characteristics of the bond so that the asset swap enables a synthetic variable-rate bond to be created out of a fixed-rate bond.
- an equity swap;
- a variance swap and volatility swap pay the volatility of an underlying;
- a correlation swap pays the correlation of a basket of assets – i.e. correlation either between the assets themselves or against a benchmark;
- an inflation swap, in which a fixed or variable rate is swapped for an inflation rate;
- a total-return swap, which exchanges the income and market risk of the value of two different assets over a given period. For example: one leg of the swap is a variable short-term rate, the other is a fixed amount linked to any type of financial investment (an index, equity, bond, etc.).

5.6.2. Associated risks

The principal risk in a swap is counterparty risk. However, margin calls or the deposit of collateral can virtually eliminate this risk.

Counterparty risk is the potential loss incurred by the party to the swap as a result of a future default of his counterparty. This risk covers two intrinsically different risks: settlement risk and credit risk.

Settlement risk is involved in any market transaction involving a simultaneous exchange of financial flows. Settlement risk arises from the failure to make the simultaneous transfers over the time required to complete the transaction.

Credit risk can be defined as the total loss incurred in a transaction if the counterparty defaults. It is also sometimes referred to as 'signature risk'.

However, in a floating rate swap (i.e. one in which payment of the financial flows is made on regular predetermined dates and not on maturity), in the event of default by the counterparty, the only loss will be the latest performance, as the non-defaulting party will stop paying if the (defaulting) counterparty does not meet its contractual obligations.

CAUTION: For each type of swap, there is a specific risk linked to the underlying or to the financial flows exchanged. Your bank will be pleased to provide any further information.

For instance, a variable-rate borrower wishes to fix his cost of borrowing, and signs a swap contract as the payer of a fixed rate. Having previously been liable for a variable rate, he is now liable for a fixed rate, regardless of the level of the variable rate. Thus, the borrower has hedged his risk of an increase in the cost of borrowing. The risk for the party paying the fixed rate is of not receiving the benefit of any fall in the variable rate and therefore missing the opportunity of cheaper borrowing. Conversely, the counterparty paying the variable rate bears the risk of an increase in interest rates.

5.7. Forwards and futures

5.7.1. Description and characteristics

With forwards and futures you undertake to deliver or take delivery of a defined quantity of an underlying on a specified expiry date at a price agreed on the contract date. Unlike with options, which (for the buyer at least) only give rise to rights, forwards and futures involve both parties entering into obligations. You do not have to pay a premium when the contract is concluded.

CAUTION: Forwards and futures can involve special risks. You should therefore only make investments of this type if you are familiar with this type of instrument, have sufficient liquid assets and are able to absorb any losses that may arise.

Futures are traded on an exchange. They take the form of contracts in which the quantity of the underlying and the expiry date are standardised.

Forwards are not traded on an exchange; hence they are referred to as OTC (over-the counter) forwards. Their specifications may also be standardised; otherwise they may be individually agreed between the buyer and seller.

The most common underlyings for forwards and futures are:

- assets (equities, bonds, precious metals and other commodities),
- benchmark rates such as currencies, interest rates and indices;
- any asset.

CAUTION: In the event of a book loss, the variation margin can be several times larger than the initial margin.

5.7.2. Associated risks

For forward sales, you must deliver the underlying at the price originally agreed even if its market value has since risen above the agreed price. The amount you risk losing will be the difference between these two prices.

CAUTION: Theoretically, there is no limit to how far the market value of the underlying can rise. Hence, your potential losses are similarly unlimited and can substantially exceed the margin requirements.

CAUTION: For forward purchases, you must take delivery of the underlying at the price originally agreed even if its market value has since fallen below the agreed price. The amount you risk losing will be the difference between these two values. Your maximum loss therefore corresponds to the originally agreed price. Potential losses can substantially exceed the margin requirements.

In order to limit price fluctuations, an exchange may set price limits for certain contracts. Find out what price limits are in place before effecting forward or futures transactions. This is important since closing out a contract can be much more difficult or even impossible if a price limit of this type is reached.

CAUTION: If you sell forward an underlying which you do not hold at the outset of the contract, this is referred to as a short sale. In this case, you risk having to acquire the underlying at an unfavourable market value in order to fulfil your obligation to effect delivery on the contract's expiry date.

The market for standardised OTC forwards is transparent and liquid. Hence, contracts can normally be closed out without difficulty. There is no actual market for OTC forwards agreed individually, and hence the positions they entail may only be closed out with the agreement of the counterparty.

Since combinations comprise a number of elements, closing out individual elements can considerably alter the risks inherent in the overall position. Before entering into any such transaction, be sure to consult your financial intermediary about the particular risks involved.

Given the many possible combinations, we cannot go into detail in this brochure about the risks involved in any particular case. Before making a purchase, be sure to seek comprehensive advice about these risks.

5.8. Structured products

5.8.1. Description and characteristics

Structured products are issued either publicly or privately. Their redemption value depends on the performance of one or more underlyings. They may have a fixed or unlimited term and consist of one or more components. They can be static or actively managed by the issuer of the structured product or by a third party. Dividends may or may not be reinvested.

What are structured products with capital protection?

Structured products with capital protection consist of two elements, such as a fixed income investment (such as a bond or a money market investment) and an option. This combination enables the holder to participate in the performance of one or more underlyings (via the option or participation component) while at the same time limiting potential losses (via the fixed-income investment or capital protection component). The capital protection component may only cover a portion of the capital invested.

What are structured products with yield enhancement?

Structured products with yield enhancement consist of two elements, such as a fixed-income investment and an option (e.g. on equities or currencies), and possibly a currency swap. This combination enables you to participate in the performance of one or more underlyings (via the option component). However, these financial instruments offer no or only conditional capital protection. The interest that is paid means you receive a higher return than with a direct investment if the price of the underlying remains essentially unchanged. On the other hand, you will not benefit from the full potential return of the underlying.

If the market value of the underlying rises, you will receive the stipulated interest and the nominal value on expiry (there may be a discount on the issue price). If the market value of the underlying rises sharply, you could possibly have earned a higher return on a direct investment. However, if the market value of the underlying falls, you will receive both the interest payment and the underlying on expiry (unless there was no discount on the issue price).

What are structured products with participation?

Structured products with participation enable you to participate in the performance of one or more underlyings. However, they offer no capital protection, or the protection offered is limited or conditional. If the participation product offers conditional capital protection, the risk is smaller than with a direct investment provided the market value of the underlying does not reach a specific barrier (termed the "knock-out").

If the market value of the underlying touches, rises above or falls below the barrier, you will lose the capital protection.

What are structured products with leverage?

Structured products with leverage enable you to achieve a leverage effect by investing less capital than you would have to if you invested directly in the underlying. This means you can benefit from short-term trends while committing very little cash or only a fraction of the face value.

Structured products with leverage are suitable for short-term speculation but also for targeted hedging of a portfolio.

5.8.2. Associated risks

Every structured product has its own risk profile, and the risks of its individual components may be reduced, eliminated or increased. In particular, you may profit to different degrees from rising, constant or falling market values of the underlying, depending on the product involved.

CAUTION: It is extremely important to find out exactly what the risks are before acquiring a product of this kind. This information can be found in, for example, the issue documents or the product description concerned.

Structured products are not categorised as collective investments under the European UCITS Directive. Unlike with collective investments, the issuer is liable with his own assets (as is any guarantor, to the extent of a guarantee they have provided), and there is no backing from specially protected assets. You therefore need to bear in mind that in addition to a potential loss resulting from a decline in the market value of the underlyings (market risk), you may in the worst case lose your entire investment because the issuer or guarantor becomes insolvent (issuer or guarantor risk).

- **Capital protection products**

Some structured products offer only conditional capital protection, which can be lost if the value touches, falls below or rises above a predefined threshold (barrier, knockout level). Repayment is then dependent on the performance of one or more underlyings.

The capital protection component can be well under 100% of the capital invested, depending on the product. Capital protection does not therefore mean 100% repayment of nominal value or the purchase price for all products. Structured products with capital protection generally offer lower returns than direct investments in the underlying, as the capital protection costs money.

Your maximum loss on a structured product with capital protection is limited to the difference between the amount invested and the amount protected, provided you hold the product until expiry.

- **Products with yield enhancement**

Many products with yield enhancement refer to several underlyings. You as investor receive the security with the worst performance on expiry (either physically or in the form of cash) if the underlying touches, rises above or falls below a predefined barrier during the term of the financial instrument. If the performance of the underlying is negative, the financial instrument can trade far below the issue price during its term even if the barrier is not touched, exceeded or undershot.

The amount paid as interest is directly related to the level of the barrier. The nearer the barrier is to the market price of the underlying on the day of issue, the higher the interest you receive will generally be, but the higher the risk that the barrier will be reached, and vice versa.

When you invest in a structured product with yield enhancement, you could in the worst case scenario lose the entire capital that you have invested.

- **Structured products with participation**

The risk of a structured product with participation is generally the same as that of the underlying. Unlike with a direct investment, however, you do not receive voting rights and you are not entitled to a dividend. You do, though, bear the solvency risk of the product's issuer.

Many products with participation are linked to several underlyings. You as investor receive the security with the worst performance on expiry (either physically or in the form of cash) if the market value of the underlying touches, rises above or falls below a predefined barrier during the term of the financial instrument. The financial instrument can trade far way below the issue price during its term even if the barrier is not touched, exceeded or undershot. Moreover, the level of participation is directly related to the level of the barrier. If you have a higher risk tolerance when selecting the barrier, you will enjoy a higher participation.

When you invest in a structured product with participation, you could in the worst case scenario lose the entire capital that you have invested.

- **Leverage products**

Because of the leverage effect, you need to carefully and regularly monitor the underlying, since structured products with leverage can produce a profit or loss proportionate to the amount of leverage used.

When you invest in a structured product with leverage, you could in the worst case lose the entire capital that you have invested.

5.9. Products used for financing or risk transfer

5.9.1. Description and characteristics

The financial instruments discussed in this section have the same or similar profit and loss structures as certain conventional financial instruments (equities or bonds).

Such financial instruments may be listed for trading on an exchange, but do not have to be.

The risks associated with these products are not necessarily the same as those of the financial instruments they contain. It is therefore extremely important to find out exactly what the risks are before acquiring a product of this kind. This information can be found in, for example, the product description concerned.

What are "credit derivatives and derivatives dependent on the occurrence of events"?

There are some products that are mainly used to transfer risks. These include derivatives and derivatives dependent on the occurrence of events. They are financial instruments where the "underlying" is an event such as a credit event (default of a borrower or an issuer) or a natural disaster. Derivatives of this type can be used by the bearer of a risk to transfer it to others. Credit derivatives come in the form of swaps, options or hybrid financial instruments.

5.9.2. Associated risks

Credit and derivatives dependent on the occurrence of events involve a liquidity risk. Often such instruments cannot be sold before the end of their term, because there is no market for them.

Loan credits securitise the risks and transfer them to third parties as credit-linked notes (CLN), collateralised debt obligations (CDO) and asset-backed securities (ABS).

As a result, the buyer takes on the risk associated with a loan portfolio.

CAUTION: Look closely at the creditworthiness of the debtor to which the CLN is linked, as the CLN can end up being valueless if a credit event occurs. There is an issuer risk, i.e. a credit risk of the issuing bank, just as with structured products. The secondary market for CLN is highly illiquid, and you should therefore assume that you will not be able to sell one before the end of its term.

CDO typically have a term of several years. As there is generally no secondary market, you should assume that you will not be able to sell the CDO before the end of its term.

Loan credits are often issued by particular types of offshore companies, so-called special purpose vehicles (SPV). In this event you should pay special attention to the issuer risk and the quality of government supervision of such SPVs.

5.10. Alternative (non-traditional) investments

a. Description and characteristics

Alternative or non-traditional investments are investments that do not fall within the traditional asset classes, such as equities, bonds or money market products. They include a wide range of instruments and strategies.

Hedge funds are among the best-known alternative investments; their investment strategy usually includes short selling, leverage effects and derivatives. Hedge fund managers are free to choose the products and markets (including emerging markets) in which they wish to invest, along with their trading methods. Hedge funds generally require investors to make a high minimum investment. The remuneration of hedge fund managers is often linked to their performance.

b. Associated risks

As every investment presents specific risks, this document is unable to provide an exhaustive description of all risks inherent in such products. Some aspects are nevertheless discussed below.

5.10.1. Hedge funds

a. Description and characteristics What are hedge funds?

Hedge funds are the best-known form of alternative or non-traditional investments. Despite what their name suggests, hedge funds do not necessarily have anything to do with hedging. Indeed, they take on sometimes very high levels of risk in order to obtain an above-average return. Hedge funds include all forms of investment funds, investment companies and partnerships that use derivatives not just for hedging but also for investment, that are able to engage in short selling or take on significant leverage by borrowing. Other features typical of hedge funds include their freedom to choose their asset classes, markets (including emerging markets) and trading methods. Hedge funds normally require high minimum investments. They frequently offer only limited opportunities for subscription and redemption, with long notice periods. The portfolio managers of hedge funds receive performance-related bonuses and often hold a personal stake in the funds.

What are funds of hedge funds or multi-manager hedge funds?

Investors invest in funds of hedge funds or multi-manager hedge funds in order to reduce risk. These funds invest their capital in a number of hedge funds and spread it across a range of hedge fund managers that cover different investment styles, markets and instruments. There are also structured products that you can use to invest in hedge funds or hedge fund indices.

b. Risks

- A hedge fund may be less transparent than a traditional investment fund, for example, as investors are not always informed about planned strategies and changes to them, or changes of portfolio manager. Hedge funds are also not subject to any disclosure requirements;
- Unlike traditional collective investments, hedge funds have limited liquidity (units may generally only be redeemed once a month, quarterly or annually).
- Normally, investors can only invest in a hedge fund at specific times. There are generally long notice periods for redemptions and long lock-up periods (periods during which investors are obliged to leave their capital in the fund);
- Delays may occur, and unfavourable prices may result, when settling buy and sell orders for hedge fund units. There is no guarantee that investors will be able to enforce their rights.

What risks do you take on when you invest in a hedge fund?

Generally speaking, hedge fund managers do not need to be licensed by an authority and are largely unregulated. In particular, hedge funds are not subject to the numerous investor protection regulations that apply to authorised collective investments. These include rules on liquidity, redemption of fund units at any time, avoiding conflicts of interest, fair prices for fund units, disclosure and limitations on borrowing.

Since these rules do not apply to hedge funds, they can use much more leverage than traditional authorised funds, and engage in complex investment transactions that are not permitted for traditional collective investments. A hedge fund is allowed to adopt aggressive strategies including the widespread use of short selling, leverage, swaps, arbitrage, derivatives and programme trading. Their investment strategies are often highly complex and lacking in transparency. You will often receive little or no information about changes of strategy that may lead to a significant increase in risk, or receive such information only at a late stage.

As part of their investment strategy, hedge funds can also use derivatives such as futures, options and swaps that may be listed for trading on an exchange but do not have to be. These instruments may be subject to significant price volatility, resulting in a high risk of loss for the fund. The low margins typically required to build up a position in such instruments mean that high levels of borrowing can be used. Depending on the instrument, a relatively small change in the price of the contract can therefore lead to a large profit or loss in comparison with the capital lodged as collateral and hence to further, unforeseeable losses that can exceed any margin cover.

CAUTION: Investment vehicles that are not listed on an exchange also involve higher risks as there is neither an exchange nor a secondary market where units can be sold or open positions closed out. It may be impossible to unwind an existing position or determine the value or risk of a position. If a hedge fund sells uncovered options on securities, it may be exposing itself to a potentially unlimited risk of loss.

What are side pockets?

Within the portfolio of an investment fund, side pockets are a way of separating illiquid investments (primarily private equity or real estate) from liquid ones. As a general rule, only investors who were initial subscribers for the units of a given fund (or who hold units in the fund at the time when an investment in the portfolio is separated) will make a profit or incur a loss from this illiquid investment when it is sold or when some event affecting its liquidity occurs (e.g. an IPO).

How are investors' rights of repayment affected by side pockets?

Investors may continue to exercise their redemption right in respect of the liquid portion of their investment in a fund. However, that right may not be exercised for any portion of their investment which is segregated in a side pocket.

The portion placed in a side pocket will therefore remain invested either until it is sold or until some event affecting its liquidity occurs. At that point, an investor exercising his redemption right can receive the net amount less performance and management fees and any other charges applicable.

What are the drawbacks of side pockets?

When an investor exercises his redemption right, he will not be redeemed for his entire investment; the liquid part of the investment will be repaid in cash, and he will remain invested in side pockets which may take several years to be sold. Investors may therefore be unable to realise their investment in full for an indefinite period, and consequently the value of that investment could fall (or rise) over that period.

Furthermore, there is no guarantee that an investment segregated in a side pocket can be disposed of by the fund at its published value when an event affecting its liquidity occurs or where it may have to be realised urgently.

Side pockets are not normally transferable.

Investors should also bear in mind that the creation of a side pocket may occur between the time a redemption request is made and the repayment date.

What are gates?

These are redemption limits expressed as the maximum percentage of units in a mutual fund which can be redeemed on each liquidity date (normally 20/25% for funds with annual liquidity and 10% for those with more frequent liquidity). These limits are intended to protect unit holders remaining in the fund in the event of massive withdrawals from the fund by other investors; they also enable managers to increase exposure to illiquid assets without the fear of liquidity problems when approaching a date on which sale orders are permitted.

How is an investor's redemption right affected by gates?

We can illustrate this by taking the example of a fund with the following characteristics: 30 days' notice, monthly liquidity, exit gate of 10%. An investor places his sale order on 3 January 2009; the order is accepted on 3 January 2009 for 30 days hence, i.e. for 2 February 2009. As the fund's liquidity is monthly, the investor sells his units at the net asset value at the end of February. If sale orders for the same period exceed 10% of the units of the fund, redemptions will be reduced pro rata for each investor wishing to sell, based on the number of units for which each investor has submitted a redemption request.

All units not redeemed during that month owing to application of the 10% limit will have priority the following month, up to the 10% limit, over units for which sale orders are placed in that month.

What are the disadvantages of gates?

If the limit on redemptions is applied, an investor naturally retains his investment in the fund in respect of those units not redeemed, and continues to be exposed to the investment risk. In the period between the date of his sale order and the date on which he receives the proceeds of his investment (which can be very long if successive gates are applied) performance can be poor.

What is a lock-up in a mutual fund?

A lock-up is a period in which the funds invested are frozen and are unavailable to the investor. In alternative investments where this condition applies, the lock-up period is normally one year.

How is an investor's redemption right affected by a lock-up?

In the case of a 'hard lock-up' the investor cannot seek redemption during the lock-up period. If it is a 'soft lock-up', he can apply for redemption during the lock-up period but will have to pay a redemption penalty.

What are the disadvantages of a lock-up?

An investor subject to a lock-up naturally has to remain invested for the lock-up period and therefore continues to be exposed to the investment risk, with no possibility of disposing of his investment during that period (except in the case of a 'soft lock-up' when he can sell on payment of a penalty).

5.10.2. Private equity

a. Description and characteristics

Private equity is a form of risk capital financing for companies that either are not exchange-listed or – occasionally – wish to delist. Investments are usually made at an early stage in a company's development, when its chances of success are uncertain and the risks are therefore high.

Where private equity flows into young companies (start-ups) or small companies with growth potential that are at an early stage in their development, the term venture capital is also used. Private equity now also extends to risk capital made available to a company immediately before it goes public (mezzanine financing).

Normally the financing is constructed in such a way that the proceeds of the initial public offering are used to wholly or partially redeem the holdings of the shareholder entrepreneurs. If a change of ownership is financed, for example a delisting, the term "buyout" is customarily used.

The success of a private equity investment depends on the correct timing of the "exit" or sale and – especially with indirect investments via a fund, for example – on the quality of the private equity manager. The exit can be effected by going public (initial public offering or IPO), a sale to another company (trade sale) or to another private equity fund (secondary sale), or a management buyout. The choice of solution will depend largely on the market conditions prevailing at the time. How easy or difficult the exit phase is, and whether the proceeds meet expectations, will depend on factors such as the performance of the equity markets.

b. Associated risks

Private equity investments are regulated less strictly than equities listed for trading on an exchange. This means that investors may be exposed to more risks, for example due to lack of transparency (e.g. limited access to financial statements, lack of publication).

Private equity investments involve considerable risks and can lead to substantial losses. They are based on a long-term approach and are much less liquid than exchange-listed equities. Normally, private equity investments cannot be sold until some years after the original investment. You should be aware that your capital will be tied up, either completely or with access subject to restrictions, for a long time. No distributions are made prior to exit from investments. You do not normally have any entitlement to exit early.

Companies that are potential candidates for private equity investments may have high levels of borrowing and therefore be more sensitive than established companies to negative market developments such as rising interest rates. There is also a greater danger of the company becoming insolvent and going bankrupt than with listed companies.

CAUTION: It is not unusual for further calls for capital to be made at short notice after the initial investment. If you fail to comply with such a demand, you may lose all the capital you have invested up to that time.

CAUTION: A change of management in a young company where the personality of the individuals occupying key functions is a particularly important factor can have a highly detrimental effect on a private equity investment.

What do you need to bear in mind when making indirect investments?

With indirect investments, there is no guarantee that the manager of a private equity fund will be able to make investments and generate profits that fulfil the expectations for this form of investment. The abilities of the private equity manager are therefore crucial to the success of an indirect investment.

5.10.3. Real estate

a. Description and characteristics

Real estate investments refer to investments in real property, such as residential, office and commercial buildings.

Investments in real estate can be made directly or indirectly. Real estate comprises office buildings, retail and industrial premises, commercial buildings and workshops, residential property and special real estate (such as hotels or hospitals). The variables that determine the value of a property are its location, construction, equipment fittings and the variety of ways in which it can be used.

What do you need to bear in mind when making direct investments?

A direct investment involves actually buying property. This will usually require a high capital outlay, a long-term investment horizon, in-depth knowledge of the sector, familiarity with the location and often personal involvement, as property needs to be professionally managed.

What about indirect investments?

Indirect investments in real estate generally require a lower capital outlay than direct investments. Indirect investments are divided into those that are exchange-listed and those that are not. Examples of unlisted indirect investments include real estate funds, shares of real estate companies that are not listed for trading on an exchange, and certificates on real estate funds. Real estate funds can reduce risk by diversifying across geographical areas and real estate categories. The main category of exchange-listed indirect investments is real estate investment trusts (REITs). These enable investors to invest in real estate without incurring certain disadvantages, such as illiquidity.

b. Associated risks

Real estate investments are based on physical assets – land and buildings – that are ultimately unique, and in which trading is not regulated.

Where real estate is concerned, it is therefore often difficult, or even impossible, to spread risks adequately or diversify investments sufficiently. With direct real estate investments especially, the high capital outlay required and the illiquidity of the property market makes diversification difficult or even impossible.

Property markets are also frequently lacking in transparency, and require precise knowledge of local circumstances. It is therefore vital to involve local experts, which hampers access to the market.

Real estate often reacts to interest rate changes in a similar way to bonds: when interest rates are low, for instance, mortgages are cheap and it is easy to generate above-average profits. Conversely, high interest rates cause profits to contract. Fiscal incentives offered by the state to promote home ownership and attractive lending conditions can also lead to excessively high prices.

5.10.4. Precious metals and other commodities

a. Description and characteristics

Commodities are physical goods that are produced via agriculture and mining, for example, and standardised for use as the underlying of a transaction. Derivatives on commodities such as energy sources, precious and other metals, and agricultural products are traded on futures markets.

Contractual agreements allow investors to buy or sell futures linked to the performance of a particular commodity. This means that they can buy a standardised amount of a commodity at a specific time in the future for a specific price.

The commonest way in which private individuals invest indirectly in commodities is via structured products. There are other alternatives, such as commodity swaps and options that are not listed for trading on an exchange. These are traded directly between the parties concerned and are tailor-made products. More information on how forwards and futures work can be found in a separate section of this brochure.

CAUTION: With commodity futures, you may receive physical delivery of the commodity concerned on expiry, while structured products normally provide for cash payment. If you prefer cash settlement, you will have to sell the futures before their expiry date. Such products are therefore more risky than, for instance, equities or collective investments.

b. Associated risks

The price of commodities is influenced by a number of factors. These include:

- the relationship between supply and demand;
- climate and natural disasters;
- state programmes and regulations, national and international events;
- state intervention, embargoes and tariffs;
- movements in interest and exchange rates;
- trading in commodities and the corresponding contracts;
- provisions relating to monetary policy, trading, fiscal and currency controls.

These variables can lead to additional investment risks.

Commodities investments are more volatile than conventional investments, and yields on commodities can collapse at short notice. The volatility of commodity prices also affects the value, and hence the price, of a futures contract based on those commodities.

Conventional futures on oil, base and precious metals are normally easy to trade, regardless of their term.

CAUTION: When market activity is limited, a contract can become illiquid. Depending on how the yield curve moves, such illiquidity can lead to significant price changes. This is a typical feature of commodities.

The purpose of this document is not to describe all possible risks inherent in financial investments. It is designed to provide some basic information and to alert you to the existence of risks inherent in all financial investments. You are strongly encouraged to assess the associated risks before investing and to only invest in accordance with your assets, needs and experience.

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