Fearnley Securities AS

Information and risks associated with financial instruments

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Fearnley Securities

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INFORMATION TO CLIENTS REGARDING THE CHARACTERISTICS OF, AND RISKS ASSOCIATED WITH FINANCIAL INSTRUMENTS

As a client, you must be aware that:

- trading in financial instruments takes place at your own risk
- before starting to trade in financial instruments, you must carefully study Fearnley Securities' general business terms and conditions as well as any other relevant information on the financial instrument in question and its characteristics and risks
- you must immediately scrutinise the contract note and submit any complaints regarding errors
- you are responsible for monitoring changes in the value of the financial instruments in which you have invested
- you must regularly assess your investments and make the necessary changes to adapt these to your investment strategy and risk profile

1. Definitions

Financial instruments. This is a generic term for the assets and liabilities that are traded in the securities market, derivative market and in part currency market and is further defined in the Norwegian Securities Trading Act.

Regulated market. A regulated market is a market for the sale of financial instruments. A regulated market has a licence and is subject to a number of rules and obligations.

Stock exchange. A stock exchange is a regulated market that has a special licence to operate as a stock exchange and is entitled to use the term "stock exchange" in or in addition to its name.

Multilateral Trading Facility (MTF). An MTF is not a regulated market; it is a trading venue for the sale of financial instruments. All investment firms that meet the objective requirements set by the MTF may trade on the MTF. Operating an MTF requires a licence.

Organised Trading Facility (OTF). An OTF is not a regulated market, it is a trading venue for bonds, structured financial instruments, emission quotas and derivatives. Operating an OTF requires a licence.

Systematic Internaliser (SI). An investment firm that carries out extensive own-account trading in financial instruments with clients must register as an SI for the financial instrument in question. An SI is obliged to offer binding bid and ask prices and to notify its clients of these.

Dark pool. A marketplace where participants can submit orders that are not shown in the order book but are automatically matched if another participant submits a corresponding order. There is often a requirement that such orders must be a minimum size and that matching must automatically take place at the mid-price, i.e. the average of the best bid and ask prices in the open order book. Some dark pools also allow investors to submit their orders to the pool themselves. The legislation stipulates a limit on the percentage of the sales in one listed share that can be traded in one single dark pool (4% of the total volume) over a certain period and the percentage that can be traded in total in dark pools (8% of the total volume) over a certain period.

Underlying assets/underlying financial instrument(s). These are the assets or financial instruments that a derivative contract gives the parties the rights and obligations to buy or sell or that the parties have agreed to base a monetary settlement on.

Option. A contract that gives one party (the Holder) for a limited period a right but no obligation to buy (a Call Option) or sell (a Put Option) an agreed volume of financial instruments at a predetermined price from/to the other party (the Writer).

Forward/futures contract. A contract according to which both the buyer and seller agree that an agreed volume of financial instruments will be transferred from the seller to the buyer at an agreed price on an agreed date that is further into the future than the normal settlement period for the underlying financial instrument covered by the contract.

Price swap. A contract linked to an agreed volume of financial instruments, a settlement price (the swap price) and a settlement date, and according to which the underlying financial instruments are not to be delivered but there is instead to be a monetary settlement based on the difference between the swap price and the market price on the expiration date.

Contract for difference (CFD). A contract according to which both the buyer and seller are bound to agree to a monetary settlement of the price developments of an agreed volume of one or a group of financial instruments, indices, currencies or similar. The buyer of a CFD makes a gain if the price rises and a loss if the price falls. A CFD does not have a predetermined expiration date but the buyer may close the position at any time.

Credit Default Swap (CDS). A contract which provides a buyer with an insurance against the issuer of a debt obligation being unable to settle the debt, in whole or in part, on the settlement date.

Index option/index futures contract. A contract where the underlying asset is an index value, not a security. Such a contract is not settled t by delivering financial instruments but by calculating the contract's monetary value.

Short sale. The sale of financial instruments that a party does not own, but has borrowed to carry out settlement on time. The financial instruments are bought at a later date and handed back to the lender. A short sale where the seller has not borrowed the underlying financial instruments is called a naked short sale and is illegal in Norway.

Securities swap. A combination of short and long positions in (at least) two financial instruments, in which the change in the price of one of the instruments (the long position) is netted against the change in the price of the other instrument (the short position) with respect to shares, government bonds and credit default swaps (CDS).

Exercising an option means demanding the trading of the underlying financial instrument in accordance with the option contract. Normally, the Holder may demand the partial exercise of the option while the option is maintained for the residual quantity.

The expiration date. The date when either a demand to exercise the option must be put forward or the option lapses as being worthless. The expiration date for a forward/futures contract is the date when the contract is changed into a trade with an ordinary settlement period for the delivery of an underlying financial instrument in return for payment of the purchase price.

The settlement date. The date when a forward/futures contract, option or price swap is finally settled by the underlying financial instruments being delivered in return for the agreed purchase price, or the monetary settlement falling due for payment. The settlement date is normally three stock market days after the expiration date.

American option. An option that the Holder may demand to exercise, in whole or in part, at any time prior to the agreed time on the expiration date.

European option. An option that the Holder may only demand to exercise on the expiration date.

Spot price/rate. The price at which the security is traded at for normal delivery on the second stock market day after the trading date.

Strike price/rate. The agreed price or rate for the exercise of an option.

Forward/futures price/rate. The agreed price or rate for the settlement of a forward/futures contract.

Swap price/rate. The agreed price(s) or rate(s) to be used when settling the individual elements in a swap.

Option premium. The amount the Holder has paid the Writer to purchase an option.

Hedge shares/hedge. If the seller of an option, forward/futures contract or swap does not want to have any price risk, he/she buys or short sells a quantity of the underlying securities so that any increase in the value of the sold derivative is offset against a corresponding increase in the value of the underlying securities. The securities that in this way protect the issuer against a price risk are often called hedge shares or a hedge.

NIBOR interest rate. An interest rate that is calculated by the Oslo Stock Exchange according to rules determined by Finance Norway and states the market interest rate for unsecured loans in NOK. The interest rate is determined daily for various terms to maturity.

***Interest rate risk*.** The risk of the financial instrument that the client invests in falling in value due to changes in the market interest rate.

Credit risk. The risk of an issuer or a counterparty being unable or less able to pay.

Clearing. The function as a counterparty between the parties to derivatives contracts or share trades that guarantees that the parties will receive settlement for the contract/trade.

2. Trading in Financial instruments

Trading in financial instruments, such as shares, equity certificates, bonds, certificates, derivatives or other rights and obligations intended for trading in the securities market, normally takes place in an organised form in a trading system.

Trading takes place through the investment firms that use the trading system. As a client, you must normally contact such an investment firm in order to buy or sell financial instruments. There are also investment firms that forward orders to another investment firm that then uses the trading system. Trading may also take place internally in an investment firm, for example by the investment firm becoming the counterparty to the trade or through a trade with another of the investment firm's clients (internal trade).

In a ***regulated market,*** financial instruments can be ***listed***. That means that the instruments are approved for trading and the marketplace monitors that the company which has issued the financial instruments meets the requirements linked to the listing. Shares, equity certificates, bonds, certificates, some fund units and derivatives linked to financial instruments are traded on the Oslo Stock Exchange.

Trading in listed financial instruments may take place in regulated markets, on an MTF or OTF, in a dark pool or through an SI.

Information on the prices of the financial instruments traded on a regulated market is published regularly on the marketplace's website, in newspapers and/or through other media.

2.1 Share trading

Shares in a limited company entitle the owner to a percentage of the company's share capital. The share entitles the owner to a percentage of the dividends or other amounts distributed by the company. Shares also provide a ***right to vote*** at the general meeting, which is the company's supreme decision-making body. The more shares an owner has, the larger the owner's percentage normally is of the capital, dividend and votes. The right to vote may vary depending on the share category. There are two types of limited company in Norway, a ***public limited company*** (ASA) and a ***private limited company*** (AS).

Only shares issued by a public limited company (ASA) or a corresponding foreign entity can be listed on a stock exchange in Norway. In addition, there are requirements as to the company's size, business history and ownership spread and the publication of the company's finances and other operations.

Less stringent rules often apply to listing on regulated markets that are not stock exchanges.

In Norway, there are currently two ***regulated markets*** for trading in shares: the Oslo Stock Exchange and Oslo Axess. Only the Oslo Stock Exchange has a ***stock exchange*** licence (www.oslobors.no). Oslo Axess (www.osloaxess.no) is on the whole subject to the same rules as the Oslo Stock Exchange as regards follow-up, monitoring and the sanctioning of breaches of the regulations.

Shares may be listed on more regulated markets, so-called secondary listings. Several Norwegian companies have secondary listings on foreign regulated markets.

Trading in Norwegian shares also takes place on a number of MTFs.

Trading in shares that are not listed on a regulated market or traded on an MTF takes place in the so-called OTC market. Here, trading takes place to a large extent based on information about prices and interests that the brokerage firms disclose to each other. In Norway, the brokerage firms can enter interest in buying or selling shares in a trading support system run by NOTC AS, a company owned by Oslo Stock Exchange. The brokerage firms then enter into agreements to buy/sell over the phone. The companies registered on this list must publish price-relevant information in the NOTC's trading-support system. For more information on the NOTC List, refer to www.notc.no.

If a share is not listed on a regulated market or traded on an MTF and does not have buy and sell interests published in a trading support system, it will normally be sold by the brokerage firm trying to assist the client by contacting other clients who may be interested in becoming a counterparty. Investments in this type of shares entail a considerable liquidity risk and significant uncertainty regarding the determination of the price.

Trading in a regulated market or other trading system comprises the ***secondary market*** for shares and equity certificates that a company has already issued. In addition, the NOTC List functions as a secondary market for shares. If the secondary market functions well, i.e. if it is easy to find buyers and sellers and the offer prices from buyers and sellers and final prices of completed trades are continuously registered, companies benefit from the fact that it is easier to issue new shares and thus raise more capital for the company's operations. The ***primary market*** is the market where new issues of shares, equity certificates and bonds are offered/subscribed for.

Shares registered on a regulated market or other trading system are normally divided into various groups depending on the company's market value or liquidity. These groups, often called lists or segments, are usually published on the trading system's website, in newspapers and via other media. The companies listed on the Oslo Stock Exchange are divided into three different segments depending on the company's liquidity: ***OBX, OB Match*** and ***OB Standard.*** In addition, there is an ***OB New*** segment for recently listed shares.

The daily key prices at which the shares are traded, such as "highest", "lowest" and "latest", as well as information on the volume traded, are published in the financial press and on various websites run by marketplaces, investment firms and information vendors to the financial industry, among other places. The relevance of this price information may vary, depending on the way in which it is published.

There are various ***classes*** of shares, usually A and B shares, and these are normally important for the exercise of voting rights at the company's general meeting. Class A shares normally entitle the holder to one vote, while class B shares usually entitle the holder to a restricted voting right or no voting rights at all. The differences in voting rights may, for example, be due to the fact that, in conjunction with a diversification of ownership, the company wants to protect the original founders' and owners' influence over the company by giving these parties stronger voting rights. For the time being, only a few Norwegian listed companies have different classes of shares

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

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

A ***stock exchange introduction*** means that shares in a limited company are listed and admitted for trading on a regulated market. In connection with this, the general public may be invited to ***subscribe for*** (buy) shares in the company. The listing is normally motivated by the company wanting better access to the capital market and improved opportunities for trading in the company's shares.

An ***acquisition*** normally involves an investor or investors inviting the shareholders of a company to sell their shares on certain terms. A buyer that obtains 90% or more of the share capital and votes in the company can petition for the ***compulsory purchase*** of the remaining shares from those shareholders that have not accepted the acquisition offer.

A mandatory bid obligation arises when a shareholder becomes such a dominant owner that he can take control over a company. The Securities Trading Act states that this takes place when a shareholder becomes the owner of, or in some other way controls, more than one third of the shares in the company. A mandatory bid obligation arises once more if the dominant owner controls more than 40% and 50% of the shares. Anyone that exceeds such a limit and does not reduce his shareholding to below the limit again as quickly as possible, is obliged to make an unconditional offer to all the company's shareholders to buy their shares at the highest price that the bidder has paid in a given period.

Share issues raise new capital for a company. If a limited company wants to expand its operations, it often requires additional capital. It raises this by issuing new shares through a share issue. The main rule in the Norwegian Private Limited Companies Act is that existing shareholders have a pre-emptive right to subscribe for shares in the share issue. The number of shares that can be subscribed for is in such case determined by the number of shares already owned by the

shareholder and the company issues subscription rights to existing shareholders. The subscriber must pay a price (the issue price) for the new shares. This price is normally lower than the market price. The subscription rights will therefore have a certain market value and the price of the shares normally drops correspondingly after the subscription rights have been detached from the shares. Shareholders who have subscription rights but do not subscribe for shares, may during the subscription period (which in a rights issue must be at least two weeks), sell their subscription rights on the marketplace where the shares are listed. After the expiry of the subscription period and allotment of the shares, the subscription rights expire and are thus useless and worthless.

A limited company can also carry out a so-called ***private placement***, which is a share issue directed solely at a limited group of investors. In order to carry out a private placement, the shareholders must have decided to relinquish their pre-emptive rights to the new shares at a general meeting. Private placements often take place according to an authorisations given to the company's board by the general meeting. In the case of a private placement, the existing shareholders' percentages of the votes and share capital in the company are ***diluted***.

2.2 Share-like instruments

Equity certificates, convertible bonds/debentures and depositary receipts may have similar properties to shares. These types of financial instruments are traded on regulated markets, but can also be traded on the OTC market.

Equity certificates are very similar to shares. The difference is primarily related to the ownership of the company's assets and influence over the issuer's corporate bodies. There are also some restrictions on the distribution of dividend. The listed equity certificates in Norway are issued by savings banks. More information on equity certificates is available at www.sparebankforeningen.no.

Convertible bonds/debentures are interest-bearing securities which may be exchanged for new issued shares, within a certain period of time and at an agreed price. A convertible bond/debenture is both an interest-rate instrument and a call option. When the conversion rate is much higher than the share's market price, a convertible bond/debenture is normally priced in the same way as any other interest-rate instrument. If the opposite is true, the price of the convertible bond/debenture will reflect both the option value and interest element. In both cases, the price is expressed as a percentage of the nominal value of the convertible bond/debenture.

Depositary receipts are a financial instrument that gives the holder all the rights of an owner to an underlying financial instrument that is registered with a custodian. A depositary receipt is normally traded in the same way as the underlying financial instrument.

2.3 Interest-bearing financial instruments

An interest-bearing financial instrument is a claim against the issuer of a loan that has not yet fallen due. The return is normally provided in the form of ***interest (coupon***). There are different types of interest-bearing instruments, depending on who the issuer is, the *security* that the issuer has provided for the loan, the *term to maturity* and how interest is paid.

Instruments with a term to maturity of one year or less are often called certificates, while instruments with a longer term to maturity are called bonds.

Many interest-bearing instruments are assessed by independent analysis firms, so-called credit rating agencies. Such an assessment, called a **rating**, is intended to express the default risk on the issuing entity and the rated instrument.

The interest (coupon) is normally paid as either a fixed or floating interest rate. The interest on a fixed-interest loan applies to the entire term of the loan. The interest on a floating-interest loan is

normally set (fixed) four times a year for three months at a time based on the NIBOR interest rate and an agreed interest-rate mark-up (interest spread). The interest spread is fixed for the entire term of the loan unless it has been agreed that certain events are to trigger a change. It is not unusual for it to be agreed that the interest spread for loans that are not rated is to change if the loan achieves a predetermined satisfactory rating.

On certain types of loans, no interest is payable and only the nominal amount is repaid on the loan's maturity date (zero coupons). The purchase of zero-coupon bonds takes place at a considerable discount, which means that the effective interest rate is the same as for bonds on which a regular coupon rate is paid. For example, all the debts that the Norwegian state issues in Treasury bills (government certificates) are zero-coupon instruments.

The interest that a borrower has to pay is linked to the market's assessment of the risk of the debt being defaulted on. It is normal to classify loans in two main groups: High Yield and Investment Grade. Interest-bearing securities that credit rating agencies classify as being lower than **bbb** or the equivalent are considered to be more likely to be defaulted on and are therefore classified as high yield securities.

A number of bonds are listed on a stock exchange. The reporting of trades in these financial instruments takes place, like listed shares, on a regulated market. In addition, the Oslo Stock Exchange offers an alternative marketplace for trading in bonds and certificates that are not listed on a stock exchange – the ***Alternative Bond Market*** (ABM). The ABM is a separate marketplace that is not regulated by, or subject to a licence, pursuant to the Norwegian Stock Exchange Act but is administered and organised by the Oslo Stock Exchange.

Bonds are normally traded in a different way to shares. In practice, the interest and currency market is regarded as a ***quoting*** or ***price-driven market***, unlike the stock market which is an order-driven market.

2.4 Derivative instruments

Share options give the Holder the right to buy or sell a share. Acquired (bought) purchase options (call options) give the owner the right to buy, within a certain period, already issued shares at a predetermined price (strike price). Acquired (bought) sales options (put options) give the owner the right to sell shares within a certain period at a predetermined price (strike price). There is an ***issued/written*** (sold) option corresponding to each ***acquired*** option.

Index options provide a gain or loss linked to in the value of the underlying index and are settled by a cash payment of the difference between the strike price and market price when this difference is in the buyer's favour.

The price of options (premium/price) normally follows changes in the price of the option's underlying shares or index.

Call options with a longer term to maturity than standardised call options are called ***warrants***. Warrants may be used to buy underlying shares or to provide a cash settlement if a gain has been achieved as a result of the price of the underlying share being higher than the agreed future purchase price/selling price. Many exchange-traded warrants are issued by investment firms or banks as part of their derivative operations. Warrants can also be issued by the company itself. Such warrants are exercised by the company issuing new shares or selling shares it owns itself.

Derivative instruments are contracts that can be traded on the capital market for financial instruments. The derivative instrument is linked to an underlying financial instrument or an underlying index value.

Derivatives can also have other types of underlying value, such as a currency or commodity, or indices for these. Such derivatives are called currency derivatives or commodity derivatives and

are by nature similar to derivatives based on financial instruments. Below, the main focus will be on derivatives based on financial instruments.

Derivative instruments may be used for many different purposes:

- to protect against negative developments in the price of owned financial instruments.
- to achieve a gain on changed market prices without having to own or short sell the underlying financial instrument.
- to achieve a gain or return with a smaller capital investment than that required to carry out a corresponding direct trade in the underlying financial instrument.
- to agree on the sale of securities with settlement in the future.

The price of a call option or a forward/future will usually fluctuate in the same direction as the underlying financial instrument. Investments in derivatives will therefore to a large extent be based on the same assessments as investments in the underlying financial instruments, but an investment in a derivative will produce a risk profile that is different to that of a direct investment.

Investors in the derivatives market can also speculate in changes to secondary parameters that affect the price of the derivative, such as interest-rate changes and the volatility in the market.

In Norway, standardised derivatives are traded on the Oslo Stock Exchange. Derivatives with Norwegian shares and indices as underlying values are also traded on other marketplaces, including the NASDAQ OMX.

Trading in unlisted derivatives takes place on the so-called OTC market. Trading on this market takes place to a large extent on the basis of information regarding prices and interests that the brokerage firms notify each other of. It is also common for the brokerage firms to carry out own-trading in OTC derivatives and to offer prices and act as counterparties to their clients.

3. Risks relating to trading in financial instruments

3.1 General about risk

Financial instruments normally provide a ***return*** in the form of a ***dividend*** (shares and fund units) or ***interest*** (interest-bearing instruments). In addition, the investor may make a gain or loss due to the price of the instrument rising or falling. The total return is the sum of the dividend/interest and change in the price of the instrument.

Naturally, the investor is seeking a total return that is positive, i.e. that produces a ***gain***. However, there is also a ***risk*** that the total return will be negative, i.e. that the investor will make a ***loss*** on the investment. The risk of loss varies between different instruments. In an investment context, the word risk is often used to express both the risk of loss and the opportunity for a gain. In the description below, however, the word risk is used solely to designate the risk of loss.

There are various ways of investing in financial instruments in order to reduce the risk involved. It is normally better from a risk point of view to invest in several different financial instruments rather than a single one or only a few financial instruments. These instruments should have characteristics so the ***risk is spread*** and they should not gather risks that may be triggered simultaneously. Investors can also invest in negative positions in instruments (short positions). Such investments will increase in value when the share price falls.

The client personally bears the risk of an investment falling in value and must therefore become acquainted with the terms and conditions, prospectuses, etc., governing trading in such instruments, and with the instruments' individual risks and characteristics. The client must also regularly monitor his/her investments in such instruments. This is the case even if the client has received personal advice in conjunction with the investment. Information for use in monitoring prices and thus changes in the value of the client's own investments may be obtained from price lists published in the media, e.g. newspapers and the internet and, in certain cases, by the investment firm itself.

The client must continuously assess the risk entailed by his investments. Many different factors may affect the value of financial instruments. The client should therefore become familiar with the factors that affect different instruments and be aware of the elements that may affect his own investments. The client should continuously assess his investment portfolio and, if necessary, make changes to adapt it to his investment strategy and risk profile.

3.2 Shares and share-related instruments

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

The price may also be affected by the general **market risk** – the risk of a fall in prices in the market in general or in certain parts of the market where the client has invested. The price developments for financial instruments listed in ***foreign*** regulated markets may also affect price developments in Norway.

The price may also be influenced by developments in the sector to which the company belongs – **sector-specific risks** – the risk of a specific sector doing worse than expected or being altered by a negative event so that the financial instruments linked to companies in the sector in question may decline in value. The share price of a company is often affected by changes in the share price of other companies in the same industry/sector irrespective of the country to which the companies belong.

Other factors directly related to the company, such as changes in the company's management and organisation, disruptions to production, etc., may also affect the company's future ability to create profits in both the long- and short-term. This is called the **company-specific risk** – the risk of a company doing worse than expected or being affected by a negative event so that the financial instruments linked to the company may fall in value.

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

The ***general interest rate level*** (market interest rate) also plays a crucial role in share-price developments. If the market interest rate increases, investing in interest-bearing financial instruments may become more attractive so that the players transfer some of their investments from the stock market to the interest-rate market and the demand for shares falls. Normally, share prices fall when demand declines. In addition, share prices are negatively affected by an increase

in the interest payable on the company's debts, since this worsens the company's future financial results.

Changes in **foreign-exchange rates** may also affect share prices. Companies whose revenues and costs are in different currencies will be especially vulnerable to such fluctuations. This applies to several Norwegian export companies. When investing in foreign markets, fluctuations in foreign-exchange rates will also affect the result after the purchase or sales amount has been converted into Norwegian krone (NOK).

In the worst case, a company may perform so poorly that it must be declared ***bankrupt*** (***in liquidation***). The shareholders have last priority for receiving any money from the entity in bankruptcy. The company's other debts must first be repaid in their entirety. This results in there only in exceptional cases being any assets left in the company after its debts have been paid, so that the shares in a bankrupt company are normally worthless.

Players in the financial market have different opinions on how share prices will develop, often because they place emphasis on different factors that affect share-price developments or expect the factors that influence the share price to develop in different ways. This means there are both buyers and sellers. If many investors share the same opinion regarding price trends, they will either buy, thereby creating pressure to buy, or sell, thereby creating pressure to sell. Prices increase when there is pressure to buy and fall when there is pressure to sell.

The turnover, i.e. the quantity of a particular share that is traded, affects the share price. In the event of a high turnover, the difference, also called the ***spread***, between the price the buyers are prepared to pay (bid price) and the price demanded by the sellers (ask price) is reduced. A share with a high turnover, where large amounts can be traded without any major effect on the price, enjoys good ***liquidity*** and is thus easy to buy or sell. Shares in companies listed in a generally used benchmark index in a regulated market are normally very liquid.

3.3 Interest-bearing instruments

The risk associated with an interest-bearing instrument consists in part of the price changes that may occur during the term to maturity due to changes in market interest rates, and in part of the market's assessment of the risk that the issuer will be unable to repay the loan. Loans for which satisfactory security for repayment have been provided are thus less risky than loans without security.

For loans where the credit risk is considered especially high the issuer has to pay a particularly high interest rate. Such interest-bearing securities are often called **high-yield** bonds.

In the case of bankruptcy or debt settlement proceedings, the owner of an interest-bearing instrument may lose all or some of his investment. In the case of a bankruptcy, all debt must be repaid before the shareholders can receive anything, so in general it can be said that the risk of loss is less in relation to interest-bearing instruments than it is in relation to shares.

The market interest rate is quoted every day for both instruments with short terms to maturity (less than one year), e.g., ***certificates***, and instruments with longer terms to maturity, such as ***bonds***. This takes place in the money market and bond market. Market interest rates are affected by analyses and assessments conducted by Norges Bank (the central bank of Norway) and other major institutional market players with regard to short-term and long-term trends in a number of economic factors, such as inflation, the state of the economy and interest rate changes in other countries.

If the market interest rate increases, the price of interest-bearing financial instruments will fall since the return on the instrument compared to the market interest rate has become less favourable. Conversely, the price of already issued instruments increases when the market interest rate declines.

Loans issued by the Norwegian state, county councils or municipalities (or guaranteed by such organisations) are deemed to be more or less risk-free with respect to redemption at the predetermined value on the due date.

3.4 Risk related to trading in derivative instruments

Trading in derivative instruments is linked to special risks in addition to the risks linked to the underlying financial instrument. The client bears this risk and must find out all about the derivatives' properties as well as about the terms and conditions in the form of the general terms and conditions, prospectuses or suchlike that apply to trading in such instruments. The client must also constantly monitor his investments (positions) in such instruments. Monitoring information may be obtained from price lists on the internet, the mass media and the client's investment firm.

Trading in derivative instruments can be described as trading in, or a transfer of, risk. For example, a party that expects prices in the market to fall can buy put options that increase in value if the market drops. To reduce or avoid the risk of a fall in share prices, the buyer pays a premium, i.e. what the option costs. Trading in derivatives is in many cases not advisable for clients with little or limited experience of trading in financial instruments, since trading in derivatives often requires specialist knowledge. The structure of a derivative instrument means that developments in the price of the underlying asset affect the price of the derivative instrument. This price effect is often stronger in relation to the investment than the change in the value of the underlying asset. The price effect is therefore called the gearing effect and may lead to a greater gain on invested capital than if the investment had been made directly in the underlying asset. On the other hand, the gearing effect may lead to the loss on the derivative instrument being greater than the relative change in the value of the underlying asset. Changes in the price of the derivative instrument and of the underlying asset must therefore be closely monitored. The client should, for his own sake, be prepared to act quickly, often that same day, if the investment in the derivative instrument starts to develop negatively.

A party that incurs an obligation by issuing/writing an option or entering into a forward/futures contract must provide collateral for his position right from the start. The requirement for collateral changes as the price of the underlying asset rises or falls so that the value of the derivative instrument rises or falls. Additional collateral may therefore be required. The gearing effect thus also influences the collateral requirement, which may change rapidly and radically. If the client does not provide sufficient collateral, the clearing organisation or investment firm is entitled to terminate the investment (close the position) without the client's consent in order to reduce its risk. A client should thus closely monitor price developments and the collateral requirement in order to avoid the involuntary closure of the position.

The term to maturity of derivative instruments may vary from a very short time to several years. The relative change in price is often largest for instruments with a short (remaining) term to maturity. The price of a held option generally falls towards the end of the term to maturity as the time value is reduced. The client should therefore also carefully monitor the term to maturity of the derivative instruments.

Some derivative trades require that the client has to provide collateral (***margin requirement***), for example in the case of sales of options, purchases and sales of futures and forwards and swap contracts. The margin requirement will vary depending on, among other things, the underlying securities, type of instrument and the instrument's term to maturity and volatility. The margin requirement may also vary considerably from day to day. For his own sake, the client should be ready to act immediately to provide additional collateral (to meet any higher margin requirement) or to terminate his investments in derivative contracts (close his positions) by buying or selling (opposite) contracts.

3.5 The risk involved in various types of derivative instruments

The main types of derivative instruments are options, forward/futures contracts and swap contracts.

3.5.1 Options

An ***option*** is a contract which involves one party (the issuer (writer) of the option contract) undertaking to buy (Put Option) or sell (Call Option) the underlying financial instrument to the other party (the holder of the contract), at a predetermined price (the strike price), if the holder so demands. The date when the holder can exercise this right depends on the type of option in question. An ***American option*** may be exercised at any time during the life of the option. A ***European option*** may only be exercised on the expiration date. The holder pays a premium to the writer for the right stated in the contract. The price of the option normally follows the price of the underlying financial instrument. The main elements in the price of an option are the difference between the market value of the underlying financial instrument and the agreed strike price as well as a time value, which is an expression of possible future fluctuations in the value of the underlying financial instrument. The time value declines as the remaining life of the option is reduced, so that the price of a call option may fall even if the value of the underlying financial instrument has risen.

An investor must take all such price elements into account when considering whether to close a derivative position or maintain it.

3.5.2 Call options

By ***buying*** a call option, an investor obtains a ***right*** to buy the underlying financial instrument on a future date at a predetermined price. When an investor buys a call option, he pays an option premium plus the costs relating to selling and administering the option contract.

The maximum amount that the holder of a call option can lose is the option premium plus the costs paid. The maximum loss arises if the price of the underlying financial instrument remains lower than or equal to the agreed strike price.

The potential gain is in theory unlimited. When exercising the option, the gain is the value of the underlying financial instrument minus the strike price and option premium including costs.

By ***writing/selling*** a call option, the writer incurs a ***duty*** to sell (if the option holder demands to buy) the underlying financial instruments on a future date and at a predetermined price. The seller of a call option receives an option premium minus the costs of selling and administering the option contract.

The potential gain on issuing/writing a call option is limited to the net option premium. If the strike price remains higher than or equal to the market price of the underlying financial instrument until the expiration date, the holder will not normally demand to buy the securities and the writer can take the entire net option premium as profit.

The writer of a call option has an unlimited loss potential if the price rises. If the holder demands to exercise the option, the writer must buy the financial instruments in the market at the market price. The loss is calculated as the market value of the underlying financial instruments minus the strike price and option premium.

If the writer has hedged his interests by owning the underlying financial instruments (a covered call), no loss is payable if the price rises but the writer misses out on the increase in value in excess of the strike price plus net option premium. By tying up the underlying financial

instruments, the writer is exposed to the risk of loss due to a fall in price and a loss arises if the fall in value is greater than the option premium. If the underlying assets are sold, the writer is subject to a risk if the price rises again. Writers of covered calls often try to manage the risk of a price fall by selling some of the underlying assets.

3.5.3 Put options

The ***buyer*** of a sell (put) option obtains a ***right*** to sell the underlying financial instrument at a future date at a predetermined price. The buyer of a put option pays an option premium as well as costs related to selling and administering the option contract.

The maximum amount that the holder of a put option can lose is limited to the option premium and the costs paid. The maximum loss arises when the price of the underlying financial instrument remains higher than or equal to the strike price.

The potential for gain is limited to the strike price minus the option premium including costs. The gain is the strike price minus the value of the underlying financial instrument on the strike date and the option premium including costs.

The ***writer/seller*** of a put option incurs a ***duty*** to buy (if the holder demands to sell) the underlying financial instruments at a future date at a predetermined price. The seller of a put option receives an option premium minus costs related to selling and administering the option contract.

The potential gain on issuing/writing a put option is limited to the net option premium. If the value of the underlying financial instrument remains higher than or equal to the strike price, the holder will not normally demand to be allowed to sell the securities and the writer can take the entire net option premium as profit.

In the case of a fall in price, a loss arises when the value of the underlying financial instruments is lower than the strike price minus the net option premium. The loss is limited to the strike price minus the net option premium.

3.5.4 Forward/futures contracts

A ***forward/futures contract*** means that the parties enter into a mutually binding contract to purchase/sell the underlying financial instrument at a predetermined price, with delivery or other performance of the contract on a further agreed date.

No option premium is paid for forward/futures contracts but the agreed forward/futures price will normally be stipulated to be the spot price (the current market price) of the underlying financial instrument plus interest costs until the forward/futures settlement date. In addition, the costs of trading and administering the forward/futures contract must be paid.

Under a forward/futures contract, the ***buyer*** has assumed the entire price risk relating to the underlying financial instrument. If the price falls, a loss arises which is equal to the difference between the value of the underlying financial instrument and the forward/futures price. If the price increases, a corresponding gain arises, equal to the difference between the value of the underlying financial instrument and the forward/futures price. In addition to the price risk, the buyer runs a credit risk related to the seller delivering the agreed financial instruments on the settlement date.

A ***seller that owns*** the underlying financial instruments runs no risk of having to pay an amount relating to developments in the price of the underlying financial instrument but loses out on the increase in value in excess of the agreed forward/futures price. The seller runs a credit risk related to the buyer being able to settle the agreed amount on the settlement date.

If the ***seller does not own*** the underlying financial instruments, he has in principle an unlimited loss potential if the price rises. The loss is calculated as the value of the underlying financial instruments minus the agreed forward/futures price. Correspondingly, in the case of a fall in price, the seller has a potential for gain which is calculated as the forward/futures price minus the value of the underlying financial instruments. The seller also runs a credit risk related to the buyer being able to settle the agreed amount on the settlement date.

A forward/futures contract is a generic term for instruments with various calculation and settlement mechanisms but with the same risk profile. Forward/futures contracts that are to be settled by the physical delivery of the underlying financial instrument are often called forward contracts, while contracts that are to be settled by a monetary payment on the settlement date are called futures contracts.

The provision of collateral for forward/futures contracts is intended to safeguard against future fluctuations in price. Traditionally, the intermediary or settlement agent in a forward/futures contract has not provided collateral but has only demanded collateral from his clients, but the mutual provision of collateral is now increasingly being required.

In a futures contract, it is common to carry out a daily calculation based on the changes in the price since the previous stock market day in addition to providing collateral for future fluctuations.

3.5.5 Contracts For Difference (CFD)

Standardized futures with individual shares or indices as underlying instruments are currently often sold as CFDs. The sellers of a CFD often require a low security collateral margin so that investors can achieve a lot of market exposure at little expense.

A Contract for Difference is highly risky. It is possible to lose more than the original investment. Prices can move quickly in the opposite direction to that expected and losses can lead to a requirement of an additional margin contribution. Under certain market conditions, it can be difficult or impossible to close a position. This may occur, for example, when the price of an underlying instrument rises or falls so quickly that trading in the underlying instrument is restricted or closed.

The risk involved in such low margins is also that the issuer may immediately, including that same day, close the position if the value of the collateral falls below the margin requirement. The client is often given very short deadlines by which to provide more collateral and rapid fluctuations may lead to the issuer (in accordance with the contract) closing the position in contravention of the client's wishes.

The value of investments in CFDs with underlying instruments listed in foreign currencies may also vary due to changes in foreign-exchange rates.

A Contract for Difference is not suitable for all clients. The client must make sure that he fully understands the risk involved and seek independent advice if necessary.

3.5.6 Swap contract

A ***swap contract*** means that the parties agree to make payments to each other on a regular basis, for example calculated at a fixed or floating interest rate (interest swap), or to swap an asset with each other, for example different kinds of currencies (currency swap), at a certain point in time.

3.6 Standardised and non-standardised derivative instruments

Derivative instruments are traded in standardised and non-standardised forms.

Trading in ***standardised*** derivative instruments takes place in regulated markets and complies with contracts and conditions which have been standardised by a stock exchange or clearing organisation. The following regulated markets in Norway offer trading in standardised derivative instruments:

- **Oslo Børs ASA –** trading in standardised options and forward/futures contracts.
    - Trades on the Oslo Stock Exchange are cleared by SIX x-clear and the London Clearing House (LCH).
- **NASDAQ OMX OSLO ASA –** carries out trading in and the clearing of commodity derivatives, including financial power contracts, as well as freight derivatives.
- **Fish Pool ASA** – trading in salmon contracts
    - Trades on Fish Pool ASA are cleared by NASDAQ OMX.

Trading in foreign standardised derivative instruments normally complies with the rules and conditions of the country in which the stock exchange trading and the clearing are organised. It is important to note that these foreign rules and conditions are not necessarily the same as those which apply in Norway.

Some investment firms offer different forms of derivative instruments which are not traded o regulated markets. These are called ***non-standardised*** derivative instruments (OTC derivatives). A party wishing to trade in this type of derivative instrument should examine the contracts and conditions which regulate trading in these extremely carefully.

3.6.1 Clearing

When clearing derivatives, the clearing institution becomes the counterparty between the investment firms that represent the buyer and the seller of the derivatives contracts, and guarantees that the investment firm will receive settlement for the contract. The clearing institution acts as the seller in relation to the buying investment firm and as the buyer in relation to the selling investment firm. In the standardised derivative market, derivative contracts are often cleared by a licensed central counterparty (CCP). In the OTC market, it is often the investment firm that has this role.

At present, CCPs provide no direct protection to end-investors. In both CCP-cleared trades and OTC trades, the investor runs the risk that his investment firm will not fulfil the contract.

Investors who do not want to run any risk relating to their investment firm can enter into an agreement to have a segregated account in the clearing company. Such a solution requires a separate body of agreement and leads to increased costs, and is most suitable for large institutional investors.

4. Mutal Funds

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

A unit holder receives the number of fund units that corresponds to the percentage of the fund's assets under management that the unit holder has invested.

The units may be issued (bought from) and redeemed (sold to) by the management company. The unit's actual value is normally calculated daily by the management company and is based on

changes in the prices of the financial instruments in which the fund has invested. Some fund units can also be traded in a regulated market (***Exchange Traded Funds*** ("ETF")), see item 5 below.

One of the purposes of a mutual fund is to invest in several different shares and other financial instruments. This means that unit holders run less of a risk than shareholders who only invest in one e or a few shares. Unit holders do not have to select, buy, sell or monitor the shares or carry out other management work related to this.

Mutual funds are regulated by various laws and regulations.

UCITS funds are funds established in accordance with EU regulations and are therefore approved for marketing throughout the EEA. Most new funds that are established are UCITS funds.

Domestic funds are funds regulated by the Norwegian Securities Funds Act.

Alternative Investment Funds are fund-like investment entities that may be organised as limited companies or in other corporate forms that are not funds. These are regulated by a separate Norwegian Act relating to alternative investment funds.

For more information on mutual funds, see www.vff.no

Mutual funds are also classified on the basis of the fund's investment mandate. Below is a brief description of the most common mutual funds:

Equity fund - a mutual fund that must normally invest at least 80 per cent of its assets under management in shares (or other equity instruments), and which must normally not invest in interest-bearing securities.

Interest fund - a mutual fund that is to invest in interest-bearing financial instruments. These funds are divided into bond funds and money market funds.

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

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

Fund of funds - a mutual fund that invests its assets in one (or possibly more) underlying mutual funds.

Specialised fund – domestic funds that are often called hedge funds. Specialised funds are managed in a more flexible way than normal mutual funds. Specialised funds may have very different levels of risk and protection. They may entail a high level of risk-taking. Specialised/hedge funds often use investment techniques such as the extensive use of derivatives, short sales, the debt financing of investments and open currency positions. Units in specialised funds can only be offered to professional clients. This means that specialised funds cannot be marketed or sold to non-professional (retail) clients and this applies irrespective of whether the initiative is taken by the client or the investment firm. Specialised funds are under the supervision of Finanstilsynet (the Financial Supervisory Authority of Norway) and are also specially regulated by the Norwegian Securities Funds Act. Foreign hedge funds may be marketed in Norway to professional clients if Finanstilsynet grants permission for this.

5. Exchange Traded Funds and Fund-like products

ETP (Exchange Traded Products) is a generic term for ETF (Exchange Traded Funds) and ETN (Exchange Traded Notes). These products are traded in various trading systems, such as the Oslo

Stock Exchange. They allow exposure to shares, indices, currencies, commodities and suchlike. Some of the products include a gearing element. The exposure can either be to a falling/bear market (short) or a rising/bull market (long). There may be huge variations in the way in which these products are structured, so investors must find out a lot about the product they choose.

An ETN is normally issued by a financial institution (bank/brokerage firm) and traded in the secondary market in the same way as a share. With this type of product, the investor normally incurs a **credit risk** in relation to the issuer. The credit risk is the risk that the issuer or a counterparty will be unable to pay. This means that if the issuer does not manage to fulfil its obligations, the securities may be worthless.

ETFs are fund units issued by a mutual/securities fund. This means that, through ownership of the fund units, the investor directly owns underlying assets and thus has no credit risk in relation to the issuer.

Several ETPs contain derivative elements and/or have inbuilt gearing which can lead to the product having a high **market risk**. This means that their prices may fluctuate more than those of the underlying assets, and that the products will normally include a greater risk of loss than a direct investment in underlying assets such as shares. In addition, the geared products are rebalanced daily. This means that the return over lengthy periods will deviate from market developments when the gearing factor is taken into account. The return may be negative even if the underlying assets have the same value on the purchase and sales dates. These properties make the geared products less suitable as long-term investment alternatives.

The fact that underlying assets are often sold in other markets and listed in currencies other than NOK also means that investors must be aware of the possible **foreign-exchange risk**. This may mean that even if the underlying developments indicate that the security should produce a positive return, the return may shrink, disappear or be negative as a result of exchange-rate developments.

ETPs normally have one or more liquidity guarantors (market makers) that have undertaken to provide bid and offer prices for the security. However, at times it may be difficult to execute trades in the ETP in question. This may be the case if, for example, there is little **liquidity** or if trading in the marketplace in question has been closed.

6. Short trading

"Short trading" means to sell financial instruments that one does not own. According to Norwegian law, uncovered short sales are illegal, so that anyone selling short has to borrow the financial instruments from the investment firm or in some other way ensure access to the instruments on the settlement date. At the same time, the borrower undertakes to return instruments of the same type to the lender on a predetermined later date.

Short trading is often used as an investment strategy when the financial instrument is expected to fall in value. The borrower expects to be able to buy the borrowed instruments on the later date when the instruments are to be returned, at a lower price than the price at which these instruments were sold. If the price rises instead, the borrower will incur a loss which, in the case of a sharp price rise, may be considerable.

Often, agreements to borrow financial instruments stipulate that the lender may at any time demand the return of the financial instruments by giving two-three days' notice. This increases the risk involved in a short sale.

7. Trading frequency and costs

The more frequent the trades, the higher the brokerage costs, since costs are normally incurred for each trade (purchase or sale). If the brokerage costs over time are larger than the return, this will result in a loss for the client. Please note that brokerage costs are also incurred in debt-financed trades.

Trading in securities incurs brokerage costs that normally increase in proportion to the size of the trade. If, for example, a client sells shares worth NOK 50,000 and the brokerage rate is 0.2%, the sale costs NOK 100. If, on the other hand, shares are sold for NOK 500,000, the brokerage cost will be NOK 1,000. In addition, minimum brokerage fees are used, so that the sale or purchase of securities for a small amount may be percentagewise more expensive than selling/buying for a larger amount.

8. Leveraged (debt-financed) trading

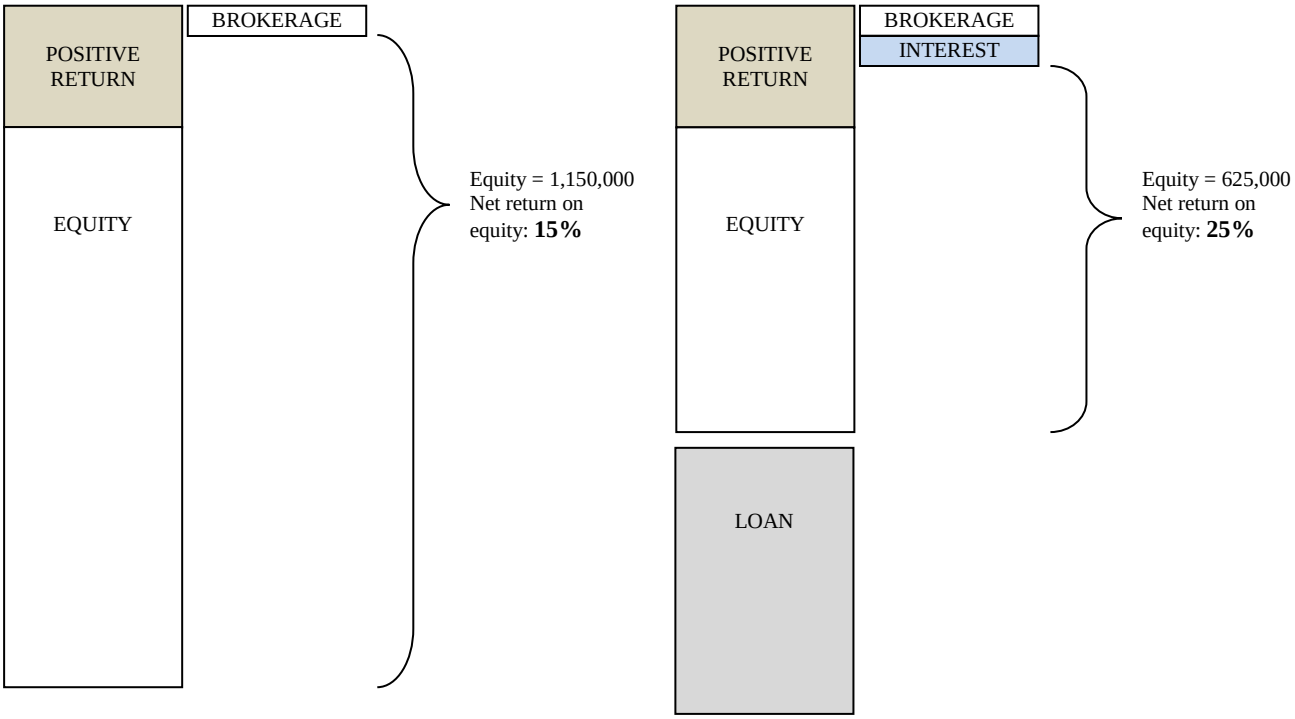
Financial instruments can in many cases be bought for partially borrowed capital. Since both the capital invested by the client and the borrowed capital affect the return, the client may make a larger gain through debt financing if the investment develops positively compared to an investment made using only the client's own capital. The debt linked to the borrowed capital is not affected by any rise or fall in the prices of the purchased instruments, which is an advantage if prices rise. However, if the price of the purchased instruments falls, this results in a corresponding disadvantage since the debt remains the same. In the case of a price drop, therefore, the client's own invested capital may be entirely or partly lost while the debt has to be repaid in whole or in part from the revenues from the sale of the financial instruments that have fallen in value. The debt must also be repaid even if the sales revenues do not cover the entire debt.

The risk entailed in a debt-financed share purchase increases with the level of debt financing. For example, a portfolio which is 80% debt-financed will lose all its equity if share prices fall by 20%. If the portfolio is 60% debt-financed, the equity will be lost if share prices fall by 40%.

The return on equity in a partially debt-financed portfolio will fluctuate more than in a corresponding equity-financed portfolio and the debt financing will only produce an additional return when the return on the investment is higher than the borrowing rate.

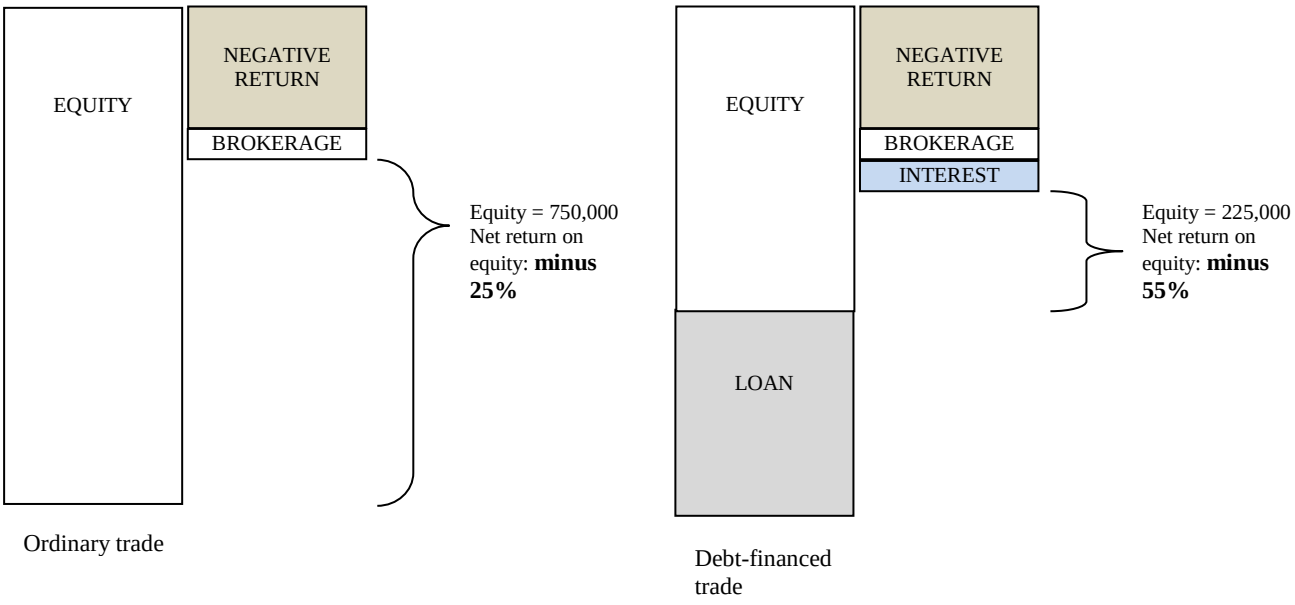
An illustration of a positive return in the case of partial debt financing is provided below.
Assumptions:

- 20% positive return
- NOK 1,000,000 invested in the market
- 5% brokerage (20 transactions each with a brokerage fee of 0.25%)
- 5% interest expense
- 50% debt financing



An illustration of a negative return in the case of partial debt financing is provided below.
Assumptions:

- As above, but a 20% negative return



INFORMATION TO CLIENTS CONCERNING THE PROPERTIES AND SPECIAL RISKS RELATING TO TRADING IN OPTIONS, FORWARD/FUTURES CONTRACTS AND OTHER DERIVATIVE INSTRUMENTS

The client must fully understand:

- that all trading takes place at his/her own risk
- the need to carefully study the conditions which apply to trading in derivative instruments
- that the conditions for trading in derivative instruments often change and must be constantly monitored
- the need to immediately check contract notes and complain about any errors
- the need to regularly monitor changes in the value of his/her investments and positions in the financial instruments
- that he/she must him/herself carry out the acts necessary to avoid the risk of loss on his/her own investments, for example by providing additional security or terminating his/her investments in derivatives contracts.

1. In general regarding the risks involved in trading in derivative instruments

Trading in derivative instruments is associated with certain risks which will be described in greater detail here. The client is responsible for the risks and must become conversant with the conditions, in the form of general business terms and conditions, prospectuses and suchlike which apply to trading in such instruments and with the instruments' characteristics, as well as the special risk that is linked to these instruments. The client must also constantly monitor his/her investments (positions) in such instruments. Information to assist in monitoring can be obtained from price lists published by the media and from the client's investment firm.

Some derivative trades may entail the client having to provide separate security (margin requirement), for example in the case of the sale of options without owning underlying shares or corresponding options, and the purchase and sale of forward/futures contracts and swap agreements. However, the margin requirement will vary depending on such things as the underlying security, type of instrument and the instrument's term to maturity and volatility. The margin requirement may also vary considerably from day to day. The client should, in his/her own interests, be prepared to take swift action should this prove necessary, for example by providing further security (to meet any margin requirement) or by terminating his/her investments in derivative contracts (closing out his/her positions) through the purchase or sale of (offsetting) contracts if this proves necessary.

For further information on trading in financial instruments, refer to INFORMATION TO CLIENTS REGARDING THE CHARACTERISTICS OF, AND RISK ASSOCIATED WITH, TRADING IN FINANCIAL INSTRUMENTS (SHARES, SHARE-RELATED INSTRUMENTS, BONDS AND MUTUAL FUNDS).

2. Use of derivative instruments

A derivative instrument is a form of agreement (contract) where the agreement itself is traded on the financial instruments market. The derivative instrument is linked to an underlying asset or an underlying value. This asset or value (described below simply as an asset) can be comprised of another financial instrument, another asset with a financial value (for example, a currency or commodity), or some form of value indicator (such as an index). Derivative instruments can be used to create a hedge against an anticipated unfavourable price development in the underlying asset. They can also be used to achieve a profit or yield with a smaller capital investment than would be required in order to trade directly in the underlying asset. Derivative instruments can also be used for other purposes. The use of derivative instruments is based on a certain expectation as to how the price of the underlying asset will develop over a certain period of time. Before starting to trade in derivative instruments, it is therefore important that the client is clear in his/her own mind as to the intended purpose and the price developments in the underlying asset that can be expected and, on that basis, chooses the right derivative instrument or combination of such instruments.

3. Various types of derivative instruments

The principal types of derivative instruments are options, forward/futures contracts and swap agreements.
For information on Exchange Traded Products (ETP), refer to chapter 7 in the document on INFORMATION TO CLIENTS REGARDING THE CHARACTERISTICS OF, AND RISK ASSOCIATED WITH, TRADING IN FINANCIAL INSTRUMENTS (SHARES, SHARE-RELATED INSTRUMENTS, BONDS AND MUTUAL FUNDS).

3.1 Options

An option is a contract which involves one party (the issuer (writer) of the option contract) undertaking to buy or sell the underlying asset to the other party (the holder of the contract) at a predetermined price (the exercise price). The date when the holder can exercise the right may depend on the type of option in question. An American option may be exercised at any time during the maturity period while a European option may only be exercised on the expiry date. The holder pays a premium to the writer and is then entitled to exercise the rights stated in the contract but has no obligation to do so. The writer, however, is obliged to fulfil the contract if the holder so wishes. The price of the option normally follows the price of the underlying asset. The risk run by the party buying an option is that it will be reduced in value or be worthless by the expiry date. The writer of an option runs a risk which, unless special precautions are taken, may be unlimited.

3.1.1 Call options

The buyer of a call (purchase) option obtains a right to buy an underlying asset at a future date at a predetermined price. The buyer of a call option pays an option premium and costs related to selling and administering the option contract.

The maximum amount the holder of a call option can lose is limited to the option premium and the costs paid. The maximum loss arises when the price of the underlying financial instrument remains lower than or equal to the exercise (strike) price.
The potential for gain is in theory unlimited. The gain is the value of the underlying financial instruments on the exercise date minus the strike price and option premium including costs.

The writer/seller of a call option incurs a duty to sell (if the option holder so requires and buys) the underlying assets at a future date at a predetermined price. The seller of a call option receives an option premium minus costs relating to selling and administering the option contract. The potential for gain on the issuance of a call option is limited to the net option premium. If the strike price remains higher than or equal to the market price of the underlying financial instrument, the writer is allowed to keep the option premium without the holder normally demanding to be allowed to buy the securities.

If the writer has hedged his/her interests by owning the underlying financial instruments, the writer does not incur a loss if the price rises but misses out on the increase in value in excess of the option premium. In the case of a fall in price, the writer incurs a loss if the price of the underlying security falls below the cost price of the security minus the option premium received. If the writer has not hedged his/her interests by owning the underlying financial instruments, he/she has an unlimited loss potential if the price rises. If the holder demands to exercise the option, the writer must buy the financial instruments in the market at the market price. The loss is calculated as the market value of the underlying financial instruments minus the strike price and option premium.

3.1.2 Put options

The buyer of a put (sell) option obtains a right to sell underlying assets at a future date at a predetermined price. The buyer of a put option pays an option premium as well as costs related to selling and administering the option contract.

The maximum amount that the holder of a put option can lose is limited to the option premium and the costs paid. The maximum loss arises when the price of the underlying financial instrument remains higher than or equal to the strike price.
The potential for gain is limited to the strike price minus the option premium including costs. The gain is the strike price minus the value of the underlying financial instrument on the exercise date and the option premium including costs.

The writer/seller of a put option incurs a duty to buy (if the holder demands to sell) the underlying asset at a future date at a predetermined price. The seller of a put option receives an option premium minus costs related to selling and administering the option contract.
The potential for gain on the issuance of a put option is limited to the net option premium. If the strike price remains lower than or equal to the price of the underlying financial instrument, the writer is allowed to keep the option premium without the holder normally demanding to be allowed to sell the securities.
In the case of a fall in price, a loss arises when the value of the underlying financial instruments is lower than the strike price minus the net option premium. The loss is limited to the strike price minus the net option premium.

3.2 Forward/futures contracts

A forward/futures contract means that the parties enter into a mutually binding contract to purchase/sell the underlying asset at a predetermined price, with delivery or other performance of the contract on a further agreed date.
No premiums are paid for forward/futures contracts but the agreed forward/futures price will normally be stipulated to be the spot price (the current market price) of the underlying financial instrument plus interest costs until the forward/futures settlement date. In addition, the costs of trading and administering the forward/futures contract must be paid.

Under a forward/futures contract, the buyer has assumed the entire price risk relating to the underlying financial instrument. If the price falls, a loss arises which is equal to the difference between the value of the underlying financial instrument and the forward/futures price. If the price rises, a corresponding gain arises, equal to the difference between the value of the underlying financial instrument and the forward/futures price. In addition, the buyer runs a credit risk related to the seller delivering the agreed financial instruments on the settlement date.
A seller that owns the underlying financial instruments bears no risk relating to developments in the price of the underlying financial instrument, he/she only runs a credit risk related to the buyer being able to settle the agreed amount on the settlement date.
If the seller does not own the underlying financial instruments, he/she has in principle an unlimited potential for loss if the price rises. The loss is calculated as the value of the underlying financial instruments minus the agreed forward/futures price. Correspondingly, in the case of a fall in price, the seller has a potential for gain which is calculated as the forward/futures price minus the value of the underlying financial instruments. The seller also runs the credit risk relating to the buyer being able to settle the agreed amount on the settlement date.

3.3 Swap agreements

A swap agreement means that the parties agree to make payments to each other on a regular basis, for example calculated at a fixed or floating interest rate (interest swap), or to swap some form of asset with each other, for example different kinds of currencies (currency swap), at a certain point in time.

4. Characteristic properties of derivative instruments

Trading in derivative instruments can be described as trading in, or the transfer of, risk. For example, a party that expects prices to fall in the market can buy put (sell) options which increase in value if the market falls. In order to reduce or avoid the risk involved in a fall in price, the buyer pays a premium, i.e., what the option costs. Trading in derivatives is in many cases not advisable for clients with little or limited experience of trading in financial instruments, since such trading often requires specialised knowledge. It is important that those intending to trade in derivative instruments are aware of the following characteristic properties of these instruments.
The structure of derivative instruments is such that the price developments in the underlying asset are reflected in the price of the derivative instrument. The change in price is often greater in relation to the amount invested than the change in the value of the underlying asset. The change in price is therefore referred to as a leverage/gearing effect and can lead to a larger profit on the invested capital than if the investment had been made directly in the underlying asset. On the other hand, the leverage effect may result in a greater loss on the derivative instrument compared to the change in value of the underlying asset if the price of the underlying asset develops differently to that expected. The leverage effect, i.e. the possibility of making a profit or risk of suffering a loss, varies depending on the derivative instrument's structure and scope. Monitoring the price developments in the derivative and underlying asset is therefore of the utmost importance. The client should, in his/her own interests, be prepared to act swiftly, often that same day, should the derivative instrument start developing in an unfavourable direction.

A party that assumes an obligation by writing an option or entering into a futures contract is required to provide collateral for his/her position from the outset. The collateral requirements vary in step with upward or downward movements in the price of the underlying asset that lead to the value of the derivative instrument increasing or decreasing. Further security in the shape of supplementary collateral may therefore be required. Thus, the leverage effect also has an impact on the collateral requirement, which can change quickly and radically. If the client fails to

provide enough collateral, the clearing organisation or investment firm is entitled to terminate the placement (close out the position), without the client's permission, in order to reduce the loss. Clients should therefore carefully monitor price developments and collateral requirements in order to prevent an unwanted closing out of their positions.
The maturity period for derivative instruments can vary from a very short period to up to several years. The relative price changes are often greatest for instruments with a short (remaining) maturity period. The price of a held option, for example, generally decreases more and more quickly towards the end of the maturity period due to the fact that the time value decreases. Clients should therefore carefully monitor the maturity periods of their derivative instruments as well.

5. Standardised and non-standardised derivative instruments

Derivative instruments are traded in standardised and non-standardised forms.

5.1 Standardised derivative instruments

Trading in standardised derivative instruments takes place in regulated markets and complies with contracts and conditions which have been standardised by a stock exchange or a clearing organisation. In the Norwegian derivatives market, for example, the Oslo Stock Exchange offers trading in standardised options and forward/futures contracts. The following regulated markets in Norway offer trading in standardised derivative instruments:

- Oslo Børs ASA* – (Oslo Stock Exchange) trading in standardised options and futures
- NASDAQ OMX Oslo ASA –commodity derivatives including financial power contracts
- Fish Pool ASA** – trading in salmon contracts

* All trades on Oslo Stock Exchange are cleared by VPS Clearing ASA.
** All trades on Fish Pool ASA are cleared by NOS Clearing ASA.

Trading in foreign standardised derivative instruments normally complies with the rules and conditions of the country where the stock exchange trading and clearing are organised. It is important to note that these foreign rules and conditions do not need to be the same as those which apply in Norway.

5.2 Non-standardised derivative instruments

Some investment firms offer different forms of derivative instruments which are not traded in regulated markets. These are called non-standardised derivative instruments (OTC derivatives). A party wishing to trade in this type of derivative instrument should examine the contracts and conditions which regulate trading in these particularly carefully.

6. Clearing

When clearing derivatives, clearing institutions become the contracting party between the buyer and seller of derivatives contracts and guarantee for the settlement of the contract. The clearing institution acts as the seller in relation to the buyer and as the buyer in relation to the seller. In the standardised derivatives market, derivatives contracts are often cleared by a licensed clearing institution. In the OTC market, it is often the investment firm that has this role.

7. Definitions

Option: a contract giving one party (the Holder) for a specific period a right, but not a duty, to buy (Call Option) or sell (Put Option) an agreed quantity of financial instruments at a predetermined price from/to the other party (the Writer).

Forward/futures contract: a contract according to which both the buyer and seller are tied to an agreed quantity of financial instruments being transferred from the seller to the buyer at an agreed price on an agreed date which is further into the future than the normal settlement date for the underlying financial instrument covered by the contract.

Option with a variable strike price: This is in principle a forward/futures contract but the margin security is paid in the form of an option premium. In addition to the purchase of an American call option, the purchase of the product includes the sale of a European put option with the same strike price. The European put option lapses if the call option is exercised or closed out. In addition, the product contains an option for the seller, in the case of a specified fall in the price of the underlying financial instrument, to demand the closing out of the option in return for the simultaneous issuance of a new option with a lower strike price and correspondingly higher premium.

Index option/Index futures contract: a contract where the underlying asset is an index value, not a security. Such a contract is settled not by delivering financial instruments but by calculating the contract's value in money.

Price swap: a contract that, from a risk point of view, is completely equivalent to a forward/futures contract but where the underlying financial instruments are not to be delivered on the expiry date. On the expiry date, a monetary settlement is carried out based on the difference between the swap price and the market price on the expiry date.

Short sale: the sale of financial instruments that a party does not own but has borrowed to carry out correct settlement. The financial instruments must be bought at a later date and handed back to the lender.

Securities swap: a combination of (at least) two financial instruments, in which a party buys one instrument (the long position) and sells the other short (the short position).

Underlying financial instrument(s): this is the financial instrument(s) that the option entitles the Holder to sell or buy, or the financial instrument(s) that it has been agreed to trade in a forward/futures contract or the financial instrument(s) that it has been agreed are to be the basis of a price swap settlement.

Exercising an option: this means demanding the trading of the underlying financial instrument in accordance with the option contract. Normally, the Holder may demand the partial exercise of the option while the option is maintained for the residual quantity.

The expiry date: the date when either a demand to exercise the option must be put forward or the option lapses as being worthless. The expiry date for a forward/futures contract is the date when the contract is settled by being changed into a trade with an ordinary settlement deadline for the delivery of an underlying financial instrument in return for payment of a purchase price.

The settlement date: the date when a forward/futures contract, option or price swap is finally concluded by the underlying financial instruments being delivered in return for the agreed purchase price or the monetary settlement falling due for payment. The settlement date is normally three stock exchange days after the expiry date.

American option or forward/futures contract: an option or forward/futures contract that the Holder may demand to exercise, in whole or in part, at any time prior to the agreed time on the expiry date.

European option or forward/futures contract: an option or forward/futures contract that the Holder may only demand to exercise on the expiry date.

Spot price/Spot rate: the price at which the security is traded for normal delivery on the third stock exchange day after the trading date.

Strike price/Strike rate: the agreed price for the exercise of an option.

Forward/futures price/Forward futures rate: the agreed price for the settlement of a forward/futures contract.

Swap price/Swap rate: the agreed price to be used when settling a price swap.

Option premium: the amount the Holder has paid the Writer for the purchase of the option.

Hedge shares/Hedge: if a seller of an option or forward/futures contract or swap does not want to run any price risk, he/she buys or short sells a quantity of the underlying security so that any increase in the value of the sold derivative is offset against a corresponding increase in the value of the underlying securities. The securities that in this way protect the issuer against a price risk are often called hedge shares or a hedge.
[This document is a translation of the Norwegian original. The Norwegian original shall be the sole authentic version and shall prevail in the event of discrepancies.]

Last updated: March 12th, 2012.

INFORMATION TO CLIENTS REGARDING THE CHARACTERISTICS AND RISKS OF CONTINGENT CONVERTIBLE SECURITIES (COCOS)

As a client, you must be aware that**:**

- trading in CoCos takes place at your own risk
- you must become familiar with and have a good understanding of the regulations, terms and conditions (including the loan agreement) applicable to the CoCo that you are to invest in as well as the CoCo's characteristics and risks
- you must become familiar with and have a good understanding of the type of institution that the issuer of the CoCo is
- you are responsible for monitoring changes in the value of the CoCos in which you have invested
- you must regularly assess your investments and make the necessary changes to adapt these to your investment strategy and risk profile

1. CoCos – in general about their characteristics and risks

A CoCo or "hybrid bond" is an unsecured interest-bearing financial instrument and thus comprises a debt that has not fallen due but is owed by the issuer, which is normally a bank or other institution that is subject to the capital adequacy requirement regulations and other financial legislation. That stated below refers to CoCos issued by banks.

Both commercial banks and savings banks may be issuers ("**Issuer**") of CoCos. For banks, the objective of issuing this type of bond is to meet the public capital adequacy requirements, or to achieve a capital adequacy level that is higher than the minimum requirements. If a bank is liquidated, the owners of CoCos will take priority over the owners of equity instruments (shares or equity certificates), but will rank behind the owners of subordinated loans and senior bonds and depositors, etc.

A CoCo must meet the requirements stipulated in regulations[1] in order to achieve the status of "other approved core capital". These regulations are based on EU rules. Internationally, bonds with these characteristics are called "contingent convertible securities", abbreviated to "CoCos".
CoCos are seen as a complex financial instrument because their characteristics can make it difficult to assess the risk involved. This can also influence their price in the secondary market.
The risk involved in CoCos is almost that involved in shares and equity certificates. The prices of CoCos will be affected by general fluctuations in the securities market, the bonds' variable liquidity and company-specific factors.

Finanstilsynet (the Financial Supervisory Authority of Norway) believes that CoCos are basically not a very suitable or expedient investment product for "consumers" and states that considerable knowledge and experience of complex financial instruments are required in order for an investor to be able to understand the risks associated with CoCos.
The regulation of CoCos creates the following risk elements:

[1] Regulations no. 435 of 1 June 1990 concerning the calculation of equity and subordinated loan capital.

- **The risk of a change to the regulations**
  - The regulations may be changed after a CoCo has been issued and this may directly affect the CoCo's characteristics and risks - since any changes to the regulations may affect the CoCo's characteristics and risks, any such changes in themselves entail a risk of the CoCo's characteristics and thus risks being changed.
- **Risk of being written down or converted**
  - The issuer must either (depending on the loan agreement) write down the value of the CoCo or convert the capital into pure core capital if the bank's pure core capital adequacy ratio falls below a stipulated percentage, currently 5.125%. However, this percentage may be altered by regulatory amendments that are determined either nationally or by the EU.
  - Finanstilsynet may instruct the Issuer to write down or convert the CoCo.
- **Risk of losing interest**
  - The Issuer may choose not to pay interest (coupon) without this being regarded as a default.
  - Finanstilsynet may order the Issuer to stop interest payments.
  - If the Issuer does not meet the capital adequacy requirements, interest payments must normally be expected to be stopped.
  - Interest that is not paid is not accumulated.
- **The risk of the investment horizon being longer or shorter than expected**
  - The loan is perpetual but the Issuer may on certain conditions repurchase all or some of the loan or redeem the CoCo after five years provided Finanstilsynet agrees to this. The Issuer may choose not to use the opportunity to redeem or repurchase (call) the loan.
  - The Issuer may, pursuant to the consent of Finanstilsynet, redeem or repurchase the CoCo if a change to the regulations leads to (all or some) of the capital no longer being counted as "other core capital" or if the tax treatment of the Issuer's CoCos is significantly altered.
- **Risk that the value will not be written up**
  - If it has had to write down the value of the CoCo, the Issuer *may* write up the value again by adding a share of the accumulated profit to it.
  - There are rules governing how quickly the Issuer can write up the CoCo again. These are among other things linked to the percentage of the profit that equals the percentage of the capital that the CoCo comprised before the write-down.

Updatet: April 20th, 2017.

INFORMATION TO CLIENTS REGARDING THE CHARACTERISTICS OF, AND RISKS LINKED TO UNSECURED BANK BONDS, CALLED SENIOR BONDS

As a client, you must be aware that:

- Trading in senior bonds takes place at your own risk
- You must find out about and have a good understanding of the special statutory regulations that apply to senior bonds and of the terms and conditions (including the loan agreement) for the senior bond in which you invest and its characteristics and risks
- You must find out about and have a good understanding of the type of institution that the issuer of the senior bond is
- You are responsible for monitoring changes in the value of the senior bonds in which you have invested
- You must regularly assess your investments and make the necessary changes in order to adapt these to your investment strategy and risk profile

1. Senior bonds – in general about their characteristics and risks

A senior bond is an unsecured interest-bearing financial instrument and is thus a claim that has not fallen due against the issuer, which will normally be a bank or other institution that is subject to the capital adequacy requirement regulations and other financial legislation. The senior bonds referred to below are those issued by banks but the same will apply to bonds issued by other financial institutions and investment firms that are covered by the same provisions of the Norwegian Financial Institutions Act.

Both commercial banks and savings banks can be an issuer ("Issuer") of senior bonds. The objective of issuing this type of bond is to finance the banks' general lending activities.

According to the Norwegian Bankruptcy Act, debt settlement proceedings or bankruptcy proceedings cannot be instituted in relation to a bank. A crisis-hit bank will be subject to authority-controlled administration or liquidation and separate crisis-management regulations are applicable[2]. The purpose of these regulations is to ensure that a crisis-hit bank can continue important parts of its operations or be liquidated without the Norwegian state having to contribute funds to the bank. In other words, the holders of senior bonds cannot assume that the Norwegian state has provided an implicit guarantee that banks, including the major banks, will be rescued by contributions of state funds in a bankruptcy-like situation.

There are two alternatives for crisis-hit banks. Either (1) authority-controlled crisis management or (2) authority-controlled liquidation. A crisis-hit bank will be liquidated unless it is in the public interest to "crisis manage" it in accordance with the special rules that apply to crisis management.

The statutory provisions governing crisis management authorise Finanstilsynet (The Financial Supervisory Authority of Norway) to among other things forcibly write-down unsecured senior bond debt or convert it into equity in the bank. This provision adds new risk elements to senior bonds that come in addition to the risk elements that apply in general to bonds. For further information on the general risk relating to bonds, read the risk memo entitled: “Information to clients regarding the characteristics of, and risks associated with, financial instruments”.

[2] Act of 10 April 2015 No. 17 on financial institutions and financial groups, chapter 20

If a crisis-hit bank is liquidated according to the regulations governing authority-controlled liquidation, holders of senior bonds have priority over owners of equity instruments (shares or equity certificates), contingent convertible securities (CoCos) and subordinated loans, but have priority after deposits. If the bank has in addition issued senior "non-preferred" bond loans, these will also have priority after an ordinary senior bond loan.

The following risk elements follow from the regulation of senior bonds:

- It is uncertain whether a crisis-hit bank will be dealt with according to the regulations governing authority-controlled crisis management or the regulations governing authority-controlled liquidation.
- The legislation and other regulations may be amended after a senior bond has been issued, and this may directly affect the senior bond's characteristics and risks. The Ministry may also issue regulations granting banks exemption from the rules in the Bankruptcy Act, Enforcement Act and certain parts of the Dispute Act. Because any amendments to the regulations may affect the senior bond's characteristics and risks, any such amendments to the regulations in themselves comprise a risk that the senior bond's characteristics and thus risks may change.

The following risk elements follow from the way in which the crisis management of banks is regulated

- The new order of priority as from 1 January 2019 means that deposits from private individuals and the SME market have priority over all other unsecured obligations. This means that if a bank is subject to crisis management, any loss incurred by unsecured bond holders may be higher than it would have been according to previous regulations.
- The potential losses incurred by investors in senior bond debts may differ depending on whether the institution has issued instruments that qualify as senior non-preferred debt.
- Finanstilsynet (The Financial Supervisory Authority of Norway) can write down the value of outstanding senior bond debt to zero or convert outstanding amounts into ordinary shares or other equity instruments.
- Finanstilsynet can order the bank to stop paying interest.
- The bank's assets may be transferred to a bridging bank or sold, which may result in the bank having a limited opportunity to meet its payment obligations.
- The term to maturity of and interest on senior bonds may be changed and payments can be suspended for a certain period.

Other risk elements during the crisis management

- The liquidity in the secondary market for senior bonds may be sensitive to changes in the financial market.
- Participants in other liquidity arrangements, such as repurchase agreements (repos) to which the bank is a party, may risk having to sell senior bonds at a substantial discount compared to the agreed price.
- Holders of senior bonds may be entitled to compensation if the amount they receive after a liquidation that takes place according to the crisis-management regulations is less than the amount they would have received following normal insolvency proceedings. The payment of any such compensation may take place far later than the agreed maturity date for the senior bond.

Updated: December 13th, 2018