

Description of Financial Instruments and Related Risks

Share

A share is an equity security that represents rights of a shareholder to participate in management, profit and liquidation balance after cancelling a joint-stock company with liquidation as a partner under the law and articles of a joint-stock company.

The share is an equity stake in a company. It has a predefined nominal value expressed in money equivalent.

The shareholder has the right to a share in profit of the company (dividend), which the general meeting decided to distribute depending on performance of the company. The shareholder does not have the right to any fixed, guaranteed yields or interests on his/her shares.

Yield

The yield from investment in shares involves a payment of dividends and foreign exchange profit/loss, which cannot be foreseen. The price of shares can increase and also decrease. The market price of shares is entirely derived from market demand and supply that are shaped by several other factors:

- Economic performance of a company (profit and loss),
- Negative or positive news about a company,
- General economic situation in a relevant country,
- Securities market situation and such factors.

The payment of dividends is not guaranteed. It depends on a decision made by the general meeting of a company. Investments in shares can only be converted into cash by selling such shares. A difference between a sale and purchase price is a profit or loss incurred by an investor.

Risk

Investment in shares is subject to a risk of a decline in the price of shares.

The price of a share can decrease in case of adverse economic performance of a company. Similarly, the value of a price can also decrease in case of a general sale of shares in a relevant country or region.

The price of shares denominated in a foreign currency can decrease or increase in case of appreciation of a local currency or depreciation of a foreign currency in which such shares are traded.

In case of shares in a non-liquid market, a demand for such shares may be lower at an appropriate price and they can be sold at a lower price as a result.

If the value of the share decreased and it is sold at a price lower than the purchase price, an investor will sustain a financial loss.

Trading

Shares are traded on public stock exchange or outside a stock exchange. Relevant stock exchange rules (traded volume, a type of orders, contractual settlement, and such rules) must be followed when trading on a stock exchange. If a share is listed on different stock exchanges in different currencies, it is exposed both to currency and exchange rate risk.

When buying shares on a foreign stock exchange, it should be remembered that foreign stock exchanges always charge a third party's fees, which are paid on top of regular bank fees. An advisor informs a client of the amount of such fees.

Bond

A bond is a debt security, in which a bondholder (“lender”) has the right to request repayment of a debt in a nominal value and payment of yields at a certain date and a party authorized to issue bonds (issuer, borrower) is obliged to meet such obligations. The bondholder does not have the right to attend the general meeting of the issuer and otherwise influence management of the issuer. The bondholder is in a position of a lender against the issuer and the issuer is a borrower vis-à-vis the bondholder. The bond expires after all yields and nominal value have been repaid.

Yield

Yields are commonly paid at regular intervals – annually, semi-annually or quarterly. The yields on bonds are called coupons. The coupon can be defined as follows:

- A fixed interest rate;
- A fixed interest rate and a share in profit;
- A difference between a nominal bond value and its lower issue rate;
- A lottery premium or a premium depending on term of bond maturity;
- A floating interest rate or development of exchange rates depending on volatility of interest rates or exchange rates in the financial market;
- Any combination of the above.

In addition to the coupon bonds, there are also so-called zero-coupon bonds. An investor, who holds a bond to maturity, will earn yields equal to a difference between the bond issue price and its nominal value.

Risk

Several factors influence the price of a bond, in particular:

- The amount of interest rates,
- The amount of a so-called credit surcharge for a relevant securities issuer,
- Liquidity of a relevant security, or an ability to sell it in a relevant market at a market price and liquidity of a relevant market,
- The exchange rate between a currency a bond is denominated in and a currency of an investor.

In case of holding a security, rising interest rates, a higher credit surcharge, a decrease in liquidity and appreciation of a local currency against a currency in which a bond is denominated have a negative impact on the price of a bond security.

As a result of adverse development of the above risk factors, the investor will sustain a loss.

Trading

Bonds are traded on public stock exchange or outside a stock exchange. Upon a client’s request, a bank can inform a client of a price at which certain bonds can be sold or bought. However, there is no entitlement to trading.

In case of bonds traded also on stock exchange, prices originated in such exchange can be substantially different from ones outside stock exchange. Setting a limit in an instruction to sell/buy can mitigate a risk of lower price.

Share Certificate

A share certificate is a type of security involving within titles of the holder (security holder) to hold a certain stake in the mutual fund's assets and revenues generated by these assets. .

The mutual fund represents assets held in common by the shareholders. The mutual fund is not an entity with legal personality. The Asset Management Company is responsible for creation and administration of the mutual funds. The Asset Management reports to shareholders for managing the assets in the mutual fund. The Asset Management Company charges the management fee for the rendered services, by which effect the net asset value is decreased.

For each mutual fund the statutes, sales prospectus and concise prospectus are available. These documents involve all-important information relevant for client's decision.

Types of mutual funds:

- Open-end funds – mutual funds in which the shareholder is entitled to request from the Asset Management company redemption of the share certificates from mutual fund's assets. It means that the investment made in the open-end fund can be at any time converted in cash. Redemption is usually performed within several days after the request for redemption has been filed.
- Closed-end funds – in which the shareholder is not entitled to be redeemed the share certificates value from mutual fund's assets. The shareholder may convert the investment in cash only upon sale of the closed-end fund's share certificates, which are traded at stock exchange. This type of funds is created for the fixed period of time. After expiry of the period, the shareholder will be either redeemed or the fund will be transformed into the open-end fund.

Yield

The yield involves two components – the changes to the market price of the share certificate and the yields paid out. The share certificate price may increase or decrease. The Asset Management Company shall pay the yields on annual basis, however the amount is not guaranteed. The market prices of the financial instruments held by the Asset Management fund determine the price of the share certificate. When assessing the market price development, the investor shall take into account composition of the assets within the relevant mutual fund and its investment strategy.

Risk

Risks inherent in the mutual funds vary from type of investment. For investments made in shares, bonds or other securities the risks related to shares, bonds, or other securities are relevant.

Risk associated with investments in shares, primarily stems from the price downturn due to deteriorated financial performance of the company or increased credit surcharges.

In case of investments in instrument denominated in foreign currency, the prices may decrease upon appreciation of the local currency or depreciation the foreign currency.

In event of investments in rarely traded instrument in the non-liquid market, the potential buyer who would purchase the share certificate at appropriate price may not be found, and the security will be sold at lower price.

If the value of the share certificate goes down upon investment, or the fees outpace the growth in prices, the investor will sustain loss.

Bill of Exchange

A bill of exchange is a marketable security. It is a written commitment bearing the prescribed form. A holder of the bill of exchange is entitled to claim disbursement in the set period or payment of the amount indicated on the bill.

Bill of exchange **requisites**.

- Name of the draft in a language in which the draft has been issued
- Date and place of issue
- Maturity
- Amount and currency
- Type
- Name and address of the beneficiary (drawer)
- Place of payment, (address)
- Drawee's name, address and signature

Types

Two categories of drafts are in common use:

- Trade bills – resulting from circulation of goods, representing payment instrument within trade operations,
- Financial bills – used for settlement of financial liabilities

Yield

The generated yield represents a difference between the amount the investor has paid at the B/E issue and amount paid on the maturity date. Should the bills be drawn by the bank, the deposit protection policy within the Fund of the Deposit Protection is not applied, since the B/Es are explicitly exempted from the deposit protection scheme.

Risk

This investment involves liquidity and currency risks.

Should the investor wish to sell the B/E before maturity, he/she may not find the buyer to purchase the B/E at the adequate price and the bill will be sold at lower price.

If drawn in the foreign currency, price of the bill may drop in event of appreciation of the local currency or depreciation of the foreign one.

If the bill is sold at the lower price than that of purchase, the investor will sustain loss.

Guaranteed Deposit

The guaranteed deposit is a term deposit bearing a higher yield. A specific yield amount, which is higher or comparable to that on term account is guaranteed. At the same time, payout of the deposited amount after the expiry of the fixed period is guaranteed. The deposit is protected under the Fund of Deposit Protection scheme.

Yield

The yield is determined by value of an underlying asset, derived for stock index or stock basket. The price of the guaranteed deposit may either grow or deteriorate. The market price is derived from the underlying asset's value, supply and demand in the market, while the latter is influenced by several factors based on deposit type.

Total yield comprises two components: the guaranteed yield and bonus yield. A client will obtain the bonus yield, if a condition for its payment has been satisfied in 3rd year.

The guaranteed yield is paid on annual basis. In 3rd year, if the payment condition has been satisfied, a bonus yield in the specific amount is paid in addition to the guaranteed yield.

Risk

Since this is a term account, the termination before maturity is either disallowed or the early termination fee is charged, while the charge exceeds the yield.

In the guaranteed deposit denominated in foreign currency, the value may drop upon appreciation of the local currency or depreciation of the foreign one.

Should 100% of the principal amount be guaranteed, direct loss may not be sustained, however, the yield from the guaranteed deposit without the bonus yield may be lower than that on other term account.

Term Currency Conversion (Forward)

A forward represents a transaction (commitment) of mutual exchange of two currencies with longer maturity than spot value date, i.e. min. D+3 and the future exchange rate is set on the day of commitment origination. It means fixing the exchange rate for future currency conversion that eliminates exchange rate risk for cash flow management in individual currencies. Forward exchange rate is based on spot exchange rate modified by forward points that represent interest rate differential for the period until the forward final maturity.

Types of forward transactions

- Delivery Forward
- Non Delivery Forward
- Time Option Forward

Yield

Yield is the difference between the actual spot exchange rate on the forward maturity date and the contracted forward exchange rate.

Risk

Exchange rate, local currency and foreign currency interest rates influence the forward price.

If these factors change at the expense of the investor he/she may suffer financial loss after performing the forward transaction or may post lower profit than he/she should make if he/she decided for interest-bearing deposit in local currency and later conversion with spot exchange rate or actual conversion and interest-bearing deposit in the foreign currency.

Currency Swap

A currency spot is a combination of currency spot and term transaction. It represents sale/purchase of one currency for another together with back purchase/sale after certain period for the exchange rate contracted in advance and the transaction amount remains the same.

Types of swap transactions

- Buy & sell – immediate purchase of the base currency + term sale of the base currency
- Sell & buy - immediate sale of the base currency + term purchase of the base currency

Yield

Yield is the difference between the actual spot exchange rate on the forward maturity date and the contracted forward exchange rate.

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Currency Option

A currency option gives the Buyer the right to buy or sell one currency for another for the exchange rate contracted in advance on the date contracted in advance. The option Buyer has the right, but not the obligation (comparing to the Seller) to perform the contracted transaction. The purchaser pays option premium for this right.

Two basic types of option are as follows:

A call option contract gives the owner the right (but not the obligation) to buy a specified amount of a currency for another currency at a specified price within a specified time.

A put option contract gives the owner the right, but not the obligation, to sell a specified amount of a currency at a set price within a specified time.

Types of currency options

- European option – may be exercised only at the expiry date of the option, i.e. at a single pre-defined point in time
- American option – may be exercised at any time before the expiry date

Yield

Yield is the difference between the actual spot exchange rate on the option exercise date and the contracted exercise option price.

Risk

The option may not be exercised and the Buyer pays only the option premium if the exchange rate is not developing favourably.

Selected Structured Products

DEPO+

DEPO+ is a deposit product allowing above standard deposit interest and participation in favourable exchange rate development. It takes advantage of the projected exchange rate development of the selected currency pair. It is designed primarily for clients who need to buy (or sell) different currency, but they are not happy with the actual spot exchange rate and have available funds meant to buy (or sell) on the current account bearing the standard interest rate.

VÚB, a.s., Mlynské nivy 1, 829 90 Bratislava 25

Obch. reg.: Okresný súd Bratislava 1

Oddiel: Sa, Vložka č. 341/B, IČO: 31320155, vub.sk

Two days before DEPO+ expiry date the contracted exchange rate for potential conversion is compared to actual NBS fix rate and if the development is positive the deposited funds are converted to the other currency at the contracted exchange rate. Otherwise the client will get the originally deposited currency.

Interest income is always credited in the original deposit currency.

Yield

Above standard deposit interest under any conditions is guaranteed. Moreover the client may earn further income representing the difference between the actual spot exchange rate on the DEPO+ expiry date and the exchange rate contracted for the potential conversion in case of favourable exchange rate followed by the currency conversion.

Risk

If the exchange rate is developing positively, but significantly exceeds the contracted level, the Investor loses the profit he/she had if he/she local currency deposit and exercised conversion later under market conditions.

BONUS DEPO

BONUS DEPO is a deposit product designed for clients who wish to have higher than market income from available funds. It makes the best of exchange rate fluctuation of a currency pair within the projected band during the monitored period.

Yield

If an exchange rate of a selected currency pair does not hit the set exchange rate band within the monitored period the bank pays out the principal and Bonus on the expiry date.

If an exchange rate gets over upper or lower level of the specified band during the monitored period the bank pays out the principal and guaranteed minimal interest (Malus) on expiry date.

Risk

Guaranteed minimal interest is usually lower than interest on a comparable term deposit. If the selected exchange rate has large fluctuations and Bonus is not paid out Investor may lose certain profit he/she had if he/she held deposit on a current term account.