Description of Nature of Financial Instruments and Inherent Risk

Applicable from 3 JANUARY 2018
for Danske Bank A/S Estonia branch, Danske Bank A/S Latvia branch and Danske Bank A/S Lithuania branch

1. GENERAL INFORMATION

This description of risks concerning securities and securities investments is general information. The investor should not make any decision based only on this information. Investment activities always involve the risk that the desired result is not achieved or the result of investment results in a loss. It should be kept in mind that the past performance is not a reliable indicator and does not guarantee the future returns.

Due to the fact that the risks and returns differ depending on the types of securities and the investors experience risks differently, the securities are broadly divided into two categories -non-complex and complex securities. Upon buying a specific financial instrument, the suitability and appropriateness of the instrument to the client is assessed, if needed (see more information in document "Classification of clients pursuant to MIFID II").

2. ABOUT THE SECURITIES

2.1. Shares

Share is a security which indicates that the holder of the share owns proportional part of a limited liability company. Holding a share gives certain rights -for example, the right to be entitled to a share in the profit distributed by the entrepreneur and right to vote in the general meeting of the shareholders. Exact rights and full overview (incl according to the type of share) are indicated in the law and the Statute of the joint-stock company.

The price of the shares reflects the market assessment to the expectations of future profit of the company. Price is influenced mainly by three types of factors:

- Internal, e.g. management competence, capability of the entrepreneur to create profit, etc;
- External, e.g. developments of a specific economic sector, market situation, etc;
- Global trends, changes in economic environment, etc.

The price movements of shares may take place during a very short time and unexpectedly. For example, the price of a share may change for more than 10% during few days. This means that the shares are securities with high level of risk. It is important to know that the investor may lose its whole investment since in case the company is going out of business, the shareholders are among the last ones who have the right to get compensation from the assets of the company.

Main risks of the equity investments are:

- Market risk;
- Issuer risk.

Share investments also often involve:

- Liquidity risk, especially in case of smaller companies;
- Currency risk in case of equity investments outside the euro zone where the base currency of the investor may significantly influence generation of profit or loss from the investment;
- Political risk, especially in case of investments to some developing markets;
- Tax risk, caused by taxation of securities transaction and custody and terms of the tax law;
- Legislative risk.

2.2. Bonds

A bond is a security based on which the issuer of the bond is obliged to pay back the nominal value and interest of the bond on an agreed maturity date (the investor lends money to the issuer of a bond). Main types of bonds are with fixed interest rate (most common group), floating interest rate (interest payable is associated with euribor or libor), and zero coupon bonds (there are no coupon payments -return is generated from the difference of bond issue or purchase price and nominal price paid at redemption of the bond).

Bonds may have different risk level. Ratings given by the rating agencies may help to orient in risk levels. In case of rating with investment grade (BBB-to AAA), the risks are lower. At the same time the bonds with non-investment grade (BB+ and lower rating) have higher risks. Rating agencies update the risk assessment and ratings with certain regularity. Depending on the developments of the economic and operational environment and company-based developments, the assessment may turn more positive as well as more negative and that may influence also the price of the bond.

Return from the bonds is mainly divided into two:

- Interest payments calculated based on nominal value of the bond;
- Profit or loss from trading the bond depends on the purchase and sales price of the bond which in turn are influenced by the changes of the level of interest rates in the market.

The price of the bonds with fixed coupon has the characteristic to change conversely with interest rates, i.e. when the interest rates rise, the prices of the bonds fall and

vice versa. The longer is the duration of the bond, the more extensive is the price movement per one unit of the interest rate change. For example, when the price of the 2% bond with 2 years remaining period would fall approximately 2% in case of 1% increase in interest rate, then similar price of the bond with 8 year remaining period would fall approximately 7%. In case of decline in interest rates, the price of the bond will increase in the same degree. Hence the longer-term bonds contain more interest risk than the shorter-term bonds.
Main risks involved in investment in bonds include:

- Interest risk;
- Credit risk;
- Issuer risk.

The bond investments may also involve:

- Currency risk. When the euro zone companies issue the bonds mainly in euros, then the more common currency in international debt market of the bonds, is US Dollar.
- It is necessary to examine the terms of the bond. Although, majority of the bonds are quite standard unsecured liabilities from which the fixed or variable coupon is paid with certain regularity, there are also series of sub-categories of bonds with their significant nuances. For example the secured bonds give the investor greater confidence that the invested funds can be recovered. In case of subordinated bonds, the investors are much more exposed to investment risk than in case of secured or standard unsecured bonds. In case of bankruptcy of the issuer, the investor who had invested in subordinated bonds can recover part of the invested funds when investors of standard bonds have received their funds;
- Elevated complexity. In case of structured notes, the size and time of redemption payment as well as coupon payment may, for example, depend on the price development of some underlying asset or occurrence of an event. In case of standard bonds, for example, an additional term useful for the issuer may be added. In case of some other type of bond, the issuer has the right to recall the bond earlier after some time. However, a right to demand early redemption of a bond may arise for the investor after a certain time, depending on agreed terms.

2.3. Investment fund units or investments to securities portfolios

Form of action of investment funds may vary by country. European Union mainly recognizes
contractual investment funds and funds founded as a public limited company, but also funds acting as trust funds.

UCITS or "undertakings for the collective investment in transferable securities" is a fund recognized in the EEA contracting state that conforms to the requirements provided in the European Union Council Directive 85/611/EEC (consolidated). Units of shares of the UCITS can be offered to public in all contracting states and this has higher investor protection.

Alternative fund primarily means an investment fund that is not a UCITS or a pension fund addressed to the retail investors. Examples of alternative investment fund is, the venture capital funds addressing the qualified investors, private equity investments funds, commodity funds and real estate funds.

Investment fund is a pool of jointly invested assets that belongs to the unit-holders of the fund according to the value of units in their possession. As a rule, investment funds are well diversified securities portfolios, hence the issuer risk and credit risk is remarkably lower than in case of direct investments to single shares or bonds. Depending on the structure of the assets invested to the fund (the fund may, for example, invest money to different shares, bonds or other funds), the risks of the funds may be different. Descriptions of risks are indicated in the prospectuses of the funds. Main risks of the securities portfolios are the same as of securities from which the relevant portfolio is formed. For example, the return of the fund investing to the shares is influenced by the decline in share price. The aim of diversification of the investments of funds as well as securities portfolio is to reduce the issuer risk and/or credit risk. Provided that different markets move differently, the aim of diversification is also to minimize market risk and/or interest risk. If diversification is limited to the issuers conforming to one economic sector, geographical region, investment style or other similar parameter, diversification may not reduce the above-mentioned risks.

3. FINANCIAL DERIVATIVES

Financial derivatives are contracts for determining a future purchase/sales transaction or compensation of certain price movement concerning certain underlying asset. When some derivative contracts may involve an obligation to deliver physical goods by certain time to certain place for certain price, then other derivative contracts include monetary net settlement in the extent of the difference in price movement.

Financial derivatives are instruments that initially have arisen in connection with the need to hedge risks but currently they are also used for the investment purposes. Financial derivatives may be related to, for example, with the prices of shares, share indexes, interest rates, bonds and debt indexes, currencies, mineral resources as well as agricultural produce.

Financial derivatives are used, for example, to:

- Protect oneself against movement of price towards adverse direction;
- Increase the investment return,
- Take specific investment visions towards some underlying assets (it is relied that, for example, the price of a share remains in moderate corridor for some time or that the short-term futures price of oil increases compared to the price of longer-term futures).

Financial derivatives may be standard or non-standard. In case of standard instruments, the main terms of the contract are always the same. Usually such instruments are traded in the stock exchange.

Non-standard instrument terms are agreed separately between the parties. Since the terms of such instruments follow the specific need and agreement of the parties, this excludes generation of an active after-market. Since these instruments are not traded in the regulated market, they are usually called also the off-exchange or over-the-counter (OTC) financial instruments.

Use of leveraged financial derivatives for investment may offer an opportunity for higher return but due to higher leverage the adverse movements in the price of underlying assets may be devastating for the value of the investment portfolio. Usually collateral is asked by the Bank to guarantee financial derivative trades. In case of bigger negative market movements, the initial collateral might not be sufficient and additional collateral is required. If it is not possible to provide additional guarantee, the financial derivative contracts are closed. If the earlier provided guarantee is not sufficient for covering the loss related to the financial derivative trade, the investor will have a debt towards the bank.

3.1. Options

Option is a security which owner has the right but not an obligation to buy (call option) or sell (put option) the agreed underlying assets with predetermined future price and date. The option owner pays the fee (option premium) to the issuer upon obtaining the option. If at the predetermined future time, the market price of the underlying asset has moved towards adverse direction, the loss is limited to the option premium paid for the option. This is at the same time the highest risk involved in purchase of options.

When the options are sold:
Option orders, which have to be completed with purchase/sales transaction involve the risk in sales between the transaction price with which the transaction with underlying security must be carried out and the price with which the underlying securities can be purchased (call option) or sold (put option) in the market. In both cases the loss may exceed the option premium the seller receives.

Cash-settled options involve the risk in sales that the option must be settled with unfavorable transaction price compared to the market price with which security it is traded at the moment of settling of the debt security. In both cases the loss may exceed the option premium the seller receives.

During the term of the option contract, the underlying asset price, expected price fluctuations of the underlying assets, dividends and money-market interest impact the market value of the option. Impact depends on the type of the option.

In case of early settlement, the seller may suffer the loss that equals to the absolute value of the negative market value.

When the options are purchased:
Risk in purchasing of options is limited to the paid premium.

3.2. Futures

Futures is an exchange traded security. The holder of futures is obliged to purchase or sell certain financial assets or raw material (underlying assets) with predetermined future price and date. Different from the option is that the option holder has the right to decide whether he or she desires or does not desire to perform the transaction at a predetermined time, the futures holder has to perform the transaction at a certain due date in any case. When it is not desired to receive/deliver the physical assets that form the basis of the futures, the futures position must be closed with the transaction contrary to the initial transaction latest on the last trading day. Trading with futures is connected with several risks:

- Leverage risk;
- Liquidity risk, especially in cases where it is impossible to realize positions;
- Risk that the stop-loss orders cannot be performed on a desired level may involve extensive loss, especially when using the leverage.

3.3. Forwards

Forward is a contract between two parties, where the holder of the contract is obliged to trade with certain financial assets or raw material (underlying asset) with predetermined future price and date. Different from the futures, the forward cannot be traded and so when possessing the forward, parties must be ready to perform the obligations upon maturity. Forward-related risks are similar to the futures-related risks except the ones that directly follow the fact that the futures are tradable securities and forwards are not. The following risks are related to forwards:

- Leverage risk;
- Security deposit insufficiency risk, i.e. risk that in case of extensive market movements a situation may occur where the security deposit or collateral does not cover the change in the value of the underlying assets due to the specified movement, and the investor must find additional guarantees during a short period. Otherwise there is a risk of closing the position;
- Transaction counterparty risk which may be expressed also towards the investor, i.e a situation may arise where the investor is not ready to perform its obligations on time and hence its counterparty may introduce sanctions towards the investor.

3.4. Swaps

Swap is a contract between two parties to swap certain interest payments, for example, a fixed interest rate against the floating interest rate (interest rate swap), or one currency against another currency (currency swap).

Swaps have high risk and as they are leveraged already a small change in the price of the underlying asset may cause high profits or losses for the investor. Theoretically the size of loss is not limited. To cover the possible losses, it is possible that the investor must pay daily additional guarantees and if the investor is not able to provide these in case of adverse price movements, the counterparty of the contract may require termination of the contract.

3.5. Structured notes

Structured note is an instrument that consists of the bond and usually several financial derivatives or underlying assets. Risk of the structured note is affected by the instruments it consists of. This may give the holder an opportunity to gain profit or suffer loss from the changes in the price of the financial instruments and assets used as underlying assets. Since the product consists of several underlying assets, this gives the investor an opportunity to diversify the risk of investing into one product. The return profile of the structured notes is sometimes complicated and this may make difficult comparing returns from investments into bonds with other investment opportunities. Sometimes the return profile may comprise the leverages, therefore even the smallest changes in the value of the underlying assets may essentially impact the value and return of the bond.

Structured notes may be with or without capital guarantee. In case of products with capital guarantee, the issuer repays the bond at a redemption date in a nominal amount of the bond. When the subscription price of the product is higher than the nominal price or the subscription includes a fee, the specified difference in price or the fee is the non-repayable expenditure related to purchase of the product. In that case, the return of the total investment may be negative (in case the bond's interest is modest or zero). In case of a product without the capital guarantee, there is no guarantee that the bond is redeemed at its initial nominal amount. In case of adverse market developments, the bond is redeemed in a smaller amount than the nominal amount and according to the worst scenario, the investor may lose all invested money.

3.6. Complexity of the investment

Structured notes are complex instruments that may involve elevated investment risk. Hence we recommend the investors to investigate the product related and additional information very thoroughly to be fully informed about circumstances that may impact the investment. It is important to keep in mind that the structured note is a "purchase and keep" type product and hence suitable for investors whose investment horizon is as long as the duration of bonds. Although the Danske Bank intends to show the bids and asks concerning the structured notes and carry out transactions in the future, it does not take any liability towards it and there is no guarantee that there will be an active after-market for the bonds and that it is liquid.

4. DESCRIPTION OF MAIN RISKS RELATED TO SECURITIES INVESTMENTS

4.1. Market risk.

The risk that the prices of securities or other assets may rise and decline due to circumstances not depending on the issuer of a certain security and influence so the value of the security. Bond's redemption price depends on specific terms but during the bond duration, the value of the bond is influenced also by several factors other than the underlying assets. General price level of the markets is influenced, among others, by economic indicators, serious circumstances, instability in ambient economic or political environment, etc.

4.2. Credit risk.

The risk that the issuer of the security does not perform its obligations or performs them only partially, and because of that, the price of the security may move towards undesired direction or the security may become worthless.
The credit risk can be minimized by diversification of the investment between several issuers, by analyzing the issuers during the investment and before investment. Independent rating agencies assess the credit rating of several issuers.

4.3. Settlement system risk.

The risk that settlement in settlement system of securities or other assets do not take place on set time or extent because the counterparty does not fulfill its obligations on time or to the full extent. To reduce the settlement system risk, it is more preferable to trade on regulated markets, e.g. stock exchange.

4.4. Liquidity risk.

The risk that the securities cannot be sold on time, with fair price or they cannot be sold at all since there is no counterparty in the market for the transaction. To minimize the liquidity risk, it is good to diversify investment between different issuers and markets.

4.5. Currency risk.

The risk that the value of the investment or the investment return changes towards adverse direction due to the changes in currency rates. The currency risk can be minimized by diversifying the investments between different geographical regions or using financial instruments designed for currency hedging.

4.6. Depository risk.

The risk of loss or destruction of assets kept by the depositary due to insolvency, bankruptcy, negligence or intentional act. To minimize the depository risk, the depositary is selected very carefully and it is monitored continuously during provision of depositary services.

4.7. Issuer risk.

The risk that the price of a specific security may move towards an adverse direction due to occurrence of adverse circumstances depending on the issuer (e.g. due to errors of the company management). The issuer's risk can be reduced by diversification of the investment between several issuers, by analyzing the issuers during the investment and before investment.

4.8. Issue risk.

In case there is not enough interest of the investors towards the product during the subscription period of the product or the market situation does not enable to open the product under indicated circumstances, the issuer has the right to cancel issuance. On the contrary, when the product is oversubscribed, the client may receive only a proportional part of his or her subscription volume.

4.9. Interest risk.

The risk that when the interest rates increase or in the situation of overall expectation of increasing interest rates, the price of the security (e.g. bond) with fixed interest rate declines. Interest risk can be diversified by investing to different markets which interest rates are mutually in low correlation and by diversifying the investment among interest instruments with different duration.

4.10. Counterparty risk.

The risk that the counterparty of the securities transaction does not perform its obligation partially or in full. The transaction counterparty risk can be minimized by selecting recognized and trustworthy partners as the counterparty for the transaction.

4.11. Political risk.

The risk that the changes in the country's legislation, structures governing the country, general political stability of the country or region will reduce the value of the issuer's security operating in a specific country or region. To minimize the political risk, the investments are diversified between different regions and countries of the world.

4.12. Concentration risk.

The risk that the value of the investment may be reduced due to concentration of assets or markets.

4.13. Legislative risk

The risk that legislation concerning operations with securities, including legislation regulating taxation system may change and influence the value of investor's assets in a negative way or reduce the investor's expectations towards the result of the investment.

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4.14. Leverage risk

Leverage is a situation where the value of the invested assets change to remarkable bigger extent than the market price of the assets. Value of the assets under leverage may unexpectedly become invaluable and depending on the guarantee agreement, obligations that lead to the situation where in addition to loss of invested assets, investor has additional financial liabilities towards the contracting parties may be imposed on the investor.

4.15. Tax risk.

Depending on the regulation, practice or a service valid on a specific market and provided by the depositary operating in a relevant market, the client might not be able to use the benefits following the double taxation convention entered into between its residence country and the securities holding state. Also the fact that the securities held by the client are stored at its consent by the depositary on an account opened on behalf of the bank may impact taxation. The result may be that the client's securities are handled as the bank's securities.