

**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), which is an attachment to the client agreement for investment services.

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), which is an attachment to the client agreement for investment services..

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, ie, 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.]