ESTABLY

Risks in securities trading

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Risks in securities trading

1 Introduction

1.1 Purpose and content

Trading in financial instruments involves opportunities, but also financial risks. In order to understand the various financial instruments and to be able to recognize and limit the risks associated with them, knowledge of their essential characteristics and risks is required.

Against the background of legally prescribed information obligations, this brochure aims to inform you about the basic terms, the most important types of financial instruments and the associated risks.

2 General risks associated with investments in financial instruments

2.1 General risks associated with investments in financial instruments

2.1.1 Issuer risk (credit risk)

Creditworthiness refers to the quality of a debtor, which is determined by its creditworthiness and solvency. The credit rating thus also reflects the ability to pay. Issuer risk is the risk of a debtor becoming insolvent, i.e. a possible inability to meet its obligations, such as dividend payments, interest payments, repayments, etc., on time or in full. This risk can be assessed by means of so-called ratings, a scale of evaluation of the debtor's creditworthiness. The rating is established by recognised rating agencies and ranges from "AAA" (best credit rating) to "D" (worst credit rating). The higher the creditworthiness risk, the worse the corresponding rating and the higher the interest (risk premium) on a financial instrument. The deterioration in the solvency or even insolvency of a debtor means at least a partial loss of the invested capital.

2.1.2 Settlement risk

A settlement risk always exists if you have to pay the purchase price in advance when buying financial instruments and only receive the securities after a time delay. In this case you run the risk of paying the purchase price and not receiving the purchased securities or not receiving them on time. The same risk exists in the opposite case, where you have to deliver financial instruments that you have sold without receiving the purchase price at the same time. Settlement risks occur primarily in emerging markets.

2.1.3 Guarantor risk

If a third party acts as guarantor for the issuer, the insolvency of the guarantor may make timely performance impossible (see also Issuer risk).

2.1.4 Inflation risk / monetary value risk

Inflation can reduce the value of an investment. The purchasing power of the invested capital decreases if the rate of inflation is higher than the return on the securities.

2.1.5 Market risk / price risk

The market or price risk is the potential fluctuation in value of a financial instrument. If the market value of the financial instrument falls, the assets are reduced.

2.1.6 Country risk / transfer risk

Investments abroad are exposed to country risk. Uncertain political, economic and social conditions in another country can have a negative impact on all debtors resident in that country. In financial terms, country risk manifests itself primarily in the form of exchange rate risks and transfer risks, which can impede or completely cancel out international payment and capital movements. The latter can take the form of foreign exchange controls, capital movement controls, debt rescheduling and, in extreme cases, the "freezing" of accounts of foreign business partners. In addition, there is a risk that political or exchange control measures may prevent or hinder the realisation of the investment or the payment of interest or dividends. Furthermore, problems may arise in the processing of an order. In the case of foreign currency transactions, such measures may also result in the foreign currency no longer being freely convertible.

2.1.7 Liquidity risk

The ability to buy or sell a financial instrument at any time at fair market prices is called tradability (= liquidity). In the case of liquid financial instruments, there is sufficient supply and demand so that a transaction can usually be concluded immediately. In the case of non-liquid financial instruments, there is no or only insufficient supply or no or only insufficient demand, so that a purchase or sale may not be possible at the desired time and/or at the desired price. Particularly in the case of unlisted public limited companies, securities of smaller companies (second-tier stocks), structured products, own issues and alternative investments or investments with sales restrictions, it must be expected that the market will not be liquid or will be temporarily illiquid.

2.1.8 Currency risk

If an investment in a financial instrument is made in a foreign currency, the income or performance of this transaction depends strongly on the development of the exchange rate of the foreign currency in relation to the investor's base currency (e.g. Swiss franc). Falling exchange rates lead to a reduction in the value of the foreign currency investment. Investors who only make investments in the currency of their country can exclude this risk. However, internationally active companies are more or less dependent on exchange rate developments. This can therefore also have an indirect effect on the price development of financial instruments.

2.1.9 Interest rate risk

Changes in interest rates on the money and capital markets have a direct impact on the prices of fixed-interest securities. Rising interest rates generally have a negative impact on the stock market quotations of equity securities and bonds. Falling interest rates, on the other hand, generally have a positive effect on prices.

2.2 Other general risks Purchase of financial instruments on credit („leverage“)

The purchase of financial instruments on credit represents an increased risk. The loan taken out must be repaid regardless of the success of the investment. Added to this are the costs of the loan, which reduce the return.

2.2.1 Risk when placing an order

Order placement is the order of a client to his bank to buy or sell financial instruments. Buy or sell orders must at least state which financial instrument is to be bought or sold in what quantity / nominal value at what price.

- **Market order:** With the order suffix "best" (without price limit) you accept any possible price; the purchase price or sales proceeds are uncertain. Market orders are usually executed immediately or according to the practices of the trading centre. Orders can be limited by setting limits to limit risk, but this may increase the risk of non-execution.

- **Price limit:** With a "buy limit" you can limit the purchase price of an order and thus the capital investment (price cap); i.e. no purchases above the price limit are executed. With a "sell limit ", the lowest acceptable selling price for you is determined (lower price limit), i.e. no sales below the price limit are carried out.

- **Time limit:** You can limit the validity of an order with a time limit. The validity of orders without a time limit is generally determined by the customs of the respective trading centre. Your client advisor will be happy to inform you about further order supplements.

2.2.2 Risks associated with the custody of financial instruments

Financial instruments are generally held in safekeeping where they are predominantly traded (in domestic or foreign markets). The regulations applicable there are therefore applied. Should your bank become insolvent, Liechtenstein law provides that the financial instruments deposited with your bank do not form part of the bankruptcy assets, but are segregated in your favour. However, insolvency proceedings may delay the transfer of the financial instruments to you or to another bank. If a third-party custodian becomes insolvent, the laws of many countries provide that the financial instruments deposited by your bank with the third-party custodian are also protected in principle. In less advanced markets, however, it may happen that the financial instruments deposited with a third-party depository there fall into the latter's bankruptcy assets.

3 Overview of the characteristics and product-specific risks of financial instruments

3.1 Bonds

3.1.1 What are bonds?

Bonds are securities for which the issuer (= debtor) undertakes vis-à-vis the holder (= creditor, buyer) to pay interest on the capital received and to repay it in accordance with the agreed terms (interest rate, issue price, maturity, denomination, repayment terms, paying agents, guarantees, etc.).

3.1.2 What are the most common types?

- **Medium-term notes** are medium-term, fixed-interest bonds that are issued on an ongoing basis according to the needs of the issuing bank.

- **Straight Bonds** are bonds issued by a public or private entity that is a cash benefit. They are long-term bonds issued for round amounts.

- **Eurobonds** are bonds of medium to long maturity (between 5 and 15 years) on the Euro capital market (Euromarket) which, unlike foreign bonds, do not correspond to the currency of the country of placement. They are usually issued by international bank consortia. Debtors are private companies, states and other public corporations as well as supranational institutions.

CAUTION: Euro Bond does not denote the currency, but merely means that the borrower is established outside the country in which the bond is issued. Thus, a Euro Bond may be issued in, for example, dollars or francs. The dominant bond currencies are US dollar, yen, Swiss franc, pound sterling and euro.

- **Notes** are privately placed medium-term debt securities of foreign borrowers, securitised in the form of securities. CAUTION: A private placement means that the securities are not traded on an exchange or regulated market, but are only made available to a limited circle of investors, which increases the liquidity risk.

- **Convertible bonds** are bonds that can be exchanged/converted into equity securities (e.g. shares) of the same company ("Convertible Bonds") or of another company ("Exchangeable Bonds") subject to certain conditions and requirements. If they are not converted, the bonds are redeemed at the end of their term at par or in accordance with the terms and conditions of the bonds.

- **Bonds with warrants** are bonds that give the holder the right to purchase a value (e.g. shares) regularly traded on a stock exchange or regulated market at a fixed price within a certain period of time in return for the warrant. This value (underlying) can be purchased in addition to the bond. These warrants can also be traded independently of the bond.

- **Mortgage bonds** are bonds issued by specially authorised mortgage bond institutions with specially structured security for the repayment and interest obligations. They are secured directly by a claim lien and indirectly by a real estate lien.

3.1.3 How are bonds traded?

Bonds are traded on an exchange or regulated market or over-the-counter. Your bank can provide you with a buy and sell price for certain bonds on request.

3.1.4 What are the potential earnings and returns

Income consists of interest on the capital provided and any difference between the purchase price and the achievable price at sale (e.g. issue price is lower than redemption price) or maturity.

CAUTION: A possible yield can only be stated in advance if the bond is held until the regular repayment date. If the bond is sold before the regular redemption date, the achievable sales price is uncertain and depends on supply and demand, i.e. the effective yield may differ from the yield originally calculated. When calculating the net yield, the expense burden must also be taken into account.

3.1.5 What are the risks in particular?

- Issuer risk / credit risk
- Inflation risk / Monetary value risk
- Market risk / price risk
- Liquidity risk
- Currency risk (for foreign currency bonds)
- Interest rate risk

3.2 Money Market Instruments

3.2.1 What are money market instruments?

The term "money market instruments" covers financial instruments that can be allocated to the money market on the basis of their maturity and their group of issuers and investors. Financial instruments are allocated to the money market if their term does not exceed 12 months.

3.2.2 What are the most common species?

The most common money market instruments include:

- **Certificates of Deposit** Money market paper with maturities generally ranging from 30 to 360 days, issued by banks.
- **Commercial papers** Short-term promissory notes with maturities generally ranging from 5 to 270 days, issued by large corporations.
- **Treasury Bills** Short-term debt obligation to a state (mainly USA, Canada, Great Britain).

3.2.3 How money market instruments are traded?

There is typically no regulated secondary market for money market instruments, i.e. there is no trading on an exchange or regulated market.

3.2.4 What are the potential yields and returns?

The potential returns and yields correspond largely to those of bonds.

3.2.5 What are the risks in particular?

Analogous to the potential returns, the risk components also largely correspond to those of bonds. Special features arise with regard to the liquidity risk. This consists in the fact that, due to the lack of a secondary market, it cannot be guaranteed that the bonds can be sold at all times. The liquidity risk fades into the background if the issuer guarantees repayment of the invested capital at any time and has the necessary creditworthiness. Due to the short maturity, the interest rate sensitivity of these instruments is lower than that of bonds.

3.3 Shares

3.3.1 What are shares?

Shares are securities evidencing the participation in a company (stock corporation).

3.3.2 What are the most common species?

- **Differentiation according to transferability** Bearer shares are very easy to trade, as the transfer of rights is effected by the transfer of the security. The shareholder remains unknown to the company. Therefore, bearer shares must always be fully paid up. In the case of registered shares, the shareholders are entered in a share register. Only those who are entered in it are recognised as shareholders. Registered shares with restricted transferability are shares whose transfer is restricted by the articles of association of the corporation.

- **Differentiation according to the rights associated with them** Compared with ordinary shares, preference shares enjoy certain privileges described in the articles of association with regard to dividends, subscription rights and liquidation proceeds. However, voting rights are often waived in return. Ordinary shares in this case are the ordinary shares. A special type of preference shares are voting shares. These are shares of the same company with a lower nominal value than the other shares, but with the same voting rights. There are also voting shares which, with the same nominal value, have a higher voting right. Companies can also issue securities similar to shares. These participation and dividend-right certificates give the owners, among other things, certain property or other rights described in the articles of association.

3.3.3 How are shares traded?

Shares can be traded on an exchange or regulated market as well as over-the-counter.

3.3.4 What are the potential earnings and returns?

The income from shares may consist of dividend payments, proceeds from subscription rights and price gains/losses and therefore cannot be predicted. The dividend is the portion of the company's profit distributed by resolution of the General Meeting. In exceptional cases, a dividend may be paid even though the company does not generate a profit. The amount of the dividend is expressed either as an absolute amount per share or as a percentage of the nominal value. With shares, shareholders thus participate directly in the economic success or failure of a company. As a rule, the more significant part of the income from shares results from the value/price development of the respective share.

3.3.5 What special rights and obligations exist?

In principle, a distinction can be made between membership rights and property rights:

- Membership rights at the General Meeting of the Company (AGM): These include the right to participate, voting rights, active and passive voting rights, control rights and the right to challenge resolutions.

- Property rights: These include in particular the right to dividends, the right to subscribe to new shares in the event of capital increases (subscription rights) and the right to a share in the liquidation proceeds.

3.3.6 What risks exist in particular?

- Issuer risk / credit risk
- Country risk / transfer risk
- Liquidity risk
- Market risk / price risk
- Currency risk

3.4 Investment funds

3.4.1 What are investment funds?

An investment fund is a legally separate body of assets constituted by a contract with identical content concluded by several investors with a management company and a depositary for the purposes of collective investment, management and custody for the account of the investors and in which the investors participate. The fund's assets are managed by a management company for the joint account of the investors, unless expressly stated otherwise, in accordance with the investment strategy and the principle of risk diversification. In the case of an investment fund, the money of numerous investors is thus pooled and reinvested. The following subcategories of investment funds exist: securities funds and non-securities funds.

Investment funds can be distinguished according to the law to which they are subject:

- Foreign investment funds which are subject to foreign legal provisions which may differ considerably from the regulations applicable in Liechtenstein.
- Domestic investment funds under Liechtenstein law, which are described in more detail below.

3.4.2 Investment funds under Liechtenstein law

Investment funds are regulated in Liechtenstein by various laws. With the Law on Certain Undertakings for Collective Investment in Securities (UCITSG) and the associated Ordinance (UCITSV), the European UCITS IV Directive has been transposed into national law for investment funds. In contrast, two laws exist for non-securities fund:

- - The Alternative Investment Fund Managers Act (AIFMG) and the associated Ordinance (AIFMV), and
- - Investment Undertakings Act (IUA) and the associated Ordinance (IUO)).

3.4.3 What types of investment funds are there?

According to the type of investment, the law distinguishes the following types of investment funds:

- **Undertakings for Collective Investment in Transferable Securities (UCITS)** Since

2011, undertakings for collective investment in transferable securities (UCITS or also called UCITS funds) have been subject to the law on certain undertakings for collective investment in transferable securities (UCITSG). This law governs the authorisation, supervision and investment activities of investment funds and their management companies. The law applies to all UCITS established in Liechtenstein or offered to the public in or from Liechtenstein. Since the Principality belongs to the EEA, Liechtenstein management companies and their UCITS funds benefit from direct access to the European market (European passport). The exclusive purpose of a UCITS is to invest money raised from the public for joint account in securities and/or other liquid financial assets in accordance with the principle of risk diversification as set out in the UCITSG and whose units are, at the request of the unitholders, directly or indirectly redeemed or paid out at the expense of the assets of these undertakings. Acts by which a UCITS seeks to ensure that the price of its units does not vary significantly from their net asset value are deemed equivalent to such redemptions or payments.

- The management company is constituted either in the form of a contract (a "unit trust" managed by a management company), an investment fund in the form of a trust ("collective trust") or in the form of a statute ("investment company"). The Investment Company must be a public limited company with variable or fixed capital.

- **Alternative Investment Funds (AIF)** The law on Alternative Investment Fund Managers (AIFMG) applies to all AIF managers of all types of funds that are neither UCITS within the meaning of the UCITSG nor investment undertakings within the meaning of the Investment Undertakings Act, irrespective of their legal or contractual form. In contrast to the UCITSG concept which focuses on the fund product, the AIFMG places the manager (AIFM) at the heart of the structure. The AIFM is responsible for compliance with the regulatory requirements. The AIF can be divided into the following forms:

– **AIF for liquid investments** comprise liquid investments to an extent of at least 70% of the net asset value (NAV).

– **AIF for illiquid investments** comprise illiquid investments to an extent of at least 70% of the net asset value.

– **Flex funds** is an AIF that may combine liquid and illiquid investments in accordance with its investment policy. The details of the investment policy must be set out in the constituent documents.

– **Leveraged AIF** are AIF for which the AIFM may use leverage financing in excess of three times the net asset value as set out in the AIFMV.

- **Investment undertaking (IU)** is any collective investment undertaking including its segments which is neither a UCITS under the UCITSG nor an AIF under the AIFMG, is exclusively intended for qualified investors and does not raise capital (nor market the units). The Investment Undertakings Act (IUA) regulates the four categories of IU for individual investors, IU for a family, IU for a community of interest and IU for a group:

IU for individual investors An IU which, according to the prospectus, is intended exclusively for a single qualified investor, does not invest assets which it has procured from more than one natural or legal person for the benefit of those persons with a view to investing and does not consist of an entity or structure which together have more than one investor.

IU for a family An IU intended exclusively for the investment of the assets of family members, irrespective of the type of legal structure, and whose sole investors are family members.

IU for a syndicate An IU intended exclusively for the investment of the assets of certain qualified investors of that syndicate, irrespective of the type of legal structure, and whose sole investors are members of that syndicate.

IU for a group of companies An IU intended exclusively for the investment of the assets of its group companies, irrespective of the type of legal structure that they may establish and whose sole investors are group companies.

ATTENTION: The above categorisation applies only to Liechtenstein investment funds. Foreign investment funds may be classified in other categories under certain circumstances.

ATTENTION: Hedge funds are considered investment funds with increased risk.

3.4.4 How are units in investment funds traded?

Investment fund units may be purchased and redeemed directly from the respective management company or AIFM, as the case may be, and/or traded on an exchange or regulated market. In the case of investment funds with variable capital ("open-ended fund"), the units may in principle be redeemed at any time at their net asset value (market value). The unit certificates are issued on an ongoing basis. Redemption may be restricted in special situations described in the prospectus.

ATTENTION: In the case of investment funds with fixed capital ("closed-ended funds"), the money is invested in specific investments. The number of unit certificates is determined in advance. It should be noted that in the case of these investment funds (e.g. SICAF), it may not be possible to redeem the unit certificates at any time.

3.4.5 What are the potential yields and returns?

The income of investment funds is composed of the annual distributions (unless the fund is an accumulation fund which does not make distributions but reinvests the income) and the development of the calculated net asset value of the investment fund and cannot be determined in advance. The performance depends on the investment policy laid down in the prospectus and on the market trend of the various assets of the mutual fund.

ATTENTION: Depending on the composition of an investment fund, special risk warnings must be observed.

3.4.6 Where to find essential information about a paricular investment fund?

A full prospectus must be drawn up for each investment fund, enabling investors to make a detailed assessment of the investments envisaged and to estimate the risks involved. For each investment fund, key investor information shall also be prepared, summarising the content of the full prospectus and containing in a clear and easily understandable form the most important information, in particular for the assessment of the investment policy, and an explanation of the risk profile.

3.4.7 What needs to be specifically taken into account for units in investment funds?

The duration of an investment fund depends on the provisions in the prospectus and is usually unlimited. Despite being redeemable at any time, investment funds are investment products that typically only make economic sense over a longer investment period (with the exception of so-called money market funds).

3.4.8 What are the risks?

The risks may vary depending on the investment strategy adopted by the mutual fund. The main risks are:

- Issuer risk / credit risk
- Inflation risk / Monetary value risk
- Liquidity risk
- Market risk / price risk
- Currency risk

3.5 Alternative (non-traditional) investments

3.5.1 What are «alternative or non-traditional investments»?

Alternative or non-traditional investments are investments that cannot be allocated to traditional asset classes such as equities, bonds or money market products. They comprise a wide range of instruments and strategies. The focus of this chapter is on precious metals and other commodities

The list is not exhaustive and this brochure cannot show all the risks and aspects that must be taken into account in alternative or non-traditional investments. You can invest both directly and indirectly in alternative or non-traditional investments.

3.5.2 What to look for when investing directly in alternative or non-traditional investments?

Direct investment instruments can be useful for diversifying a portfolio (risk diversification), because their returns depend less on factors such as stock market and interest rate trends than those of conventional investments. However, the minimum amount for direct investments is generally very high, and often they are not accessible to all investors.

3.5.3 What about indirect investments in alternative or non-traditional investments?

In order to remove these hurdles and to avoid the risks associated with large direct investments, the financial sector has developed instruments for indirect investment such as certificates, notes, funds, funds of funds, futures on commodities and futures contracts. All these structures are based on one or more of the investment categories mentioned below. If you are interested in indirect investments, you should not only consider the risks of alternative investments as an asset class, but also the risks of the respective instrument, such as the risks associated with structured products.

3.5.4 Precious metals and other commodities

What are commodities?

Commodities are physical goods produced, for example, in agriculture or mining, which are standardised with a view to use as the underlying asset for a transaction. Derivatives on commodities such as energy sources, precious and other metals and agricultural products are traded on futures markets. Contractual agreements give investors the opportunity to sell or purchase futures linked to the development of a specific commodity. This allows the investor to buy a standardized quantity of a commodity at a specified price at a certain point in the future. The most common way in which private individuals invest indirectly in commodities is through structured products. There are other ways to invest in commodities, such as instruments that are not admitted to trading on an exchange or regulated market, for example commodity swaps and options. These are traded directly between the parties concerned and are tailor-made products.

3.5.5 What are the risks of commodity investments?

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

- demand-supply balance
- Climate and natural disasters
- government programs and regulations, national and international events
- State intervention, embargoes and tariffs
- Interest and exchange rate fluctuations
- Trading activities in commodities and related contracts
- provisions relating to monetary policy, trade, fiscal and exchange controls

These variables may give rise to additional investment risks.

Commodity investments are subject to greater fluctuations in value than conventional investments, although commodity prices can often collapse even in the short term. The price volatility of a commodity also affects the value and thus the price of a futures contract on which the commodity is based. Conventional futures on oil, base and precious metals are usually easy to trade, regardless of their term.

CAUTION: A contract may become illiquid if market activity is limited. Depending on the development of the forward curve, such illiquidity can result in significant price changes. This is a typical feature of commodities.

4 Contact details

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