NATURE AND SPECIFIC RISKS OF THE MAIN FINANCIAL INSTRUMENTS

The present section is intended to communicate to you, in accordance with the Directive, general information on the characteristics of the main financial instruments and on the risks attached to them. More precise information can be obtained, on request, from your relationship manager.

1.1. Fixed income investments

1.1.1. Deposits and cash certificates

1.1.1.1. Definition

The term deposits refers to funds deposited with financial institutions, interest bearing or not, in return for which the financial institution in question is entitled to use these funds for the purpose of its activity, but with the requirement to return them to the depositor and to provide the latter with cash facilities.

We distinguish here between current deposits, term deposits, and term deposits, in euro and foreign currencies.

Cash certificates (bons de caisse/kasbons) are securities representing a claim on a credit institution, issued by such institutions "on tap", in most cases in minimum denominations of EUR 200, and for a period of 1 to 5 years, but occasionally also for 10 years and more.

In particular we distinguish (the list below is not exhaustive):

- ordinary cash certificates, where the interest rate is fixed permanently at the time of issue;
- floating rate cash certificates. Where the subscriber is entitled to claim reimbursement of the certificate at regular prescribed intervals, it being understood that the longer he holds the bond, the higher the interest will be;
- growth bonds, which offer the choice, at each due date, between capitalization and the accrual of interest;
- capitalization certificates, where the interest is automatically capitalized.

1.1.1.2. Risks:

- Foreign exchange risk for investments denominated in foreign currencies (evolution of the exchange rate compared to the reference currency), which will influence the return on investment;
- Risk of bankruptcy of the financial institution with which the assets are deposited or which issues the cash certificate.

1.1.2. Money market securities

1.1.2.1. Definition

Belgian treasury certificates are book-entry securities representing a debenture certificate with a term of 3, 6 or 12 months, issued by auction by the Belgian Finance Ministry.

These are adapted to the needs of professional investors. Private investors (retail clients) may also buy them on the secondary market.

Belgian government bonds are securities representing a debenture certificate, with a term between 3 and 10 years, issued by the Belgian Finance Ministry. The interest rate is fixed or open to revision, but in the latter case generally with a guaranteed minimum.

Only private individuals can subscribe. The minimum subscription amount is EUR 200.

Thanks to the X/N compensation system of the National Bank of Belgium, any private person or legal entity may hold them. This compensation system allows to distinguish between holders subject to withholding tax and holders who are exempted of withholding tax.

Treasury bills are securities representing a debenture certificate issued by commercial companies, as well as by certain public authorities (State, Communities, Regions, provinces, etc.) both Belgian and foreign. Their minimum amount may not be lower than EUR 1.000 or the foreign currency equivalent.

Certificates of deposit are securities representing a debenture certificate issued by Belgian or foreign credit institutions operating in Belgium. Their minimum amount is the same as for treasury bills.

1.1.2.2. Risks

- Foreign exchange risk for treasury bonds, treasury bills and certificates of deposit denominated in foreign currencies (evolution of the exchange rate compared to the reference currency), which will influence the return on investment;
- Risk of capital loss where the security is sold on the secondary market prior to maturity;
- Risk of bankruptcy of the issuer in the case of treasury bills and certificates of deposit (non-payment of interest and non-reimbursement of the invested capital);
- Liquidity risk, especially for treasury bills and certificates of deposit, if the secondary market for the securities involved is narrow;

1.1.3. Bonds

1.1.3.1. Definition

A bond is a security representing a claim on a corporate entity (state, commercial company, etc.) relating to a borrowing of a predetermined term (generally over one year) and amount.

The price (issue, trading or redemption price) of a bond may be equal to or higher or lower than its face value, depending on whether the bond is issued at, above or below par. Certain bond loans may be prepaid, generally at the issuer's initiative.

We distinguish in particular between (the list below is not exhaustive):

- fixed rate bonds: bonds whose interest rate is fixed and defined with respect to the face value of the bond;
- revisable rate bonds: bonds where the interest rate is not set once and for all, but can be revised (almost all of these bonds carry a minimum interest rate);
- floating rate bonds: bonds where the interest rate varies at certain regular dates according to the parameters defined at the time the bond was issued (a minimum rate is often guaranteed);
- bonds carrying warrants entitling their holders to subscribe to or acquire one or more shares or bonds: bonds carrying a right (warrant) entitling their holder to acquire or subscribe, during a specified period, a share or bond of the issuer of the warrant or of another company, at a price generally set in advance. The price of the bond and the attached warrant are frequently listed separately;
- convertible bonds and "reverse convertible": bonds which may, at the holder's request, be converted into new shares of the company, at the end of a certain period or at a specified date. The conversion of the bond into a share may require, in certain cases, the payment of a balancing amount to the issuing company. In the case of a reverse convertible, the conversion is at the initiative of the issuer;
- zero coupon bonds: bonds for which no regular interest payments are made, but for which the redemption price is higher than the issue price;
- subordinated bonds: bonds in respect of which the holder accepts, in case of bankruptcy, liquidation or any other situation involving the cessation of payment in respect of the issuer's assets, to be repaid (and/or be paid interest) after the creditor's unsubordinated debtors;
- linear bonds (OLO's): fixed-income, book-entry securities issued by the Belgian government by auction, in minimum denominations of EUR 1.000, and with terms varying between 3 and 12 years. Subscription is limited to certain categories of persons, primarily financial sector professionals. After subscription, these persons are required to promote and distribute the linear bonds among the general public (physical persons, companies, etc.).
- eurobonds: bonds issued by public authorities or private companies, outside their domestic markets, in currencies other than that of the borrower. These bonds are generally placed among the investing public by an international syndicate of financial organisations. As with other bonds, there exist different types of eurobonds (convertible eurobonds, eurobonds with warrants, with foreign exchange options, floating rate, zero coupon, etc.).

1.1.3.2. Risks

- Risk of non-payment of interest and/or non-reimbursement of the invested capital as a function of the debtor's solvency. This risk is higher when the bond is subordinated;
- Risk of capital loss where the bond is sold on the secondary market prior to maturity;

- Foreign exchange risk for eurobonds and bonds denominated in foreign currencies;
- Liquidity risk where the secondary market for the bonds in question is narrow.

1.1.3.3. Rating of the issuer

Most issuers of bonds are attributed a rating which is a standard rating attributed by independent rating agencies (Moody's, Standard & Poors, Fitch…). This rating is an indication of the credit profile of the issuer. As the rating increases (for instance, AAA), the default risk of the issuer falls. During the life cycle of a bond, the rating may be reviewed by the rating agencies, taking into account the economic and financial circumstances impacting the solvency of an issuer.

Ratings below à Baa3 or BBB- are considered to be speculative and may go to Ca or C (issuer in a state of default with little hope of recovery)

1.2. Equity investments

1.2.1. Shares

1.2.1.1. Definition

A share (or equity) is a co-ownership security issued by a Belgian or foreign company, which represents a part of the capital and entitles its holder, pro rata to his participation, to receive a dividend distributed by the company and, except where otherwise stipulated in the articles of association, to vote at the general meetings, often proportionally to the amount of capital held in the company.

1.2.1.2. Risks

- Risk of absence of income, given that dividends represent variable income, which depends on the profitability of the company and its dividend policy;
- Risk of volatility of stock market prices due to both the management of the company and the macroeconomic, microeconomic and financial climate;
- Risk of bankruptcy of the company issuing the shares;
- Foreign exchange risk for foreign shares;
- Liquidity risk where the secondary market for the shares in question is narrow.

1.2.2. Collective Investment Fund

1.2.2.1. Definition

Collective Investment Funds can take the form of: either investment funds (with assets held jointly by all fund holders), or investment companies (constituted as corporate entities), and are composed of: either a variable number of shares, in which case the issuing body is required to accept on a regular basis applications for the issue or repurchase of shares at the request of participants, based on the net asset value of these shares (open-ended investment funds or SICAVs), or a fixed number of shares, in which case participants wishing to dispose of their shares are required to find a buyer (closed-end investment funds). Collective investment funds are managed by specialists, and invest mainly, depending on the provisions of their issue prospectuses, in shares, bonds, other financial instruments (in particular in the shares of other collective investment funds), claims or real estate (Sicafi).

Depending on how the income is to be distributed, the shares in collective investment fund take the form either of distribution shares (dividends are distributed to shareholders) or capitalization shares (dividends are capitalized).

1.2.2.2. Risks

- In principle, the risks are identical to those of the shares, bonds and other categories of investments in which the collective investment funds invests, but the diversification of the collective investment funds investments basically mitigates the risks incurred;
- Liquidity risk in the case of collective investment funds with a fixed number of shares, if the secondary market for the shares of the particular collective investment fund is narrow.

1.3. Other securities

1.3.1. Structured products

1.3.1.1. Definition

"Structured product" is the term for a financial instrument which corresponds in most cases to a combination of several other financial instruments, very often options, the yield on which (received in the form of capital gain and/or interest) depends on the development of, as the case may be, indices, financial instruments, currencies, commodities or other underlying values.

1.3.1.2. Risks

- Risks (capital loss, volatility, foreign exchange, etc.) attached to the type of underlying asset;
- Risk of bankruptcy of the issuer of the structured product. In certain cases, where financial instruments are used in building a product, the risk of loss and/or profit can be modelled upwards or downwards in relation to a direct investment in the underlying security;
- Liquidity risk where the secondary market for the particular product is narrow.

1.3.2. Warrant

1.3.2.1. Definition

The warrant is a security giving the holder the right to purchase or subscribe to a specified number of shares or bonds of a specified company, at a date and price generally set in advance. The characteristics of the warrant are very similar to those of an option (see below).

1.3.2.2. Risks

- Risk of price volatility during the life of the warrant, which is a speculative investment instrument;
- Risk of loss, identical to that of an option, other than that, in the case of a warrant, the risk of loss is always limited to the amount of capital invested;

- Risk of bankruptcy of the issuer of the warrant;
- Liquidity risk where the market for the warrant in question is narrow.

1.3.3. Forward foreign exchange contract

1.3.3.1. Definition

A forward foreign exchange contract is a contract to buy or sell foreign currency at a date and price set at the time of concluding the contract. Payment is made only on delivery of the currency. There is no organised market for forward foreign exchange contracts. This means that these operations are governed only by individual agreements between the parties.

The characteristics of a forward foreign exchange contract are similar to those of a future (see below "Futures"). In a context of non-speculative management, these contracts enable an investor to cover his portfolio against possible foreign exchange risks, in return for taking a limited risk. Forward foreign exchange contracts can also be concluded for more speculative purposes, in order to take advantage of exchange rate fluctuations. In this case the risks involved can be greater.

1.3.3.2. Risks

- Risk of loss linked to how and for what purpose the forward foreign exchange contract is used (see above);
- Risk of bankruptcy of the counterparty;
- Liquidity risk in the sense that, in the absence of an organised market, the investor is unable to sell on his forward foreign exchange contract or to liquidate his position in advance, other than by agreement with his counterparty, unlike Futures (see below).

1.3.4. Swap

1.3.4.1. Definition

A distinction is generally made between currency (foreign exchange) swaps and interest rate swaps. A currency swap is a contract by which two parties agree to exchange, at dates determined at the time of concluding the contract, capital amounts denominated in different currencies. An interest rate swap is a contract by which two parties agree to pay each other, at dates determined at the time of concluding the contract, interest calculated in different ways on the same amount, known as the "notional amount". In general the swap involves interest amounts based on a fixed rate and on a floating rate. Different variants are possible, for example parties can agree to swap at the same time capital amounts denominated in different currencies and interest calculated in different ways on these capital amounts ("Interest Rate Currency Swaps").There is no organised market for swap contracts. This means that these operations are governed only by individual agreements between the parties.

Swap contracts have various uses.

In a context of non-speculative management, they enable an investor to cover his portfolio against any foreign exchange risks, in return for taking a limited risk. They can also be concluded for more speculative purposes, in order to take advantage of interest rate fluctuations. In this case, the risks involved can be greater.

1.3.4.2. Risks

- Risk of loss linked to how and for what purpose the swap is used (see above);
- Risk of default of the counterparty;
- Liquidity risk in the sense that, in the absence of an organised market, the investor is unable to sell on his interest rate swap contract or to liquidate his position in advance, other than by agreement with his counterparty.

1.3.5. Private Equity and Funds of Private Equity

1.3.5.1. Definition

The concept 'private equity' encompasses a variety of investment types, which have in common that they are private investments, in other words, not listed on any regulated market, and not very liquid. Hence, it is difficult to sell them before the maturity. Indeed, they require a long-term view (7 to 10 years or more). The objective of this type of investments is generally to generate high returns, but it also exhibits high risks of capital loss, which may amount to 100% of the principal invested.

- Private equity funds

  Typically, a private investment fund invests in a series of non-listed companies, pursuing an investment strategy that has been defined beforehand, in accordance with a series of predefined criteria. Investors in such a fund commit to putting in a certain amount of capital and they are supposed to provide investments upon request of the manager. Payments to investors are also spread in time, according to the sales realized by the fund. A private equity fund generally benefits from a certain level of diversification in the light of a particular strategy. Indeed, the manager deploys the capital in a portfolio consisting of several investments.

  The strategies which are mostly used encompass the buy-out, the venture capital, capital development, secondary funds, co-investment funds, etc. There are also private equity funds which specialize in private debt, investing in infrastructure, real estate, etc. Such strategies distinguish themselves in function of their cash flow and risk profile.

- Buy-out strategy

  This strategy, applied to a fund, consists of taking a controlling stake in the capital of a company, or at least a sizeable stake in the capital, comprising certain rights and an influence on the management of this company. By taking up the role of an active professional investor, the fund's objective will be to pursue or accelerate the development of the target company, and to sell it again with a profit. Value creation comes from revenue and cash flow growth of the target company, but also, and often, of the redemption capacity of the initial acquisition debt (hence, we speak of 'leveraged buy-out').

- Co-investment strategy

  This strategy consists of co-investing alongside private equity funds (most often buy-out funds) as a minority partner in one or several of their investments. Some private equity managers have developed funds deploying the capital of their investors exclusively in that way, by multiplying, in one and the same portfolio, partnerships with a series of distinctive fund managers.

- Secondary private equity strategy

  This strategy consists of acquiring, at particular private equity investors, their positions in existing private equity funds, mostly a couple of years after the launch of this funds, while this fund has already constituted its investment portfolio.

- Investments in direct private equity

  Acquiring a stake in the capital of a non-listed company is also part of the private equity concept in the broad sense of the word. Hence, we speak of direct 'private equity'. It may also be related to a co-investment, when an investor participates to such an operation alongside one of several partners. The risk profile of these investments depends on the type of intervention and on the development level of the target company (taking over the control of a company, often in collaboration with its management, capital injection in a start-up, management of the succession of a family company, etc.). Due to its very nature, private equity is targeted towards qualified investors, who have sizeable net worth, enabling them to engage in such investments with limited liquidity in the long term, and to take losses.

1.3.5.2. Risks

- Risk of capital loss linked to the evolution of the investments (please see above);
- Default risk of the companies being the subject of the investments;
- Illiquidity risk, as an investor, due to the fact there is no regulated market, may not sell his stake, unless an agreement is found with a buyer and the manager of the fund.

1.3.6. Real estate certificate

1.3.6.1. Definition

A real estate certificate is a transferable security giving its holder a claim on the income generated by a real estate investment (income from the letting of the building and any capital gain on its sale). Without being strictu sensu a legal co-owner of the building, the certificate holder is effectively an economic co-owner.

Risks:

- Unpredictable capital gain or repayment risk due to the lack of a guarantee on the maturity date and the net proceeds of sale of the underlying real estate right,

- Risk of absence of income in the event that the property represented by the real estate certificate is not leased out or in the event of an increase in the (real estate or financial) costs borne by the company issuing the certificate,
- Liquidity risk where there is no secondary market or the secondary market for the real estate certificate is narrow,
- Interest rate risk, if the rates are higher than the current yield (coupon) on the certificate.

1.3.7. Gold

1.3.7.1. Definition

The precious metal most used for investment purposes, generally acquired in the form of bars, coins or ounces of gold.

1.3.7.2. Risks

- Risk of price volatility, as a function of macroeconomic, financial and geopolitical developments;
- Foreign exchange risk, given that the price of gold is generally set in US dollars on world markets;
- Income risk: total absence of income/return.

1.3.8. Hedge Funds and Funds of Hedge Funds

1.3.8.1. Definition

The term “Hedge Fund” covers a variety of investment vehicles having in common the fact of undertaking non-traditional investment strategies, aimed at achieving an absolute performance, i.e. independent of the general economic climate or the development of the underlying sector. Depending on its management strategy (see below), the Hedge Fund can invest in equities, bonds, commodities, liquid assets, as well as leverage instruments (futures options, uncovered sales of assets).

For a long time Hedge Funds were reserved for institutional investors. So-called alternative management has, however, gradually become accessible to private investors through funds of funds, managed by professionals. The degree of risk attached to an investment in a Hedge Fund is linked to its management strategy. This risk level is generally – but not always – higher than that attached to an investment in collective investment funds (see above). In addition, hedge funds have a much smaller liquidity.

Among the many strategies available, there are three , each generating distinct risks in terms of performance and volatility:

- “Relative value” strategy

  This strategy seeks to benefit from a “malfunctioning” in the pricing of a particular financial instrument (equity, convertible bond, option, etc.). Quantitative or qualitative analyses serve in an attempt to identify financial instruments whose price deviates from the fair value or historic norm.

Relative value strategies generally exhibit low levels of volatility and are therefore less risky.

- "Event-driven" strategy

  This strategy seeks to take advantage of special situations affecting certain companies, which offer short-term opportunities for gain. Such special situation can be, for example, public takeover bids for cash or shares, management buy-ins/buy-outs, or other similar events that temporarily affect the price of a company's shares.

- "Opportunistic" strategy

  This strategy, generally aggressive in nature, aims to achieve gains by investing in assets of every kind on every kind of market, with uncovered purchases and sales and often using the leverage effect. Opportunistic strategies are among the most volatile and therefore the most risky.

  Funds of hedge funds for non-professional clients generally follow a low volatility management objective and seek a relatively stable return over time. This objective is achieved by diversification in terms of asset category, strategy and fund managers included in the Fund of Hedge Funds. The implementation of very specific investment strategies through hedge funds often generates relatively high fees (including performance fees).

1.3.8.2. Risks

- Risk of price volatility linked to the underlying assets and the management techniques used (uncovered sales, leverage effect, etc.);
- Risk of loss related to the way the hedge fund is managed. In the case of funds of hedge funds, the diversification of the investments attenuates in principal the risks incurred in terms of both volatility and potential loss;
- Liquidity risk: generally these funds can be redeemed only at fixed intervals (minimum one month) with sometimes fixed notice, or gates (exit barriers if too many assets are requested at the same time);
- Foreign exchange risk: hedge funds in currencies can be very volatile as a result of leverage.

1.4. Transactions involving derivatives

1.4.1. Options

1.4.1.1. Definition

An option is a right, but not an obligation, to buy (a buy or "call" option) or sell (a sell or "put" option) at a given price (the "exercise price" or "strike price") a specified number of underlying assets (shares, foreign currency, commodities, indexes, etc.) during a specified period (American-type option) or at a specified date (European-type option). The buyer of the option pays a premium to the seller. This premium depends in particular on the maturity and strike price of the option, as well as on the price and volatility of the underlying asset.

There may be two types of option exercise, the physical delivery of the underlying asset or the cash delivery corresponding to the payment of the (positive) difference between the value of the index on the strike date and the exercise price.

Options allow an investor to take large positions in return for a small investment. This leverage effect explains why a relatively small market movement will have a proportionally larger impact on the investor's portfolio. This leverage effect can multiply the investor's gains, but it can also multiply his losses, when the market fluctuates in the direction opposite to his expectations.

The writer (seller) is required to provide for cover, in particular on the BXS Derivatives market. In any writing (sale) of options, the investor is required to put up initial cover, in cash or securities, representing a certain percentage of the contract written. The option is revalued at the end of each trading day and, depending on the development of the market, the writer (seller) of the option may be required to provide additional cover. If the investor fails to pay the additional cover which he is required to put up, the broker is entitled to close his position.

At Degroof Petercam, coverage in cash or securities is requested of any client entering into an OTC contract, in order to cover the risk of this position. The amount of this coverage is calculated by risk management at issuance of the option.

Options have various uses. In a context of non-speculative management, they allow an investor to cover a portfolio against possible fluctuations, and to limit the risk of loss strictly to the price paid for the option.

Options can also be used for more speculative purposes, in order to benefit, in return for a limited investment, from fluctuations in the value of the underlying asset. In this case, because of the leverage effect (see above), options can give rise to larger risks than when holding shares or bonds directly. The risks attached to uncovered, or "naked" option trading (operations in which the investor does not hold the underlying asset) are in theory unlimited.

1.4.1.2. Risks

- Risk of price volatility, given that an option is a speculative investment instrument;
- Risk of loss linked to how and for what purpose the option is used (see above). The leverage effect can multiply the risks when the price of the underlying asset fluctuates in the direction opposite to the investor's expectations;
- Option buyer's risk, limited to the premium paid for this option;
- Option seller's risk: theoretically unlimited;
- Liquidity risk if the secondary market for the option in question is narrow.

1.4.2. Futures contracts

1.4.2.1. Definition

A futures contract is a contract to buy or sell an underlying asset (shares, bonds, foreign currencies, commodities, indexes, etc.) at a date and price specified when concluding the contract. The underlying assets are paid for only upon delivery.

Futures contracts enable an investor to take large positions in return for a small investment. This leverage effect explains why a relatively small market movement will have a proportionally larger impact on the investor's portfolio. This leverage effect can multiply the investor's gains, but it can also multiply his losses, when the market fluctuates in the direction opposite to his expectations.

A margin system is imposed on buyers and sellers of futures on most organised markets. For all transactions (purchase or sale), an initial margin deposit must be put up, in cash or securities, representing a percentage of the value of the contracts purchased or sold. At the end of every day's trading, contracts are revalued, giving rise to additional margin calls or margin credits, depending on the price of the future in question. If the investor fails to pay the additional margin which he is required to put up, the broker is entitled to close his position.

Futures have various uses. In a context of non-speculative management, they permit an investor to cover his portfolio against any fluctuations, in return for taking a limited risk. They can also be used for more speculative purposes, in order to benefit, in return for a limited investment, from fluctuations in the value of the underlying asset. In this case, because of the leverage effect (see above), options can give rise to larger risks than when holding shares or bonds directly. The risks attached to uncovered futures operations are theoretically unlimited.

1.4.2.2. Risks

- Risk of price volatility, given that a future is a speculative investment instrument;
- Risk of loss linked to how and for what purpose the future contract is used (see above);
- Liquidity risk where the market for the future in question is narrow.

1.5. Exchange traded products (ETP)

ETC/ETF instruments are used in our portfolios in order to capture exposure in an indexed way to some specific investment segments .

1.5.1. Exchange Traded Funds

ETF (Exchange Traded Funds), (also called "trackers") comply with European directives UCITS.

They are index funds that seek to replicate as closely as possible the performance of a stock market index, the "underlying", in a passive manner.

With these funds, it is possible to track almost all the indices of the world's main financial centres. Among the most popular indices are equity and sector ETFs (technology, sustainable development, etc.).

ETFs aim to replicate changes in their underlying index as closely as possible. Changes in performance between the ETF and its index are translated into a "tracking-error". The smaller the tracking error, the more the ETF fulfils its management objective: to replicate the variations of a market, but not to outperform it.

To match indices, managers can use a physical replication or synthetic replication method.

- Physical replication: the manager manages the ETF like a traditional index fund and holds " directly " the securities making up an index, whether equities or bonds.
- Synthetic replication: with this method, the securities are not held directly. The "synthetic" portfolio is constructed on the basis of derivatives (swaps, futures, etc.). They are responsible for duplicating the performance of the underlying.

1.5.2. Exchange Traded Commodities

ETC (Exchange Traded Commodities) offer the possibility to invest in single commodities and precious metals with ease. There are ETCs for precious metals, industrial metals, oil, natural gas, soft commodities and livestock.

The performance of an ETC is based either on the spot price (price for the immediate supply) or the future price (price for the supply in the future) of a single commodity or a basket of commodities.

ETCs are traded on the stock exchange just like ETFs and offer the same advantages. But there is an important difference: the capital invested in an ETC is not a fund asset that is protected in case of insolvency of the issuer. ETC concerns a debenture of the ETC provider. The investor has an issuer risk in case of an ETC as compared to an ETF. Issuers rely on different methods of collaterisation for minimization of this risk.

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