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Warning about Risks Associated with the Use of Investment Instruments

A risk can be defined as inability to achieve the expected return on invested capital, or complete loss of invested capital. This risk can result from a number of causes. It is therefore impossible to list all the types of risks associated with the use of investment instruments.

General Warnings about Risks

- Past yields from investment instruments are no guarantee of future yields.
- Investment involves the risk of fluctuating value.
- The return on originally invested funds is generally not guaranteed.
- The chosen strategy associated with the use of an investment instrument and the financial goals should correspond to client's risk profile.
- The higher the potential yield, the higher the risk.

The risk management system and organisation of risk management are based on products and services of Citfin – FT and on all other related activities. The organisation of risk management is based on defined rights and responsibilities arising from the organisational system and internal organisational structure of Citfin – FT.

Basic Types of Investment Risks

Foreign Exchange Risk

Foreign exchange risk is affected by the development of an investment instrument denominated in a foreign currency. In case of futures trades, this risk can mean that the client would have been able to potentially exchange foreign currency during or at the end of the maturity period for the trade at a better rate than at the time the trade was arranged. The potential losses may exceed the original value of the trade.

Interest Rate Risk

Interest rate risk arises from the inability to know future changes of market interest affecting the potential yield from the investment instrument. This risk becomes more significant with larger drops or increases in market interest rate. The value of a futures deal can change not only depending on the exchange rate, but also as a result of changes to interest rates of currencies traded on the market. This can have a significant impact on futures deals with longer maturity.

Solvency Risk

Solvency risk expresses the inability of a debtor to fulfil its obligations. It is associated with the risk of insolvency of the business partner. That may lead to temporary or definitive inability of the client to settle the foreign exchange futures trade.

Liquidity Risk

Liquidity risk means a situation where the volume of payables and receivables at a given time does not add up (more payables than receivables or other quick liquidity assets). The liquidity risk involves for example a late payment of an obligation by a third party and the resulting need for extending the maturity of a futures deal. This delay in maturity can bring additional costs.

Market Risk

Market risk is affected by fluctuations in yield rates and prices of investment instruments as a result of market fluctuations. Market risk encompasses a number of factors – the economic and macroeconomic development, consumer preferences and political changes.

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Credit Risk

Credit risk is a risk of losses arising from the failure of the contractual counter-party to fulfil its obligations according to the terms of the contract based on which the company became a creditor.

Operational Risk

Operational risk is associated with risks caused by human or technical failure, inadequacy or failure of internal processes or systems, influence of external events and breach or non-fulfilment of applicable legal standards.

Concentration Risk

Concentration risk involves a group of risks arising from disproportionate concentration of exposures to variously connected parties or groups of parties or to parties from the same domain or geographical area, or risks arising from the same activity, traded commodity or from other concentrations with a common risk factor.

Counter-Party Risk

The counter-party risk or credit risk is a risk involving the fact that counter-party of the deal cannot meet its obligations (provide services or other deliverables) to which it committed in the contract. Regarding futures, Ciftin FT is the counter-party for the client.

Specific types of risk connected with products offered by Ciftin FT

Risk connected with Ciftin FT futures

Futures risks are primarily associated with the current exchange rate that may turn negative for the client (the market exchange rate is more profitable for the client that the futures deal exchange rate), which may lead to a loss in the amount exceeding the value of the collateral provided by the client.

Risk connected with swaps

Swap transactions involve the exchange of assets (in case of foreign exchange swaps, currency swaps for a certain period of time; the price however remains at 100%), rights or obligations (in case of exchange rate swaps, replacement of a fixed interest rate with a variable rate and vice versa) for a specific period of time. The risk is that the client can sell or buy the assets exchanged for a (significantly) better rate or that the interest rate obtained or paid is lower/higher than what the client expected.

Risk connected with forwards

When trading forwards, the client commits to buy or sell certain underlying assets as a futures deal, i.e. with a future obligation but for the rate agreed today.

This brings the risk that the client can – after the period has ended – obtain or sell the underlying assets for a much better rate than that stated in the contract which the client signed. The potential loss is unlimited.

Leverage

The risk arises from investing little resources when compared with the nominal value of the futures deal purchased by the client. Leverage makes it possible for the client to trade and bear the financial risk in a bigger volume than what the initial investment was, e.g. by providing a deposit. This means that even a small change in the rate can bring a high profit but also a high loss for the client proportionate to the deposit placed. The client can be forced in this situation to stock up the collateral or make a counter-deal and implement the loss made.