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## ***FIXED INCOME RISK DISCLOSURE NOTICE***

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*This Notice is intended solely to inform you about the risks associated with a fixed income derivative financial instrument (the "Instrument") described below, and to ensure that you're aware of its nature and risks so that you are able to make informed decisions. We do not intend to provide any investment, legal, financial, tax or other advice through this Notice, and you should not rely on this Notice as a recommendation to enter into the transaction with the Instrument. Nothing in this Notice amends or supersedes the express terms of the transaction with the Instrument between you and us or any related governing documentation<sup>1</sup>.*

*We are acting solely as an arm's length contractual counterparty in connection with the Instrument, and not acting as your advisor, representative and/or fiduciary. Despite any communications between you and us in connection with or with respect to the transaction with the Instrument (before or after its settlement), SBERBANK CIB (UK) LIMITED ("CIB UK") neither provides any guarantees, representations or warranties, nor accepts any liability whatsoever, for any actual financial results, intentions or expectations you may have in connection with the Instrument or its conformity with any specific goals.*

*Notwithstanding any other provision herein, you may refer to your professional financial, legal and/or tax advisers for a full and comprehensive analysis of economic and legal nature of the Instrument, as well as its tax and/or accounting impact.*

*This Notice contains five sections, and will take you through the nature of fixed income derivative products, descriptions of the associated risks and volatility, the impediments to divestment of fixed income derivative products, the commitments or obligations of the investor (the "Investor") arising from a transaction, and any margin requirements, associated with transaction.*

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<sup>1</sup> In this notice,

- "we", "us" refer to CIB UK;
- "you", "your" refer to each person to whom this Notice is delivered or addressed in connection with entering into, executing or agreeing upon the terms of, transactions with the Instrument and any/or of associated or affiliated companies and their directors, officers, employees and agents.

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## Table of Contents

1.	NATURE OF THE PRODUCT .....	3
1.1.	Credit Default Swap (CDS) .....	3
1.1.1.	Key characteristics .....	3
1.1.2.	Legal nature of the instrument .....	4
1.2.	Bond Forward .....	5
1.2.1.	Key characteristics .....	5
1.2.2.	Legal nature of the instrument .....	6
2.	DESCRIPTION OF RISKS AND VOLATILITY .....	8
2.1.	Types of risks included .....	8
2.1.1.	Market Risk .....	8
2.1.2.	Insolvency and Credit Risk .....	9
2.1.3.	Operational Risk .....	9
2.1.4.	Regulatory/Legal/Tax Risk .....	10
2.1.5.	Settlement Risk .....	10
2.2.	Leverage .....	11
2.3.	Price volatility .....	11
2.4.	Scenario Analysis .....	12
2.4.1.	Credit Default Swap (CDS) .....	12
2.4.2.	Bond Forward .....	13
2.5.	Explanation of capital protection or guarantees .....	14
3.	IMPEDIMENTS FOR DIVESTMENT .....	15
3.1.	Barriers to divestment .....	15
3.2.	Illustration of possible exit methods and consequences .....	15
4.	INVESTOR COMMITMENTS OR OBLIGATIONS .....	17
5.	MARGIN REQUIREMENTS .....	18

# 1. NATURE OF THE PRODUCT

The following section defines what a fixed income derivative is, describes in more detail a Credit Default Swap (CDS) and Bond Forward, and outlines their key characteristics and legal nature. Each of the fixed income derivative types is defined in a separate sub-section.

Broadly speaking, a derivative is a financial instrument, which derives its value from the value, price or level of an underlying asset (the "Underlier"), such as but not limited to interest rates, foreign exchange rates and currencies, credit instruments, equities, commodities, and other market and/or economic factors. The Instrument may be used by counterparties to exchange money, assets or some other value as of any future date(s) based on the performance of the Underlier, instead of trading or exchanging the Underlier itself.

Fixed income derivatives involve, or at the option of either party may involve, the exchange of payments referred to debt of a certain obligor, usually a corporation or government ("reference entity" or "reference obligor").

The terms of a fixed income derivative transaction may incorporate standard definitions published by industry bodies, annexes and supplements thereto, master confirmations and other market standard terms, which may in turn be amended or customized pursuant to the terms of the fixed income derivative transaction and its governing documentation. Before entering into a fixed income derivative transaction, you should obtain and carefully review any such materials incorporated by reference, as their content could materially affect your rights and obligations under the contract, its value and how appropriate it is to your particular objectives.

You should be aware that CIB UK has no ability to influence the value of a reference entity.

The following is a discussion of certain material risks, terms and characteristics of some common fixed income derivative transactions. The categories used below are illustrative only, and are intended to assist you in understanding key features of certain prospective fixed income derivative transactions. The discussion should not be viewed as a comprehensive description of any particular fixed income derivative transaction. Because nomenclature is neither standardized nor sufficiently descriptive of the fixed income derivative transaction to capture all important transaction features and variations, a particular fixed income derivative transaction may (despite the same name) have additional or different risks, terms and characteristics than described herein.

You shall not enter into a transaction with the Instrument if its economic and legal essence, documentation, conditions and/or risks remain unclear or do not correspond to your purposes, intentions and expectations.

## 1.1. Credit Default Swap (CDS)

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### **1.1.1. Key characteristics**

A Credit Default Swap (CDS) is a credit derivative that protects a buyer against the occurrence of a credit event on an underlying reference entity. A credit event is any reduction of the creditworthiness of the reference entity. Examples of credit events include ratings downgrades, bankruptcies and corporate restructurings.

A CDS seller protects the buyer against some reference obligation defaulting. The buyer of the CDS makes a series of payments (the CDS "fee" or "spread") to the seller and, in exchange, receives a payoff if the loan defaults. In the case of loan default, the seller of the CDS takes possession of the defaulted loan.

If CIB UK sells protection, and the reference entity defaults, one of two kinds of settlement can occur:

- Investor delivers a defaulted asset to CIB UK for payment of the par value, which is known as physical settlement;
- CIB UK (as seller) pays the Investor the difference between the par value and the market price of a specified debt obligation (even if the reference entity defaults there is usually some recovery), which is known as cash settlement.

The "spread" of a CDS is the annual amount the protection buyer must pay the protection seller over the length of the contract, expressed as a percentage of the notional amount. Payments are usually made on a quarterly basis, in arrears. These payments continue until either the CDS contract expires or a credit event on the reference entity occurs

The buyer of a CDS does not need to own the underlying security and does not even have to suffer a loss from the default event.

### **1.1.2. Legal nature of the instrument**

In legal terms, a transaction with a CDS originates when the Investor enters into a CDS contract with CIB UK, with agreed payment terms, maturity date and a reference entity. Investor and CIB UK are legally bound by the terms of the transaction from the moment they agree on those terms. Note that CDS transaction terms do not imply lending/borrowing of any assets, and therefore debtor-creditor relations do not arise under a CDS.

The following paragraph provides the general notion of a CDS contract and obligations of the involved parties. We do not intend to provide any legal advice through the following paragraph. You should be aware that particular CDS transactions may have additional or different terms and characteristics than described below; therefore, additional review of the particular transaction and its specifics may be required.

The general mechanism of a CDS is as follows:

- I. The CDS market is generally divided into three sectors:
  - single-credit CDS, referencing credit of specific corporates, banks and sovereigns;
  - multi-credit CDS, referencing a custom portfolio of credits agreed by buyer and seller;
  - index CDS, referencing credits of a basket of entities, (a CDS index contains a portfolio of actively traded liquid names in a particular sector of the market).
- II. one party “sells” risk based on the reference entity(s), and the counterparty “buys” that risk;
- III. the “seller” of credit risk pays a periodic fee (usually quarterly) to the risk “buyer” for the duration of the contract;
- IV. in return, the risk “buyer” agrees to pay the “seller” a set amount if there is a default (credit event);
- V. The settlement terms are determined when the contract is written:
  - the protection seller pays the buyer par value, and in return takes delivery of a debt obligation of the reference entity, or;
  - cash payment equal to the difference between the bonds market value and par value can be received
- VI. A CDS contract provides a risk “seller” with protection against credit events that may occur on the reference entity. Below are the most common credit events that trigger a payment from the risk “buyer” to the risk “seller”;
  - Bankruptcy: the reference entity becomes insolvent or is unable to pay its debts;
  - Failure to Pay: the reference entity fails to make interest or principal payments when due;
  - Debt Restructuring: debt obligations are changed in such a way that the credit holder is unfavorably affected;
  - Obligation Acceleration: debt obligations of the reference entity become due before their originally scheduled maturity date;
  - Repudiation/Moratorium: the issuer of the underlying bond (reference entity) rejects their debt, effectively refusing to pay interest and principle;
- VII. The performance of a CDS is closely related to changes in credit spreads. Credit spread is the difference in yield between two different debt obligations that are the same in all aspects except for the credit rating. This sensitivity makes them an effective tool to hedge or gain exposure to credit;
- VIII. overall economic effect of the transaction is to be determined based on the total

amount of payments made by Investor to CIB UK and total amount of payments received by Investor from CIB UK during the life of the transaction provided there is no default or early termination of the transaction.

As a result of a credit event, the amount payable by Investor to CIB UK may significantly exceed the above mentioned periodic payments made by CIB UK to Investor. As a result, an Investor as the risk “buyer” may incur sudden and significant loss. An Investor as risk “seller” may also incur significant loss, and is exposed to the risk that the buyer may default on the contract, depriving the Investor of expected revenue. Please refer to Section 2 DESCRIPTION OF RISKS AND VOLATILITY, and notably subsection 2.1 for further information on potential changes of Underliers.

## **1.2. Bond Forward**

### **1.2.1. Key characteristics**

A Bond forward is a non- standardized contract for the purchase of an underlying asset at a set price and at a certain future date. The underlying asset can be any type of corporate bonds or government bonds, such as treasury bonds, discount bonds, zero-coupon bonds, etc.

The instrument can be used for various purposes; to hedge risk, as a means of speculation, or to allow a party to take advantage of a quality of the underlying instrument which is time-sensitive. The risk in holding a bond forward contract is that market interest rates for the underlying bonds can increase or decrease, which affects the bond’s yield and thus its price.

### **1.2.2. Legal nature of the instrument**

In legal terms, a transaction with a bond forward originates when the Investor enters into a bond forward with CIB UK with a bond as the Underlier. Investor and CIB UK are legally bound by the terms of transaction from the moment they agree on those terms. Note that bond forward agreement terms do not imply lending/borrowing of any assets, and therefore debtor-creditor relations do not arise under bond forwards.

The following paragraph provides the general notion of a bond forward, and the obligations of the involved parties. We do not intend to provide any legal advice through the following paragraph. You should be aware that particular bond forwards may have additional terms and characteristics other than described below; therefore, additional review of the particular transaction and its specifics may be required.

The general mechanism of a bond forward is as follows:

- I. the party agreeing to buy the underlying asset in the future assumes a long position;

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- II. the party agreeing to sell the asset in the future assumes a short position;
- III. the value of the contract is the bond price, less the present value of coupons, less the present value of the price that will be paid at expiration;
- IV. the buyer is obligated to pay a price (the “forward price”) that is fixed on the trade date;
  - no cash changes hands at the time the contract is made, settlement is at the time specified in the future
- V. while the number of coupon payments for the life of the bond may exceed the life of the contract, only the payments during the contract period are considered;
  - contracts must also mature before the maturity date of the bond
- VI. the seller is obligated to deliver an Underlier, or make a payment of equivalent value, on or as of a specified future date;
- VII. settlement can therefore be cash or physical;
- VIII. if physical delivery of an Underlier is specified in the contract, investor should understand any applicable restrictions on their ability to make or take physical delivery;
- IX. the net economic result of the bond forward is comprised of the net economic effect from the difference between the contracted price and the market price, provided there hasn’t been any default or early termination of the bond forward contract. If the market price of the bond has increased above the contracted forward price on maturity, the buyer gains the difference. Conversely, if the market price of the bond has decreased, the buyer loses since the market price has decreased.

As a result of market interest rates for the underlying bond, the amount payable by Investor to CIB UK may significantly exceed the above mentioned payments made by CIB UK to Investor. As a result, Investor may incur significant loss. Please refer to Section 2 DESCRIPTION OF RISKS AND VOLATILITY 2 DESCRIPTIONS OF RISKS AND VOLATILITY, and notably subsection 2.2 for further information on potential changes of Underliers.

## **2. DESCRIPTION OF RISKS AND VOLATILITY**

This section describes the risks and volatility characterizing fixed income derivatives, and will take you through the different types of risk involved, impact of leverage usage, price volatility and its causes, feasible scenarios and their impact (scenario analysis is presented separately for CDS and bond forwards), and capital protections or guarantees embedded in fixed income derivatives.

### **2.1. Types of risks included**

Not all derivative instruments are suitable or appropriate for all investors. Bearing in mind your circumstances, objectives and expectations, financial position and level of expertise, you should also be comfortable that your chosen derivative instrument is appropriate and suitable for you and, where necessary, you should seek appropriate independent advice in advance of any decisions.

Derivative instruments involve a high degree of risk and are intended primarily for knowledgeable and sophisticated parties that are willing to accept such risks and are able to absorb losses that may occur. The loss in derivative instruments can potentially be unlimited, and is not proportional to the initial amount invested or exchanged (paid or received). You should not deal in derivative instruments unless you understand the nature of the transaction you are entering into and the extent of your exposure to risk. Where you are unclear as to the meaning of any of the disclosures or warnings described below, we would strongly recommend that you seek independent legal, financial, and tax advice.

Derivative instruments involve a combination of significant risks. The price, value or level of the underlying asset depends on a variety of factors including prices of equities, debts and commodities, interest rates, currency exchange rates, etc. These factors are influenced by, among other things: political instability, government trade or action, fiscal and monetary programs, exchange rate and interest rate policies, state of the market and industries, as well as the external environment. No assurance can be given that you will not incur substantial losses in transaction with derivative instruments because of such factors or otherwise. If the market moves against your position and you fail to perform your obligations within the time and amount prescribed, the transaction may be terminated at a loss and you will be liable for any resulting loss or damage. Specific risks of each derivative financial instrument depend largely on its terms as well as on the financial position of its counterparties.

Risk factors may occur simultaneously and/or may compound each other resulting in an unpredictable effect on the value of any derivative instrument.

#### **2.1.1. Market Risk**

The value of an Instrument or amount of payments/deliveries depends on many factors, including price, value or level of an underlying asset, currency exchange and interest rates

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or indices, as well as their volatilities, liquidity and correlations. These factors are influenced by, among other things, the terms of a particular transaction, collateral or other credit support arrangements, creditworthiness of parties involved, political instability, government trade, fiscal and monetary programs, exchange rate policies the state of the market and industries, as well as the external environment.

In respect of any fixed income derivative transactions a movement in the underlying price or interest rates may have a favorable or unfavorable effect on the gain or loss achieved on such transactions.

Fixed income valuations are linked to a host of environmental, economic, social and political factors and can fluctuate greatly, even during intra-day trading.

Fixed income prices are inherently volatile as further outlined in section 2.3.

Furthermore, a specific kind of risk for the CDS seller is jump risk or jump-to-default risk. A default creates a sudden obligation on the protection sellers to pay significant amounts to protection buyers. This risk is not present in other over-the-counter derivatives.

### **2.1.2. Insolvency and Credit Risk**

A major risk of off-exchange derivatives is known as counterparty credit risk, whereby a party is exposed to the inability of its counterparty to perform its obligations under the relevant transaction. The insolvency or default of the counterparty with whom you are dealing may lead to positions being liquidated or closed out without your consent or, indeed, counterparty's obligations to you not being fulfilled.

The counterparty to Investor under a fixed income derivative transaction is CIB UK, being part of Sberbank Group (the "Group"). Investor should constantly monitor the creditworthiness/solvency of CIB UK and the Group. Financial indicators of CIB UK and the Group are published on its official Internet website.

Investor shall also note that there are different methodologies that could be used to assess creditworthiness/solvency of CIB UK and the Group. It is up to Investor to choose a specific methodology, however we strongly encourage Investor to use professional financial advisors to assess the creditworthiness/solvency of CIB UK and the Group prior to the transaction. Investor shall not rely exclusively on the opinion of rating agencies or other institutions (including analytical units or representatives within) periodically publishing their assessment of creditworthiness/solvency of CIB UK and the Group.

### **2.1.3. Operational Risk**

Operational risk is the risk of loss to the Investor, arising from inadequacies in, or failures of, processes, procedures, systems and/or controls for conducting transactions, including (i) recording, monitoring and quantifying the risks and contractual obligations associated with transactions, (ii) recording and valuing transactions, (iii) making payments or deliveries, (iv) exercising rights before they expire, including option exercise rights, in

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a manner that complies with the terms of the relevant transactions, (v) meeting regulatory filing, reporting and other requirements, or (vi) detecting human error or systems failures, including disaster recovery procedures. Losses from operational risks can be substantial, including the loss of the entire value of a derivative transaction.

#### **2.1.4. Regulatory/Legal/Tax Risk**

All derivative products could be exposed to regulatory, legal or tax risks.

At inception of a fixed income derivative transaction, Investor should consider the regulatory, legal, tax and accounting consequences of the transaction. The Investor is required to obtain qualified advice from legal, tax and other professionals that may be needed to understand and assess regulatory, legal and tax risks inherent in such transactions, as well as the treatment of the transaction in accounting and reporting. Such consultations should be conducted before the transaction inception.

Markets are subject to ongoing and substantial regulatory changes. Regulatory or legal actions and changes can, amongst other issues, alter the economic effect of any transaction. Legal changes could even have the effect of making a previously acceptable derivative instrument illegal or not legally enforceable.

Due to the complexity of tax laws and different considerations applicable to each market participant, you should also consider your tax consequences of a derivative instrument. It is possible that the current interpretation of tax laws or understanding of practice may change, or even that the law in some countries may be changed with retrospective effect.

In some areas, legislation and regulations governing transactions in derivative financial instruments may be absent or subject to inconsistent or arbitrary interpretation. Accordingly, it is possible that the legal and tax implications may differ significantly from the original assumptions of the Investor, so the tax and legal consequences of the transaction will be different to those that the Investor has assumed.

Such risks are unpredictable and can depend on numerous political, economic and other factors. Legal documentation governing derivative instruments is rather complex and not easy to understand. Note that legal terms and conditions of a transaction may contain provisions which could operate against your interests. For example, they may permit early redemption or termination at a time which is unfavorable to you. Where you are unclear as to the technicality of legal documentation or any expressions which are used to reflect terminology used in the derivatives market, we would strongly recommend that you seek independent legal advice.

You also may be exposed to risk as a result of differences in legal documentation between a transaction and the particular exposure you wish to hedge, including differences in how the underlying reference entity is defined under the hedged item and the definition applicable to the transaction, or as a result of differences in the dates or times as of which prices, values or levels are to be determined for the hedged item

versus the transaction. You are therefore advised to ask about the terms and conditions of the specific derivatives and associated obligations.

### **2.1.5. Settlement Risk**

When entering into a CDS, both the buyer and seller of credit protection take on counterparty risk. The buyer takes the risk that the seller may default. If the seller and reference entity default simultaneously ("double default"), the buyer loses its protection against default by the reference entity. If the seller defaults, but the reference entity does not, the buyer might need to replace the defaulted CDS at a higher cost.

The seller takes the risk that the buyer may default on the contract, depriving the seller of the expected revenue stream. Note that a seller can limit its risk by buying offsetting protection from another party — that is, they hedge exposure. If the original buyer drops out, the seller squares its position by either unwinding the hedge transaction or by selling a new CDS to a third party. Depending on market conditions, that may be at a lower price than the original CDS and may therefore involve a loss to the seller.

## **2.2. Leverage**

Although no leverage<sup>2</sup> is embedded in fixed income derivatives, you should remember that the use of leverage (which has the effect of magnifying potential positive or negative outcomes) may significantly increase the impact on you of any of the risks described.

## **2.3. Price volatility**

The underlying asset price may not be related to the valuation of the amount of liabilities under a financial derivative. Absence of such correlation in prices can be caused, for example, by suspension of trading as a result of a drastic change in prices of a basic asset and/or for any other reason. Absence of the current price of the underlying asset makes it difficult to assess liabilities under a financial derivative.

Overall price volatility of fixed income derivatives – especially in emerging markets – can be extreme. Price discrepancies, low trading volumes and wide pricing spreads are widespread, and unpredictable price movements are not uncommon on the market. Additionally, as news about a reference entity becomes available, the financial markets may react with dramatic price increase and/or decrease within a very short period of time. Emerging markets generally lack the level of transparency, liquidity, efficiency, market infrastructure, legal certainty, and regulation found in more developed markets. For example, these markets might not have regulations governing the market, and/or price manipulation, and/or insider trading, and/or other provisions with respect to the availability of information and the use or misuse thereof in such markets. The risks associated with nationalization or expropriation of assets, the imposition of confiscatory or punitive taxation, restrictions on investments by foreigners in an emerging market, sanctions, war and revolution shall also be considered.

As terms of transactions are not standardized and no centralized pricing source exists (as exists for exchange traded instruments), transactions may be difficult to value. Different pricing formulas and financial assumptions may yield different values, and different financial institutions may quote different prices for the same derivative transaction. In addition, the value of an off-exchange derivative will vary over time and is affected by many factors, including the remaining time until maturity, market price, price volatility, and prevailing interest rates.

Please note that neither we nor you can predict the future performance of an asset based on historical performance. The price, value, or level of the underlying asset over the term of a transaction may bear little or no relation to the historical price, value, or level of the underlying asset. Changes in prices, values, or levels of an underlying asset may not result in a comparable payment or delivery under, or change in the value of, the transaction.

Potential outcomes of risk events and price volatility are illustrated below.

Financial risks taken by Investor under fixed income derivative transactions are related to changes in the value of the reference entity and interest rates. Below are some scenarios for CDS and bond forward contracts, and their impact on the financial risks for Investor under fixed income derivative transactions.

## **2.4. Scenario Analysis**

The list of scenarios below is not exhaustive and aims to demonstrate the economic effect of fixed income derivative transactions (for a CDS and bond forward) in relation to possible credit events and changes in interest rates. It is important for Investor to acknowledge that there is no limit to the possible scenario variations of fixed income derivative transactions. The list of scenarios below is provided for illustrative purposes only. Past performance is no guarantee of future performance and the highlighted scenarios may or may not occur. Note that the actual values will differ depending on specifics of the contract, and this analysis should not be considered an indicator of future performance.

Probability of each scenario could differ and depends on political situation, government trade, fiscal and monetary programs, exchange rate policies, state of the market and industries, as well as the external environment, etc.

### **2.4.1. CreditDefaultSwap (CDS)**

The following paragraph provides the general notion of a CDS. You should be aware that particular CDS transactions may have additional terms and characteristics other than described below; therefore possible scenarios and outcomes could differ from the ones listed below.

<sup>2</sup> Leverage is any technique involving the use of borrowed funds in the purchase of an asset, with the expectation that the after tax income from the asset and asset price appreciation will exceed the borrowing cost.

Consider the example where an Investor believes that XYZ Co. will soon default on its debt. The Investor buys EUR 5 million worth of CDS protection for two years from CIB UK, with XYZ Co. as the reference entity, at a spread of 500 basis points (5%) per annum.

#### Scenario 1: Favorable scenario for Investor under the Transaction

A favorable scenario (where Investor receives net amount from CIB UK) is associated with the following dynamics of the market parameters during the life of the CDS:

- A credit event occurs on the reference entity

By way of example, if XYZ Co. defaults after one year, then Investor will have paid EUR 250,000 to CIB UK, but then receives EUR 5 million (assuming zero recovery rate, and that CIB UK has the liquidity to cover the loss), thereby making a profit. CIB UK will incur a EUR 4.75 million loss minus recovery.

#### Scenario 2: Unfavorable scenario for Investor under the Transaction

An unfavorable scenario is associated with the following dynamics of the market parameters during the life of the CDS:

- A credit event does not occur on the reference entity

By way of example, if XYZ Co. does not default, then the CDS contract runs for two years, and Investor pays EUR 500,000, without any return, thereby making a loss. CIB UK would make a profit for taking the risk of selling protection.

#### Scenario 3: Investor liquidates position

As a third possibility; the Investor could potentially liquidate their position after a certain period of time in an attempt to realize its gains or losses. However, no market is guaranteed.

By way of example, if after 1 year, the market considers the probability of XYZ Co. defaulting more likely, and the CDS spread widens from 500 to 1500 basis points. Investor may sell EUR 5 million worth of protection for 1 year at this higher rate if they find a buyer. Therefore, in this example over the two years the Investor pays  $2 * 5\% * \text{EUR } 5 \text{ million} = \text{EUR } 500,000$ , but receives  $1 * 15\% * \text{EUR } 5 \text{ million} = \text{EUR } 750,000$ , giving a total profit of EUR 250,000.

In another scenario, after 12 months the market considers XYZ Co. much less likely to default, so its CDS spread tightens from 500 to 250 basis points. The Investor may choose to sell EUR 5 million worth of protection for 1 year at this lower spread if they find a buyer.

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Therefore, over the two years Investor pays  $2 * 5\% * \text{EUR } 5 \text{ million} = \text{EUR } 500,000$ , but receives  $1 * 2.5\% * \text{EUR } 5 \text{ million} = \text{EUR } 125,000$ , giving a total loss of EUR 375,000. This loss is smaller than the EUR 500,000 loss that would have occurred if the second transaction had not been entered into.

Transactions such as these do not even have to be entered into over the long-term. If XYZ Co. CDS spread had widened by just a couple of basis points over the course of one day, the Investor could have entered into an offsetting contract immediately and generated a profit over the life of the two CDS contracts.

## 2.4.2. Bond Forward

The following paragraph provides the general notion of a bond forward transaction. You should be aware that particular bond forwards may have additional terms and characteristics other than described below; therefore possible scenarios and outcomes could differ from the ones listed below.

Bond forward contracts can be written on both zero-coupon bonds (such as T-bills) and coupon paying bonds. Since bonds have a maturity date, the forward contracts on these bonds must also settle before the maturity date of the bond.

Assume a 180-day T-bill selling at 3%. This 3% is the annualized discount rate at which the T-bill is selling. Therefore, a EUR 1,000 par T-bill is selling at  $\text{EUR } 1000 * 0.03 * (180/360) = \text{EUR } 985$ . If this T-bill is held till maturity, the Investor can sell for EUR 1,000.

Two parties can enter into a forward agreement such that Investor will buy this T-bill from CIB UK at a price of EUR 990 sixty days from now. This will be a forward contract.

Scenario 1: Favorable scenario for Investor

Favorable scenario is associated with the following dynamics of the market parameters during the life of the bond forward:

- Market interest rates decrease;

By way of example, when the market interest rates decrease, the discount rate will decrease, leading to a rise in the T-bill price. Since the Investor (long position) is required to purchase the bond from CIB UK, an increase in price will be a profit for the Investor and a loss for CIB UK (short position). Note: discount rate is the amount by which the market price of a bond is lower than its principle value at maturity, known as par value. Therefore, as discount rates decrease, the market price is approaching the bonds par value.

Scenario 2: Unfavorable scenario for Investor

Unfavorable scenario is associated with the following dynamics of the market parameters during the life of the bond forward:

- Market interest rates increase;

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By way of example, when the market interest rates increase, the discount rate will increase, leading to a fall in the T-bill price. Since the Investor (long position) is required to purchase the bond from CIB UK, a decrease in price will be a loss for the Investor and profit for CIB UK (short position).

In case of coupon paying bonds, the price in the forward contract will be stated in terms of yield to maturity as on the settlement date. The yield excludes the accrued interest. There are separate provisions for the risk of default, and other features such as an embedded option. These forward contracts can be on individual bonds as well as portfolio of bonds.

## **2.5. Explanation of capital protection or guarantees**

No capital protection or guarantees are embedded into fixed income derivative transactions, so the Investor has no guarantee of getting back any part of the amount invested.

## **3. IMPEDIMENTS FOR DIVESTMENT**

This section deals with divestment of fixed income derivatives, describing the potential barriers and illustrating the possible exit methods.

### **3.1. Barrier to divestment**

Derivative markets can be illiquid. Over-the-counter derivative financial instruments do not circulate on stock exchanges or within bidding process organizers; they allow for a variety of customization options aimed at achieving specific financial or managerial objectives and risk mitigation, which, however, may or may not be achieved.

Customization of derivative financial instruments entails a serious risk of loss/lack of liquidity of such derivative financial instruments as well as other complex risks. If the market is not sufficiently liquid, you may be unable to liquidate or even partially close out your derivative position at the desired time.

This means that after transaction settlement with an over-the-counter derivative financial instrument, an Investor may not subsequently be able to make a similar new transaction, terminate the previously completed transaction at an acceptable price, or perform an offset (replacement, counter) transaction.

In addition, the difference between the bid price and the offer price of a given derivative contract may be significant, especially if the derivative contract involves highly customized features and other market sensitive terms. Prices on derivatives markets can fluctuate considerably, depending on a number of factors that are difficult to forecast. Price and liquidity of any derivative instrument depends upon availability and value of the underlying asset, which can be affected by a number of extrinsic factors including, but not limited to, political, environmental and technical ones. Such factors can also affect the ability to settle or perform on time, or at all. In addition, unless provided for by the transaction terms, the counterparty to a derivative contract may not have to accept early

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termination of the contract and there may therefore be zero liquidity in the product. In other cases, early termination, realization or redemption may result in Investor receiving substantially less than initially paid for the product or, in some cases, receiving nothing at all. Market liquidity may also be adversely affected by the development of updated or new industry standard terms, their adoption by market participants, and the migration of trading interest to such new or updated standard terms.

### **3.2. Illustration of possible exit methods and consequences**

Instrument risks may be managed or exited by means of:

- Entering into the opposite side of a new derivative contract with CIB UK or any other provider, which may require the Investor to pay fees to be determined by the provider;
- Any break or termination clauses in the contract.

A fixed income derivative transaction may be subject to early termination in the case of default or termination events in relation to you, us, and/or any third party specified. Early termination may also occur in the case of extraordinary events which are relevant to the underlying fixed income derivative, or there may be an optional early termination right for one or both of the parties (as defined in the ISDA Master Agreement).

Any such termination may lead to payment of an early termination amount which largely depends on the market conditions at that time, as well various other factors (market volatility for underlying fixed income, interest rates, currency rates, etc.). Terminology and costs calculation approach are defined in the ISDA Master Agreement. You may be obliged to pay an early termination amount even if you are not a defaulting or affected party. Termination and the corresponding determination of an early termination amount could occur at a time when the relevant markets are volatile, illiquid or not functioning in accordance with normal market conditions and the value of the transaction is such that you would owe a substantial termination payment.

In addition to standard Events of Default and Termination Events, the terms of the fixed income derivative transaction and governing documentation gives CIB UK the right to terminate early the fixed income derivative transaction upon occurrence of a specific Additional Termination Event, as well as the right for the Parties to require reduction in the Notional Amount (as such terms defined in the ISDA Master Agreement).

As derivative financial instruments are revalued on a continuous basis (mark-to-market changes when underlying market parameters change), the economic effect of future early termination cannot be precisely calculated at transaction inception and depends on future dynamics of certain market parameters, such as (but not limited to) the reference entity. In the case of early termination of fixed income derivative transactions for any reason

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(including, but not limited to, voluntary early termination agreed by the Parties, occurrence of a Termination Event, Additional Termination Event, or an Event of Default with respect to either Party or otherwise as provided in the governing documentation), Investor may be required to pay an Early Termination Amount. The more mark-to-market value of the fixed income is in favor of CIB UK at the time of early termination of the fixed income derivative transaction, the higher is the Early Termination Amount payable by Investor as a result of such early termination.

Investor should take into account that voluntary early termination of a fixed income derivative transaction is possible only by mutual written consent of the parties. However, consent of the other party remains entirely at its discretion, the other party is not obliged to give its consent and such voluntary early termination may be refused.

Investor should take into account that early termination of a fixed income derivative transaction initiated by Investor may be difficult, will depend on specific market conditions at the time of proposed termination, and is not guaranteed by CIB UK.

Among other things, Investor should pay attention to the conditions of events that impede implementation (e.g. delivery of physical bonds) and the alternatives applicable in such cases to the fixed income derivative transaction, and under these conditions the event preventing the execution is defined by CIB UK as a settlement agent.

#### **4. INVESTOR COMMITMENTS OR OBLIGATIONS**

When entering into a fixed income derivative transaction with CIB UK, Investor bears in full all relevant obligations and commitments according to the nature of the instrument described in paragraph 1. Investor should be aware that, depending on terms of the fixed income derivative transaction and market conditions described in paragraph 2.4, it might be obliged to make periodic or non-recurrent payments in favor of CIB UK.

The change in the underlying bond price directly and considerably affects the amount of payment obligations of Investor. The change in payment obligations is not always directly proportional to the change in the underlying bond price. Accordingly, even a minor change in the underlying bond price can cause a disproportionately larger (significant) impact on the amount of payment obligations of Investor. Such an effect may be either in favor or against Investor depending on the transaction modalities and the direction of the underlying bond price change.

Payment obligations, as well as expenses (losses) on a derivative financial instrument can massively exceed the cost of its settlement or any benefit or saving due to the conclusion of a derivative financial instrument.

## **5. MARGIN REQUIREMENTS**

Margin requirement refers to the percentage of cash the Investor must pay for, using their own money. It can be further broken down into initial margin requirement and maintenance margin requirement.

An initial margin requirement generally refers to the percentage of cash required to be provided when the Investor opens a position. When the Investor holds fixed income derivatives bought on margin, in order to allow some fluctuation in price, there are certain minimum margin requirements. This is generally called the maintenance margin requirement. If the value of the Investors position falls below the maintenance margin requirement, a margin call occurs.

If the Investor is subject to margin requirements, CIB UK will require Investor to provide assets as margin that are related to them, in order to ensure that CIB UK has sufficient margin as required at any time.

The arrangements relating to how the margin calls will be funded will be set out in our client clearing agreement.

If Investor is not subject to margin requirements, no margin requirements or similar obligations are applicable.