

## Complex Financial Instrument Information Sheet

### DERIVATIVES AND SIMILAR INSTRUMENTS<sub>3</sub>

This Information Sheet is intended to provide you with an overview of the risks associated with Derivatives and similar instruments (a description which may include Options, Contracts for Differences, Warrants, Securitised Derivatives/Covered Warrants, and certain Exchange Traded Funds). These investments may not be right for all investors and before investing you should ensure that you are familiar with their features and risks. If you invest, your capital will be at risk and you may get back nothing at all. Certain transactions using derivatives can create potentially unlimited losses. If you are unsure, we strongly suggest that before investing you seek advice from a qualified adviser.

This Information Sheet should be read in conjunction with the 'Complex Financial Instruments Assessment'.

#### What are Derivatives?

A Derivative is a financial instrument whose price is dependent upon or derived from one or more underlying assets. The Derivative itself is merely a contract between two or more parties which has a stated expiry date. The value of the contract is determined by fluctuations in the value of the underlying asset (for example, a share, currency, commodity, or index) and the length of time before the Derivative expires. The main types of Derivatives and similar instruments which are available using the Frequent Trader Service are summarised below.

- 1) Warrants are similar to Options but the contract is issued by the company that issued the underlying share or asset. For example, a Warrant may entitle the investor to buy shares in the company that issued the Warrant at a specified price up to a given date.
- 2) Securitised Derivatives/Covered Warrants are tradable products, which are typically created by investment banks and are linked to a particular underlying share or asset. An investor pays an amount of money for the right to receive either cash or the underlying share or asset up to a given date. Unlike the Warrants described in point 3 above, they are exercisable against the issuing investment bank, rather than the company that issued the underlying share or asset.
- 3) Exchange Traded Funds (sometimes referred to as ETFs) are funds which are traded on a stock exchange much like a share. Traditionally, the Exchange Traded Fund itself invests in shares and other assets such as commodities and bonds. They are usually designed to track an index (such as the FTSE 100 or S&P 500). Relevant to this Information Sheet are 'Synthetic Exchange Traded Funds' which are investments that mimic the behaviour of an Exchange Traded Fund but through the use of Derivatives such as Options (rather than investing in shares and other assets).

*Note: the list above is not intended to be a complete list of all Derivatives or similar instruments. Other Derivatives and similar instruments are available but you may not be able to deal in them using the Frequent Trader Service.*

#### What are the risks and features associated with Derivatives and similar instruments that mean they are 'complex'?

The risks of and features associated with Derivatives and similar instruments can vary widely between the different types of instruments (e.g. a Warrant and a Synthetic Exchange Traded Fund) and also between different investments of the same type (e.g. two Options).

This Information Sheet cannot disclose all the risks and other significant aspects of Derivatives and similar instruments. However, some of the main risks factors and features which may apply are set out in the list below.

- 1) The price of a Derivative or similar instrument may be geared or leveraged over the underlying share or asset. This means a relatively small movement in the price of the underlying share or asset results in a disproportionately large movement, unfavourable or favourable, in the price of the Derivative. The prices of Derivatives and similar instruments can therefore be volatile.
- 2) The investment may have a limited life, and may (unless you are investing in a product or investment where there is some form of guaranteed return to the amount you are investing) expire worthless if the underlying share or other asset does not perform as expected. This is particularly relevant to Options and Warrants.
- 3) Where the Derivative or similar instrument is not traded on an exchange, it can be difficult if not impossible to sell or close-out a particular position.
- 4) Sometimes, it may be difficult for investors to gain information in respect of certain Derivatives or similar instruments meaning it will be difficult to reasonably assess how the investment may perform. This is particularly relevant in the case of Synthetic Exchange Traded Funds where investors may not be able to obtain details of the Derivatives being used.
- 5) Whilst you may lose all of your investment in a Derivative or similar instrument, certain options trading strategies may have potentially unlimited losses. Further explanation about Options is set out in the appendix below.
- 6) There is no such thing as a 'guaranteed' counterparty as was witnessed by the collapse of Lehman Brothers in September 2008. In the case of Synthetic Exchange Traded Funds, these involve the counterparty to the Derivative agreeing to match the movements of securities or commodities the Exchange Traded Fund is trying to track and therefore there is a danger that a Synthetic Exchange Traded Fund may fail to deliver the performance of the index it is meant to be following in periods of financial stress.

For the specific risks associated with a particular Derivative or similar instrument, as a minimum, you should consider the nature of the Derivative, the terms of any contract, and the nature and prospects of any underlying share or other asset.

If you have any queries regarding this Information Sheet or general questions about Derivatives or similar instruments, please contact us.