

## **MiFID II Schedule of Product and Service Risk Disclosures**

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This Schedule of Product and Service Risk Disclosure is for use by professional clients (as defined by the Markets in Financial Instruments Directive, 2014/65/EU) of Chatham Financial Europe (“Chatham”) and must not be relied upon by anyone else.

This document cannot disclose all risks and significant aspects of products and services Chatham may provide you. It is intended to give you information on and a warning of the risks associated with Chatham’s products and services so that you are aware of the nature and risks of the services, as well as the specific types of investments being offered so that you may make an informed investment decision. This guidance is not intended to be and must not be treated as investment advice tailored to your personal circumstances, a recommendation to enter into any of the services described, or a recommendation to invest in any of the products below. If you are unclear as to the meaning of any of the disclosures or warnings described below, you should seek independent legal or financial advice.


You should not deal in these or any other products unless you understand the nature of the contract you are entering into and the extent of your exposure to the risks associated with it. You should also be satisfied that the product and/or service is suitable for you in light of your circumstances and financial position and, where necessary, you should seek appropriate independent advice in advance of any investment decisions.

Risk factors may occur simultaneously and/or may compound each other resulting in an unpredictable effect on the value of any investment. In any of the situations described below, the use of leverage (which has the effect of magnifying potential positive or negative outcomes) may significantly increase the impact of any risks described.

All financial products carry a certain degree of risk and even low-risk investment strategies contain an element of uncertainty. The types of risks that apply depend on various factors, including how an instrument is created, structured, or drafted. The specific risks of a particular product or transaction will depend upon the terms of the product or transaction and the particular circumstances of, and relationships between, the relevant parties involved in such product or transaction. Different instruments involve exposure to different levels of risk and in deciding whether to trade in such instruments or become involved in any financial products you should be sure you understand the nature of the investment and its risks.

### **PRINCIPAL RISK FACTORS IN DERIVATIVES**

**Market Risk** is the risk that the value of a derivatives transaction will be adversely affected by fluctuations in the level of volatility, correlations, or relationships between one or more market prices, rates, indices, or other market factors. Given the complexity of financial markets, market risks are inherent to financial transactions. Illiquidity in the market for the relevant transaction or



in a related market may also occur, which may cause you to be unable to sell or terminate a transaction for a period of time, or could cause you to be unable to sell or terminate a transaction at a previously quoted price.

**Credit Risk** is the risk that a counterparty will fail to perform on its obligations when due. Credit risk is also the risk that, upon such failure by a counterparty, you may experience delays in collecting, or be unable to collect, collateral or margin you have previously posted.

**Funding Risk** is the risk that, as a result of mismatches in the economic terms of a derivative, including, without limitation, delays in the timing of cash flows due from or to your counterparties in derivatives transactions or related hedging, trading, collateral or other transactions, you or your counterparty will not have adequate cash available to fund current obligations.

**Operational Risk** is the risk of loss to you arising from inadequacies in or failures of your internal systems and controls for monitoring and quantifying the risks and contractual obligations associated with derivatives transactions, for recording and valuing swaps and related transactions, or for detecting human error, systems failure, or management failure.

**Foreign Currency Risk** is the risk of the amount of capital exposed to fluctuations in the value of a foreign currency. Trading on exchanges in different countries may present different risks due to differences in national regulatory regimes applicable to financial instruments.

**Legal Risk** is the risk that transaction and netting arrangements entered into may not meet legal requirements.

**Risk Associated with Individually Negotiated and Over-the-Counter Contracts:** Because the price and other terms on which you may enter into or terminate a derivatives transaction are individually negotiated and often traded over-the-counter (OTC), these may not represent the best price or terms available to you from other sources.

**Risk of Modification or Termination:** In evaluating the risks and contractual obligations associated with a particular OTC derivatives transaction, you should also consider that an OTC derivatives transaction may be modified or terminated only by mutual consent of the original parties and subject to agreement on individually negotiated terms modifying or terminating the transaction. Accordingly, it may not be possible for you to modify, terminate or offset your obligations or your exposure to the risks associated with a transaction prior to its scheduled termination date.

**Indicative or Mid-Market Quotation Risks:** While market makers and dealers generally quote prices or terms for entering into or terminating derivatives transactions and provide indicative or mid-market quotations with respect to outstanding swap transactions, they may not be required to do so under applicable laws and regulations and are generally not contractually obligated to do so or to continue to do so once a line of credit has been established for you with that market maker or dealer. In addition, it may not be possible to obtain indicative or mid-market quotations

for a derivatives transaction from a market maker or dealer that is not a counterparty to the transaction. Consequently, it may be difficult for you to establish an independent value for an outstanding derivatives transaction. You should not regard your counterparty's provision of a valuation or indicative price at your request as an offer to enter into or terminate the relevant transaction at that value or price, unless the value or price is identified by the counterparty as firm or binding. Additionally, any valuation or indicative price estimate that Chatham may provide is solely a good faith mid-market estimate and you should be aware that provision of a valuation or price estimate by Chatham does not provide any assurance that you will be able to execute, cash-settle or terminate a transaction at such price. Actual pricing offered in the derivatives marketplace can be affected by many factors not considered in calculating a mid-market valuation or indicative pricing estimate.

**Speculative and Volatility Risks:** Although Chatham generally provides advice for hedging purposes, a portion of many trades may not correlate perfectly with the underlying risk being hedged, leading to additional risk of loss similar to speculative trades. A decision to enter into a trade that only partially hedges an underlying position may not be distinguishable economically from a speculative trade. Prices quoted in the OTC markets may be highly volatile (i.e., prices either increase or decrease rapidly based upon various market or global occurrences). Chatham cannot provide assurance that its advice will result in a perfect hedge or a profitable result in the case of trades that only partially hedge underlying positions.

**Leverage Risks Associated with Derivatives Trading:** The low margin deposits normally required in derivatives trading permit a high degree of leverage. The higher the leverage employed, the more risk that can be expected. A relatively small price movement in a derivatives instrument may result in immediate loss.

**Liquidity Risks:** Derivatives markets may pose a risk that a particular quote may not be provided by any dealer or trading venue which could pose substantial risk if a client was unable to close out a position. Counterparties in derivatives markets generally have no obligation to continue to make markets in derivatives contracts. Illiquidity and, at times, a lack of price transparency in one or more derivatives markets may affect trades to the detriment of Chatham's clients.

**Diversification Risks:** Chatham's services are generally limited to derivatives. The advice and trade recommendations that Chatham provides are not diversified amongst asset classes such as stocks, bonds, real estate, etc. In addition, Chatham's trading advice is not typically diversified amongst commodity classes since hedging instruments tend to be in the same commodity class as the underlying commodity risk being hedged.

There may be other significant risks that should be considered based on the terms of a specific transaction. Highly customised derivatives, in particular, may increase liquidity risk and introduce other significant risk factors of a complex character.

**This brief statement does not purport to disclose all of the risks and other material considerations associated with a swap transaction. You should refrain from entering into**

**any transaction unless you have fully understood the terms and risks of such transaction, including the extent of your potential risk of loss.**

**RISKS OF DERIVATIVES, INCLUDING OPTIONS, FUTURES, SWAPS, FORWARD RATE AGREEMENTS, DERIVATIVE INSTRUMENTS FOR THE TRANSFER OF CREDIT RISK, FINANCIAL CONTRACTS FOR DIFFERENCE**

A derivative is a financial instrument, the value of which is derived from an underlying asset's value. Rather than trade or exchange the asset itself, an agreement is entered into to exchange money, assets, or some other value at some future date based on the underlying asset. A premium may also be required to acquire the derivative instrument.

There are many types of derivative, but options, futures, and swaps are among the most common. An investor in derivatives often assumes a high level of risk. Therefore, investments in derivatives should be made with caution. This is especially true for less experienced investors or investors with a limited amount of capital to invest.

If a derivative transaction is particularly large, or if the relevant market is illiquid (as may be the case with many privately negotiated OTC derivatives), it may not be possible to initiate a transaction or liquidate a position at an advantageous price.

On-exchange derivatives are additionally subject to the risks of exchange trading generally, including, potentially, the requirement to provide margin. Off-exchange derivatives may take the form of unlisted transferable securities or bi-lateral OTC contracts. Although these forms of derivatives may be traded differently, both arrangements may be subject to credit risk of the issuer (if transferable securities) or the counterparty (if OTC and uncleared) and, like any contract, are subject also to the particular terms of the contract (whether a one-off transferable security or OTC, or a master agreement), as well as the risks discussed above. In particular, with an OTC contract, the counterparty may not be bound to "close out" or liquidate this position, and so it may not be possible to terminate a loss-making contract. Off-exchange derivatives are individually negotiated. As the terms of the transactions are not standardised and no centralised pricing source exists (as exists for many exchange traded instruments), the transactions may be difficult to value. Different pricing formulas and financial assumptions may yield different values. Different financial institutions may quote different prices for the same 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, the market price, volatility, and prevailing interest rates.

Derivatives can be used for speculative purposes or as hedges to manage other investment or economic risks. In all cases, the suitability of the transaction for a particular investor should be very carefully considered.

You are therefore advised to ask about the terms and conditions of the specific derivatives and associated obligations you are entering into, e.g., the circumstances under which you may become obligated to make or take delivery of an underlying asset and, for options, the expiration

dates and restrictions on the time for exercise. Under certain circumstances the specifications of outstanding contracts (including the exercise price of an option) may be modified by the exchange or clearing house to reflect changes in the underlying asset.

Normal pricing relationships between the underlying asset and the derivative may not exist in all cases. This can occur when, for example, the futures contract underlying the option is subject to price limits while the option is not. If it were to occur, the absence of an underlying reference price caused by the difference in price limits may make it difficult to assess fair value.

The points set out below in relation to different types of derivative are not only applicable to these derivatives, and to derivatives more generally. All derivatives are potentially subject to the major risk types described above, especially market risk, credit risk, and any specific sector risks connected with the underlying asset.

### **Futures/Forwards/Forward Rate Agreements**

Transactions in futures or forwards involve the obligation to make or take delivery of the underlying asset of the contract at a future date, or in some cases to settle the position with cash. They carry a high degree of risk. The “gearing” or “leverage” often used in futures and forwards trading means that a small deposit or down payment can lead to large losses as well as gains. It also means that a relatively small movement can lead to a proportionately much larger movement in the value of your investment. This can work against you as well as for you. Futures and forwards transactions have a contingent liability, and you should be aware of the implications of this, in particular margin requirements. Margin requirements can require you to transfer cash to cover losses on a daily basis. If you fail to transfer the required cash payment, the contract may be terminated.

### **Options**

There are many different types of options with different characteristics subject to the following conditions.

**Put Option:** A put option is an option contract that gives the holder (“buyer”) of the option the right to sell a certain quantity of an underlying security to the writer of the option at a specified price (the “strike price”) up to a specified date (the “expiration date”).

**Call Option:** A call option is an option contract that gives the holder (“buyer”) the right to buy a certain quantity of an underlying security from the writer of the option, at a specified price (the “strike price”) up to a specified date (the “expiration date”).

**Buying Versus Selling Options:** Buying options involves less risk than selling options because, if the price of the underlying asset moves against you, you can simply allow the option to lapse. The maximum loss is limited to the premium, plus any commission or other transaction charges. However, you will be exposed to further risks associated with futures contracts if you buy a call option on a futures contract and later exercise the option to acquire the underlying futures

contract. Certain options markets operate on a margined basis, under which buyers do not pay the full premium on their option at the time they purchase it. In this situation, you may be called subsequently to pay margin on the option up to the level of your premium. If you fail to do so, your position may be closed or liquidated.

**Writing Options:** If you write an option, the risk involved is considerably greater than buying options. You may be liable for margin to maintain your position and a loss may be sustained well in excess of the premium received. By writing an option, you accept a legal obligation to purchase or sell the underlying asset if the option is exercised against you--no matter how far the market price is from the exercise price.

If you already own the underlying asset which you have contracted to sell (“covered call options”), the risk is reduced. If you do not own the underlying asset (“uncovered call options”), the risk can be unlimited. Only experienced persons should contemplate writing uncovered options. Even then, they should only do so after securing full details of the applicable conditions and potential risk exposure.

Depending on the type of option entered into, there may be increased exposure to market risk compared to other financial products. There are several option styles including (but not limited to) American, European and Bermudan. An American-style option may be exercised at any time prior to its expiration. A European-style option may only be exercised on a specific date, the expiration date. A Bermudan-style option may be exercised on certain specified dates during the term of the option.

If you buy an American-style call option and the market price of the underlying asset never rises above the option’s strike price, or if you fail to exercise the option while the market price is above the strike price, the option will expire unexercised and you will have lost the premium you paid for the option. Similarly, if you buy an American-style put option and the relevant market price for the underlying asset does not fall below the option strike price, or if you fail to exercise the option when it does, the option will not be exercised and you will have lost the premium you paid for the put option.

Purchasing European-style or Bermudan-style options may carry additional market risk since the option could be “in-the-money” for part or substantially all of the holding period but not on the specified exercise date(s). A call option is in-the-money if the strike price is lower than the relevant market price for the underlying asset. A put option is in-the-money if the strike price is higher than the relevant market price for the underlying asset.

It is possible for the holder of an exercised, in-the-money option to lose money on an option transaction. Such a situation can happen whenever the value received from exercising the option is less than the costs of entering into the option (i.e., the premium and any other costs and expenses).

If you are a potential writer of an option, you should consider how the type of option affects the timing of your potential payment and delivery obligations thereunder. As the writer of a

European-style option, the timing of any payment and delivery obligations is predictable. Absent early termination, no settlements will be necessary prior to the expiration date. As the writer of an American-style option, however, you must be certain that you are prepared to satisfy your potential payment and delivery obligations at any time during the exercise period.

**Traditional options:** Certain London Stock Exchange member firms write a particular type of option called a traditional option. These may involve greater risk than other options. Two-way prices are not usually quoted and there is no exchange market on which to close out an open position or to effect an equal and opposite transaction to reverse an open position. It may be difficult to assess the option's value or, for the seller, to manage their exposure to risk.

### **Contracts For Differences**

Certain derivatives are referred to as contracts for differences. These can be options and futures on the FTSE 100 Index or any other index, equities, or currency and interest rate swaps, amongst others. However, unlike other futures and options (which may, depending on their terms, be settled in cash or by delivery of the underlying asset), these contracts can only be settled in cash. Investing in a contract for differences carries the same risks as investing in a future or an option as referred to above. Transactions in contracts for differences may also have a contingent liability.


### **Swaps**

A swap agreement is a derivative where two counterparties exchange one stream of cash flows against another stream, calculated by reference to an "underlying" (such as securities' indices, bonds currencies, interest rates or commodities or more intangible items).

A swap agreement may also be combined with an option. Such an option may be structured in two different ways. "Swaptions" are transactions where the purchaser pays a premium for the right to exercise or not to exercise its right to enter into a pre-agreed swap agreement. The right exists for the period of time specified in the option. "Caps", "floors" and "collars" enable a party, for the payment or receipt of a premium, to protect itself against, or to take an exposure on, the variation on the value or level of an underlying.

A major risk of off-exchange derivatives is known as counterparty risk, whereby a party is exposed to a counterparty's failure to perform its obligations under the relevant financial instrument. For example, if a party, A, wants a fixed interest rate loan and so swaps a variable rate loan with another party, B, thereby swapping payments, this will synthetically create a fixed rate for A. However, if B goes insolvent, A will lose its fixed rate and will be paying a variable rate again. If interest rates have gone up a lot, it is possible that A will struggle to repay.

The swap market has grown substantially in recent years. A large number of banks and investment banking firms act both as principals and as agents, utilising standardized, master swap agreements to trade swaps for a broad range of underlying assets. While the swap market for certain underlying assets has become more liquid, there can be no assurance that a liquid



secondary market will exist at any specified time for any particular swap.