APPENDIX 2

NOTICE IN RELATION TO FINANCIAL INSTRUMENTS AND RISKS ASSOCIATED WITH INVESTING IN FINANCIAL INSTRUMENTS IN HSBC FRANCE (SPÓŁKA AKCYJNA) ODDZIAŁ W POLSCE

This notice is provided to you in connection with implementation of the MiFID rules to Polish legislation.

This notice contains information about financial instruments, including their description and guidance on and warnings of the risks associated with those financial instruments. It has been provided to you so that you are able to understand the nature and risks of the service and of the specific type of financial instrument being offered and, consequently, take investment decisions on an informed basis.

This notice cannot disclose all the risks and other significant aspects of financial instruments. You should not deal in these products unless you understand their nature and the extent of your exposure to risk and potential loss. Certain option strategies, such as a 'spread' position or a 'straddle', may be as risky as a simple 'long' or 'short' position.

Although derivative instruments can be utilised for the management of investment risk, some of these products are unsuitable for many investors. Different financial instruments involve different levels of exposure to risk and in deciding whether to transact in such financial instruments you should be aware of the following:

1. **Foreign Exchange Spot**

Spot foreign exchange

A spot contract is a binding obligation to buy or sell a certain amount of foreign currency at the current market rate, for settlement usually in two business days' time.

Purpose

Companies involved in international trade may be required to make payments, or to receive payments, in a foreign currency. A spot contract allows a company to buy or sell foreign currency on the day it chooses to deal. A spot deal will settle (in other words, the physical exchange of currencies) two working days after the deal is struck. The difference between the deal and settlement date reflects both the need to arrange the transfer of funds and, the time difference between the currency centres involved. Occasionally spot date may be different so it is advisable to check the settlement date.

Risks

Forecasting exchange rates is very difficult. For a company to use only the spot market for its foreign currency requirements may be a high risk strategy because exchange rates could move significantly in a short period of time. For example, if a company placed an order for raw materials from abroad for payment in three months' time, and use the spot market to meet the invoice when it falls due, the company could lose significantly if rates move against it.

2. **Foreign Exchange Forward Contracts**

Forward exchange contracts

A forward exchange contract (or forward contract) is a binding obligation to buy or sell a certain amount of foreign currency at a pre-agreed rate of exchange, on a certain future date.

Purpose

A forward contract is the simplest method of covering exchange risk because it locks in an exchange rate. This strategy overcomes one of the problems that a company can experience when importing or exporting in foreign currency, as it can now budget at a known rate of exchange. The price of a forward contract is based on the spot rate at the time of the trade, with an adjustment which represents the interest rate differential between the two currencies concerned.

Risks

- A forward contract is an obligation to buy or sell a certain amount of foreign currency at a pre-determined date at a pre-determined rate. Even if your requirements change over the term of the forward contract, the company is still obliged to deal in the future at the agreed rate.

- A forward contract is an obligation to deal at a specific rate – a company is not in a position to benefit from any favourable movements in exchange rates between entering into the contract and settling the deal.
- Thus through the life of transaction a company may face a mark-to-market differences (profits or losses) that may need to be posted to the P/L account.

3. **FX Derivatives (Currency Options)**

A currency option is a financial derivative which represents the right, but not the obligation for the buyer to purchase one currency in exchange for a secondary currency at a pre-determined rate on a pre-determined date in the future. In exchange for that right the option buyer pays to the option seller a premium.

Purpose

FX option is one of the most effective ways to mitigate currency risk as it provides the demanded hedge rate and allows to determine maximum cost of the protection. FX Option allows a company to benefit fully from any favourable exchange rate movement. An FX Option offers flexibility as it enables company to purchase or sell currency at the level of individual budget rate and benefit, if the market moves favourably. The price of FX Option is based on the spot rate at the time of the trade, with an adjustment which represents the interest rate differential between the two currencies concerned, tenor of the contract and probability of its exercise at the time of the trade.

Risks

- Buying options involves less risk than selling options because, if the FX rate moves in your favour, you can simply allow the option to expire worthless and the maximum loss is limited to the premium paid for the option.
- In case of writing an option, the risk involved is considerably greater than buying options. By writing an option, a company accepts a legal obligation to purchase or sell the currency (depending on the option type) if the option is exercised by the buyer, no matter how far the market rate has moved away from the option exercise rate.
- FX options can be structured into strategies with different pay-off profiles. The rights and obligations resulting from such created pay-off profiles will be subject of individual analysis each time before entering into transaction.

4. **Interest rate swaps**

Interest Rate swap (IRS) is the bilateral exchange of stream of interests based on floating rate into fixed rate, or vice versa, in the specified future settlement dates.

There are many types of Interest Rate Swaps, the most popular among them are:

- Basis Swap – where the exchange of interest payments is from floating rate into another floating rate (e.g. 3m WIBOR into 6, WIBOR)
- Cross Currency Swap – where payments are exchanged from one currency into another.

Purpose

A company that borrows at a margin over a floating rate of interest will incur additional costs if interest rates rise. The company may wish to eliminate this risk by entering into a Interest Rate Swap. The IRS stands apart from the underlying loan – it is possible to enter into a swap to protect debt with another financial institution. The settlement is based on net payment resulting from the difference between fixed rate and floating reference rate on each pre-determined settlement date.

Risks

- If a company wish to terminate loan early, there may be a cost involved depending on prevailing market rates at the time to unwind the swap.
- If interest rates fall, a company is obliged to pay the agreed fixed rate which may be higher than the floating base rate
- In case of Cross Currency swap if there is no initial and final exchange of notional agreed upon inception of the trade, there is additionally FX risk involved.

5. **Interest Rate Options – Caps & Floors**

Interest Rate Option – Cap or Floor is a financial derivative which represents the right, but not the obligation for the buyer to pay the interest at the pre-determined interest rate on a pre-determined date in the future. In exchange for that right the option buyer pays to the option writer a premium.

Purpose

A company that borrows at a margin over a floating rate of interest will incur additional costs if interest rates rise. The company may wish to eliminate or reduce this risk by buying an Interest Rate Cap. By doing so, the company receives a guaranteed maximum hedge level and benefits each time the prevailing market rates are more favourable, for the total cost of premium, specified at the trade date. The settlement is based on net payment resulting from the difference between guaranteed hedge rate and floating reference rate on each pre-determined settlement date. The Interest Rate Cap stands apart from the underlying loan – it is possible to enter into a swap to protect debt with another financial institution.

Analogically, a company with surplus of cash can buy Interest Rate Floor to protect its assets against the risk of lower interest rates in the future.

Risks

- Buying options involves less risk than selling options because, if the interest rates move in your favour, you can simply allow the option to expire worthless and the maximum loss is limited to the premium paid for the option.
- In case of writing an option, the risk involved is considerably greater than buying options. By writing an option, a company accepts a legal obligation to exchange a stream of interest if the option is exercised by the buyer, no matter how far the market rate has moved away from the option exercise rate.
- Interest Rate Options can be structured into strategies with different pay-off profiles. The rights and obligations resulting from such created pay-off profiles will be subject of individual analysis each time before entering into transaction.

6. **Bonds and t-bills**

Bond – debt security, in which the authorized issuer owes the holders a debt and, depending on the terms of the bond, is obliged to pay interest (the coupon) and/or to repay the principal at a later date, termed maturity. A bond is a formal contract to repay borrowed money with interest at fixed intervals.

Bill – short term security (maturity up to 1 year) which, rather than paying fixed interest payments like conventional bonds provides the return to the holder by appreciation of the bond.

Bonds differ from each other depending on coupon calculation. The most common are:
- Fixed – pay fixed coupon on each payment period
- Floating – pay variable coupon depending on the underlying interest rate (e.g. Libor, Wibor etc.)
- Zero-coupon – similar to t-bills but with longer maturity as the appreciation of the bond provides the return to the holder.

Certificates of deposit (CDs) and commercial papers are considered to be money market instruments NOT Bonds or Bills.

Purpose

Bonds and bills are mostly traded by banks and financial institutions. Typically bonds and bills are regarded as safer than equities and commodities and are considered as long-term investments. Many investors are limited to buying only bonds and bills (e.g. dedicated bond investment funds and large share of pension fund portfolio – min 60%)).

Risks

Forecasting securities yields may be difficult as such factors as central bank interest rates, inflation etc. may influence price moves. Investors must also be aware of potential liquidity shortages when market conditions deteriorate. Ultimately the highest risk for bondholders is related to potential default of the issuer which may result in non-payment of interest and / or redemption at maturity.