Markets in Financial Instruments Directive (MiFID)

General Info

With effect from 16 February 2018 a new ***Markets in Financial Instruments Act*** has come into force, introducing the provisions of ***Directive 2014/65/EU of the European Parliament and of the Council, dated 15 May 2014, on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EC (MiFID 2), which has fully replaced Directive 2004/39/EC (MIFID)***

As from 03.01.2018 in effect are **Regulation (EU) № 600/2014,** dated 15 May 2014, on markets in financial instruments (MiFIR) as regards disclosure of commercial data, reporting of transactions to the competent authorities, trade in derivatives at organized venues and **Commission Delegated Regulation (EU) 2017/565** as regards organizational requirements and operating conditions for investment firms and defined terms for the purposes of Directive 2014/65.

As per the new requirements it is mandatory for each client - legal entity, which is about to conclude deals in financial instruments, to have an issued identification code - **Legal Entity Identifier (LEI)**.

The main goal of the new regulation is to achieve a higher level of transparency through the mechanism for disclosing of data prior to and after the transaction, while also encompassing the debt instruments and expanding the existing requirements to share instruments. The requirements to the protection of investors have been enhanced with the application of additional measures for management of products, strengthening the controlling mechanisms and the supervision.

UBB provides its current and potential clients with the following information, which you can find in this section on our website, as well as in the General Terms, applicable to agreements for investment services:

- General information about UBB and the offered investment products, as well as the services, offered by it in its capacity as a distributor of financial instruments, including also the offering of mutual funds;
- Information on categorization of clients;
- Information on the protection of financial instruments;
- Information on the financial instruments and the risks, associated with those
- Information on expenses and related fees
- Best Execution Policy

The Bank demands from clients to provide certain information prior to being rendered a service, in line with:

- Their categorization under MiFID;
- The performed suitability and appropriateness test;
- The initiation of all sufficient measures for achieving the best possible result for the client upon order execution;

- Initiation of all possible measures for the effective management of the types of conflicts of interest, which may originate as a result of rendering investment and/or auxiliary services.

Client Categorization

One of the regulatory requirements of MFIA and the measures on its implementation is, for investment intermediaries, such as UBB, effective since 1 November 2007, to categorize their clients into one of the following categories:

- retail;
- professional;
- eligible counterparty – a subgroup of professional clients

The level of protection for each client category depends on the presumed experience and knowledge, inherent to the given category. Retail clients are given the full level of protection, envisaged in the MFIA and Ordinance 38, professional clients receive a certain level of protection, envisaged in MFIA and Ordinance 38, in accordance with their experience and knowledge, while eligible counterparties obtain the lowest level of protection in accordance with MFIA. The level of protection is expressed in the relations, maintained by the Bank with its clients, and these differ depending on the client's classification category, while differences are in line with:

- the type of information, provided to the Client;
- the type of information, required from the Client and kept with UBB;
- the process of providing investment services, performing investment activities, execution of client orders and providing the respective level of protection.

A professional client is such, having experience, knowledge and skills for independent making of investment decisions and adequately assessing the risks, relating to investment activities. Such clients are of two types:

I. Clients that consider themselves professionals with regard to all investment services, investment activities and financial instruments:

1. Entities, for which it is required to have a permit issued for the performance of activities on the financial markets, or which activity on these markets is regulated in some other way by the local legislation of a member state, regardless whether this has been complied with Directive 2004/39/EC of the European Parliament and of the Council, as well as entities that have obtained a permit for performing such activities or are regulated in some other way by the legislation of a third country, as follows:

a) Credit institutions;
b) Investment intermediaries;
c) Other institutions, subject to licensing or regulated in some other way;
d) Insurance companies;
e) Collective Investment Schemes and their management companies;
f) Pension funds and pension insurance companies;
g) Entities, trading by way of business on their own account with commodities or commodity derivatives;

h) Legal entities, rendering investment services or performing investment activities, expressed only in proprietary trading on the markets of financial futures or options or other derivative financial instruments on the money market only for the purpose of hedging positions on the markets of derivative financial instruments, or which trade on the account of other participants on these markets, or determine prices for those and which have been guaranteed by clearing members on these same markets, when the responsibility for the execution of the agreements, concluded by such entities, is being taken by clearing members on these same markets;
i) Other institutional investors.

2. Large enterprises, meeting at least two of the conditions below:

a) Balance sheet total – the BGN equivalence of EUR 20 000 000 at the minimum;
b) Net turnover - the BGN equivalence of EUR 40 000 000 at the minimum;
c) Own funds - the BGN equivalence of EUR 2 000 000 at the minimum.

3. National and regional government authorities, government bodies, involved in sovereign debt management, central banks, international and supranational institutions such as the World Bank, the International Monetary Fund, the European Central Bank, the European Investment Bank and other similar international organizations.

4. Other institutional investors, which main activity is investing in financial instruments, including entities, performing securitization of assets or other financial transactions.

II. Clients, which may be treated upon their request as professional clients, in case they meet at least two of the following identification criteria:

1. Over the last year this person/entity has concluded an average of 10 deals per quarter of a considerable volume on the respective market;
2. The value of the investment portfolio of the person/entity, including financial instruments and cash deposits, exceeds the BGN equivalence of EUR 500 000;
3. The person operates or has operated in the financial sector for not less than one year at a position, requiring knowledge about the respective deals or services.

In order for clients under Item II to be treated as professional clients, the following procedure should be observed:

1. Clients need to request in writing from the Bank to be treated as professional clients in terms of all investment services or deals;
2. The Bank is obliged to warn in writing the client, that he/she/it will not enjoy the respective level of protection upon the provision of services and performing of activities, as well as the right to be compensated by the Investors in Financial Instruments Compensation Fund;
3. The client should declare that he/she/it has been informed of the consequences from the preceding item;
4. Prior to making a decision whether the client should be treated as a professional client, the Bank has to initiate the necessary actions to ensure that the client complies with the identification requirements, stated in Item II, 1.

Eligible counterparty – this is a processional client, which operates actively in the financial sector and which is considered as having the needed experience for investment decision-making, based on its corporate profile. Exactly for these reasons this is the category, which is provided with the lowest level of protection, pursuant to MFIA.

Retail client is a client that does not meet the requirements for a professional client. This group of clients enjoys the highest level of protection, in accordance with the effective legislation.

A change in the categorization of a client may be made upon his/her/its request or at the Bank's discretion. The change may be made in view of providing a higher level of protection (opting-down) or a lower level of protection (opting-up) to the client. The Bank is entitled to judge and refuse a change in the categorization based on its experience and the available information about the client. A refusal will aim at protecting the client's interest, while taking into account the policy of the bank for work with the different client categories.

Financial Instruments

This document does not aim at providing a thorough analysis of the risk, related to the financial instruments offered and traded by UBB.

The purpose of this document is to provide you with **summarized information** about certain deals and the related risks, so as to enable you to understand the core meaning of the risks, pertaining to financial instruments and as a result of that to make an informed investment decision.

We strongly advise against executing deals/ transactions without having first understood the meaning of the respective deal/ transaction and the degree to which you will be exposed to the inherent risks.

Financial instruments within the meaning of MFIA are:

1. Securities – transferable rights, registered in accounts with the Central Depository,while for government securities– registered in accounts with the Bulgarian National Bank or in a sub-depository of government securities or with foreign institutions, performing such activities(dematerialized securities), or documents, materializing transferable rights (materialized securities), which may be traded on the capital market, with the exception of payment instruments, such as:
a) shares in companies and other securities, equivalent to shares in capital companies,partnerships and other legal entities, as well as depository receipts for shares;
b) bonds and other debt securities, including depository receipts for such securities;
c) other securities, providing entitlement for acquisition or sale of such securities or which entail payment of cash, determined through securities, FX rates, interest rates or yield, commodities or other indices or indicators.

2. Instruments other than securities:
a) Instruments on the money market- instruments, which are usually traded on the money market, such as short-term government securities(T-notes), certificates of deposit and commercial papers, with the exception of payment instruments;
b) Units of Collective Investment Schemes;
c) Options, futures, swaps, forwards agreements with a fixed interest rate and other derivative contracts on securities, foreign currency, interest rates, income or other derivative instruments, indices or financial indicators, the liabilities under which may be fulfilled through delivery or through a cash payment;
d) Options, futures, swaps, forward agreements with a fixed interest rate and other commodity

derivatives, the liabilities under which have to be fulfilled through a cash payment or the liabilities under those may be fulfilled through a cash payment upon the request of one of the parties (apart from the cases of non-performance or other agreement termination grounds);
e) Options, futures, swaps and other commodity derivatives, the liabilities under which may be fulfilled through delivery, when such are traded on a regulated market and/or through a Multilateral Trading Facility;
f) Options, futures, swaps, forward contracts and other commodity derivatives, outside the scope of those stated in indent""e"", the liabilities under which may be fulfilled through delivery, which are not commercial papers and which in accordance with Art. 38, Para 1 of Commission Regulation (EC) № 1287/2006 have the characteristic features of other financial derivatives, depending on whether these are subject to clearing and settlement, including through recognized clearing houses, or are used as collateral upon margin purchases or short selling;
g) Financial derivatives for transfer of credit risk;
h) Contracts for differences (CFDs)
i) Options, futures, swaps, forward agreements with a fixed interest rate, as well as any other derivative contracts in relation to changes in climate, freight tariffs, prices of quotas for emissions trading, inflation rates and other official economic statistical indicators,the liabilities under which have to be fulfilled through a cash payment or the liabilities under which may be fulfilled through a cash payment upon the request of one of the parties(apart from the cases of non-performance or other agreement termination grounds), as well as any other derivative contracts, relating to assets, rights,obligations, indices and indicators outside those stated in this article, which have the characteristic features of the other financial derivatives, depending on whether these are traded on a regulated market, whether they are subject to clearing and settlement, including through recognized clearing houses, or are used as collateral upon margin purchases or short-selling, as well as the derivative contracts in accordance with Art. 38,Para 3 of Commission Regulation (EC) № 1287/2006.

Transations and services provided by UBB and related risks

In view of the above stated legal definitions we would like to provide you with additional clarifications regarding the instruments, with which UBB executes transactions.

Shares – securities, manifesting the right of ownership of their holder on a respective portion of the assets of a company (joint-stock company). The capital with which such company is established is allocated into a certain number of shares with precisely determined par value. The par value of shares theoretically might be any, as long as the number of the issued shares multiplied by their par value equals the capital, subscribed by the shareholders. Also theoretically, the par value of one share is the limit of the eventual claims by the shareholders towards the assets of the company upon the latter's liquidation.
Holders of shares of a given company are entitled to participate in its management and receive a pro rata share of the profit in the form of annual dividend, in case the company decides on the payment of such. Dividends are not guaranteed, and a company may decide not to pay dividends or to pay a smaller amount, compared to previous periods.
When investing in shares, investors may generate profit through the sale of these shares. However the return on the investment is not guaranteed, because the price of one share depends both on the performance of the respective company, as well as on the market valuation of its performance, the economic environment, the respective industry and the company-specific risk.
Due to the stated reasons the risk of investing in shares is related not only to non-payment of dividend, but also to the probability of capital loss. Admission of shares for trading on a regulated market does not guarantee their liquidity.

Investments in shares may both be on a very high profit, as well as on a very high loss.These are one of the riskiest securities out of the so-called traditional instruments. Any decision for purchase or sale of shares should be preceded by an assessment of the potential gains and losses. You should invest only those funds, which loss will not put you in financial difficulties. You should trace the market reaction upon any news,relating to the securities you have invested in.

Bonds – debt securities. These are a type of credit relations or a form of a loan. They manifest the liability of their issuer towards their holder for payment of their nominal amount plus a certain interest on a particular future date, or over a precisely determined period. Issuers of bonds may be governments, municipalities, companies.

Bonds are considered lower-risk assets,compared to shares, due to several major differences between them:
In most cases bonds are secured with assets /property, securities, receivables, etc./,which are encashed upon impossibility to repay the loan. In contrast to shares, bonds /in the cases when the issuer is a company/ are not a form of participation in the company, and, consequently their holders are entitled to neither representation at the General Meeting of Shareholders, nor to participation in the management. They are not entitled to dividend either. On the other hand, upon announcing the company inliquidation, bondholders rank in the first group of creditors, which are remedied with preference. For comparison, shareholders are among the last with entitlement to compensation for the made investment.

Bonds have maturity (period of existence) and fixed payments during this period. Shares have no maturity, and dividends are not guaranteed.
The stock exchange price of shares may theoretically vary in much wider range, than prices of bonds.

Due to differences in the financial stability of separate issuers, the risk of the loan non-repayment differs. Because of the assumption that sovereign defaults are rather exceptions, their debts are considered as entailing the lowest risk. Debts of municipalities rank next in this sequence. Although non-guaranteed by the respective country such bonds are treated as more secure than corporate bonds. The latter entail the highest level of risk, which is also naturally reflected in the higher yield that could be received by investors.
Apart from the risk, inherent in each issuer, of non-performance on the liabilities under the loan, there are also various financial stability evaluation methods, based on which the so-called issuer credit rating is also determined. These assessments are performed by specialized auditing companies. In order for the credit rating to be taken into account it should be determined by certified auditors.

The profit from bonds may have two sources– interest and FX rate differences in the price. Cash flows are also of two types– from interest and principal payments. The interest may be paid in bullet form at maturity, at certain intervals or to be calculated in the issuing price (zero-coupon bonds). The principal may also be paid in bullet form at maturity or at certain intervals. In Bulgaria most popular are coupon bonds, i.e. such, which interest is paid at a certain periodicity, as at maturity the last interest is paid together with the principal.

Complex Bonds

Complex bonds enable investors to access other financial instruments, and in particular, shares, through initial investment in bonds. The types of most frequently used bonds, giving access to shares, are explained further below

Convertible Bonds

These bonds may be replaced upon the bondholders' will. The maturity and theconversion date are stated in the respective issuing document. The documentation, specifying the characteristics of securities, determines the conversion terms and may include a possibility for the issuer to prepay its debt. Bondholders' rights are also described in detail in the documentation. Upon the conversion of bonds into shares,bondholders become shareholders and forfeit their previous rights. In case bondholders do not avail themselves of their right to convert their bonds into shares they will retain their status as issuer's creditors.

The issuer is also entitled to request conversion of the bonds into shares.In this case bond holders are exposed to the same risks, as in case of investment in shares.

Instruments on the money market – The instruments on the money market or the transferable debt instruments are debt securities, having a period, which usually is shorter than one year. These can be certificates of deposit, commercial papers and others. These instruments are traded on the local money markets (organized by the Central Bank) or on international markets. Holders of these financial instruments are exposed to most of the major risks, described in the second part of this document (Description of the risks) and in particular to interest rate and liquidity risk.

Instruments on the money market, offered by UBB:

Repo deals (sell-purchase) – a transaction in which the Bank sells a security to a client with the proviso for its repurchase on the repo maturity date at a price, determined in advance. Reverse repo (purchase-sell) is a transaction, in which the bank purchases a security from a client and fixes the price, at which it is going to sell that same security to that same client on a future date.

Forward – An FX forward is an arrangement between UBB and the client, in which the currencies are purchased and sold at prices, negotiated now, but the delivery is on an agreed future date at the so-called forward rate, without the need to transfer the funds prior to the agreed future date. In contrast to transactions with today's value date, in which currencies are purchased and sold at prices, negotiated now with present-day delivery; or spot deals, in which currencies are purchased and sold at prices agreed now with delivery two days after the agreement date.

Swap – The swap is a contract, in which its parties exchange interest payments or foreign currency. Depending on that they are split into two main types:

- FX Swap – An agreement for exchange of an amount in one currency type against another, with arrangement for their reverse exchange on a certain future date and at an FX rate negotiated in advance, which allows for the optimum management of the current liquidity in the currency, needed by the client. The main risk, relating to this type of swap, is the risk of a change in the FX rate of the two currencies or of only one of those, liquidity risk and the risk of the counterparty's non-performance.

- Interest Rate Swap – An agreement between the Bank and the client to exchange the interest payments on a preliminarily negotiated principal, as one of the interest payments is based on a fixed interest rate, while the other is based on a floating interest rate, bound with the value of a certain interest rate index. The main risk with this type of swap is the risk of a change in the interest rate and the risk of the counterparty's non-performance.

FX Order – A client's order, in which the latter states irrevocable willingness to either purchase or sell one currency against another at an exchange rate, determined by him/her/it in advance on condition that the market achieves these levels during the order lifecycle.

Currency Option – The purchase of a currency option provides the right, but not the obligation to either purchase or sell the base currency at an exchange rate, agreed in advance (strike price) on a determined date (European-type option) or on any date until occurrence of the specified future date (American-type option). Through the purchase of a currency option a buyer would minimize his/her/its eventual losses upon unfavourable FX rate fluctuations up to the amount of the paid premium (the price of the option), by maintaining at the same time the possibility to profit from a favorable fluctuation.

Structured products – A structured product is a financial instrument, tailored to the specific needs of the client. These products are usually associated with one or more of the following characteristics:

- Behaviour, determined by an underlying instrument or a combination of such–interest rate, securities, indices and others, or calculated through a formula;
- Leverage effect;
- Other characteristics, agreed between the parties, such as a repurchase agreement or the availability of a guarantee;
- A product, which does not allow for preliminary requests for quotations from various financial institutions;
- Lack of a secondary market or a non-liquid secondary market.

Each structured product contains a risk profile of its own. Due to the large number of possible combinations, the risk, inherent in each structured product, cannot be described in details. Prior to initiating an investment in structured products, a client should investigate those in detail.

Mutual Funds

Mutual funds are an open-end collective scheme, for investment predominantly inBulgarian shares, in shares of foreign companies, admitted for trade on internationally recognized and liquid regulated markets, in shares/ units of other collective investment schemes.

This investment product has been created for individuals, companies, institutions, ready to invest cash funds in mid-term and long-term perspective, to take low to medium investment risk, in view of generating higher yield and wishing to have secure and fast liquidity, without infringing upon the achieved investment yield, aim at diversifying the risk of their own portfolio and want their money to be managed by financial markets professionals.

Risks related to investing in Mutual Funds:

- **Market Risk**. Market prices of the Fund's investments may vary due to occurred changes in the economic and market environment, while the value of the Fund's units may decrease over certain periods.
- **Interest Rate Risk**. This is the probability for the return on the investments in debt instruments to be either better or worse than expected, due to changes in the interest rates.

- **Credit Risk**. The issuer, respectively the entity guaranteeing the debt securities, in which UBB invests, may not be capable of or may refuse payment of the due interest or principal.
- **FX Risk**. It is manifested in the cases when the investments have been made in foreign currency and their value depends on the exchange rate of the respective currency. .
- **Liquidity Risk** This is the probability of the Fund's failure to meet its obligations due to impossibility to obtain adequate financing or liquid assets.
- **Political Risk**. It is manifested upon occurrence of unfavourable internal political cataclysms and a change in the economic legislation.

General Risks

Apart from the specific risks for each and every financial instrument, mentioned above, there are also general risks, impacting each and every financial instrument and each and every investment.

Market Risk

Market risk is the risk that the value of the investment will decrease due to fluctuation of market factors – prices of financial instruments, interest rates, FX rates and others. The market prices of investments may vary due to occurred changes in the economic and market environment, monetary policies of central banks, the business activity of issuers, the demand and supply on the market of the respective instrument.

Interest Rate Risk

This is the risk that changes in the market interest rates could impact negatively the yield or value of the instruments. Changes in interest rate levels may threaten holders of financial instruments with the risk of capital loss. The significance of risk differs for the respective financial instruments.

FX Risk

Investments in instruments, denominated in foreign currency, may be unfavorably affected by reduction of the FX rate of this currency against another one. FX rates' upward and downward fluctuations may result in either loss or profit for the securities in their currency denomination.

Prepayment Risk

This is the risk that the issuer of a bond may pay its liability prior to the maturity date, this is the risk that investors in this bond might not find the same investment terms and conditions on the market upon cancellation of the existing investment.

Operational Risk

It is defined as the risk of direct or indirect losses as a result of inadequate internal control, human action, organization or external event. This risk covers human error, malicious acts on the part of employees, information systems’ failure, problems, related to management of human resources, company affairs, as well as external events such as accidents, fires, floods and others.

Liquidity Risk

Liquidity risk arises in situations, in which a party, interested in selling a certain asset, cannot do so, since nobody on the market wishes to trade in this asset. There is demand, however there is no supply or vice versa.

Volatility Risk

This is the risk related to price fluctuations of a given financial instrument. Volatility is high in case the financial instrument is subjected to severe fluctuations over a certain period of time. Volatility risk is calculated as the difference between the lowest and highest prices of the financial instrument over the given time period.

Credit Risk

This risk may be determined as the probability for the counterparty to deliberately non-perform or to be in incapacity to fulfill the commitment undertaken by him/her/it under the signed agreement. Investors should assess the quality of issuers of financial instruments, as well as their capacity to repay their obligations.

Foreign Investment Risk

This risk is related to the location of the respective asset’s market. When the market is not the native one to the investor, he/she/it undertakes FX risk.

External Markets: Each investment, containing a foreign element, is subjected to the risks, inherent in the particular market. These risks may differ from those on the market where the financial instrument has been issued or where the investor is located.

Emerging Markets: Investments in emerging markets entail risks that are not always encountered on the developed markets. These risks also exist when a larger part of the issuer’s business is being carried out on these markets.
Investments in these markets are often of speculative nature. Investments in emerging markets should be considered carefully and the various risks, existing in the reviewed markets, should be assessed.

Settlement Risk

This is the risk, that the settlement in a payment system will not be made due to inability of a participant in the payment system to fulfill its obligations. This risk equals the difference between the price of a given asset and the theoretical date of execution and the price of the asset on the execution date. This is the difference between the settlement price, approved for the financial instrument and the current market price at the time of settlement, when the difference may result in loss.
In certain situations the settlement procedures may be influenced by the number of transactions and thus impede their execution. The inability to perform the settlement due to similar problems may

impede investors from taking profitable investment opportunities and may result in loss. Settlement risk may originate as both credit and liquidity risk.

Custody risk

Investments on certain markets and in particular emerging markets, in which the rules and regulations, relating to the system of custodian services may have a lower level of development from the point of view of investors' protection, compared to those markets, which have strict custody rules. Assets on these markets, entrusted to custodians, where needed, may be exposed to risks, related to the impossibility of the custodian to fulfill its obligations. This risk increases when on the respective market there is no scheme for compensating investors, or in case such scheme exists, a certain investor is not covered by the protection it offers.

Legal Risk

The risk of uncertainty as a result of legal actions or uncertainty with regard to the applicability of agreements, acts and subordinate legislation enactments, as for example the agreement's conformity with law, the party's legal capacity to conclude agreements.

Political Risk

The risk that the government will impose new taxes, regulatory or legal obligations or restrictions on financial instruments, held already by a certain investor. For example, the government may decide to prohibit the repatriation of assets from this country.

Investment Services and Activities, Ancillary Services

Investment services and activities are:

1. Receipt and transmission of orders in relation to one or more financial instruments, including intermediation for conclusion of deals in financial instruments

2. Execution of orders for the account of clients

3. Proprietary dealing in financial instruments

4. Portfolio management

5. Provision of investment advice to clients

6. Underwriting of issues of financial instruments and/or initial placing of financial instruments for subscription /proprietary acquisition on a firm commitment basis

7. Initial placing of financial instruments for proprietary acquisition on best effort basis

8. Operation of Multilateral Trading Facilities (MTF).

Ancillary services are:

1. Safekeeping and administration of financial instruments for the account of clients, including custodianship (keeping of financial instruments and funds of clients with a depositary institution) and related services, such as cash/collateral management

2. Granting of loans for effecting of transactions in one or more financial instruments, on condition that the lending entity is involved in the transaction under terms and procedure, stipulated in a regulation

3. Advice to undertakings on their capital structure, industrial strategy, related issues and advice, as well as advice and services, relating to mergers and purchase of undertakings

4. Provision of services, relating to foreign means of payment, in line with the rendered investment services

5. Investment research and financial analyses or other forms of general recommendations, relating to transactions in financial instruments

6. Services, related to underwriting issues of financial instruments

7. As per Para 2 and Item 1 – 6 in line with the underlying asset of financial derivatives, as per Art. 3, item 2, indents “d”,” e”, “f”, and “i”, where these relate to the provision of services under Item 1 - 6 and under Para 2.