This risk analysis provides a summary of the main types of financial instruments and the risks involved in investing in them. The list is not exhaustive and other factors than those mentioned here can affect the value of the financial instrument in question. In assessing whether a financial instrument is suitable for an investor, the following must be borne in mind:

a The investors must have sufficient expertise and experience to evaluate the financial instrument in question.

b The investor must be aware of the risks in connection with investing in the financial instrument concerned and the market where it is traded.

c The investor must acquaint him-/herself with the terms and conditions which apply to the financial instrument concerned and the markets where it is traded.

d The investor must be able to evaluate, either on his/her own or with the help of advisors, the impact which external factors, such as economic cycles, interest rate movements etc., can have on investments in the financial instrument concerned.

Financial instruments involve a variety of risks and before taking an investment decision it is important to become acquainted with the nature of the financial instrument in question and the risks connected to it. Emphasis is placed on having investors never undertake transactions with financial instruments without being fully aware of the risk involved, having regard their financial strength and experience of such investments.

1 GENERAL RISK FACTORS

1.1 Economic risk

The price of financial instruments is generally strongly correlated with economic fluctuations. Economic cycles vary in both their length and scope and their impact on different industrial sectors can vary. In deciding on an investment, sufficient attention must be paid to general economic cycles, for instance, in different countries and different economies. Failure to pay heed to these factors or incorrectly analysing economic developments when making investment decisions can result in losses.

1.2 Inflation risk

Investments must be assessed with a view to the inflation rate and inflation outlook at any given time. In deciding on an investment, regard must be had for the estimated real return over the specified period, i.e. after deducting inflation from the nominal return. Investors must therefore assess the real value of their assets in terms of the real return they can be expected to deliver.

1.3 Leveraging risk

Leveraged investments are considerably more sensitive to movements in the price of the financial instruments purchased than are investments which do not involve borrowing. Investments in financial instruments which are financed with credit are risky for investors. On the one hand, margin calls may be made if price developments cause the value of collateral to fall below the authorised limit. If the investor cannot provide additional collateral, the mortgagee may be forced to sell the financial instruments in its custody at an unfavourable moment. Secondly, the loss resulting from unfavourable movements in the price of a financial instrument may exceed the amount of the initial investment. Fluctuations in the price of financial instruments may negatively affect an investor's ability to repay loans.

Investors must be aware that, due to the leveraging involved in purchasing financial instruments with borrowed funds, such investments are relatively more sensitive to price volatility. As a result, while the potential profit increases, the risk of loss grows accordingly. This means that the risk on such purchases grows the higher the leveraging is.

1.4 Political risk

Even if the issuer of a financial instrument is completely solvent, the issuer could be unable to repay the principal and/or interest on a loan at maturity, and the loan could even end up in complete default, e.g. because the issuer cannot acquire foreign currency due to currency controls, changes in legislation, etc. Government actions can result in both economic and political instability.

In the case of financial instruments in foreign currency, there is a risk that investors may be repaid in a currency which is no longer convertible due to currency controls. No actions can protect investors against risk of this sort.

1.5 Currency risk

Investments in financial instruments which are denominated in foreign currencies generally involves currency risk, since exchange rates of individual currencies can fluctuate considerably. Unfavourable exchange rate movements can result in financial loss to the investor. Those tangible aspects which affect exchange rates include, for instance, the level of inflation in the country concerned, the domestic-foreign interest rate spread, assessment of business developments, the global political situation and the security of the investments concerned. The domestic political situation can also weaken the exchange rate of the currency in question.

1.6 Liquidity risk

Low market liquidity can make it difficult for investors to sell financial instruments at market value. A distinction must be made between illiquidity resulting from supply and demand on the market, on the one hand, and from the characteristics of the financial instrument and trading practices, on the other.

Illiquidity arising from market supply and demand is due to low or no supply or demand for financial instruments at a specific price. Under such circumstances it can be impossible to execute by or sell orders immediately, or even to partly execute them, and then on unfavourable terms. In addition the cost of transactions can be higher.

Illiquidity due to the characteristics of the financial instrument, or to market trading practices, for instance, may be the result of time-consuming transfer processes for trading listed equities, long delays in settlement due to market practices or other trade-impeding circumstances.

Illiquidity can also result from a temporary liquidity shortage, which cannot be met sufficiently rapidly with the sale of financial instruments.

1.7 Subjective risk

The market price of financial instruments is sensitive to what might be called market sentiment, which is shaped by current trends and developments, the tendencies and behaviour of market players, news and opinions of opinion makers or rumours. Market prices can fluctuate strongly due to such sentiments, regardless of the actual performance of those factors which determine the value of financial instruments, e.g. the operations or situation of companies listed on the market.

2 RISK ON INDIVIDUAL TYPES OF FINANCIAL INSTRUMENTS

2.1 Bonds

2.1.1 General

A bond is a debt instrument whereby the issuer of the security promises to pay to the owner of the security a specific monetary debt at a specified time on the interest terms prescribed in the security. A bond is an instrument covered by claims law, i.e. the purchaser of the bond is the lender and has a claim against the issuer (the debtor). The terms of bonds may vary but are always determined in advance, such as the interest rate and repayment of the debt. Interest rates may be fixed or variable and bonds can be inflation-indexed. Bonds may be issued to the bearer or registered to a specific owner.

The principal characteristics of bonds are that their yields are determined by interest payments and, as the case may be, the increase in the price of the security. Bonds are issued for different lengths of time, i.e. repayment can be made over a number of months or years. Repayment of bonds is made on the agreed due dates and the interest depends on the terms of the loan. It is common for bond interest rates to be linked to market rates (e.g. REIBOR, LIBOR or EURIBOR).

2.1.2 Risk factors

Issuer risk/Solvency risk

The issuer of bonds may become temporarily or permanently unable to pay interest or to repay the loan. The issuer's solvency may change with general economic developments and/or due to changes in connection with its operations or its sector, and/or political circumstances which result in economic consequences. If the issuer's cash flow worsens this can have a direct impact on the price of the financial instruments which it issues. Similarly, the issuer's credit rating may change due to the positive or negative development of its activities.

Interest rate risk

Uncertainty concerning the future development of the interest rate level means that the purchaser of a bond with a fixed interest rate bears the risk that the price for the bond may drop if interest rates increase. The longer the term of the loan is and the lower the interest rate level, the more sensitive the bond is to increases in market interest rates.

Prepayment risk

The issuer of a bond may include provisions authorising it to prepay the amount to the owner of the bond if market interest rates drop. As a result, the real return could be less favourable to the investor than the expected return.

Call risk

A bond may have provisions authorising the issuer to call the bond prior to maturity, e.g. if market interest rates drop. It is difficult to estimate the duration of bonds which are called. As a result, the estimated return on the bonds may change unexpectedly.

Risks connected to specific types of bonds

There may be additional risks connected with some types of bonds, such as floating rate notes and reverse floating rate notes, zero coupon bonds, foreign bonds, convertible bonds, indexed bonds, subordinated bonds etc. In the case of bonds of these types, investors should acquaint themselves with their risks by reading their prospectuses and terms and conditions, and should not purchase such bonds until they are confident that they understand all of the risks they involve.

In the case of subordinated notes, investors should ask about their rights compared with the issuer's other obligations. If an issuer becomes insolvent, bonds of this sort are not paid until all other creditors with higher priority have been paid.

Convertible bonds involve the risk that the investor will not receive full repayment, but rather only an amount equivalent to the underlying financial instruments on the due date.

2.2 Shares (Equities)

2.2.1 General

Shares are certificates of shareholders' rights in a limited liability company. These rights are financial ownership rights determined by law and the Articles of Association of the company concerned. Shares are commercial paper and subject to all the traditional rules which apply to such paper, including on transfer.

Shares are generally riskier than bonds. The risk is due in particular to the higher volatility in the price of shares than that of bonds. Investment in shares can, however, be more profitable than investment in bonds in the longer term. Return on shares takes two forms. Firstly, there is a return in the form of a change in the value or price of the shares concerned and, secondly, owners of limited companies can expect to receive a dividend on their shareholdings. Distributing investments in shares by purchasing shares in many different companies can reduce the risk linked to individual limited companies considerably.

2.2.2 Risk factors

Investment risk

No claims rights exist for shareholders against the share issuer, i.e. the company, unlike bonds. The shareholder contributes share capital and thereby gains a share of the company's potential profit. The investment is therefore dependent upon the company's operations and the investor is at risk of losing the entire investment if the company's operations fail.

Risk due to price volatility

The value of shares fluctuates greatly, increasing the risk that investors could suffer financial loss on their investments. Fluctuations in the value of shares in the shorter or longer term can be unforeseeable. A distinction must be made between general market risk and the risk which is connected directly to the individual company. Both these factors, together or separately, can affect share price developments.

Dividend risk

Dividends paid to shareholders depend upon the company's performance. A decision on payment of dividend is generally taken at a shareholders' meeting. If the company has performed poorly, returning little or no profit, dividends may be reduced or even cancelled.

2.3 Funds

2.3.1 General

Funds for collective investment in financial instruments and other assets (UCITS) and investment funds are intended exclusively to accept funds from members of the public for collective investment in financial instruments and other assets on the basis of spreading risk, in accordance with a previously stated investment strategy. Management companies can also set up funds which do not accept funds from the public and issue units or shares. There are many types of funds with varying investment strategies, in addition to which the legal framework which applies to their activities may also vary. Funds are either open-end or closed-end. In open-end funds, the total share capital is not determined in advance, which means that the number of shares and participants is not determined. The fund may issue additional units depending upon demand and may also redeem units. The fund is obliged to redeem units at the specified redemption price and in accordance with contract provisions. In the case of closed-end funds, the total share capital remains unchanged unless measures are taken to alter this. Unlike open-end funds, there is no redemption obligation for units in closed-end funds.

Investment in funds can involved the following risks and investors are advised to acquaint themselves with the investment strategy of the fund in question before making a decision on investment.

2.3.2 Risk factors

Management risk

The activities and performance of individual funds depends upon the ability of its management and employees. A fund manager generally takes decisions on investments in accordance with the fund's investment strategy. If the contracts of the fund manager or key employees are terminated, it may not be possible to engage capable replacements without causing a loss to the fund. In addition, wrong decisions may result in losses.

Legal risk

The activities of individual funds may be subject to Icelandic or foreign laws, which could mean that certain investor protection rules or restrictions on activities, which apply in one jurisdiction, do not apply in certain instances. Applicable legislation may also be amended, with a resulting impact on the activities of the fund concerned or the value of the investment.

Leveraging risk

Some funds finance certain aspects of their activities through borrowing. Such leveraging can increase the risk in the fund's activities and result in expense which could lead to a decrease in the price of the investor's units in the funds.

Lack of influence

Fund investors generally have little or no right to participate in and/or influence the activities of the fund in question.

Risk linked to investment strategy

Funds' investment strategies can vary greatly. Some funds specialise in their investments, investing exclusively in certain types of financial instruments and/or in certain countries. The risk the fund bears is therefore primarily linked to the financial instruments and countries concerned. Some funds have a predefined investment strategy which is considered highly risky. Other funds invest in sectors where competition is high and as a result there are fewer investment opportunities.

Valuation risk

If a fund invests in assets which are not liquid, it can be difficult to assess the value of its units/shares.

Risk connected to underlying assets

Underlying assets can vary greatly and include both buying and short selling financial instruments. The fund can be subject to market risk and the risk inherent in its investment strategy, such as for investments outside a regulated securities market, short selling of financial instruments and leveraged buying and/or selling, could result in a loss to the fund concerned. The investor's risk which is involved in directly investing in the underlying assets is also significant for assessing the risk involved in investing in the fund concerned.

Risk of price slump

Funds are subject to risk of a price slump, reflecting a drop in the price of the financial instruments or currencies which comprise the fund's asset portfolio. The more diversified the fund's assets are, the less risk there is of loss. Conversely, the risk is greater in specialised investments and where diversification of assets is less. It is therefore important to consider both the general and specific risk factors which pertain to the financial instruments and currencies which comprise the fund's assets. Investors can, for instance, obtain information on funds by reading their prospectuses.

2.4 Derivatives

2.4.1 General

Derivatives are financial instruments whose value changes depending on the performance of the underlying assets. The underlying asset may be a financial instrument, market index, interest rate level, currency, commodity price, or even another derivative.

A Options, are contracts where the holder has a right but not an obligation to conclude a transaction. The option writer (seller of the option) is irrevocably bound to fulfil the contract while the other party (the buyer of the option) may decide at its discretion whether or not to exercise its right.

B In standardised and non-standardised forward contracts parties conclude a contract for a transaction to be fulfilled on a specific date in the future. In the case of a forward contract the parties are both irrevocably obliged to conclude the transaction on the specified date.

C In swaps the parties agree to make regular payments to one another, e.g. at fixed or variable interest rates (interest rate swaps), or to exchange specific assets, e.g. different currencies (currency swaps).

2.4.2 Options

Characteristics

Options are contracts that give one party, the buyer, the right but not the obligation, to buy (call option) or sell (put option) a specific asset (the object of the contract) at a predetermined price (strike price) at a designated point in time (expiration date) or within certain time limits (period of validity of the option). In return for granting this right, the other party, the writer of the option, collects a payment indicating the market value of the option at the commencement of the contract period. All changes to the value of the object result in a proportionally greater change to the value of the option. The option writer is irrevocably bound to fulfil the contract while the buyer of the option may decide at its discretion whether or not to exercise its right.

Risk factors

(i) *Market Risk*

Options can be traded on a stock exchange or an OTC market. They are subject to the law of supply and demand. Important factors in the pricing of an option are, on the one hand, its market liquidity and, on the other hand, the actual or expected development in the value of the underlying asset. A call option agreement decreases in price in tandem with a decline in the value of the underlying asset, while a put option increases in price if the value of the underlying asset drops. The price of an option not only reflects price fluctuations in the underlying asset. Other factors can have an effect, such as the duration of the option contract or the frequency and scope of any changes to the value of the underlying asset. As a result, the option premium may fall sharply, even if the value of the underlying asset remains unchanged.

(ii) Leveraging risk

Because of leveraging effects, changes in the premium on an option contract are generally greater than changes in the value of the underlying asset. As a result, the owner of an option can profit from major increases, but can also sustain high losses. The risk involved in buying options increases with the extent of the leveraging.

(iii) Risk in option purchases

Option purchases are considered a highly unstable investment. The probability of an option becoming worthless on its expiration date is relatively high. In such a case the investor loses all its investment, i.e. the price it paid for the option as well as commissions. The investor is therefore faced with three options: to hold its position until the expiration date, to attempt to dispose of the contract prior to the expiration date or, in the case of an American option, to exercise its option prior to the expiration date. Exercising an option may involve either a payment of the difference between the reference price and the market price or the purchase/delivery of the underlying asset. If the object of the option contract is a standardised forward contract, exercising it will mean taking a position in accordance with a standardised forward contract, which results in certain obligations regarding security cover.

(iv) Risk in selling options

Selling options generally involves higher risk than buying them. For instance, although the price obtained for an option is fixed, there is theoretically no limit for the loss an option writer could sustain. If the market price of the underlying asset changes unfavourably, the seller of the option must change its security cover?? to maintain its position. If the option sold is an American option, the seller could even have to fulfil the contract at any time until it expires. If the object of the option is a standardised forward contract, the seller takes a position in the forward market and will have to fulfil its obligations with regard to security cover??. The seller's risk can be hedged by taking a position towards the underlying asset (a financial instrument, index or other object) which corresponds to the option sold.

2.4.3 Standard and OTC forward contracts

<u>Characteristics</u>

A future is a standardised and transferable contract which obliges the contracting parties to buy or sell a specific asset for a certain price at a pre-determined time. The value of a future is often calculated daily and the contracting party's position recorded in accordance with the calculation. A forward is a non-transferable contract which obliges the contracting parties to buy or sell a specific asset for a certain price at a pre-determined time. Settlement of such contracts can either by made with the delivery of the underlying asset or a financial settlement. In both the case of a purchase of a standardised forward contract or sale of an underlying asset, the original premium is determined when the contract is concluded. The premium is generally designated as a percentage of the contract's value. In general an investor can settle the contract or close it prior to maturity, either by selling the contract or by concluding an opposing contract. Settlement closes the position taken and the gain or loss which has accumulated until the settlement is realised. Parties must fulfil those contracts which have not been closed prior to settlement. Contracts which have a tangible valuable as their underlying asset can be fulfilled by delivering the asset. If an asset is delivered, then the provisions of the contract must be satisfied in full, while if settlement of a contract is expected to be made in cash, only the difference between the contract price and the market price at the time of payment must be paid. Investors therefore have to have more capital available for contracts which specify the delivery of an underlying asset than for contracts which provide for cash settlement.

<u>Risk factors</u>

(i) *Changes to the value of the contract or underlying asset*

Regardless of the increase in the value of the contract or underlying asset, the seller in a forward contract must deliver the underlying asset at the price agreed upon originally, which may prove to be much lower than the current price. For the seller, the risk is equivalent to the difference between the agreed price in the contract and the market price on the settlement date. Since the market price can theoretically rise without end, the seller's potential loss is unlimited and can far exceed the security cover.?? If the value of the contract or underlying asset decreases, the buyer in a forward contract nonetheless must take delivery of the asset at the price originally agreed in the contract, which can be much higher than the current market price. For the seller in such a contract, the risk is equivalent to the difference between the agreed price in the contract and the market price on the delivery date. Thus the maximum loss of the buyer is the original contract price. The loss can, however, far exceed the security cover.?? Transactions are revalued at regular intervals (updated to reflect market prices – marked-to-market). The investor must have constant access to satisfactory collateral. If the collateral becomes insufficient during the term of a forward contract, additional collateral will be demanded from the investor at short notice (margin call). If the investor fails to respond the transaction will be settled prior to the end of the contract.

(ii) *Difficult or impossible to sell*

In order to prevent excessive price fluctuations, a stock exchange may set limits for certain contracts. Investors must bear in mind that it may be extremely difficult, if not actually impossible for some time, to sell the contract under such circumstances and therefore the investor should check on such limits. It will not always be possible (depending upon the market and the terms of the transactions) to sell contracts at any given time to avoid risk or to reduce the risk on outstanding transactions. If it is possible to conclude transactions to stop further losses, this may only be possible during office hours. Such transactions will not limit the loss to a specified amount, but will be concluded as soon as the specified limit is reached.

(iii) *Risk of buying and selling short*

Selling an asset without owning it when the transaction is concluded (short selling) involves a risk that the seller may have to acquire the underlying asset in an unfavourable market in order to be able to fulfil the contract when settled and deliver the underlying asset.

(iv) *Special risk arising from transactions with non-standard derivatives*

The market for standard transactions is generally efficient and transparent, which makes it generally possible to sell off contracts. However there is no market for non-standard transactions, and therefore the only way to get out of a contract is with the counterparty's agreement (closing the contract).

2.4.4 Swaps

Characteristics

Swaps are contracts in which contracting parties pay each other amounts determined by changes in their respective reference instruments during the contract period. Specifically, the contracting parties exchange payments which are based on changes in underlying references, such as interest rates or currencies. When concluding the contract the parties decide on the frequency of these payments.

Risk factors

(i) *Interest rate risk*

Uncertainty concerning the future development of the interest rate level means that the purchaser of a bond with a fixed interest rate bears the risk that the price of the bond may drop if interest rates increase. The longer the term of the loan and the lower the interest rate, the more sensitive are swaps to an increase in market interest rates. Inflation risk is inherent in swaps linked to inflation.

(ii) *Exchange rate risk*

Currency swaps are subject to exchange rate risk. Since exchange rates are subject to fluctuations, investment in financial instruments in foreign currencies generally involves exchange rate risk. The tangible factors affecting exchange rates include the inflation level in the country concerned, the spread between domestic interest rates and interest rates in other countries, assessment of economic developments, the global political situation and the security of the investment concerned.

2.5 Alternative investments

2.5.1 General

Alternative investments are investments in funds for collective investment which follow an investment strategy which differs from the traditional investments in shares and bonds. Hedge funds are the most common form of alternative investment. Their investment strategy often involves short-selling, leveraging?? and derivatives. Investments in private equity funds also fall into this category (venture capital, buy-out financing). Investors interested in alternative investments, especially in offshore funds, must be aware of these risk factors. Before undertaking an investment the investment product itself needs to be thoroughly examined.

2.5.2 Risk factors

Leveraging

Investment in this area may involve a very high degree of risk. As a result of the effect of leveraging, for example, minor market fluctuations can lead to high profit or high losses. In some instances the entire investment may be lost.

Lack of information

Investors in alternative assets often have very little information to work from. The investment strategy followed by funds, which may be extremely complex, is often very opaque for investors. Changes in strategy, which may result in a substantial increase in risk, are often not evident to investors, who may even seriously underestimate the risk.

Possible illiquidity

Alternative investments may be more difficult to dispose of than other investments. Sometimes their liquidity is extremely low. Redemption of shares in hedge funds, for example, may only be possible on a monthly, quarterly or yearly basis. Investments in private equity funds may be locked in for as long as 10 years or more.

Minimum regulation

A considerable number of funds of this sort are registered on offshore financial markets (offshore funds). It is common for such offshore jurisdictions to exercise a minimum of supervision of the funds. As a consequence, various difficulties or delays may arise in executing instructions to buy or sell and the banks concerned cannot be held responsible. There is no systematic insurance that investors' rights will not be violated.