What is a currency swap?

A currency swap is an agreement to swap interest payments and principal in two different currencies. You could say that a currency swap is an agreement to swap two currencies for an agreed period of time.

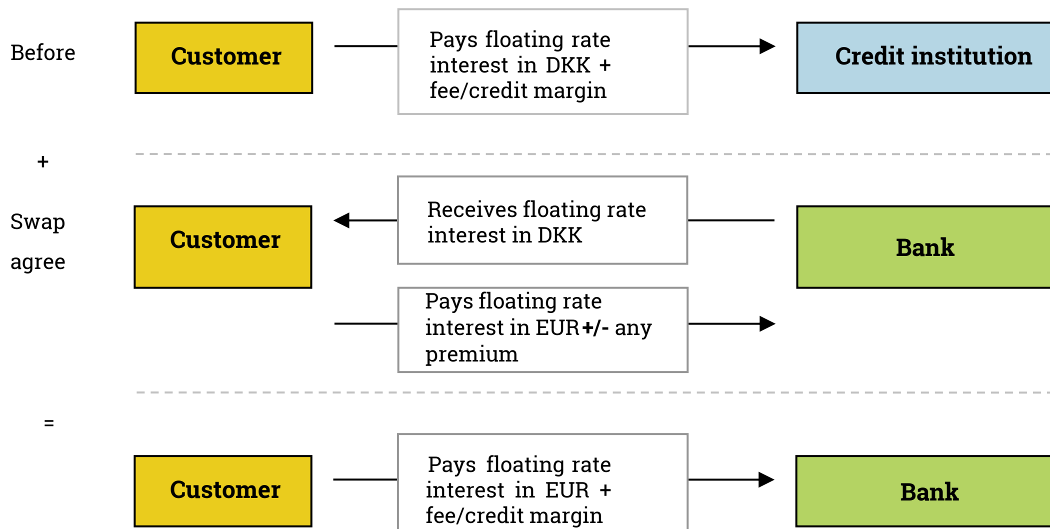
For which investors are currency swaps relevant?
Currency swaps are relevant for investors who over a period of time want to swap interest payments and principal in two different currencies.

Opportunities offered by currency swaps
In a currency swap, interest rates may be fixed or floating, resulting in these four combinations:

- Fixed/fixed: you pay fixed rate interest in one currency and receive fixed-rate interest in the other currency.
- Floating/floating: you pay floating rate interest in one currency and receive floating-rate interest in the other currency.
- Fixed/floating: you pay fixed rate interest and receive floating rate interest in the other currency.
- Floating/fixed: you pay floating rate interest in one currency and receive fixed rate interest in the other currency.

Example - Hedging of currency risk
If you have regular income in euro and loan in Danish kroner and if you want to reduce the risk of the exchange rate, it is an advantage to select a currency swap where interest is paid in euros to the Bank and interest is received in Danish kroner. This could look like this.

Example: floating/floating currency swap EUR/DKK



In the above example, the sensitivity to changes in the exchange rate is as follows:

- If the euro weakens against the Danish krone, the market value of the swap increases;

- if the euro strengthens against the Danish krone, the market value of the swap declines;
- other things being equal, an increase in the floating interest rate of the euro will result in higher costs for you, and similarly an increase in the interest rate of Danish kroner will result in lower costs for you. And vice versa at a fall in the interest rate of euro and the interest rate of Danish kroner.

Since in a currency swap the loan itself is not changed, the Bank can also offer currency swaps for loans provided by other lenders than the Bank and also for lease rentals.

A currency swap can also be used to hedge a commercial currency flow.

What happens in practice?

- your loan continues;
- you enter into a currency swap agreement with the Bank, which runs concurrently with your loan. The Bank confirms all agreements by sending the agreement to you which you must accept by your signature and return to the Bank;
- you need not sign any new loan agreement as you would have had to do if you were refinancing an ordinary loan;
- the currency swap can be closed at any time and is calculated on the basis of the current interest rate and FX market.

Terms and conditions
When you trade financial instruments like currency swaps with the Bank, you always sign a **service agreement** in which the Bank stipulates how we manage /monitor the risk you assume. The service agreement entitles the Bank to close the currency swap or demand security. This will happen if the **market value** of the currency swap moves in negative direction and at the same time exceeds certain agreed and granted credit limits.

The market value expresses the value of the currency swap relative to current market rates, exchange rates and time to expiry.

The service agreement will contain 'amber' and 'red' alerts, indicating a negative net market value. The current market value appears from a special account which can be viewed in the Netbank. You may close the transaction early. In the event of special, extreme market conditions, without current market prices, the Bank may not be able to offer you to close the transaction, which may lead to losses.

In addition to the basic service agreement, a currency swap agreement **may** in principle, include your or the Bank's right to end the agreement early, also known as a '**break clause**'.

For further information – please see the individual fact sheets:

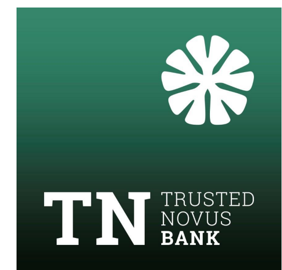
"Calculation of risk on derivative financial instruments" *and* ***"About break clauses".***

They are available upon request from your relationship manager.

Costs and market value
The margin, which the Bank charges for the transaction, is included in the calculation of the market value. Therefore, the market value will generally be negative from the start of the swap because all future payments are discounted back to the present time at an interest rate corresponding to the market rate.

About risk
Depending on the structure of the currency swap, the market value of the swap may become negative. See pages 4 and 5 for examples.

To assess the risk involved in a currency swap, you must know in detail all your cash flows in various currencies. It is important that you have sufficient financial strength when you use financial instruments. You should be able to withstand any



negative consequences of changes in interest rates/currencies and market risk – even in case of extreme movements in interest rates/currencies. This means that your position may be less favourable, both with respect to credit conditions and borrowing opportunities.

You should be aware that you are buying a derivative financial instrument and will be in a different position than if you had refinanced the underlying loans by traditional means.

When using benchmarks (e.g. interest rate benchmarks) in currency swaps, you must be aware of the risk that these benchmarks are or can be subject to national, international or other initiatives, which may mean that the composition of the benchmark is changed or that the benchmark completely disappears.

Further information is available at:

trustednovusbank.gi/general-terms/fallback-plans

A currency swap is a financial product classified as red according to the risk classification.

Read more about the risk classification of investment products at:

trustednovusbank.gi/investmentinformation

We recommend that you seek advice from professional advisers about any accounting and tax consequences before entering into currency swaps.

What you should know before trading

If you wish to receive personal advisory services in connection with the establishment and the ongoing development of the currency swap, a suitability test must be performed allowing the Bank to assess the suitability of the currency swap relative to the purpose and the time horizon. Your financial strength, risk tolerance and knowledge of and experience with currency swaps will be included in the test. We recommend that you contact your relationship manager if you have any questions in relation to anything described in this fact sheet, or if, generally, you would like to have some points clarified.

Tax

We do not give advice on tax issues in connection with specific transactions. If you wish to learn about the specific importance of the tax rules for you, we recommend that you consult your accountant.

Pros and cons

<table>
<tr><th>CURRENCY SWAP – YOU PAY INTEREST AT A FIXED RATE AND RECEIVE INTEREST AT A FIXED RATE</th><th>CURRENCY SWAP – YOU PAY INTEREST AT A FLOATING RATE AND RECEIVE INTEREST AT A FIXED RATE</th></tr>
<tr><td>Pros
• You know the amount of interest payable;
• If the interest rate falls in the currency you receive, the market value of the swap will be positive;
• If the interest rate increases in the currency you pay, the market value of the swap will be positive;
• You may receive a capital gain if the rate of the currency you pay falls.</td><td>Pros
• Typically, you pay interest at a lower rate since a currency swap gives you an opportunity to swap currency and interest conditions on your loan - for instance during periods when it is cheaper to borrow in a different currency than Danish kroner;
• You will benefit from interest rate declines in the currency you pay;
• If the interest rate falls in the currency you receive, the market value of the swap will be positive;
• You may receive a capital gain if the rate of the currency you pay falls.</td></tr>
<tr><td>Cons
• You will not benefit from interest rate declines in the currency that you pay;
• If the interest rate falls in the currency you pay, the market value of the swap will be negative;
• If the interest rate increases in the currency you receive, the market value of the swap will be negative;
• You risk suffering a foreign currency loss if the rate of the currency you pay increases;
• As currency swaps are not listed, there is no uniform price in the market;
• A traditional currency swap is non-callable.</td><td>Cons
• If the interest rate differential develops unfavourably, your interest saving may be lower or even negative when you swap from fixed rate interest in one currency to floating-rate interest in another;
• You do not know your interest during the agreed term;
• If the interest rate increases in the currency you receive, the market value of the swap will be negative;
• You risk suffering a foreign currency loss if the rate of the currency you pay increases;
• As currency swaps are not listed, there is no uniform price in the market;
• A traditional currency swap is non-callable.</td></tr>
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<table>
<tr><th>CURRENCY SWAP - YOU PAY INTEREST AT A FLOATING RATE AND RECEIVE INTEREST AT A FLOATING RATE</th><th>CURRENCY SWAP - YOU PAY INTEREST AT A FIXED RATE AND RECEIVE INTEREST AT A FLOATING RATE</th></tr>
<tr><td>Pros
• Typically, you pay interest at a lower rate;
• You will benefit from interest rate declines in the currency you pay;
• You will benefit from interest rate increases in the currency you receive;
• You may receive a capital gain if the rate of the currency you pay falls.</td><td>Pros
• You know the amount of interest payable;
• You will benefit from interest rate increases in the currency you receive;
• If the interest rate increases in the currency you pay, the market value of the swap will be positive;
• You may receive a capital gain if the rate of the currency you pay falls.</td></tr>
<tr><td>Cons
• If the interest rate differential develops unfavourably, your interest saving may be lower or even negative when you swap from floating-rate interest in one currency to floating rate interest in another.
• You risk suffering a foreign currency loss if the rate of the currency you pay increases;
• As currency swaps are not listed, there is no uniform price in the market;
• A traditional currency swap is non-callable.</td><td>Cons
• Your net liquidity will be lower if the interest rate falls in the currency you receive;
• If the interest rate falls in the currency you pay, the market value of the swap will be negative;
• You risk suffering a foreign currency loss if the rate of the currency you pay increases;
• As currency swaps are not listed, there is no uniform price in the market;
• A traditional currency swap is non-callable.</td></tr>
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