



Investment  
Managers



AXA INVESTMENT MANAGERS UK

# **Segregated Mandates and Advisory Agreements Risk Factors 2024**

# Risk Factors

## Introduction

This booklet sets out a list of risks which clients should consider in connection with the management of, or advice given in relation to, a portfolio by the investment manager.

Clients should be aware that not all risks set out in this booklet will be relevant to a portfolio and should only consider those risks in Part B (*Specific Risks related to Investment Strategies*) relating to those instruments, assets and strategies relevant to their portfolio in addition to the generic risks set out in Part A (*Generic Risks*).

The risks described in this booklet should not be considered an exhaustive list and clients should be aware that a portfolio may involve risks of an exceptional nature from time to time, which are not set out here.

Reference to "investment manager" below means the investment manager appointed as discretionary investment manager of, or investment adviser in relation to, a portfolio or portfolios from time to time.

**This booklet shall be published on our website: <https://www.axa-im.co.uk/important-information/mifid>. Any changes to the risk disclosures in this booklet (which may be material) shall be deemed notified to clients by the updating of the booklet on this website from time to time.**

## **Part A: Generic Risks**

### **General Risks**

The following risks relate to the management of, or advice given in relation to, a portfolio generally:

- Past performance is not a guide to future performance.
- There is no assurance or guarantee that the investment objectives of a portfolio, or any part thereof, will be achieved, or that any investment strategy recommended or used will be successful.
- The securities and instruments in which a portfolio may invest are subject to normal market fluctuations and other risks inherent in investing in such securities and instruments and there can be no assurance that any appreciation in value will occur.
- Unless a portfolio's performance keeps up with or beats inflation, the real value of an investment made by the portfolio will fall over time.
- All of a portfolio's investments are at risk. The value of investments and the income from investments may go down as well as up and accordingly, a client may not get back the full amount invested and may not receive a return which is sufficient to meet their own investment objective. An investment in a portfolio should only be made by those clients who are able to sustain a loss on their investment.
- Where a portfolio aims for relatively high performance, such portfolio may incur a greater level of risk than those portfolios adopting a more moderate approach.
- There may be a variation in performance between portfolios with similar objectives and policies due to the selection of different investments within the portfolio.
- It is a client's responsibility (or their professional advisor) to ensure that the investment objective of a portfolio, or an investment strategy recommended or used by the investment manager, meets its requirements.
- The investment manager will apply its investment techniques and strategies in making investment decisions for a portfolio, but there can be no guarantee that the investment manager will be successful, and it may incur losses for the portfolio, which will impact the value of the portfolio.
- The success of investment activities will depend on the investment manager's ability to make use of particular investment instruments with which to implement the relevant investment strategies. No assurance can be given that such investment instruments will be indefinitely available to the investment manager. The lack of availability of such instruments will reduce the scope for the investment strategies and may require the investment manager to adopt one or more alternative investment strategies in coordination with a client.
- Investment choices made by the investment manager will also affect the overall level of risk within a portfolio. For example, from time to time, as a result of the investment manager's particular conviction, a portfolio may invest a significant proportion of its portfolio in one or more individual companies (subject to the applicable rules on diversification), types of company, sectors or regions, giving rise to a greater level of risk than where investments are more diversified. This level of risk is likely to vary over time due to changing market conditions and/or changes to the holdings in the portfolio.

### **Operational Risks**

Operational risk, such as breakdowns or malfunctioning of essential systems and controls, including IT systems, can impact on all investment types. Business risk, especially the risk that the business is run incompetently or poorly, could also impact on clients. Operational risk may not be apparent from outside the organisation.

Failure of operational systems and processes may impact the management of client assets and the investment manager's activities. The investment manager's activities may also be impacted by external events that affect internal operational processes. Risks falling within the scope of operational risks include:

- Systems risk

- Process/execution risk
- External event driven risks
- Model risks
- Valuation risks
- Business continuity process and procedures
- Third party operations risk

## Legal / Regulatory / Tax Risks

All investments could be exposed to regulatory or legal risk.

Returns on all, and particularly new, investments are at risk from regulatory or legal actions and changes which can, amongst other issues, alter the profit potential of an investment. Legal changes could even have the effect that a previously acceptable investment becomes an ineligible investment for a portfolio on the grounds of illegality.

Changes to related issues such as tax may also occur and could have a large impact on profitability. Such risk is unpredictable and can depend on numerous political, economic and other factors.

## Tax Rules

Governments may change the tax rules which affect a client or the portfolio in which the client has a holding.

## Cyber Security Risks

The investment manager and its service providers are susceptible to operational and information security and related risks of cyber security incidents. In general, cyber incidents can result from deliberate attacks or unintentional events. Cyber security attacks include, but are not limited to, gaining unauthorised access to digital systems (e.g. through “hacking” or malicious software coding) for purposes of misappropriating assets or sensitive information, corrupting data or causing operational disruption. Cyber attacks also may be carried out in a manner that does not require gaining unauthorised access, such as causing denial-of-service attacks on websites (i.e. efforts to make services unavailable to intended users). Cyber security incidents affecting the investment manager or other service providers such as financial intermediaries have the ability to cause disruptions and impact business operations, potentially resulting in financial losses, including by interference with the ability to calculate the value of investments; impediments to trading of investments for a portfolio; the inability of clients to withdraw or contribute assets to a portfolio; violations of applicable privacy, data security or other laws; regulatory fines and penalties; reputational damage; reimbursement or other compensation or remediation costs; legal fees; or additional compliance costs. Similar adverse consequences could result from cyber security incidents affecting issuers of securities in which a portfolio invests, counterparties with which the investment manager engages in transactions, governmental and other regulatory authorities, exchange and other financial market operators, banks, brokers, dealers, insurance companies and other financial institutions and other parties. The investment manager itself has in place a cyber security policy which a) describes the procedures whereby the investment manager satisfies itself with respect to any threat to the investment manager from a cyber security related event or attack, and b) ensures the investment manager has appropriate safeguards in place to mitigate the risk of a successful cyber-security attack and to minimise the adverse consequences arising from any such event or attack. While information risk management systems and business continuity plans have been developed by the investment manager which are designed to reduce the risks associated with cyber security, there are inherent limitations in any cyber security risk management systems or business continuity plans, including the possibility that certain risks have not been identified.

## **Part B: Specific Risks related to Investment Strategies**

### **Fixed Interest Securities**

A portfolio may invest in fixed interest securities. Fixed interest securities are the borrowings of governments or companies (the issuers), generally in the form of bonds. The issuers will pay the following to a holder of bonds: (a) a fixed rate of interest on the debt (also known as the coupon) on fixed due dates; and (b) the capital value of the debt (the principal) after a fixed period (the maturity). The market price of a bond is determined by its redemption yield. The redemption yield of a bond is the rate of return paid to a holder (expressed as an annual percentage of its current market value) if the bond is held to its maturity. The redemption yield (and therefore the market price) of such bonds are affected by a number of factors, including short term interest rates (shorter duration bonds respond more to these) and economic outlook and inflation expectations (medium and longer duration bonds follow these longer term trends and views) as well as the creditworthiness of the issuer.

### **Interest rate risk**

Interest rate risk is the risk that the market value of financial instruments (such as fixed-rate bonds) held by a portfolio could change as a result of changes in market rates (yields). Yields can change as a result of, among other things, the economic and inflation outlook which also affects supply and demand as well as future interest rate expectations, without necessarily a change in official central bank short term interest rates. Higher yields result in a decline in the value of fixed-rate bonds and may also affect the value of other financial instruments. Conversely, lower yields tend to increase the value of fixed-rate bonds and may also affect the value of other financial instruments. Duration (a measure based on the coupon and maturity payments schedule of a bond) is an important concept in understanding how the price of that bond might change for a 1% move in its redemption yield. A bond with a longer duration is more sensitive to a change in yields and, generally speaking, will experience more volatility in its market value than bonds with shorter durations.

### **Credit risk**

All bonds have a potential credit risk, in that the issuer could default on its obligations to pay income and/or capital. An issuer default would likely result in a large drop in the value of that bond. The value of an investment will also be affected by the perceived credit risk of the issuer, including changes to credit ratings and the general level of aversion to credit risk in the market. Generally, an increased level of perceived credit risk leads to a fall in the value of the bond, and vice versa. Credit risk can be measured by ratings assigned to issuers of bonds by third party credit rating agencies. The largest credit rating agencies are Moody's, Standard & Poor's and Fitch Ratings. Each credit rating agency uses different designations. The highest designation (Aaa (Moody's), AAA (Standard & Poor's and Fitch Ratings)) are intended to represent a lower probability of default of the issuer. The credit rating agencies designate "investment grade" bonds as Baa3 or above (Moody's) or BBB- or above (Standard & Poor's or Fitch Ratings). See further below under "High yield bonds risk".

### **High yield bonds risk**

High yield bonds (also known as sub-investment grade bonds) are fixed interest securities issued by companies or governments with lower credit ratings (Ba1 and below (Moody's) or BB+ and below (Standard & Poor's and Fitch Ratings)). They are potentially more risky than investment grade bonds which have higher ratings. The issuers of high yield bonds will be at greater risk of default or ratings downgrades. The capital value of a portfolio's investment in high yield bonds and the level of income it receives may fall as a result of such issuers ceasing to trade. A portfolio may endeavour to mitigate the risks associated with high yield bonds, by diversifying their holdings by issuer, industry and credit quality.

## Prepayment and extension risk

Prepayment risk is the risk associated with the early unscheduled return of capital (i.e., repayment of the debt) by the issuer on a bond. Prepayment generally occurs in a declining interest rate environment. When capital is returned early, no future interest payments will be paid on that part of the capital. If the bond was purchased at a premium (i.e., at a price greater than the value of the capital), the return on the bond will be less than what was estimated at the time of purchase.

The opposite of prepayment risk is extension risk which is the risk of a bond's expected maturity lengthening in duration due to a slowdown in prepayments of capital. Extension risk is mainly the result of rising interest rates. If the bond was purchased in anticipation of an early repayment of capital, an extension of the maturity could impact the price of the bond.

## Index-linked bonds risk

Index-linked bonds are fixed interest securities whose capital repayment amounts and interest payments are adjusted in line with movements in inflation indices. They are designed to mitigate the effects of inflation on the value of a portfolio. The market value of index-linked bonds is determined by the market's expectations of future movements in both interest rates and inflation rates.

As with other bonds, the value of index-linked bonds will generally fall when expectations of interest rates rise and vice versa. However, when the market anticipates a rise in inflation rates, index-linked bonds will generally outperform other bonds, and vice versa.

Index-linked bonds bought in the secondary market (i.e., not directly from the issuer) whose capital values have been adjusted upward due to inflation since issuance, may decline in value if there is a subsequent period of deflation.

Due to the sensitivity of these bonds to interest rates and expectations of future inflation, there is no guarantee that the value of these bonds will correlate with inflation rates in the short to medium term.

## Risks linked to investment in sovereign debt

A portfolio may invest in bonds issued by countries and governments (sovereign debt). The governmental entity that controls the repayment of sovereign debt may not be able or willing to repay the capital and/or interest when due in accordance with the terms of such debt. In such a scenario, the value of investments of a portfolio may be adversely affected. A governmental entity's willingness or ability to repay capital and interest due in a timely manner may be affected by, among other factors, its cash flow situation, the extent of its foreign currency reserves, the availability of sufficient foreign exchange on the date a payment is due, the relative size of the debt service burden to the economy as a whole, the governmental entity's policy towards the International Monetary Fund and the political constraints to which a governmental entity may be subject. Governmental entities may also be dependent on expected disbursements from foreign governments, multilateral agencies and others abroad to reduce principal and interest on their debt. In addition, there are no bankruptcy proceedings for such issuers under which money to pay the debt obligations may be collected in whole or in part. Holders may be requested to participate in the rescheduling of such sovereign debt and to extend further loans to the issuers.

Certain countries are especially large debtors to commercial banks and foreign governments. Investment in sovereign debt issued or guaranteed by such countries (or their governments or governmental entities) involves a higher degree of risk than investment in other sovereign debt.

Certain portfolios may be further subject to the risk of high concentration in bonds issued by and/or guaranteed by a single sovereign issuer which is below investment grade and/or unrated which is also subject to higher credit risk. In the event of a default of the sovereign issuer, such a portfolio may suffer significant loss.

## Convertible bonds risk

A portfolio may invest in convertible bonds which are fixed interest securities issued by companies which may be converted either at a stated price or stated rate for shares in the issuing company at specified times during the life of the convertible bonds. Although to a lesser extent than with fixed interest securities generally, the market value of convertible securities tends to decline as interest rates rise. Because of the conversion feature, the market value of convertible securities also tends to vary with fluctuations in the market value of the underlying shares. Convertible bonds may also have call provisions and other features which may give rise to the issuing company forcibly converting them to shares. The value and performance of the portfolio may also be adversely affected as a result.

Investments in convertible bonds are subject to the same interest rate, credit and prepayment risks associated with comparable conventional corporate bonds. The net asset value of investments in the portfolio may be adversely affected as a result of such risks.

## Equity risk

The value of shares in which a portfolio may invest fluctuate pursuant to market expectations. The value of such shares will go up and down and equity markets have historically been more volatile than fixed interest markets. Should the price of shares in which the portfolio has invested fall, there is a likelihood that the net asset value of the portfolio will also fall.

Portfolios investing in shares are generally more volatile than portfolios investing in bonds or a combination of shares and bonds but may also achieve greater returns.

## Equity Related Securities and Warrants

Equity related securities may include warrants (which give a portfolio the right to subscribe to or purchase shares), convertible bonds and other securities whose value is linked to the performance of shares. Equity related securities are generally subject to the same market risks as the shares or baskets of shares to which they relate.

Warrants can provide a greater potential for profit or loss than an equivalent investment in the underlying shares. Prices of warrants do not necessarily move in tandem with the prices of the underlying shares and may be volatile. Warrants have no voting rights, pay no dividends and offer no rights with respect to the assets of the issuer other than an option to buy shares. If a warrant held by a portfolio is not exercised by the date of its expiration, the portfolio would lose the entire purchase price of the warrant.

Upon the maturity of a security linked to the performance of shares, a portfolio generally receives a return of principal based on the increase in value (if any) of the underlying shares. If the underlying shares decline in value, the security may return a lower amount at maturity. The trading price of such a security also depends on the value of the underlying shares. Such securities involve further risks associated with purchases and sales of investments, including currency risk, credit risk and counterparty risk.

## Concentrated portfolios

A portfolio may have a concentrated portfolio of assets. This can give rise to more risk than where investments are spread over a large number of companies. Whilst this may increase the potential gains, it may also increase the risk of loss to the portfolio as a result of the portfolio's greater exposure to the performance of individual companies.

## Industry sector or region risk

An investor may invest in a portfolio of shares which is focused towards one particular market sector or geographic region. This focus may result in higher risk when compared to a portfolio that has spread or diversified investments more broadly. Some sectors and regions can experience rapid and extreme price movements when compared with movements in securities markets generally. Investors should note that investments with a specific focus should be considered as part of a wider diversified portfolio.

## Changing technology risk

A portfolio may invest in companies which are particularly vulnerable to rapidly changing technology and a relatively high risk of obsolescence caused by scientific and technological advances. In addition, investment in, for example, internet related or biotechnology businesses may be more volatile than investment in broader based technological or healthcare related businesses or other more diversified industries.

## Smaller companies risk

Investments in smaller companies offers the possibility of higher return but also involves a higher degree of risk than investments in well established, larger companies. Investments in smaller companies can be more volatile which may lead to increased volatility in the value of the assets of a portfolio.

## Liquidity risk

Under certain market conditions, it may be difficult to buy or sell investments for a portfolio. For example, smaller company shares may trade infrequently and in small volumes and corporate and emerging market bonds may be affected by the demand in the market for such securities carrying credit risk, particularly in times of significant market stress. In addition, a portfolio may invest in securities or investment funds that may be subject to legal or other restrictions on transfer, redemption, or for which no liquid market exists. As a result, it may not be possible to buy or sell such investments at a preferred time, close to the last market price quoted or in the volume desired or liquidate positions promptly. The investment manager may be forced to buy or sell such investments as a consequence of clients buying or selling shares in the portfolio. Depending on market conditions at the time, this could lead to a significant drop in the portfolio value.

## Leverage

A portfolio may be leveraged through borrowing cash or use of derivatives (i.e., the exposure of the portfolio to an asset may be greater than the amount invested). In addition, the portfolio may invest in investment funds which utilise leverage in their investment programs (which may take the form of trading on margin, using derivative instruments or other forms of direct and indirect borrowings).

While leverage presents opportunities for increasing the capital return, it has the effect of potentially increasing losses as well. Any event which adversely affects the portfolio's underlying investment would be magnified to the extent the capital is leveraged. The cumulative effect of the use of leverage in a market that moves adversely to the underlying investment vehicles would result in a substantial loss to capital that would be greater than if capital were not leveraged.



## Emerging Markets risk

Investment in emerging markets (countries that are transitioning towards more advanced financial and economic structures) may involve a higher risk than those inherent in established markets. Emerging markets and their currencies may experience unpredictable and dramatic fluctuations from time to time. Investors should consider whether or not investment in such portfolios is either suitable for or should constitute a substantial part of an investor's portfolio.

Companies in emerging markets may not be subject to:

- a. accounting, auditing and financial reporting standards, practices and disclosure requirements comparable to those applicable to companies in developed markets; and
- b. the same level of government supervision and regulation of markets as countries with more advanced securities markets.

Accordingly, certain emerging markets may not afford the same level of investor protection as would apply in more developed jurisdictions.

Restrictions on foreign investment in emerging markets may preclude investment in certain securities by a portfolio referred to above and, as a result, limit investment opportunities for a portfolio. Substantial government involvement in, and influence on, the economy, as well as a lack of political or social stability, may affect the value of securities in certain emerging markets.

The reliability of trading and settlement systems in some emerging markets may not be equal to that available in more developed markets, which may result in delays in realising investments.

Lack of liquidity and efficiency in certain of the stock markets or foreign exchange markets in certain emerging markets may mean that from time to time the investment manager may experience more difficulty in purchasing or selling holdings of securities than it would in a more developed market.

## Political economic, convertibility and regulatory risk

Some geographical areas in which a portfolio may invest (including but not limited to Asia, the Eurozone and the US) may be affected by economic or political events or measures, changes in government policies, laws or tax regulations, currency convertibility, or by currency redenomination, restrictions on foreign investments, and more generally by economic and financial difficulties. In such contexts, volatility, liquidity, credit and currency risks may increase and adversely impact the net asset value of a portfolio.

## Foreign ownership risk

Certain governments impose restrictions on foreign investment in companies incorporated in their jurisdiction to address concerns such as those relating to loss of national sovereignty. In the event that the portfolio holds shares which become the subject of foreign ownership restrictions, there may be a delay in the investment manager becoming aware of such restrictions. This may result in the compulsory sale of shares in circumstances where it might otherwise prefer to retain such assets, thereby causing loss to a portfolio.

## Currency risk

Assets of a portfolio (including cash), and any income paid on those assets, may be denominated in a currency other than the base currency of the portfolio. Changes in the exchange rate between the base currency and the currency of an asset may

cause the value of the asset/income (expressed in the base currency) to fall as well as rise even if there is no change of the value of such assets in its local currency. This may also cause additional volatility in a portfolio's value. It may not be possible or practicable to hedge against such exchange rate risk.

For certain portfolios, the investment manager may reduce the risk of movements in exchange rates on the value of all or part of the assets of a portfolio through the use of currency exchange transactions. A portfolio may enter into currency exchange transactions either on a spot basis (i.e., exchanging at the current price) or through forward currency transactions (i.e., agreeing to purchase the currency at an agreed price at a future date). Neither spot transactions nor forward currency transactions will completely eliminate fluctuations in the prices of a portfolio's securities or in foreign exchange rates or prevent loss if the prices of these securities should decline. The performance of a portfolio may be strongly influenced by movements in foreign exchange rates because currency positions held by a portfolio may not correspond with the securities positions held.

Although these transactions are intended to minimise the risk of loss due to a decline in the value of the hedged currency, they also limit any potential gain that might be realised should the value of the hedged currency increase. Forward currency transactions may also have the effect of reducing or enhancing a portfolio's performance due to the difference between the exchange rate available on such transactions compared to the current (spot) exchange rate. Under normal market conditions this difference in exchange rates is mainly caused by the different short-term interest rates applicable to the currency of the assets and the base currency of a portfolio. Where the interest rate applying to the foreign currency is higher than that of the portfolio's base currency, this can reduce the portfolio's performance and vice-versa. This impact on performance is usually far less pronounced than the effect of fluctuations of exchange rates that the use of such transactions is intended to reduce, but the impact can be significant over time, particularly where there is a wide gap between the interest rates applicable to the two currencies. The precise matching of the relevant contract amounts and the value of the securities involved will not generally be possible because the future value of such securities will change as a consequence of market movements in the value of such securities between the date when the relevant contract is entered into and the date when it matures. Therefore, the successful execution of a hedging strategy which matches exactly the profile of the investments of a portfolio cannot be assured. Furthermore, it may not be possible to hedge against generally anticipated exchange or interest rate fluctuations at a price sufficient to protect the portfolio from the anticipated decline in value of its assets as a result of such fluctuations.

## Counterparty and broker credit risk

At any one time, a portfolio may be exposed to the creditworthiness and stability of the counterparties with which, and the brokers and dealers and exchanges through which, it transacts (including derivative and stock lending and repo/reverse repo transactions).

In particular, the portfolio will be subject to the risk of the inability of its counterparties to perform its obligations under such transactions (default), whether due to insolvency, bankruptcy or other causes. In the event of the insolvency of a counterparty, the portfolio might not be able to recover cash or assets of equivalent value, to that invested, in full. The portfolio may receive assets or cash from the counterparty (collateral) to protect against any such adverse effect. Where relevant, a counterparty will forfeit its collateral if it defaults on the transaction with the portfolio. However, if the collateral is in the form of securities, there is a risk that when it is sold, it will realise insufficient cash to settle the counterparty's debt to the portfolio under a transaction or to purchase replacement securities that were lent to the counterparty under a stock lending arrangement. In relation to stock lending arrangements, there is also the risk that while cash is recovered in the event of a default, the actual stock cannot be repurchased. Furthermore, to the extent that collateral is not present to cover part or all of the debt, a counterparty default may result in losses for the affected portfolio. To assist in managing these types of risks, the investment manager may set criteria around the types of eligible collateral a portfolio may accept.

Furthermore, the portfolio will also be subject to the risk of loss of assets held by a broker in the event of the broker's bankruptcy, the bankruptcy of any clearing broker through which the broker executes and clears transactions on behalf of the portfolio, or the bankruptcy of an exchange clearing house. In the case of any such bankruptcy, the portfolio might recover, even

in respect of property specifically traceable to them, only a pro rata share of all property available for distribution to all of the broker's customers. Such an amount may be less than the amounts owed to the portfolio.

## Derivatives risk

A portfolio may enter into a variety of transactions taking the form of "derivatives transactions" (namely, options, futures or contracts for differences/swaps) or forward currency transactions. A derivatives transaction must either be in a derivative which is traded or dealt in on an eligible derivatives market, and effected in accordance with the rules of that market, (an "exchange traded" derivative), or be an off-exchange derivative entered into with an eligible counterparty (an "over-the-counter" or "OTC" derivative). Forward currency transactions are over-the-counter transactions. Derivative transactions are designed to provide exposure to the value or performance of different assets including shares, bonds and indices, the credit risk of companies or governments, interest rates, the value of currencies or other assets or investments, without the portfolio owning the relevant asset(s) or making a direct investment. A forward currency transaction is a contract that locks in the exchange rate for the sale or purchase of a particular currency on a future date. Each derivative and forward transaction bears various risks and its use may result in losses to the portfolio. The price or value of derivative and forward currency transactions may move in unexpected ways, particularly in abnormal market conditions, and therefore the use of derivatives and forward currency transactions may increase the volatility of the value of relevant investments of the portfolio. If a derivative transaction involves leverage (i.e., it increases the portfolio's exposure to the underlying asset or investment), this may magnify investment losses suffered by the portfolio and the portfolio may lose in excess of the amount invested. Exchange traded and OTC transactions are subject to liquidity risk as it may not always be possible to sell or terminate the relevant transaction. OTC derivative and forward currency transactions are subject to counterparty risk as the counterparty to the transaction may not settle the transaction in accordance with its terms and conditions (due to dispute of the terms or because of a credit or liquidity problem), thus causing the portfolio to suffer a loss. Derivative and forward currency transactions may also involve legal risk which may result in loss due to the unexpected application of a law or regulation or because contracts are not legally enforceable or documented correctly.

A transaction with a derivatives counterparty may be subject to provisions entitling the counterparty in certain circumstances to terminate a transaction prior to their normal maturity date. The termination of a transaction prior to its normal maturity date in any such circumstance could affect the ability of a portfolio to meet its objective.

The successful use of derivative and forward currency transactions (whether for investment purposes or for Efficient Portfolio Management purposes (such purposes being hedging and investment techniques where derivatives are used for one or more of the following purposes: reduction of risk, reduction of cost or generation of additional capital or income with a risk level which is consistent with the relevant risk profile of a portfolio)) requires sophisticated management and a portfolio will depend on the ability of the investment manager to analyse and predict market movements and manage the transactions. The value of a derivative or forward currency transaction will be determined by a range of factors, including the volatility and market price of the underlying asset, interest rates, government intervention in derivatives markets, the duration of the contract and the risk of default of the counterparty. As a result, there are many factors upon which market participants may have divergent views and there is a risk that the investment manager may incorrectly value the derivative/currency forward. Furthermore, there is a risk that the value of the derivative/currency forward may not correlate to the underlying asset or investment in the way anticipated by the investment manager, due to unexpected market behaviour or interest rate trends. Therefore, where a portfolio uses derivative or forward currency transactions to achieve a particular result, whether for investment purposes or for Efficient Portfolio Management, there is a risk that such use will not be successful and could leave the portfolio in a worse position than if such transactions had not been used.

In certain circumstances, the portfolio may use derivatives or forward currency transactions to reduce or eliminate risk arising from fluctuations in interest rates or exchange rates and in the price of investments or use them for other Efficient Portfolio Management purposes. Where such transactions are used for the purposes of reducing or eliminating (i.e., hedging) certain risks (for example, the use of forward currency transactions to hedge against movements in foreign currency exchange rates), such use will limit any potential gain for the portfolio should the value of the hedged asset increase. The precise matching of the relevant contract amounts and the value of the hedged asset involved will not generally be possible because the future value of

such assets will change as a consequence of market movements between the date when the relevant contract is entered into and the date when it matures. Therefore, the successful execution of a hedging strategy which matches exactly the profile of the investments of any portfolio cannot be assured. Furthermore, it may not be possible to hedge against generally anticipated exchange rate or interest rate fluctuations at a price sufficient to protect the portfolio from the anticipated decline in value of its assets as a result of such fluctuations.

The use of derivatives and forward currency transactions by the portfolios is not intended to increase the overall risk profile of the portfolio compared to similar portfolios investing directly in securities. However, in unusual market situations their use may lead to higher volatility in the value of the portfolio.

## Contingent convertible bonds risk

In the framework of new banking regulations, banking institutions are required to increase their capital buffers and have therefore issued certain types of financial instrument known as subordinated contingent capital securities (often referred to as “CoCo” or “CoCos”). The main feature of a CoCo is its ability to absorb losses as required by banking regulations, but other corporate entities may also choose to issue them.

Under the terms of a CoCo, the instruments become loss absorbing upon certain triggering events, including events under the control of the management of the CoCo issuer which could cause the permanent write-down to zero of principal investment and / or accrued interest, or a conversion to equity that may coincide with the share price of the underlying equity being low. These triggering events may include (i) a deduction in the issuing bank’s capital ratio below a pre-set limit, (ii) a regulatory authority making a subjective determination that an institution is “non-viable” or (iii) a national authority deciding to inject capital.

Furthermore, the trigger event calculations may also be affected by changes in applicable accounting rules, the accounting policies of the issuer or its group and the application of these policies. Any such changes, including changes over which the issuer or its group has a discretion, may have a material adverse impact on its reported financial position and accordingly may give rise to the occurrence of a trigger event in circumstances where such a trigger event may not otherwise have occurred, notwithstanding the adverse impact this will have on the position of holders of the CoCos.

CoCos are valued relative to other debt securities in the issuer’s capital structure, as well as equity, with an additional premium for the risk of conversion or write-down. The relative riskiness of different CoCos will depend mainly on the distance between the current capital ratio and the effective trigger level, which once reached would result in the CoCo being automatically written-down or converted into equity.

It is possible in certain circumstances for interest payments on certain CoCos to be cancelled in full or in part by the issuer, without prior notice to bondholders. Therefore, there can be no assurances that clients will receive payments of interest in respect of CoCos. Unpaid interest may not be cumulative or payable at any time thereafter,

Notwithstanding that interest not being paid or being paid only in part in respect of CoCos or the principal value of such instruments may be written down to zero, there may be no restriction on the issuer paying dividends on its ordinary shares or making pecuniary or other distributions to the holders of its ordinary shares or making payments on securities ranking pari passu with the CoCos resulting in other securities by the same issuer potentially performing better than CoCos.

CoCos generally rank senior to common stock in an issuer’s capital structure and are consequently higher quality and entail less risk than the issuer’s common stock; however, the risk involved in such securities is correlated to the solvency level and / or the access of the issuer to liquidity of the issuing financial institution.

The structure of CoCos is yet to be tested and there is some uncertainty as to how they may be impacted by liquidity challenges and industry concentration in a stressed environment of deteriorating financial condition.

## ESG and Sustainability risk

Applying ESG and sustainability criteria to the investment process may exclude securities of certain issuers for non-investment reasons and therefore some market opportunities available to portfolios that do not use ESG or sustainability criteria may be unavailable for the portfolio, and the portfolio's performance may at times be better or worse than the performance of comparable portfolios that do not use ESG or sustainability criteria. The selection of assets may in part rely on a proprietary ESG scoring process or ban lists that rely partially on third party data. The lack of common or harmonised definitions and labels integrating ESG and sustainability criteria at EU level may result in different approaches by investment managers when setting ESG objectives and determining that these objectives have been met by the portfolios they manage. This also means that it may be difficult to compare strategies integrating ESG and sustainability criteria to the extent that the selection and weightings applied to select investments may to a certain extent be subjective or based on metrics that may share the same name but have different underlying meanings. Clients should note that the subjective value that they may or may not assign to certain types of ESG criteria may differ substantially from the investment manager's methodology. The lack of harmonised definitions may also potentially result in certain investments not benefitting from preferential tax treatments or credits because ESG criteria are assessed differently than initially thought. "Sustainability risk" means an environmental, social or governance event or condition that, if it occurs, could cause an actual or a potential material negative impact on the value of an investment.

## Repurchase Agreements and Securities Lending risks

Repurchase and securities lending agreements are classified as Securities Financing Transactions and may create risks for portfolios such as (i) counterparty risk (as described above), ii) legal risk, iii) custody risk, iv) liquidity risk (i.e. risk resulting from the difficulty to buy, sell, terminate or value an asset or a transaction due to a lack of buyers, sellers, or counterparties), and, v) risks arising from the reuse of such collateral (i.e. mainly leverage risk and the risk that such collateral posted might not be returned due to the failure of the counterparty for example). Repurchase and securities lending agreements will generally be entered into pursuant to industry standard master agreements such as the ISLA commissioned Global Master Securities Lending Agreement or the SIFMA/ICMA commissioned Global Master Repurchase Agreement. Should the borrower of securities fail financially or default in any of its obligations under a repurchase or securities lending transaction with a portfolio, the collateral received by a portfolio in connection with such transaction will be called upon. Throughout the life of the transaction, the type and value of any collateral received by a portfolio in respect of the transaction shall be maintained by a portfolio (and on such terms as may be negotiated with the counterparty to the transaction, and considered acceptable by the investment manager, on behalf of a portfolio, and within the limits set by applicable regulation from time to time). However, there is a risk that the value of the collateral may be insufficient. In addition, as with any extensions of credit, there are risks of delay and recovery. A portfolio may also invest cash collateral received. A portfolio investing collateral will be exposed to the risk associated with such investments, such as failure or default of the issuer of the relevant security. Repurchase transactions are a form of leverage that may also increase the volatility of a portfolio. Repurchase and securities lending agreements may include provisions entitling the counterparty in certain circumstances to terminate a transaction prior to their normal maturity date. The termination of a transaction prior to its normal maturity date in any such circumstance could affect the ability of a portfolio to meet its objective.

## Reverse Repurchase Agreements

The entering into of reverse repurchase agreements involves certain risks. For example, if the seller of securities under a reverse repurchase agreement defaults on its obligation to repurchase the underlying securities, as a result of its bankruptcy or otherwise, the respective portfolio will seek to dispose of such securities, which action could involve costs or delays. If the seller becomes insolvent and subject to liquidation or reorganisation under applicable bankruptcy or other laws, the portfolio's ability to dispose of the underlying securities may be restricted. If the seller fails to repurchase the securities, the portfolio may suffer a loss to the extent proceeds from the sale of the underlying securities are less than the repurchase price.

## Investment model risk

In seeking to achieve a portfolio's investment objectives, the investment manager may use stock recommendations and outcomes generated by proprietary quantitative analytical models owned and operated by the AXA Investment Managers Group. Quantitative modelling is a very complex process involving hundreds of thousands of data points and settings encoded in computer software, and the investment manager and its affiliates review these codes and the various components to the models with a view to ensuring that they are appropriately adapted and calibrated to reflect the investment manager's views as to the potential implications of evolving external events and factors, including constantly changing economic, financial market and other conditions. This process involves the exercise of judgments and a number of inherent uncertainties. The investment manager's views, including those related to the optimal configuration, calibration and adaptation of the models, may change over time depending on evolving circumstances, on information that becomes available to the investment manager and its affiliates and on other factors.

While the investment manager attempts to ensure that the models are appropriately developed, operated and implemented on a continuing basis, sub-optimal calibrations of the models and similar issues may arise from time to time, and neither the investment manager nor any of its affiliates can guarantee that the models are in an optimal state of calibration and configuration at all times. Further, inadvertent human errors, trading errors, software development and implementation errors,

and other types of errors are an inherent risk in complex quantitative investment management processes of the type that the investment manager employs. While the investment manager's policy is to promptly address any such errors when identified, there can be no guarantee that the overall investment process will be without error or that it will produce the desired results. There can be no guarantee that the investment manager will be able to implement their quantitative strategies on an ongoing basis.

## Investing in Investment Funds

### *General*

A portfolio may invest in investment funds. Depending on the specific strategy of the portfolio and the constraints set by the investment management agreement, investment funds may be open-ended or closed-ended and may be established in regulated and/or unregulated jurisdictions. The jurisdictions in which investment funds are organised may not provide a level of investor protection equivalent to the level of protection that investors in the EEA (including the United Kingdom) are afforded.

Notwithstanding any due diligence carried out on an investment fund selected and/ or recommended by the investment manager, the client should be aware that the asset manager of an investment fund may take undesirable tax positions, employ substantial leverage, or otherwise manage the collective investment scheme in a manner not anticipated. In addition, an investment fund or its asset manager may be subject to other adverse events or circumstances that are difficult to anticipate or detect, such as fraud.

### *Cost and Charges*

Depending on the nature of the investment, the client may bear, along with the other investors in the investment funds, the client's portion of the expenses of the investment fund, including management, performance or other fees. These fees could be in addition to the fees and expenses associated with the services of the investment manager in connection with the portfolio.

### *Legal and Regulatory Risk*

The operation of investment funds is substantially affected by legal, tax and regulatory requirements, including requirements imposed by the securities laws and companies laws in various jurisdictions, including the United Kingdom, as well as all laws and regulations applicable to the assets of an investment fund. No assurance can be given that future legislation, administrative rulings or court decisions will not adversely affect the operation of investment funds. The effect of any future regulatory change on investment funds could be substantial and adverse.

In particular, the regulatory environment for hedge funds is evolving, and changes in the regulation of hedge funds may adversely affect the value of the holdings of a portfolio in hedge funds. In case of discretionary management, such changes may affect the ability of the investment manager to obtain the leverage it might otherwise obtain or to pursue its trading strategies.

### *Limited operating history*

A portfolio may invest in investment funds with limited operating and investment performance history, if any.

### *Management Risk*

Any actively managed investment fund is subject to the risk that its asset manager will make poor investment selections. The asset manager will apply its investment techniques and risk analyses in making investment decisions for an investment fund, but there can be no guarantee that such investment techniques and risk analyses will produce the desired results.

### *Defaulting on capital calls*

Depending on the nature of the investment, some of the investment funds may provide that investors shall be required to make additional capital contributions to cover "capital calls" or similar requests for capital being made by the asset manager of such investment funds. The consequences to the client, as an investor of such investment fund, should it default on a capital call

obligation associated to an investment fund may include, without limitation: (i) the client accumulating a significant amount in late payment interest, which becomes payable to the non-defaulting investors in the investment fund; (ii) forfeiture of the client's share of all or any portion of future distributions made by the investment fund; (iii) the client being excluded from participating in future transactions made by the investment fund; (iv) the client being forced to sell its interests in the investment fund, potentially at a reduced sale price or for no consideration other than the assumption of its obligations in the investment fund; (v) the client losing its voting rights in connection with the investment fund; and (vi) the client being prohibited from making any additional contributions to the investment fund, resulting in a dilution of the client's ownership stake relative to other investors in the investment fund. Unless the asset manager or similar entity managing the business and affairs of the investment fund of the client elects to terminate the client's unfunded capital commitment following a default by the client, the client will continue to remain obligated to make capital contributions to the investment fund, up to the full amount of its unfunded capital commitment.

#### *Impact of other terms applying to investment in, and redemption from investment funds*

A portfolio may be subject to unfavourable investment terms that are imposed by an investment fund in which the portfolio invests and the portfolio may experience difficulty in achieving its investment objective.

A portfolio may invest in portfolio funds that impose redemption terms which require the portfolio to fully redeem its investment over prolonged period (such as a period of one year or more), or which may subject the portfolio to increased redemption fees for full redemptions within a shorter timeframe. Significant redemption fees may adversely impact the investment returns of the portfolio.

Clients should note that from time to time, a portfolio may also be invested in investment funds which are subsequently put into liquidation or which are subsequently transformed into side pocketed investments. It may take a significant amount of time to receive redemption proceeds from such investment funds.

Furthermore, such investment funds may be contractually prohibited from disposing of investments for a specified period of time and, under adverse market or economic conditions, such investment funds may find it difficult to sell assets, which would thereby prolong such investment funds' periods of liquidation or side pocketing. Accordingly, such investment funds may be prevented from liquidating unfavourable positions promptly, may need to liquidate positions by incurring substantial losses or may distribute in-kind distributions to the portfolio.

Delays faced by investment funds in liquidating unfavourable positions promptly or the liquidation of positions at a substantial loss may affect adversely the performance of the portfolio.

Receipt by a portfolio of in-kind distributions from such investment funds will have an analogous impact on the portfolio, as the portfolio is likely to experience similar difficulty in disposing of such assets or may sell such assets at a substantial loss.

## **Investment in China A Shares via the Stock Connect program risk**

Some portfolios may invest in China A shares (shares issued by domestic markets in mainland China in Chinese renminbi) through the Stock Connect program. China A shares are generally only available for investment by residents of mainland China or by foreign investors through tightly regulated structures. The Stock Connect program is one structure through which foreign investors can invest in China A shares by providing mutual market access via the Hong Kong Stock Exchange, Shanghai Stock Exchange and Shenzhen Stock Exchange. In addition to the risks disclosed under Emerging Markets Risk and Political, Economic, Convertibility and Regulatory Risk, investment by the portfolio via the Stock Connect program also involves the following risks.

#### *Investment limitations*

The Stock Connect program is subject to quota limitations applying across all participants and utilised on a first-come-first-served basis. Once the quota is exceeded, buy orders will be rejected although sell orders would not be impacted. Such quota



limitations may restrict a portfolio's ability to invest in China A shares through the Stock Connect program on a timely basis, and the portfolio may not be able to effectively pursue its investment strategy.

In addition, a particular stock may be recalled from the scope of eligible stocks for trading via the Stock Connect program and in such a case a portfolio would not be able to buy that stock (although it could sell it). This may affect the ability of the portfolio to implement its investment strategy.

Each of the stock exchanges participating in the Stock Connect program reserves the right to suspend trading if necessary for ensuring an orderly and fair market and that risks are managed prudently. Consent from the relevant regulator would be sought before a suspension is triggered. A suspension could adversely affect a portfolio's ability to access the mainland China stock markets.

The Stock Connect program only operates on days when both the Chinese and Hong Kong markets are open for trading and when banks in both markets are open on the corresponding settlement days. As a result, there may be occasions when it is a normal trading day for the mainland China market but a portfolio cannot trade China A Shares via the Stock Connect program as that day is not a trading day in Hong Kong. The portfolio would be subject to a risk of price fluctuations in China A Shares for the period it cannot trade via the Stock Connect program.

#### *Operational risk*

The Stock Connect program is premised on the functioning of the operational systems of the relevant market participants. Market participants are permitted to participate in this program subject to meeting certain operational and risk management requirements. The securities regimes and legal systems of Hong Kong stock exchange and the mainland China stock exchanges differ significantly and market participants may need to address issues arising from the differences on an on-going basis.

There is no assurance that the system of the stock exchanges and market participants will function properly or will continue to be adapted to changes and developments in both markets. In the event that the relevant systems fail to function properly, trading in both markets through the program could be disrupted. A portfolio's ability to access the China A share market and pursue its investment strategy may be adversely affected.

#### *Ownership of Stock Connect securities*

China A shares purchased via the Stock Connect program are held by the sub-custodian in accounts in the clearing system of Hong Kong's central securities depository. The Hong Kong central securities depository, in turn, holds the China A shares as nominee through an omnibus securities account in its name registered with the Chinese central securities depository. This means that there are multiple legal frameworks involved in establishing legal title to the China A shares and there are increased operational risks involved in the servicing of the holding of the shares (e.g. processing dividend payments). A portfolio will be exposed to the credit risk of both the Hong Kong and Chinese central securities depository. Trading via the Stock Connect program is not covered by investor protection/compensation funds in either Hong Kong or mainland China.

## Loans

Corporate loans, or "High Yield Loans", are characterized by a higher probability of default than investment grade issuers. Loans carry a free option to prepay and the portfolio may experience a high level of prepayment. Part of the corporate loan portfolio may be subject to an extension of maturity. The extension of the maturity of a loan adversely affects the market value of the loan and affects the expected return on investment. The liquidity offered on corporate loans is less than the liquidity which can be found on equity and other traditional fixed income instruments. Loans experience long settlement times as they do not trade in a regulated market. Counterparty risk exists when selling a loan if a counterparty fails to deliver on the payment.

## Securitised assets

Securitized assets (CLO, ABS, RMBS, CMBS, CDO, etc.) are subject to credit, liquidity, market value, interest rate and certain other risks. Such financial instruments require complex legal and financial structuring and any related investment risk is heavily correlated with the quality of underlying assets which may be of various types (leveraged loans, bank loans, bank debt, debt securities, etc.), economic sectors and geographical zones.

Depending on the rating of securitized assets tranche, the level of leverage varies and the thinness of the tranche varies. Reaching a certain level of default and loss post recovery in the underlying portfolio could trigger a downgrade rating migration and even losses at the most junior tranches levels.

Securitized asset securities generally are limited recourse obligations of the related securitized asset issuer, payable solely from the related securitized asset collateral or proceeds thereof. Consequently, holders of securitized asset securities must rely solely on distributions on the related underlying securitized asset collateral or proceeds thereof for payment in respect thereof.

The investment in securitized assets may have an expected maturity that may be shorter or longer depending on market conditions and portfolio management. The liquidity offered on securitized assets loans is less than the liquidity which can be found on equity and other traditional fixed income instruments. Securitized assets are exposed to performance of the underlying portfolio with inherent risks such as, among other things, default, recovery, prepayment, liquidity and interest rate risk. Securitized assets may at any time be subject to significant price movements, which will negatively impact the valuation of the securitized assets and may lead to the loss in case of redemption.

## E.U./ UK Securitisation Regulation Verification and Due Diligence Requirements

Regulation (E.U.) 2017/2401 (the "Securitisation Regulation" and, together with any supplementary regulatory technical standards, implementing technical standards and any official guidance adopted in relation thereto by applicable E.U. and UK authorities (including, in the case of the E.U., the European Banking Authority and the European Securities and Markets Authority, and, in the case of the U.K., the Financial Conduct Authority and Prudential Regulation Authority), the "Securitisation Laws") restricts certain types of E.U.- and UK-regulated investors ("E.U./UK Institutional Investors") from investing in securitisations unless certain requirements are satisfied (the "Risk Retention and Transparency Requirements"): inter alia (i) the originator, sponsor or original lender in respect of the relevant securitisation has explicitly disclosed that it will retain, on an on-

going basis, a net economic interest of not less than five per cent. in respect of certain specified credit risk tranches or securitised exposures; and (ii) it is able to demonstrate that it has undertaken certain due diligence in respect of various matters including but not limited to its risk position, the underlying assets and (in the case of certain types of investors) the relevant sponsor or originator. Failure to comply with one or more of the requirements may result in various penalties including, in the case of those investors subject to regulatory capital requirements, the imposition of a punitive capital charge on the instruments acquired by the relevant investor.

The Risk Retention and Transparency Requirements may be amended, supplemented or revoked from time to time. There is no guarantee that pre-existing securitised transactions will be grandfathered into the regime which results from such amendments, supplements or revocations and, as a result, the securitised transactions in which the E.U./UK Institutional Investors will invest may become non-compliant with the Risk Retention and Transparency Requirements.

There are uncertainties regarding the scope of the obligations in the Securitisation Regulation and the obligations in the technical standards that will be adopted pursuant thereto which will provide details of the requirements under the Securitisation Regulation.

## **UN SDG alignment risk**

Certain portfolios may seek to contribute to the achievement of certain UN Sustainable Development Goals within their responsible investment approach, and as such, their investment universe is limited to assets that meet specific criteria designed to measure contribution to the UN SDGs (intentionality, materiality, additionality, negative externality and measurability). As a result, their respective performance may be different from a portfolio implementing an otherwise similar investment strategy which does not apply such criteria within their responsible investment approach. The selection of assets may in part rely on third party data provided at the time of investment that may evolve over time.