Risk Disclosures of Exchange-Traded Derivative Products

Warning:

Structured products are complex products, and are usually embedded with derivatives, where value is based on underlying assets. Some structured products are listed on the stock exchange, such as derivative warrants and callable bull/bear contracts. Structured products are not principal protected and investors may lose all the investment. Investors should exercise caution in relation to the product.

Although there is a secondary market for the exchange-traded derivative products, it is not possible to predict if such market will be liquid or illiquid. It is possible that the issuer could early terminate the products for illegality or impracticability. Past performance is not indicative of future performance. Investor should understand the product or seek professional advice and read the relevant product information before making investment decision. The offering documents or information provided by the product issuers have not been reviewed by the Securities and Futures Commission and investors are advised to exercise caution in relation to the offer.

General major risks of trading exchange–traded derivative products include but not limited to the following:

Issuer Default Risk

If a derivative product issuer becomes insolvent and defaults, investors will be considered as unsecured creditors and may lose all the investment.

Uncollateralized Product Risk

Uncollateralized derivative products are not asset backed. If issuer bankrupts, investors can lose their entire investment. Therefore, investors should refer to the listing documents to determine if a product is uncollateralized.

Gearing Risk

Derivative products are leveraged and the value could fluctuate rapidly according to the gearing ratio relative to the underlying assets. Investors should understand that the value of such derivative products may fall to zero resulting in a total loss of the initial investment.

Expiry Considerations

Derivative products have an expiry date after which the issue may become valueless. Investors should be aware of the expiry time horizon and select a product with an appropriate lifespan to fit their own trading strategy.

Extraordinary Price Movements

The price of a derivative product may not match its theoretical price due to outside influences such as market supply and demand factors. As a result, actual traded prices can be higher or lower than the theoretical price.

Liquidity Risk

There is a liquidity provider for each derivative product. The role of liquidity providers is to provide two way quotes to facilitate trading of their products. If a liquidity provider defaults, investors may not be able to buy or sell the derivative product until there is a new liquidity provider.

Foreign Exchange Risk

Investors trading derivative products with underlying assets not denominated in Hong Kong dollars are exposed to exchange rate risk. Currency rate fluctuations can adversely affect the underlying asset value, also affecting the price of the derivative product.

Risk of margin trading

The risk of loss in financing a transaction by deposit of collateral is significant. You may sustain losses in excess of your cash and any other assets deposited as collateral with the licensed or registered person. Market conditions may make it impossible to execute contingent orders, such as "stop-loss" or "stop-limit" orders. You may be called upon at short notice to make additional margin deposits or interest payments. If the required margin deposits or interest payments are not made within the prescribed time, your collateral may be liquidated without your consent. Moreover, you will remain liable for any resulting deficit in your account and interest charged on your account. You should therefore carefully consider whether such a financing arrangement is suitable in light of your own financial position and investment objectives.

In addition, there are risks pertaining to the particular type of derivative products:

Callable Bull/Bear Contracts (CBBC)

Mandatory Call Risk

Investors trading CBBCs should be aware of their intraday "knockout" or mandatory call feature. A CBBC will cease trading when the underlying asset value equals the mandatory call price/level as stated in the listing documents. Investors will only be entitled to the residual value of the terminated CBBC as calculated by the product issuer in accordance with the listing documents. Investors should also note that the residual value can be zero.

Funding Costs

The issue price of a CBBC includes funding costs. Funding costs are gradually reduced over time as the CBBC moves towards expiry. The longer the duration of the CBBC, the higher the total funding costs. In the event that a CBBC is called, investors will lose the funding costs for the entire lifespan of the CBBC. The formula for calculating the funding costs are stated in the listing documents.

Derivative Warrants

Time Decay Risk
All things being equal, the value of a Derivative Warrant will decay over time as it approaches its expiry date. Derivative Warrants should therefore not be viewed as long term investments.

Volatility Risk
Prices of Derivative Warrants can increase or decrease in line with the implied volatility of underlying asset price. Investors should be aware of the underlying asset volatility.

Synthetic Exchange-Traded Fund (Synthetic ETF)

Market Risk
Investors are exposed to the political, economic, currency and other risks related to the Synthetic ETF's underlying index.

Counterparty Risk
Where a Synthetic ETF invests in derivatives to replicate the index performance, investors are exposed to the credit risk of the counterparties who issued the derivatives, in addition to the risks relating to the index. Further, potential contagion and concentration risks of the derivative issuers should be taken into account (e.g. since derivative issuers are predominantly international financial institutions, the failure of one derivative counterparty of a Synthetic ETF may have a "knock-on" effect on other derivative counterparties of the Synthetic ETF). Some Synthetic ETFs have collateral to reduce the counterparty risk, but there may be a risk that the market value of the collateral has fallen substantially when the Synthetic ETF seeks to realise the collateral.

Tracking Error
There may be disparity between the performance of the Synthetic ETF and the performance of the underlying index due to, for instance, failure of the tracking strategy, currency differences, fees and expenses.

Trading at a Discount or Premium
Where the index/market that the Synthetic ETF tracks is subject to restricted access, the efficiency in unit creation or redemption to keep the price of the Synthetic ETF in line with its net asset value (NAV) may be disrupted, causing

the Synthetic ETF to trade at a higher premium or discount to its NAV. Investors who buy a Synthetic ETF at a premium may not be able to recover the premium in the event of termination.

Leveraged and Inverse Products

Investment Risk
Leveraged and Inverse Products ("L&I Products") are derivatives. Trading L&I Products involves investment risk and are not intended for all investors. There is no guarantee of repaying the principal amount.

Volatility Risk
Prices of L&I Products may be more volatile than conventional exchange traded funds (ETFs) because of using leverage and the rebalancing activities.

Unlike Conventional ETFs
ETF L&I Products are different from conventional ETFs. They do not share the same characteristics and risks as conventional ETFs.

Long-term Holding Risk
L&I Products are not intended for holding longer than the rebalancing interval, typically one day. Daily rebalancing and the compounding effect will make the L&I Product's performance over a period longer than one day deviate in amount and possibly direction from the leveraged/inverse performance of the underlying index over the same period. The deviation becomes more pronounced in a volatile market. As a result of daily rebalancing, the underlying index's volatility and the effects of compounding of each day's return over time, it is possible that the leveraged product will lose money over time while the underlying index increases or is flat. Likewise, it is possible that the inverse product will lose money over time while the underlying index decreases or is flat.

Risk of Rebalancing Activities
There is no assurance that L&I Products can rebalance their portfolios on a daily basis to achieve their investment objectives. Market disruption, regulatory restrictions or extreme market volatility may adversely affect the rebalancing activities.

Liquidity Risk
Rebalancing typically takes place near the end of a trading day (shortly before the close of the underlying market) to minimize tracking difference. The short interval of rebalancing may expose L&I Products more to market volatility and higher liquidity risk.

Intraday Investment Risk

Leverage factor of L&I Products may change during a trading day when the market moves but it will not be rebalanced until day end. The L&I Product's return during a trading day may be greater or less than the leveraged/opposite return of the underlying index.

Portfolio Turnover Risk

Daily rebalancing causes a higher level of portfolio transaction when compared to conventional ETFs, and thus increases brokerage and other transaction costs.

Correlation Risk

Fees, expenses, transactions cost as well as costs of using financial derivatives may reduce the correlation between the performance of the L&I Product and the leveraged/inverse performance of the underlying index on a daily basis.

Termination Risk

L&I Products must be terminated when all the market makers resign. Termination of the L&I Product should take place at about the same time when the resignation of the last market maker becomes effective.

Leverage Risk (For Leveraged Products Only)

The use of leverage will magnify both gains and losses of leveraged products.

Unconventional Return Pattern (For Inverse Products Only)

Inverse products aim to deliver the opposite of the daily return of the underlying index. If the value of the underlying index increases for extended periods, inverse products can lose most or all of their value.

Inverse Products vs Short Selling (For Inverse Products Only)

Investing in inverse products is different from taking a short position. Because of rebalancing, the performance of inverse products may deviate from a short position in particular in a volatile market with frequent directional swings.

Options

Options are financial contracts that give the buyer the right to buy or sell an underlying asset (stock, market index, currency or commodity) from the seller at a set price within a certain time.

You can trade options on the HKEx. The risks and returns of the option buyer and seller are different. If you are the buyer, the maximum loss is the premium you pay to the seller. If you are the seller, you get the premium. But you must also make a deposit as a guarantee to go ahead to buy or sell the underlying asset. Like futures trading, the option seller faces the risk of a margin call. Again, the loss for the seller could be much more than the premium.

The risk of loss in trading options is substantial. In some circumstances, you may sustain losses in excess of your initial margin funds. Placing contingent orders, such as "stop-loss" or "stop-limit" orders, will not necessarily avoid loss. Market conditions may make it impossible to execute such orders. You may be called upon at short notice to deposit additional margin funds. If the required funds are not provided within the prescribed time, your position may be liquidated. You will remain liable for any resulting deficit in your account. You should therefore study and understand options before you trade and carefully consider whether such trading is suitable in the light of your own financial position and investment objectives. If you trade options you should inform yourself of exercise and expiration procedures and your rights and obligations upon exercise or expiry.