Explanation of risks for listed derivatives in Hong Kong and Overseas Markets

Derivative investment involves high risks. Before you purchase any listed derivatives, you should ensure you understand the nature of the listed derivatives and carefully study the full details and risk factors set out in the relevant listing documents and, where necessary, seek professional advice before you invest in any of these products. You should also ensure that you fully understand the potential risks and rewards and independently determine that they are appropriate for you given your objectives, experience, financial and operational resources and other relevant circumstances.

Listed Derivative Warrants

Derivative warrants are instruments which give investors the right to buy or sell an underlying asset such as stock at a pre-set price prior to a specified expiry date.

- Derivative warrants are not bank deposits.
- Derivative warrants constitute general unsecured contractual obligations of the issuer and of no other person. You rely on the creditworthiness of the issuer and, if applicable, the guarantor. In the event that the issuer or, if applicable, the guarantor defaults, the potential maximum loss could be 100% of the investment amount and no return may be received. Further, you have no rights under derivative warrants against any company which issues or comprises the underlying asset of the relevant issue of warrants or the sponsor of any underlying asset that is an index.
- Purchasing derivatives warrants is not the same as buying the underlying asset, you will not be entitled to have voting rights, rights to receive dividends or distributions or any other rights under the underlying assets.
- The values of derivative warrants at any time prior to expiry are governed by a number of factors, such as the time left till expiry, the price or level of the underlying asset compared with the exercise price or strike level of derivatives warrants, the volatility of the underlying asset, market interest rate movements, credit quality of the issuer and the guarantor etc. There is no assurance that a change in value or market price of derivative warrants will correspond in direction or magnitude with the change in price or level of the underlying asset.
- You are warned that prices of derivative warrants may fall in value as rapidly as it may rise and holders may sustain a total loss of their investment.
- Assuming that all the other factors are held constant, the value of the derivative warrant will decay over time and may have no value upon expiry. You should now view derivative warrants as long term investments.
- Derivative warrants may be illiquid. Although listed derivative warrants have liquidity providers, there is no guarantee that you will be able to liquidate your position whenever you wish.

- You should recognize the complexities of utilizing derivative warrants to hedge against the market risk associated with investment in an underlying asset or shares comprising any underlying asset that is an index. The issuer or sponsor of the underlying asset will have no involvement in the offer and sale of derivative warrants and no obligation to the investors in such derivative warrants. In addition, their decisions on corporate actions may have adverse impact on the value and market price of derivative warrants.
- Investors trading listed derivative warrants with underlying assets not denominated in the currency of your home jurisdiction are exposed to exchange rate risk. Currency rate fluctuations can adversely affect the return of your investment.

Callable Bull/ Bear contract (CBBC)

CBBCs are a type of structured product that tracks the performance of an underlying asset. They are issued either as Bull or Bear contracts with a fixed expiry date, allowing investors to take bullish or bearish positions on the underlying asset. The price movement of a CBBC correlates to the movement of the price of the underlying asset.

- CBBCs are not bank deposits.
- CBBCs have an intraday “knockout” or a 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. You will only be entitled to the residual value of the terminated CBBC as calculated by the product issuer in accordance with the listing documents. The residual value can be zero, and you may lose all of your investments in the CBBCs. You should exercise special caution when a CBBC is trading close to its call price.
- CBBCs constitute general unsecured contractual obligations of the issuer and of no other person. You rely on the creditworthiness of the issuer and, if applicable, the guarantor. In the event that the issuer or, if applicable, the guarantor defaults, the potential maximum loss could you 100% of the investment amount and no return may be received. You have no rights under CBBCs against any company which issues or comprises the underlying asset of the relevant issue of CBBCs or the sponsor of any underlying asset that is an index.
- Purchasing CBBCs is not the same as buying the underlying asset or having a direct investment in the underlying asset, you will not be entitled to have voting rights, rights to receive dividends or distributions or any other rights under the underlying assets.
- The values of CBBC at any time prior to expiry are governed by a number of factors, such as the time left till expiry, the price or level of the underlying asset compared with the exercise price or strike level of derivative warrants, the volatility of the underlying asset, market interest rate movements, credit quality of

the issuer and the guarantor etc. There is no assurance that a change in value or market price of CBBCs will correspond in direction or magnitude with the change in price or level of the underlying asset. You are warned that prices of derivative warrants may fall in value as rapidly as it may rise and holders may sustain a total loss of their investment.

- Assuming all other factors are held constants, the value of CBBCs will decline over time. If you hold CBBCs until expiry and no mandatory call event occurs during the observation period, the cash settlement amount payable upon exercise at expiry will depend on how much the closing price or level of the underlying asset is above (in the case of bull CBBCs) or below (in the case of bear CBBCs) the strike price or level. The cash settlement amount may be substantially less than your initial investment in the CBBCs and may even be zero.
- 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.
- CBBCs may be illiquid. Although CBBCs have liquidity providers, there is no guarantee that you will be able to liquidate your position whenever you wish.
- You should recognize the complexities of utilizing CBBCs to hedge against the market risk associated with investing in an underlying asset. The issuer or sponsor of the underlying asset will have no involvement in the offer and sale of CBBCs and no obligation to the investors in such CBBCs. In addition, their decisions on corporate actions may have adverse impact on the value and market price of CBBCs.
- Investors trading CBBCs with underlying assets not denominated in the currency of your home jurisdiction are exposed to exchange rate risk. Currency rate fluctuations can adversely affect the return of you investment.

Exchange Traded Funds (ETFs)

ETFs are typically designed to track the performance of certain indices, market sectors, or groups of assets such as stocks, bonds, or commodities. ETF managers may use different strategies to achieve this goal, but in general they do not have the discretion to take defensive positions in declining markets. Investors must be prepared to bear the risk of loss and volatility associated with the underlying index/assets.

- You are exposed to the political, economic, currency and other risks related to the synthetic ETF’s underlying index.
- You may expose to tracking errors (i.e. the disparity in performance between an ETF and its underlying index/assets), due to, for instance, failure of the tracking strategy, currency differences, fees and expenses.
- Where an ETF invests in derivatives (i.e. Synthetic ETF) or by using total return swaps to replicate the index performance, customers are exposed to the credit

risk of the counterparties who issued the derivatives, in addition to the risks relating to the index. A synthetic ETF may suffer losses equal to the full value of the derivatives issued by the counterparty upon its default or if such counterparty fail to honour their contractual commitments.

- Where the index/market that the ETF tracks is subject to restricted access, the efficiency in unit creation or redemption to keep the price of the ETF in line with its net asset value (NAV) may be disrupted, causing the ETF to trade at a higher premium or discount to its NAV. Investors who buy an ETF at a premium or sells when the market price is at a discount to NAV, may sustain losses.
- ETFs can be illiquid. Although most ETFs are supported by one or more market makers, there is no assurance that active trading will be maintained. In the event that the market makers default or cease to fulfill their role, investors may not be able to buy or sell the product. A higher liquidity risk is involved if a synthetic ETF involves derivatives which do not have an active secondary market. You may suffer a loss with a wider bid-offer spreads in the price of the derivatives. Even where collateral is obtained by an ETF, it is subject to the collateral provider fulfilling its obligations. There is a further risk that when the right against the collateral is exercised, the market value of the collateral could be substantially less than the amount secured resulting in significant loss to the ETF.
- There can be no guarantee that an ETF will fully replicate its underlying index and may hold non-index assets. The ETF manager’s strategy, the implementation of which is subject to a number of constraints, may not produce the intended results. In addition, the manager has absolute discretion to exercise unitholders’ rights with respect to the constituents of the ETF.
- The creation and redemption of units of an ETF may only be effected through participating dealers. Participating dealers will not be able to create or redeem units during any period when, among other things, dealings on the relevant exchange are restricted or suspended, settlement or clearing of securities through the clearing system is disrupted or the underlying index is not complied or published. In addition, the number of participating dealers at any given time will be limited, there is a risk that investors may not always be able to create or redeem unites freely.
- Investors and potential investors will not be able to buy, nor will investors be able to sell, unites on the relevant exchange during any period in which trading of the units is suspended. An exchange may suspend the trading of units whenever it determinates that it is appropriate in the interests of a fair and orderly market to protect investors. The subscription and redemption of units may also be suspended if the trading of units is suspended.
- The underlying index of an ETF is subject to fluctuations. Composition of and weightings in the underlying index may change. The price of the ETF units may rise or fall as a result of such changes. An investment in units will generally reflect the underlying index as its constituents change from time to time, and not necessarily the way it is comprised at the time of an investment in the units. In

addition, there can be no guarantee that a particular ETF will at any given time accurately reflect the composition of the relevant underlying index.

- The index providers do not have any obligation to take the needs of the ETF manager or investors into consideration in determining, composing or calculating the relevant underlying index. The process and the basis of computing and compiling each underlying index and any of its related formulae, constituent companies and factors may at any time be changed or altered by the index providers without notice. Consequently, there can be no guarantee that the actions of an index provider will not prejudice the interests of the relevant ETF, managers or investors.
- As an ETF manager is normally granted a licence by each of the index providers to use the relevant underlying index, an ETF may be terminated if the relevant licence agreement is terminated, or if the relevant underlying index cases to be compiled or published. Further, a regulator reserves the right to withdraw the authorization granted to an ETF or impose such conditions as it considers appropriate and such withdrawal may make it illegal, impractical or inadvisable to continue an ETF.
- Investor trading ETFs with underlying assets not denominated in local currencies are also exposed to exchange rate risk. Currency rate fluctuations can adversely affect the underlying asset value, also affecting the ETF price.

Exchange Traded Notes (ETNs)

Exchange Traded Note (ETN) is a type of unsecured, unsubordinated debt security issued by an underwriting bank, designed to provide investors access to the returns of various market benchmarks. The returns of ETFs are usually linked to the performance of a market benchmark or strategy, minus applicable fees. Similar to other debt securities, ETNs have a maturity date and are backed only by the credit of the issuer.

Investors can buy and sell the ETNs on the exchange or receive a cash payment at the scheduled maturity or may early redeem the ETNs directly with the issuer based on the performance of the underlying index less applicable fees, with redemption restrictions, such as the minimum number of ETNs for early redemption, may apply.

- Although both ETFs and ETNs are linked to the return of a benchmark index, ETNs as debt securities do not actually own any assets they are tracking, but just a promise from the issuer to pay investors the theoretical allocation of the return reflected in the benchmark index.
- In the event that the ETN issuer defaults, the potential maximum loss could be 100% of the investment amount and no return may be received, given ETN is considered as an unsecured debt instrument.

- The value of the ETN may drop despite no change in the underlying index, instead due to a downgrade in the issuer's credit rating. Therefore by buying ETNs, investors get direct exposure to the credit risk of the issuer and would only have an unsecured bankruptcy claim if the issuer declares bankruptcy.
- There is no guarantee that investors will receive at maturity, or upon an earlier repurchase, investors' initial investment back or any return on that investment. Significant adverse monthly performances for investors' ETNs may not be offset by any beneficial monthly performances.
- ETNs provide limited portfolio diversification with concentrated exposure to a specific index and the index components.
- The issuer of ETNs may have the right to redeem the ETNs at the repurchase value at any time. If at any time the repurchase value of the ETNs is zero, investors' investment will expire worthless.
- The principal amount is subject to the periodic application of investor fee or any applicable fees which can adversely affect returns.
- Investors may have leveraged or unleveraged exposure to the underlying index, depending on the product feature. The value of ETNs can change rapidly according to the gearing ratio relative to the underlying assets. You should be aware that the value of an ETN may fall to zero resulting in a total loss of the initial investment.
- ETNs may be illiquid. There is no guarantee that you will be able to liquidate your position whenever you wish.
- Investors trading ETNs with underlying assets not denominated in local currencies are also exposed to exchange rate risk. Currency rate fluctuations can adversely affect the underlying asset value, also affecting the ETN price.

Explanation of derivative-related Risks for Unit Trusts

Some unit trusts may invest in financial derivative instrument such as options, futures, warrants, swaps, forward contracts, with an aim to reduce risks or costs or to generate additional capital or income, or generate a certain payoff structure in order to meet the investment objectives of the fund. Investing in financial derivative instrument may involve additional risks, including, without limitation, counterparty credit risk, leverage risk, market risk, liquidity risk, which may lead to a higher volatility to the net asset value of the unit trusts, and expose the unit trusts to potential significant losses.

- Counterparty Credit Risk – A loss may be sustained by the unit trusts as a result of the failure of another party to a derivatives (usually referred to as a "counterparty") to comply with the terms of the derivative contract.
- Leverage Risk – Many derivatives have a leverage component, adverse changes in the value or level of the underlying asset, rate or index can result in a loss substantially greater than the amount invested in the derivative itself.

- Market Risk – Where the value of the underlying asset of a derivative instrument changes, the value of the derivative instrument will become positive or negative, depending on the performance of the underlying asset.
- Liquidity Risk – If a derivative transaction is particularly large or if the relevant market is illiquid, it may not be possible to initiate a transaction or liquidate a position at an advantageous price