

Media Workshop on Structured Product Regulations

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20 November 2012

Agenda

1**Overview of Structured Products Market****2****Structured Products Regulatory Regime****3****Recent Regulatory Enhancements**

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1**Overview of Structured Products Market**

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Structured Products Regulatory Regime

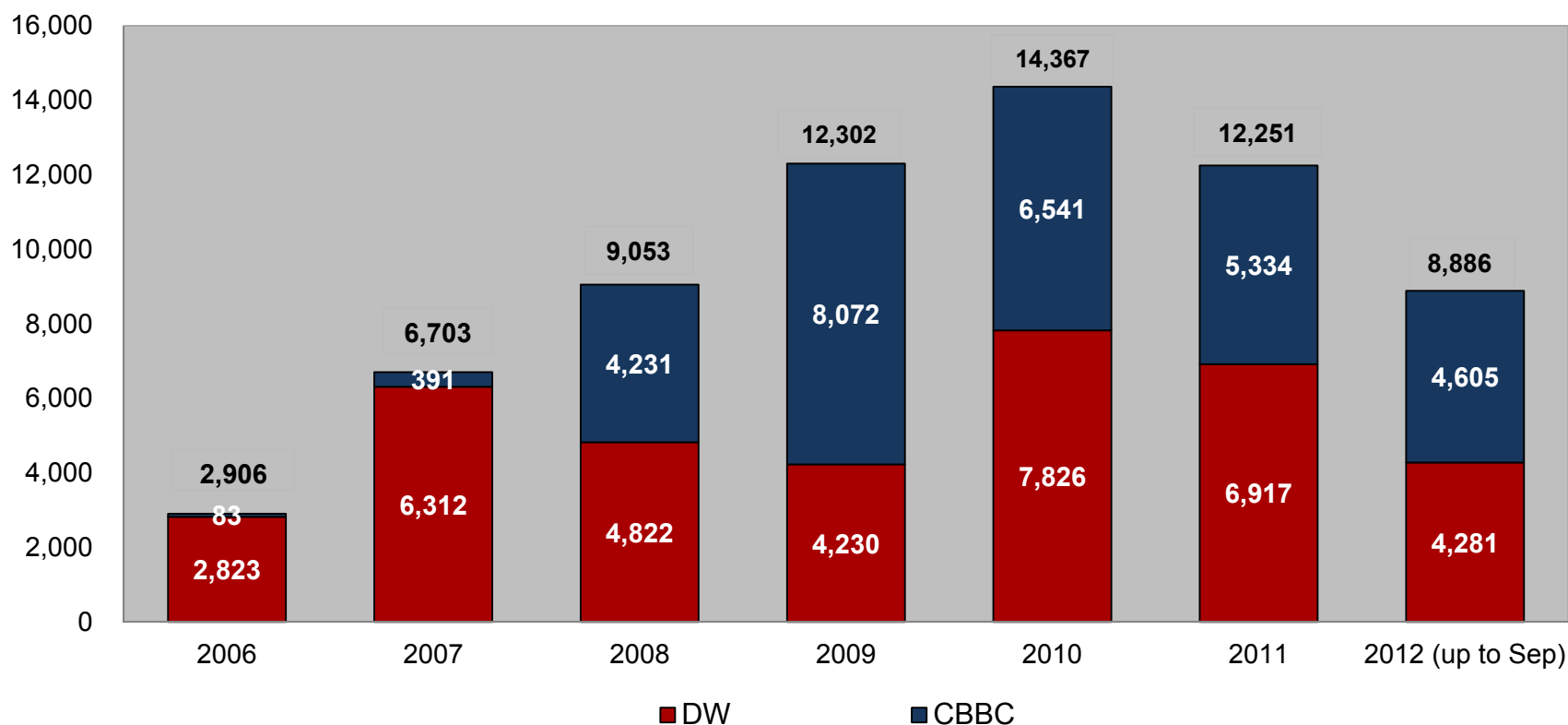
3

Recent Regulatory Enhancements

Steady Growth in Number of Issues Split Between DWs and CBBCs

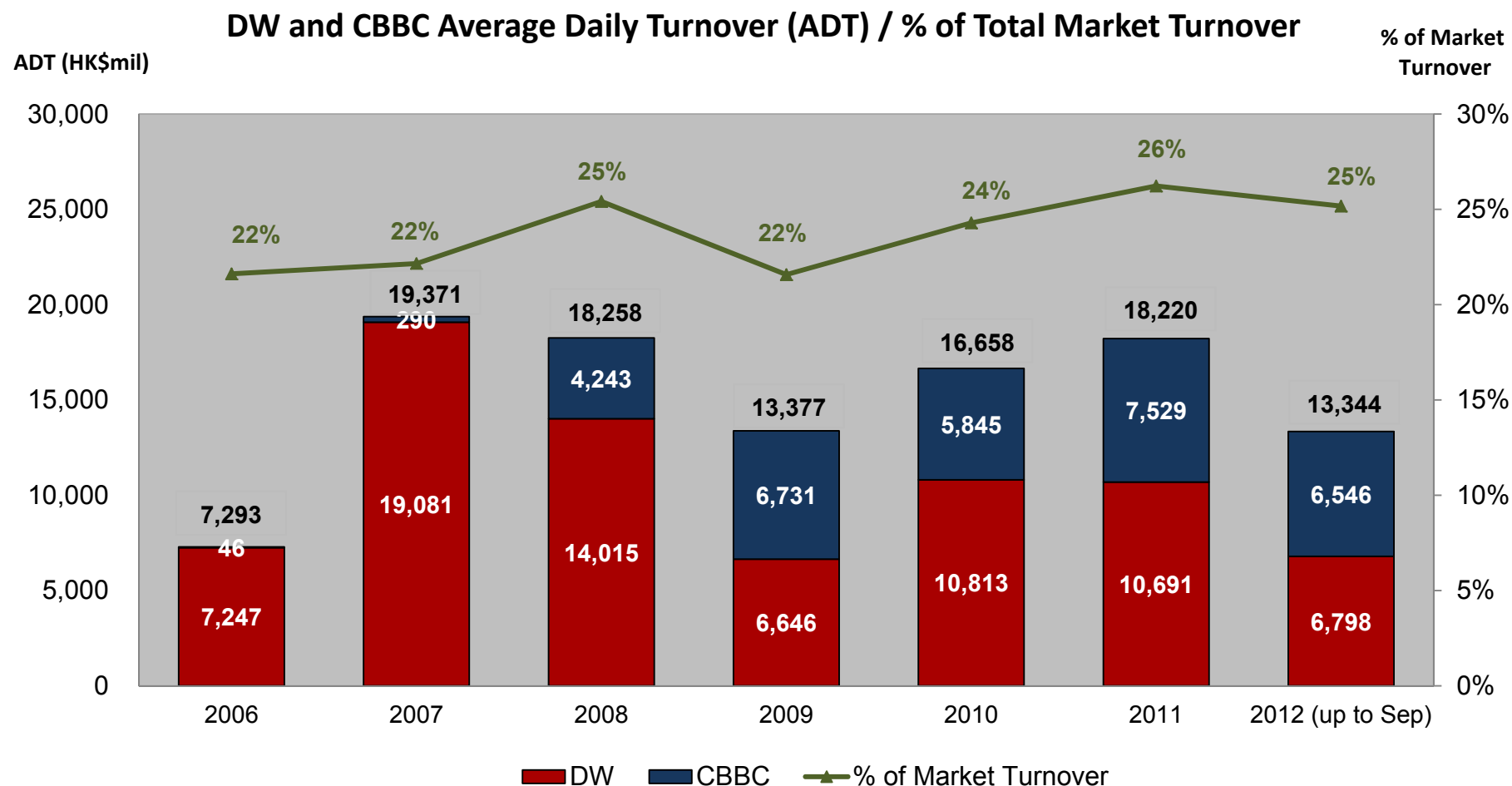
No. of Newly Listed
Structured Products

Number of Newly Listed DWs and CBBCs



* CBBC was launched in Jun 2006

Structured Product Turnover In Line with Cash Market Turnover



* CBBC was launched in Jun 2006

Structured product turnover has hovered around 22 - 26% of total turnover in recent years.

Issues and Turnover Concentrated on Hang Seng Index and Most Liquid Listed Securities



	Underlying	Underlying turnover ranking	DW		CBBC		Structured product (DW+CBBC)	
			New issues	% of DW turnover	New issues	% of CBBC turnover	New issues	% of structured product turnover
	HSI		448 (10%)	36.0%	3,552 (77%)	97.8%	4,000 (45%)	66.3%
	HSCEI		70 (2%)	1.3%	85 (2%)	0.7%	155 (2%)	1.0%
1	China Life	10	176 (4%)	8.9%	79 (2%)	0.1%	255 (3%)	4.6%
2	HSBC	5	198 (5%)	8.6%	28 (1%)	0.1%	226 (3%)	4.4%
3	China Mobile	3	217 (5%)	6.9%	64 (1%)	0.1%	281 (3%)	3.6%
4	Hutchison Whampoa	15	189 (4%)	6.1%	65 (1%)	0.1%	254 (3%)	3.1%
5	China Construction Bank	1	175 (4%)	5.2%	40 (1%)	0.0%	215 (2%)	2.7%
6	Tencent	9	214 (5%)	3.7%	137 (3%)	0.2%	351 (4%)	2.0%
7	ICBC	2	153 (4%)	2.7%	40 (1%)	0.1%	193 (2%)	1.4%
8	iShares A50	7	115 (3%)	2.1%	118 (3%)	0.3%	233 (3%)	1.3%
9	HKEx	16	136 (3%)	2.1%	76 (2%)	0.1%	212 (2%)	1.1%
10	Ping An	12	99 (2%)	2.0%	21 (0.5%)	0.0%	120 (1%)	1.0%
Total			2,190 (51%)	85.5%	4,305 (93%)	99.7%	6,495 (73%)	92.5%

* Data for 2012 (Jan to Sep)

**Investors are interested in trading DWs on the HSI / most liquid securities.
CBBC trading is heavily concentrated on the HSI.**

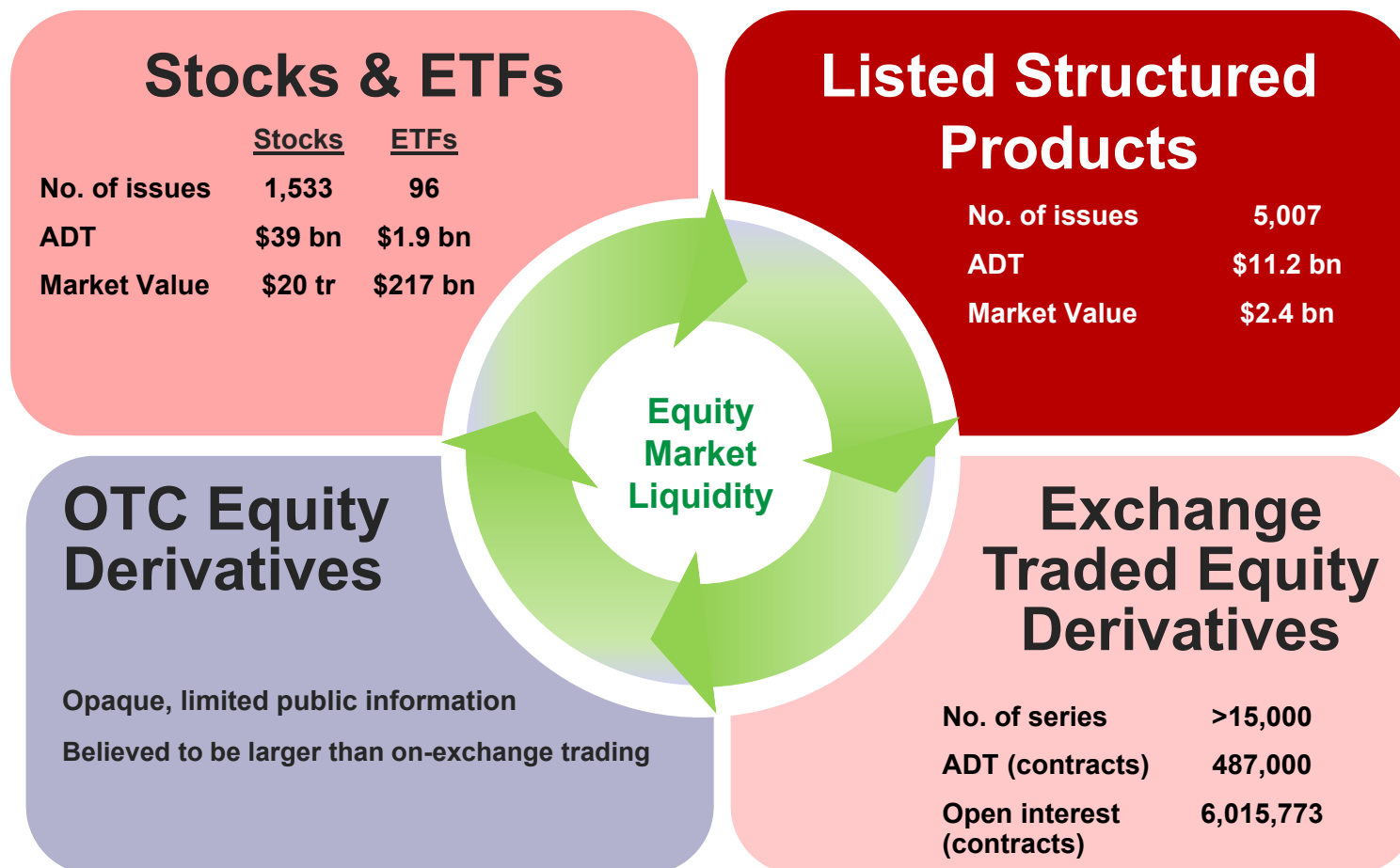
Competition and Product Choices

	Underlying	No. of available structured products	No. of issuers involved
	HSI	983	14
	HSCEI	88	9
1	China Life	142	15
2	HSBC	168	16
3	China Mobile	195	16
4	Hutchison Whampoa	182	15
5	China Construction Bank	144	16
6	Tencent	202	16
7	ICBC	130	17
8	iShares A50	180	18
9	HKEx	180	17
10	Ping An	101	16
Others		2,312	19

* Data as of Sep 2012

Investors have multiple choices on structured products issued by competing issuers.

Listed SP Market an Integral Component of the Hong Kong Equity Market



*Data as of Sep 2012

Structured products provide an alternative choice for investing, hedging, and arbitrage in the equity market.

Listed Structured Products in Major Markets



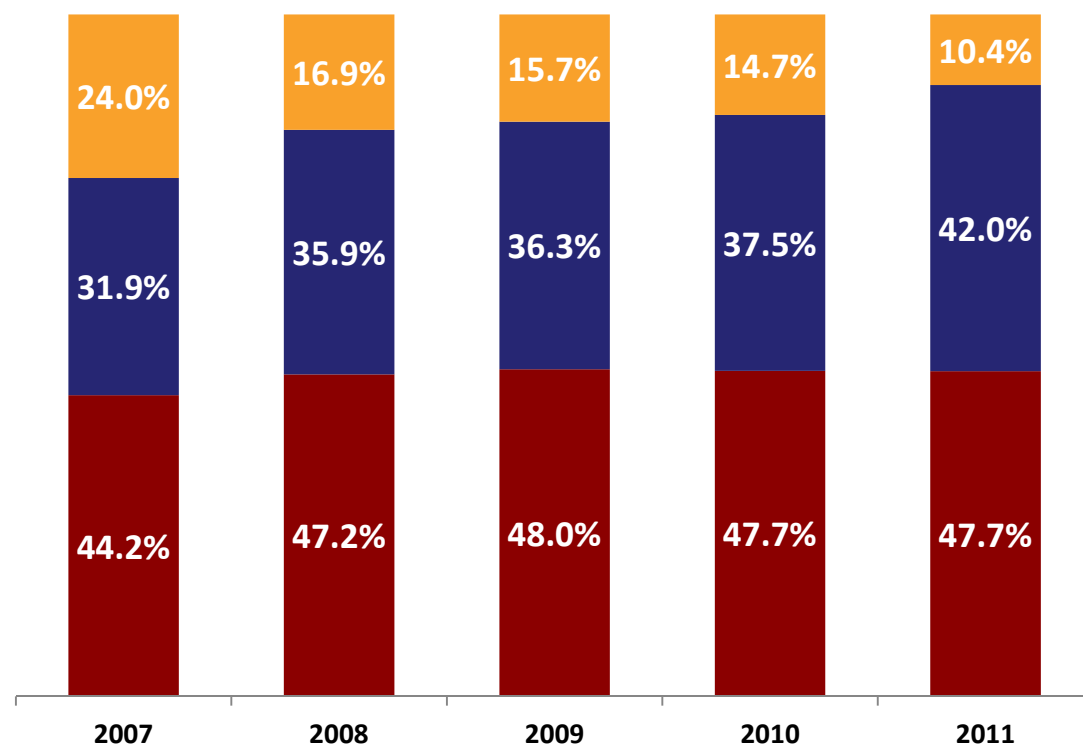
Source: World Federation of Exchanges (Sep 2012 data)

Most major exchanges operate a listed structured product market.

Increasing Proportion of Structured Product Turnover by Professional Investors

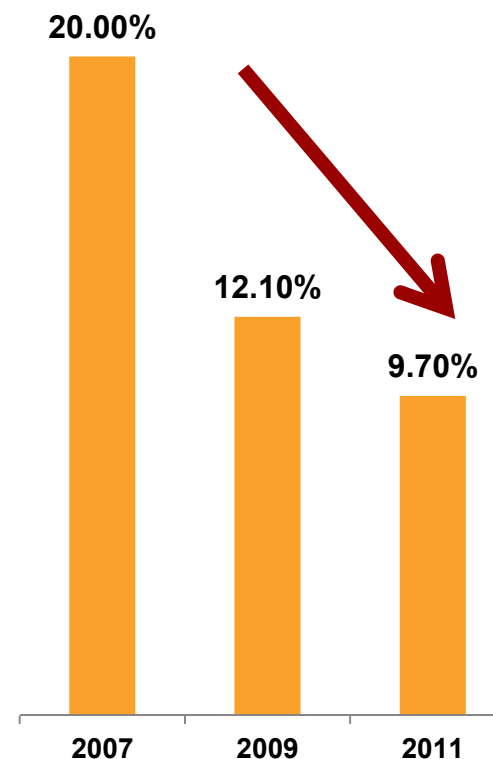


Proportion of Structured Product Turnover



- Liquidity providers
- Top 15 brokers mainly serving professional investors and proprietary trading
- Other brokers serving generally all investors including retail investors

Retail Participation in Structured Product Market



Source: HKEx's Biennial Retail Investor Survey

***Increasing participation by sophisticated professional investors
Decline in retail participation***

Retail Investor Profile



Typical Structured Product Investor

Typical Stock Investor

Age	42 years old	47 years old
Education level	Tertiary or above	Matriculation or above
Monthly household income	HK\$ 55,000	HK\$ 35,000
No. of transactions in 12 months (median)	75	10

Source: HKEX's Retail Investor Survey 2011

***Typical structured product retail investors have tertiary or above education.
They are younger and have a higher household income.
They are more likely to be employed in the financial industry.***

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Recent Regulatory Enhancements

HKEx is the Frontline Regulator of the Listed Structured Products Market



SFC has oversight over HKEx

HKEx as frontline regulator

- Enforce Chapter 15A of the Listing Rules
 - Approve issuer eligibility
 - Approve product issuance
 - Conduct post listing monitoring
- Promote market transparency and market education
- Provide a fair, orderly and efficient market for trading of securities and maintain investor confidence in the market

Issuer Eligibility



Entry Criteria

- Net assets of HK\$2 billion to ensure the issuer is committed to the business; and
- One of the top three investment grades to limit issuers to large scale, reputable houses with a minimum A grade credit rating; or regulated by either the SFC or the HKMA to ensure issuers are subject to appropriate regulatory oversight

Disclosure

- Issuer's financial statements in base listing documents
- Credit rating and regulatory body in supplemental listing documents for each issuance

On-going Compliance

- Publication of updated financial statements such as interim / quarterly reports when available
- Prompt publication of credit rating changes

***Stringent qualifying requirements and full risk disclosure.
Exposure to credit risk as unsecured creditors.
Should invest only after assessing all investment risk, including issuers' credit risk.***

Product Issuance

Underlying Eligibility

Limit issuance to liquid stocks to ensure liquidity:

- Constituent of the Hang Seng Index; or
- Public float capitalisation of HK\$4 billion for 60 business days

Liquidity Provision

- Require liquidity provision
- All issuers' dealings through appointed liquidity provider with broker number starting with 95xx and 96xx, thus providing trading transparency
- Specify minimum service levels for quote request (*new*)
- Introduce active quote as an industry standard (*new*)

Documentation

- Require listing document to
 - contain risk statements
 - set out the spread, response time to quote request and quote size
- Adopt standardised templates for supplemental listing documents (*new*)
- Listing document is a binding contractual agreement between issuers and investors

Publication

- Publish launch announcements and supplemental listing documents on the HKEx website and issuers' own websites for each product issuance
- Highlight uncollateralised nature of DW/CBBC and associated risks (*new*)

Post Listing Monitoring



Monitoring

- **Issuer performance monitoring**
 - Capability of managing issuance and proper conduct
- **Liquidity provision monitoring**
 - Fulfillment of committed service levels
- **Market monitoring**
 - Unusual trades indicating possible disorderly market

Enforcement

- Give consideration to the cause of the incident, materiality, market impact, frequency of errors and prior compliance records
- Possible actions include guidance, warnings, public censure, suspension of issuances and/or referral to the SFC, where appropriate

We are closely monitoring issuer / liquidity provider performance and will take appropriate regulatory actions to uphold a high industry standard.

Market Transparency and Market Education



Issuer / Liquidity Provider

- Publish daily trading summary of transactions
 - ✓ Number of products bought/sold
 - ✓ Average price bought/sold
 - ✓ Percentage outstanding in the market
 - ✓ Whether a product is subject to active quote for reference purposes (*new*)
- Use of broker number starting with 95xx or 96xx for trading transparency and easy monitoring
- Announce changes in credit ratings
- Inform market of interruptions in liquidity provision
- Publish listing documents and announcements on issuers' websites
- Post industry FAQ on issuers' websites (*new*)
- Maintain a dedicated / user friendly investor hotline

HKEx

- Manage Derivative Warrant / CBBC Resource Centre on HKEx website for investor education
- Search / sort function of product terms by issuer, underlying assets, type or maturity
- List of products subject to active quote for reference purposes (*new*)
- Lists of newly launched products and products with upcoming expiries
- Latest credit rating information about issuers
- FAQ and investor education materials on product features and risks

Investors should understand product features, the regulatory framework and product risks before investing in structured products.

Derivative Warrant Resource Centre

Derivative Warrants

HKEx and/or its subsidiaries endeavour to ensure the accuracy and reliability of the information provided, but do not guarantee its accuracy and reliability and accept no liability (whether in tort or contract or otherwise) for any loss or damage arising from any inaccuracy or omission or from any decision, action or non-action based on or in reliance upon information contained in this website. Where the information is supplied by a third party, it is displayed on an "as is" basis. HKEx and/or its subsidiaries do not warrant and make no representation as to the accuracy, reliability, updatedness and completeness of the information and accepted no liability (whether in tort or contract or otherwise) for any claim, loss or damage arising directly or indirectly from any inaccuracies or omissions, or the use of or reliance on any information or otherwise howsoever.

- ▶ [Understanding Risks of Structured Products](#)

Derivative Warrant Information

- ▶ [Derivative Warrant Search](#)
- ▶ [Derivative Warrant Issuance](#)
 - ▶ [Newly Launched but not yet Listed Derivative Warrants](#)
 - ▶ [Newly Listed Derivative Warrants in the past month](#)
 - ▶ [Derivative Warrants With Further Issuance](#)
 - ▶ [Exotic Warrant Information](#)
 - ▶ [Basket Warrant Information](#)
- ▶ [Latest Derivative Warrant News](#)
- ▶ [Trading Information](#)
 - ▶ [Pre-Listing Trading Summary](#)
 - ▶ [Daily Trading Summary](#)
 - ▶ [Derivative Warrants Manual Transactions for the Day](#)
 - ▶ [Derivative Warrants with Change in Stock Short Name in Current Two Weeks](#)
- ▶ [Expiring Derivative Warrants](#)
 - ▶ [Derivative Warrants to be expired in the coming month](#)
 - ▶ [Derivative Warrants expired in the past month](#)
- ▶ [Download Historical Data](#)
 - ▶ [by Warrant](#)
 - ▶ [by Month for all Warrants](#)

Derivative Warrant Eligible Underlying Assets

- ▶ [Eligible Single Hong Kong Stocks for Derivative Warrant Issuance in Current Quarter](#)
- ▶ [Eligible Single Hong Kong Stocks for Derivative Warrant Issuance in Previous Quarter](#)
- ▶ [Structured Products on Non-Hong Kong Underlying Assets](#)

Derivative Warrant Issuer and Liquidity Provider Information

- ▶ [Issuers](#)
 - ▶ [Hyperlinks to Issuers](#)
 - ▶ [Issuers Credit Rating](#)
- ▶ [Liquidity Providers](#)
 - ▶ [Derivative Warrants Liquidity Provider Information](#)
 - ▶ [Understanding Liquidity Provider Obligations](#)
- ▶ [Liquidity Provision Service Standards](#)
 - ▶ [Guide on Enhancing Regulation of the Listed Structured Products Market](#)
 - ▶ [Industry Principles on Liquidity Provision for Listed Structured Products](#)

Derivative Warrant Education

- ▶ [Understanding Derivative Warrants](#)
- ▶ [Naming Conventions of Stock Short Name and Stock Code Allocation Plan for Derivative Warrants](#)
- ▶ [Derivative Warrant Pricing Calculation](#)
- ▶ [Frequently Asked Questions](#)

Derivative Warrant Resource Centre website: <http://www.hkex.com.hk/DWRC>
CBBC Resource Centre website: <http://www.hkex.com.hk/CBBC>

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Recent Regulatory Enhancements

Recent Regulatory Enhancements

Measures Introduced

Documentation and Conduct

- Standardise listing documents
- Enhance issuers' internal controls and systems
- Advocate good conduct among issuers and strengthen staff personal account dealing rules

Liquidity Provision

- Tighten liquidity provision for quote requests
- Promote new active quotes as industry best practices (to commence 31 Dec 2012)
- Enhance liquidity provision performance monitoring
- Promote understanding of liquidity provision standards

Issuer Creditworthiness

- Enhance disclosure in listing documents and marketing materials
- Establish protocol for issuers' credit rating downgrade
- Work with issuers on individual credit enhancement arrangements

These proposals, jointly developed with SFC staff and the industry, are implemented for long term healthy market development.

Documentation and Conduct



Document Standardisation

- Enhance the readability and facilitate the clear comparison of competing product offerings
 - same structure and document flow to facilitate easy product comparison
 - all issuers adopt common industry terms
 - consistent settlement on a board lot basis

Systems and Controls

- Enhance system to ensure information accuracy and non-interruption of liquidity providing services
- Improve market surveillance system to monitor unusual price and volume movement

Issuer Conduct

- Act in the best interests of the structured products market; do not bring the market or the Exchange into disrepute
- Formulate best practices on staff personal account dealing

All supplemental listing documents now adopt standardised templates.

Standardised Templates

Standardised Content Flow:

- Key terms
- Information on guarantor and credit rating
- How does the product work
- Liquidity provision
- Fees and charges
- Key risk factors

Liquidity Provision Tightened Quote Request for Two-way Quotes



Prior to 31 October 2012

Response time	No prescribed requirement, majority issues adopted ≤ 15 minutes
Bid-ask spread	No prescribed requirement, majority issues adopted ≤ 25 spreads
Holding time	No requirement
Quote size	≥ 10 board lots

New Mandatory Quote Request Requirements

≤ 10 minutes
≤ 20 spreads
≥ 5 minutes
≥ 20 board lots

Quote request is available for all products at all times except:

- when the underlying is suspended or during the first five minutes of the morning trading session
- when the theoretical value is $< \text{HK\$}0.01$
- Some exceptional circumstances under extreme market conditions

***Issuers are generally able to comply with the new tightened standards.
We will continue closely monitoring the results.***

Liquidity Provision Active Quote Principles



Complement Quote Request

- Additional liquidity provision service to further enhance liquidity
- Issuers actively provide two-way quotes with even tighter spreads
- Investors can continue to make quote requests for two-way quotes when there are no active quotes from issuers

Consistent Industry Standard

- Industry best practices adopted by all issuers
- Transparent service level

Focus Liquidity Provision Resources

- Applicable to
 - Active underlyings
 - Active trading ranges related to the underlying price / level movements
 - When there may not be sufficient supply in public hands
- Available most of the time in a trading day but may not be continuous

***Active quotes are best practices set out in the Industry Principles put forward by issuers.
Standards to balance investor interest to trade and issuers' hedging difficulties.
92% of total DW and CBBC turnover are covered under the active quote standards.***

Liquidity Provision

Active Quote Standards



Active Underlying

Active quote focuses on active underlyings with high market interest:

- Local index : HSI, HSCEI
- Active stocks : Top 30 stocks by turnover; and market capitalisation > HK\$10 billion (i.e. CBBC eligible list)

Active Trading Range

DW :

- $\pm 20\%$ moneyness when the warrant is neither deeply in, or out, of-the-money
- Expiry date not less than one month

CBBC :

- Prevailing index level falls outside 1% of call level
- Prevailing underlying price falls outside 2% of call price

Insufficient Supply in Market

Active quote is required for products with 50% or less of the issue outstanding in the market when there may not be sufficient public holding to meet supply and demand

Active Quote May Not be Continuous

- 90% of the time on a trading day; and
- Each no quote duration ≤ 10 minutes

Liquidity providers may need to pause active quotes for a short period of time to adjust quote parameters in response to market conditions or operational needs

Issuer hotline to answer enquiries on whether a product is under active quote on a real time basis.

Liquidity Provision

Maximum Bid-Ask Spreads for Active Quote



Active Quote
Industry Standard

Product Type	Bid-ask Spreads
Warrant with an index underlying	≤5 ticks
CBBC with an index underlying	≤10 ticks
Warrant with an actively traded stock underlying	≤10 ticks
CBBC with an actively traded stock underlying	≤15 ticks

Variations in bid-ask spreads for different product types due to different underlying and hedging costs

Maximum bid-ask spreads under active quote are tighter than quote requests.

Example 1

Active Quote Criteria : $\pm 20\%$ Moneyness (Warrant)



Moneyness $\pm 20\%$

**Underlying Stock Spot Price:
\$75**

Warrant	Strike	Active Quote
A	92	No
B	88	Yes
C	62	Yes
D	58	No

$\$75 \times (1+20\%) = \90

$\$75 \times (1-20\%) = \60

Warrants with strike falling within \$60 to \$90 are subject to active quote criteria.

Example 2

Active Quote Criteria : Call Level (CBBC)



Prevailing stock price falls outside 2% of call price
Prevailing index level falls outside 1% of call level

For index CBBC, HSI spot level:
20300

HSI Bull CBBC	Call level	Active Quote
A	20200	No
B	20000	Yes

*HSI Bull CBBC A is not subject to active quote when HSI spot level ≤ 20402 (20200×1.01)
HSI Bull CBBC B is subject to active quote when HSI spot level > 20200 (20000×1.01)*

Issuer Creditworthiness

Listing Documents

- Full risk disclosure in listing documents
- Prominently display the non-collateralised nature of DWs and CBBCs in marketing materials

Advertising Materials

“Investors may sustain a total loss of their investments.”

“SPs are non-collateralized products. If the issuer is insolvent or defaults, investors may not recover part or all of the amount due.”

Investor Education

- FAQ to reinforce risk awareness and highlight that structured products are not suitable for all investors

Credit Risk Mitigation

- Explore individual issuer credit enhancement arrangements

Loss of Eligibility Due to Credit Rating Downgrade

- Announcement of credit rating downgrades
- No launch of new or further issues
- Withdrawal of products with no outstanding position in the market
- Continue to fulfill liquidity provision and settlement obligations at expiry for existing issues

Over 110 Questions with Case Studies on Six Key Areas:

- General product features
- Product risks
- Trading arrangements
- Liquidity provision
- Pricing issues
- Mandatory call events, expiry and settlement

Hyperlink: <http://www.hkex.com.hk/industryfaq>



Questions and Answers