Explanation of Risks Associated with Exchange-Traded Derivative Products

If you wish to trade exchange-traded derivative products as mentioned below, you should read carefully and understand fully the relevant risks associated with the products as set out herein.

General Major Risks Associated with Exchange-Traded Derivative Products (including but not limited to the following)

1. Issuer default risk

In the event that an exchange-trade derivative product issuer becomes insolvent and defaults on their issued products, investors will be considered as unsecured creditors and will have no preferential claims to any assets held by the issuer. Investors should therefore pay close attention to the financial strength and credit worthiness of exchange-traded derivative products issuers.

2. Uncollateralised product risk

Uncollateralised structured products are not asset backed. In the event of issuer bankruptcy, investors can lose their entire investment. Investors should read the listing documents to determine if a product is uncollateralised.

3. Gearing risk

Exchange-traded derivative products such as derivative warrants and callable bull/bear contracts are leveraged and can change in value rapidly according to the gearing ratio relative to the underlying assets. Investors should be aware that the value of an exchange-traded derivative product may fall to zero resulting in a total loss of the initial investment.

4. Expiry considerations

Most of the exchange-traded derivative products have an expiry date after which the products may become worthless. Investors should be aware of the expiry time horizon and choose a product with an appropriate lifespan for their trading strategy.

5. Extraordinary price movements

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

6. Foreign exchange risk

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

7. Liquidity risk

HKEx requires all exchange-traded derivative product issuers to appoint a liquidity provider for each individual issue. The role of liquidity providers is to provide two way quotes to facilitate trading of their products. In the event that a liquidity provider defaults or ceases to fulfill its role, investors may not be able to buy or sell the product until a new liquidity provider has been assigned.

Common Types of Exchange-Traded Derivative Products and Relevant Risks

1. Derivative Warrants

Derivative warrants are an instrument that gives an investor the right to "buy" or "sell" an underlying asset at a pre-set price prior to a specified expiry date. They may be bought and sold prior to their expiry in the market. In Hong Kong derivative warrants are usually settled in cash when they are exercised at expiry.

Derivative warrants are issued by third parties such as financial institutions and are generally divided into calls and puts. Holders of call warrants have the right, but not obligation, to purchase from the warrant issuer a given amount of the underlying asset at a predetermined price (also known as the exercise price) within a certain time period. Conversely, holders of put warrants have the right, but not obligation, to sell to the warrant issuer a given amount of the underlying asset at a predetermined price within a certain time period. Derivative warrants in Hong Kong normally have an initial life of six months to two years and when trading in the market each derivative warrant is likely to have a unique expiry date.

The time value of a derivative warrant decreases over time. All things being equal, the value of a derivative warrant will decrease over time as it approaches its expiry date. Derivative warrants are not principal protected and the price of derivative warrants may fall in value as rapidly as they may rise and investors may not be able to get back the principal and may lose all the investment.

2. Callable Bull/Bear Contracts (CBBCs)

CBBCs are a type of structured product that tracks the performance of an underlying asset without requiring investors to pay the full price required to own the actual 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. CBBC are issued by a third party, usually investment banks, independent of HKEx and of the underlying asset.

CBBCs are issued with the condition that during their lifespan they will be called by the issuers when the price of the underlying asset reaches a level (known as the "Call Price") specified in the listing document. If the Call Price is reached before expiry, the CBBC will expire early and the trading of that CBBC will be terminated immediately.

CBBCs have a Call Price and a Mandatory Cali Feature - For Bull contracts, the Call Price must be either equal to or above the Strike Price. For Bear contracts, the Call Price must be equal to or below the Strike Price. If the underlying asset's price reaches the Call Price at any time prior to expiry, the CBBCs will expiry early. The issuer must call the CBBCs and trading of the CBBCs will be terminated immediately. Such an event is referred to as a mandatory call event ("MCE"). However, when the underlying asset of a CBBC is trading at a price close to its Call Price, the change in the value of CBBCs may be more volatile and disproportionate with the change in the value of the underlying asset,

There are two categories of CBBCs, namely Category N CBBC and Category R CBBC. (i) A Category N CBBC refers to a CBBC where its Call Price is equal to its Strike Price, and the CBBC holder will not receive any cash payment once the price of the underlying asset reaches or goes beyond the Call Price. (ii} A Category R CBBC refers to a CBBC where its Call Price is different from its Strike Price, and the CBBC holder may receive a small amount of cash payment ("Residual Value") upon the occurrence of an MCE but in the worst case, no Residual Value will be paid.

CBBCs can be held until maturity (if not called before expiry) or sold on the HKEx before expiry,

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 calculation of the funding costs is stated in the listing documents.

Although the price of a CBBC tends to follow closely the price of its underlying asset, but in some situations it may not (i.e. delta may not always be close to one). Prices of CBBCs are affected by a number of factors, including its own demand and supply, funding costs and time to expiry.

3. Exchange Traded Funds (ETFs)

ETFs are passively managed and open-ended funds, which are traded on the HKEx. All listed ETFs are authorized by the Securities and Futures Commission (SFC) as collective investment schemes. ETFs are designed to track the performance of their underlying benchmarks (e.g. an index, a commodity such as gold, etc) and offer investors an efficient way to obtain cost-effective exposure to a wide range of underlying market themes. Synthetic ETFs utilising a synthetic replication strategy use swaps or other derivative instruments to gain exposure to a benchmark.

ETFs are exposed to the economic, political, currency, legal and other risks of a specific sector or market related to the index and the market that it is tracking. There may be disparity between the performance of the ETF and the performance of the underlying asset pool or index or market due to, for instance, failure of the tracking strategy, currency differences, fees and expenses. Where the underlying asset pool/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 synthetic ETF to trade at a higher premium of discount to its NAV. Investors who buy an ETF at a premium may not be able to recover the premium in the event of the termination. 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 realize the collateral. A higher liquidity risk is involved if a synthetic ETF involves derivatives which do not have an active secondary market. Wider bid-offer spreads in the price of the derivatives may result in losses.

4. Equity Linked Instruments (ELIs)

ELIs are structured products which are marketed to retail and institutional investors who want to earn a higher interest rate than the rate on an ordinary time deposit and accept the risk of repayment in the-form of the underlying shares or losing some or all of their investment.

When an investor purchases an ELI, he is indirectly writing an option on the underlying shares. If the market moves as the investor expected, he earns a fixed return from his investment which is derived mainly from the premium received on writing the option. If the market moves against the investor's view, he may lose some or all of his investment or receive shares worth less than the initial investment.

Investors may lose part or all of their investment if the price of the underlying security moves against their investment view. Investors are exposed to price movements in the underlying security and the stock market, the impact of dividends and corporate actions and counterparty risks. Investors must also be prepared to accept the risk of receiving the underlying shares or a payment less than their original investment. Investors should note that any dividend payment on the underlying security may affect its price and the payback of the ELI at expiry due to ex-dividend pricing. Investors should also note that issuers may make adjustments to the ELI due to corporate actions on the underlying security. Most ELI offer a yield that is potentially higher than the interest on fixed deposits and traditional bonds, the return on investment is limited to the potential yield of the ELI.

This document is intended as a general guide to highlight basic facts and risks of certain types of derivative products. RHB Securities Hong Kong Limited endeavours to ensure the accuracy and reliability of the information provided, but do not guarantee its accuracy and reliability and accept no liability for any loss or damage arising from any inaccuracies or omissions. Trading in derivative products involve high risks. Investors should read the relevant listing documents to obtain a thorough understanding of the features, risks and terms and conditions of the derivative products before making an investment decision. Investor may also go to the websites of HKEx (www.hkex.com.hk) and SFC (www.sfc.hk) for more information on Derivative Products.

Date:

敬啟者:

<u>經交易所買賣衍生產品所附帶之風險說明</u>

經修訂之《證券及期貨事務監察委員會持牌人或註冊人操守準則》(《操守準則》) 內的投資者分類規定已於2011年9月4日起生效 (「生效日」)。根據該項修訂本公司需要評估客戶對衍生工具的認識，並根據客戶對衍生工具的認識而作出客戶分類。此後，本公司將只提供所有於香港交易及結算所有限公司買賣的衍生產品(包括但不限於: 衍生權證、牛熊證、交易所買賣基金及股票鈎票據，以下統稱為「衍生產品」) 的交易服務，給已確認完全明白及接受衍生產品之相關風險之客戶。

如閣下欲繼續透過本公司買賣衍生產品，請閱讀並填妥附件所載衍生產品之相關風險說明及以下表格以確認閣下完全明白並接受所載之相關風險，然後交回本公司。如本公司未有收到 閣下的確認，除在某些特定情況下，本公司將不會接受 閣下之衍生產品交易指示。

如有任何垂詢，歡迎與閣下的營業代表聯絡。
此致

興業金融證券有限公司謹啟此通知毋須簽署
附件 – 交易所買賣的衍生產品所附帶的風險說明

<u>**確認表格**</u>

致: 興業金融證券有限公司

本人/吾等，帳戶持有人，確認本人/吾等完全明白和接受與香港交易及結算所有限公司買賣的衍生產品附帶之風險，並在此聲明，本人/吾等同意繼續透過興業金融證券有限公司買賣衍生產品。

____
客戶簽署:
帳號: ______________________
帳戶名稱: __________________
日期: ______________________

Date:

Dear Client(s),

Re: Explanation of Risks Associated With Exchange-Traded Derivative Products

According to the Investor Characterization requirements under the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission ("**Code of Conduct**") which has come into effect on 4 September 2011 (the "**Effective Date**"), we are required to assess a client's knowledge of derivatives and characterize the client accordingly. We will only offer trade service of the derivative products which are traded on the Hong Kong Exchanges and Clearing Limited including but not limited to Derivative Warrants, Callable Bull/Bear Contracts, Exchange Traded Funds and Equity Linked Instruments (collectively, the **"Derivative Products**") to clients who fully understand and accept the risks associated with them.

If you would like to trade the Derivative Products, please read and confirm your understanding and acceptance of the risks associated with the Derivative Products as mentioned in the Appendix by completing and signing the "Acknowledgement Form" below and then return it to us, failing which we may not accept your trade order on Derivative Products except with certain circumstances.

Should you have any queries, please feel free to contact your serving account executive.

Yours faithfully,
RHB Securities Hong Kong Limited

This is a general notice and does not require a signature.
Encl.
Appendix – Explanation of Risks Associated with Exchange-Traded Derivative Products

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Acknowledgement Form

To: RHB Securities Hong Kong Limited

I/We, the undersigned account holder, confirm that I/we fully understand and accept the risks associated with derivative products traded on the Hong Kong Exchanges & Clearing Limited (the "Derivative Products") and hereby declare that I/we would like to continue the trade service of the Derivative Products through RHB Securities Hong Kong Limited.

____
Authorized Signature(s) :
Account No:
Account Name:
Date: ______________________