Box 4.1

The Callable Bull/Bear Contract market in Hong Kong

Callable Bull/Bear Contracts (CBBCs) are a type of structured product that tracks the performance of an underlying asset without requiring investors to pay the asset's full price[1]. In essence, CBBCs allow investors to take a leveraged bullish or bearish view on the underlying asset, with an inbuilt stop-loss mechanism. The CBBC market has grown rapidly since its launch in the Hong Kong Exchanges and Clearing Limited (HKEx)'s securities market on 12 June 2006 and has now become a major activity area.

Basic features of CBBCs

The following are some key features of the CBBCs listed on HKEx :

- CBBCs are issued either as Bull or Bear contracts with a fixed expiry date;
- They are issued with the condition that during their lifespan they can be called back (i.e. terminated) by the issuers if the price of the underlying asset reaches a level known as the call price (such event is referred to as a mandatory call event, MCE), and investors could suffer losses if the call price is reached before expiry and the CBBC is terminated immediately;
- There are 2 categories of CBBCs - Category N and Category R : Category N CBBCs have no residual value at call (though Category N CBBCs are rare in Hong Kong) while Category R CBBCs have residual value at expiry or at call;
- They have a lifespan of 3 months to 5 years and are settled in cash only; and
- At 13 October 2009, 30 Hong Kong stocks, 3 local indices and 4 overseas stock indices are eligible assets for CBBC issuance.

There are a number of similarities and differences between CBBCs and derivative warrants (DWs), which are another type of securitised derivatives traded on the HKEx :

Both CBBCs and DWs

- are regarded as structured products issued by third parties;
- have maturity not exceeding 5 years;
- are not subjected to stamp duty; and
- will be adjusted for capital changes in the underlying securities.

On the other hand,

- CBBCs can have a shorter minimum maturity (3 months, versus 6 months for DWs);
- price movements of CBBCs tend to track closely the price of the underlying asset while the price of a DW depends on various factors including the volatility of the underlying asset's price and time to maturity;
- DWs do not have the mandatory call feature of CBBCs; and
- DWs have a wider coverage of eligible stocks (177 stocks, at 19 October).

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[1] Products of a similar nature traded in overseas markets are commonly known as contracts for difference or "knock-out"/"stop-loss" certificates.

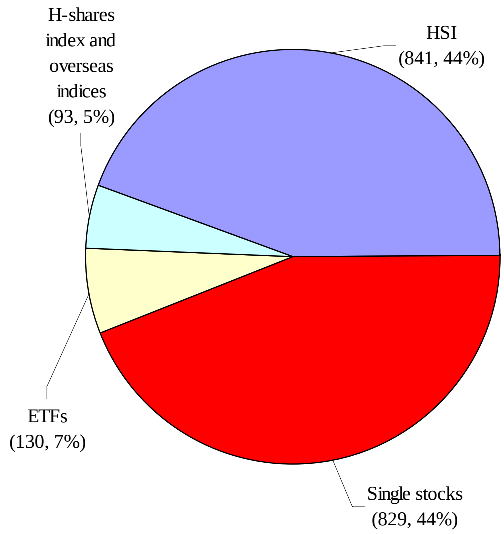
Box 4.1 (Cont'd)

Development of the HKEx CBBC market

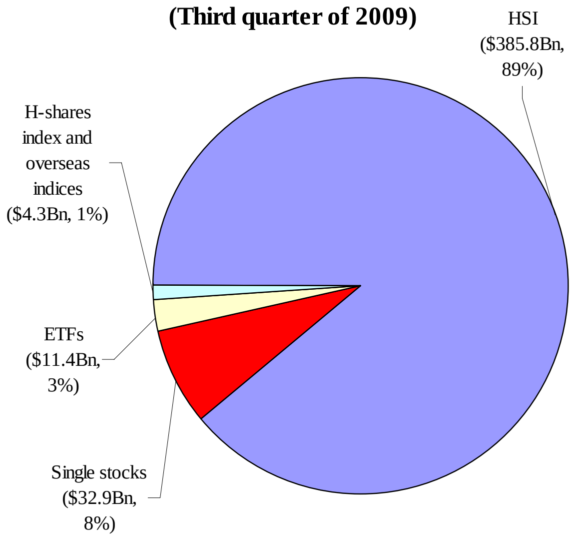
At end-September 2009, 1 893 CBBCs were listed on the HKEx and together they constituted 29.1% of the total number of listed securities. In terms of turnover, CBBCs recorded an average daily turnover of $6.7 billion in the third quarter of 2009, accounting for 10.0% of total value of securities market turnover.

Regarding underlying asset types, Hang Seng Index (HSI) and single stocks were the most popular. At end-September, there were 841 HSI-related CBBCs and 829 single-stock CBBCs listed on the HKEx, accounting for 44.4% and 43.8% respectively of all the listed CBBCs. However, HSI-related issues dominated the trading volume and took up 88.8% of the turnover in CBBCs in the third quarter. Apparently there is room for the HKEx CBBC market to broaden in terms of asset coverage and issuer participation.

Number of CBBCs listed by underlying asset (At end-September 2009)



Total trading value by underlying asset (Third quarter of 2009)



Note : Due to rounding, figures may not add up to 100%.