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).

\(^1\) 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.

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