Risk Disclosure Statements for all Clients

Supplemental to Client Agreement (Specification No.: 2009/1.0_APRIL 2009)

Part 3A – Risk Disclosure Statements for all Clients

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Risk of investing in Renminbi-denominated products

A renminbi product is a generic term which may include a wide range of investment products denominated or settled in renminbi or have exposure to renminbi-linked assets or investments. For the avoidance of doubt, "Renminbi-denominated products" shall include "listed Renminbi-denominated securities".

Investment / market risk: Like any investments, renminbi products are subject to investment risk and may not be principal protected i.e. the assets that the products invest in or referenced to may fall as well as rise, resulting in gains or losses to the product. This means that the Client may suffer a loss even if renminbi appreciates.

Liquidity risk: Renminbi products are also subject to liquidity risk as renminbi products are a new type of product and there may not be regular trading or an active secondary market. Therefore the Client may not be able to sell his investment in the product on a timely basis, or the Client may have to sell the product at a deep discount to its value.

Issuer / counterparty risk: Renminbi products are subject to the credit and insolvency risks of their issuers. The Client should consider carefully the creditworthiness of the issuers before investing. Furthermore, as a renminbi product may invest in derivative instruments, counterparty risk may also arise as the default by the derivative issuers may adversely affect the performance of the renminbi products and result in substantial losses.

Currency risk: In general, a non-Mainland (including Hong Kong) investor who holds a local currency other than renminbi will be exposed to currency risk if he invests in a renminbi product. This is because renminbi is a restricted currency and subject to exchange controls, the Client may have to convert the local currency into renminbi when the Client invests in a renminbi product. When the Client redeems / sells his investment, the Client may also need to convert the renminbi received upon redemption / sale of his investment product into the local currency (even if redemptions / sale proceeds are paid in renminbi). During these processes, the Client will incur currency conversion costs and the Client will also be exposed to currency risk. In other words, even if the price of the renminbi product remains the same when the Client purchases it and when the Clients redeems / sells it, the Client will still incur a loss when the Client converts the redemption / sale proceeds into local currency if renminbi has depreciated. Like any currency, the exchange rate of renminbi may rise or fall. Further, renminbi is subject to conversion restrictions and foreign exchange control mechanism.

Depending on the nature of the renminbi product and its investment objective, there may be other risk factors specific to the product which the Client should consider. Before making an investment decision, always read the risk factors as set out in the offering documents and seek professional advice where necessary.

Risk of Exchange Traded Funds (ETFs)

Market risk: 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.

Tracking errors: Tracking errors refer to the disparity in performance between an ETF and its underlying index/assets. Tracking errors can arise due to factors such as the impact of transaction fees and expenses incurred to the ETF, changes in composition of the underlying index/assets, and the ETF manager's replication strategy. (The common replication strategies include full replication/representative sampling and synthetic replication which are discussed in more detail below.)

Trading at discount or premium: An ETF may be traded at a discount or premium to its Net Asset Value (NAV). This price discrepancy is caused by supply and demand factors, and may be particularly likely to emerge during periods of high market volatility and uncertainty. This phenomenon may also be observed for ETFs tracking specific markets or sectors that are subject to direct investment restrictions.

Foreign exchange risk: Investors trading ETFs 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, also affecting the ETF price.

Liquidity risk: Securities Market Makers (SMMs) are Exchange Participants that provide liquidity to facilitate trading in ETFs. Although most ETFs are supported by one or more SMMs, there is no assurance that active trading will be maintained. In the event that the SMMs default or cease to fulfill their role, investors may not be able to buy or sell the product.

Counterparty risk involved in ETFs with different replication strategies:

(a) **Full replication and representative sampling strategies:** An ETF using a full replication strategy generally aims to invest in all constituent stocks/assets in the same weightings as its benchmark. ETFs adopting a representative sampling strategy will invest in some, but not all of the relevant constituent stocks/assets. For ETFs that invest directly in the underlying assets rather than through synthetic instruments issued by third parties, counterparty risk tends to be less of concern.

(b) **Synthetic replication strategies:** ETFs utilising a synthetic replication strategy use swaps or other derivative instruments to gain exposure to a benchmark. Currently, synthetic replication ETFs can be further categorized into two forms:

(i) **Swap-based ETFs:**

(aa) Total return swaps allow ETF managers to replicate the benchmark performance of ETFs without purchasing the underlying assets.

(bb) Swap-based ETFs are exposed to counterparty risk of the swap dealers and may suffer losses if such dealers default or fail to honor their contractual commitments.

(ii) **Derivative embedded ETFs**

(aa) ETF managers may also use other derivative instruments to synthetically replicate the economic benefit of the relevant benchmark. The derivative instruments may be issued by one or multiple issuers.

(bb) Derivative embedded ETFs are subject to counterparty risk of the derivative instruments' issuers and may suffer losses if such issuers default or fail to honour their contractual commitments.

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.

It is important that investors understand and critically assess the implications arising due to different ETF structures and characteristics.

Risk of investing in REITs

A Real Estate Investment Trust (REIT) is a collective investment scheme that aims to deliver a source of recurrent income to investors through focused investment in a portfolio of income-generating real estate such as shopping malls, offices, hotels and service apartments.

Investment risk: A REIT is an investment product. There is no guaranteed return of investment in a REIT and the Client may suffer substantial losses of capital. Distributions received from a REIT may not be sufficient to recoup the Client's investment capital.

Market risk: Investments in real estate are subject to the risk of the general economic conditions. Any cyclical economic factors may cause fluctuations in occupancy and rental rates of the real estate held by a REIT. This will in turn adversely affect the income derived by a REIT from its real estate investment.

Concentration risk: Where a REIT relies on a single real estate to generate all of its revenue, any circumstance that adversely affects the operations or business of that single real estate, or its attractiveness to tenants, may adversely affect the revenue generated and the REIT will not have income from other real estate to mitigate any ensuing loss arising from such circumstance. A concentration of investment in a single real estate causes the REIT to be highly susceptible to relevant real estate market conditions.

Interest rate risk: Fluctuations in interest rates may increase the interest costs incurred by a REIT in respect of its borrowings and may have an adverse effect on the level of activity in the property market. The financial position of the REIT and its ability to make distributions this may be adversely affected. Moreover, the trading price of the REIT units is likely to decline if there is an increase in interest rates.

Distribution risk: The distributions of a REIT may be made out of capital. The Client should pay attention to the composition of distributions declared by a REIT (for example, the extent to which the distribution declared is composed of, and the types of, income and capital) as disclosed in the relevant results announcement and the financial reports of the REIT.

Risk of Structured Products

Issuer default risk: In the event that a structured product issuer becomes insolvent and defaults on their listed securities, 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 structured product issuers.

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.

Gearing risk: Structured products such as derivative warrants and callable bull/bear contracts (CBBCs) 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 a structured product may fall to zero resulting in a total loss of the initial investment.

Expiry considerations: Structured products have an expiry date after which the issue may become worthless. Investors should be aware of the expiry time horizon and choose a product with an appropriate lifespan for their trading strategy.

Extraordinary price movements: The price of a structured product may not match its theoretical price due to outside influences such as market supply and demand factors. As a result, actual traded prices can be higher or lower than the theoretical price.

Foreign exchange risk: Investors trading structured 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, also affecting the structured product price.

Liquidity risk: The Exchange requires all structured 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.

Additional Risk of Trading Derivative Warrants

Time decay risk: All things being equal, the value of a derivative warrant will decay over time as it approaches its expiry date. Derivative warrants should therefore not be viewed as long term investments.

Volatility risk: Prices of derivative warrants can increase or decrease in line with the implied volatility of underlying asset price. Investors should be aware of the underlying asset volatility.

Additional Risks Involved in Trading CBBCs

Mandatory call risk: Investors trading CBBCs should be aware of their intraday "knockout" or 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. Investors will only be entitled to the residual value of the terminated CBBC as calculated by the product issuer in accordance with the listing documents. Investors should also note that the residual value can be zero.

Funding costs: 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 calculating the funding costs are stated in the listing documents.

(Effective Date: May 2011)