



HIKE_x
香港交易所

Overview of Index Products and Development of ETFs in Hong Kong

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Agenda

- **Overview of Index Products in Hong Kong**
- Hong Kong ETF Market
- ETF Market Participants in Hong Kong
- Future Challenges and Opportunities in ETF Market

Index Products in Hong Kong

Broad range of index-based products traded in HKEx

Cash Market

ETFs

Index Warrants

Index CBCs
(Callable Bull/Bear
Contracts)

Derivatives Market

Index Futures

- Hang Seng Index
- HSCEI Index
- Dividend Indexes
- HSI Volatility Index (in progress)

Index Options

- Hang Seng Index
- H-Shares Index
- Flexible Options

Link to product Information:

<http://www.hkex.com.hk/eng/prod/secprod/CMProducts.htm>

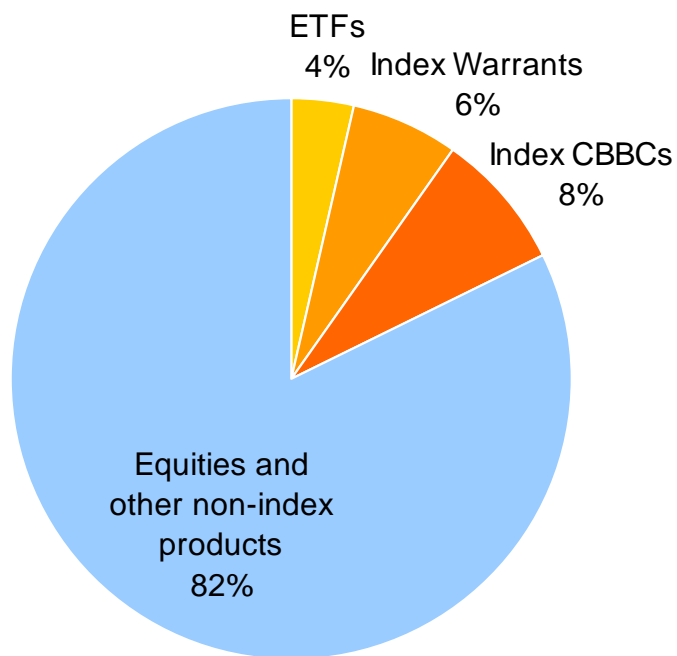
<http://www.hkex.com.hk/eng/prod/drprod/DMPProducts.htm>

Index Products in Hong Kong

Index based products constitute a significant percentage of trading in HKEx

Cash Market

Breakdown of 2010 Turnover

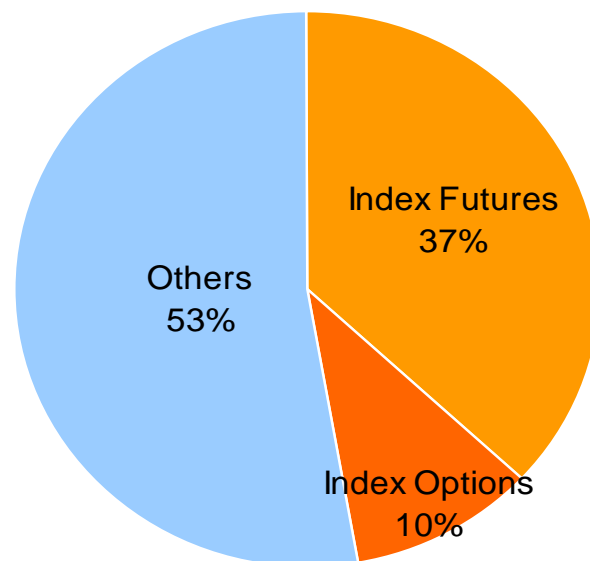


- No.1 globally in securitized derivatives trading
- 59% index-based securitized derivatives

Derivatives Market

Breakdown of 2010 Volume

(No. of Contracts)



- 5th globally in notional turnover of Index Futures
- 7th globally in notional turnover of Index Options

Index Products in Hong Kong

Hong Kong ranked 1st globally in turnover of Securitized Derivatives (i.e. Derivatives Warrants and CBCs)

Jan – Dec 2010

Exchange		Turnover (US\$M)
1	Hong Kong Exchanges	533,930
2	Korea Exchange	354,347
3	Deutsche Börse	79,651
4	SIX Swiss Exchange	38,066
5	NYSE Euronext (Europe)	34,773
6	Tel Aviv SE	32,464
7	London SE Group	20,967
8	Shenzhen SE	8,624
9	Taiwan SE Corp.	6,607
10	Singapore Exchange	4,483

Index Products in Hong Kong

Hong Kong ranked 5th and 7th globally in notional turnover of Index Futures and Index Options

Index Futures Jan – Dec 2010

Exchange		Notional Turnover (US\$M)
1	CME	39,783,292
2	EUREX	21,050,635
3	KRX	8,568,580
4	NYSE.Liffe Eu	5,781,483
5	HKEx	4,103,641
6	OSE	3,903,018
7	TAIFEX	1,533,532
8	TSE	1,484,362
9	ASX SFE	1,056,729
10	NSE	890,626

Index Options Jan – Dec 2010

Exchange		Notional Turnover (US\$M)
1	KRX	14,792,467
2	EUREX	12,412,042
3	CME	4,905,564
4	NSE	3,225,940
5	NYSE.Liffe Eu	3,148,453
6	Tel Aviv SE	2,204,583
7	HKEx	1,423,999
8	TAIFEX	1,221,192
9	ASX	223,060
10	OMX Nordic Ex	195,937

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- **Hong Kong ETF Market**
- ETF Market Participants in Hong Kong
- Future Challenges and Opportunities in ETF Market

Hong Kong ETF Market

Hong Kong ranked 8th globally and 1st regionally in terms of ETF turnover

Global Jan – Mar 2011

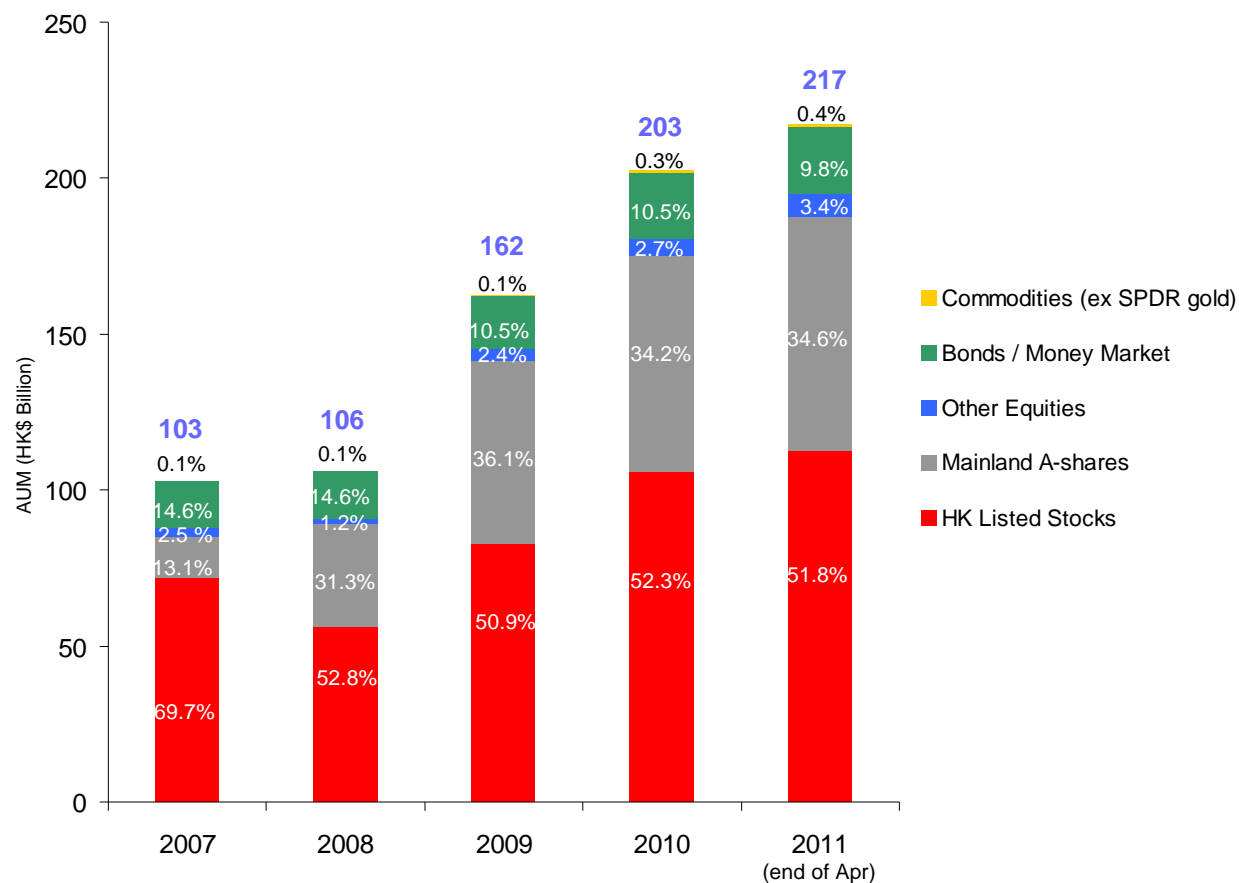
Exchange	Turnover (US\$M)	No.
1 NYSE Euronext (US)	968,253	1,175
2 NASDAQ OMX	858,858	86
3 London SE Group	79,182	1,345
4 Deutsche Börse	72,430	788
5 NYSE Euronext (Europe)	52,526	618
6 TSX Group	29,420	226
7 SIX Swiss Exchange	26,595	519
8 Hong Kong Exchanges	20,325	72
9 Mexican Exchange	19,045	379
10 Shanghai SE	11,739	17

Asia Jan – Mar 2011

Exchange	Turnover (US\$M)	No.
1 Hong Kong Exchanges	20,325	72
2 Shanghai SE	11,739	17
3 Tokyo SE Group	11,029	101
4 Korea Exchange	9,697	74
5 Osaka SE	7,934	15
6 Shenzhen SE	6,719	5
7 Taiwan SE Corp.	2,473	15
8 Singapore Exchange	1,966	80
9 Australian SE	1,884	42
10 National Stock Exchange India	532	26

Hong Kong ETF Market

Asset accumulation increases over time and consists of diverse underlying



Underlying Asset No. of ETFs

Hong Kong Listed Stocks

14

Mainland A-shares

24

Other Equities

Asia Pacific	7
Brazil	1
Europe	1
Global	4
Greater China	2
India	3
Russia	2
Taiwan	4
US	3
Other East Asia	5

Bonds / Money Market

Asia Pacific	1
Hong Kong	1
US	1

Commodities

Gold	2
Index	1

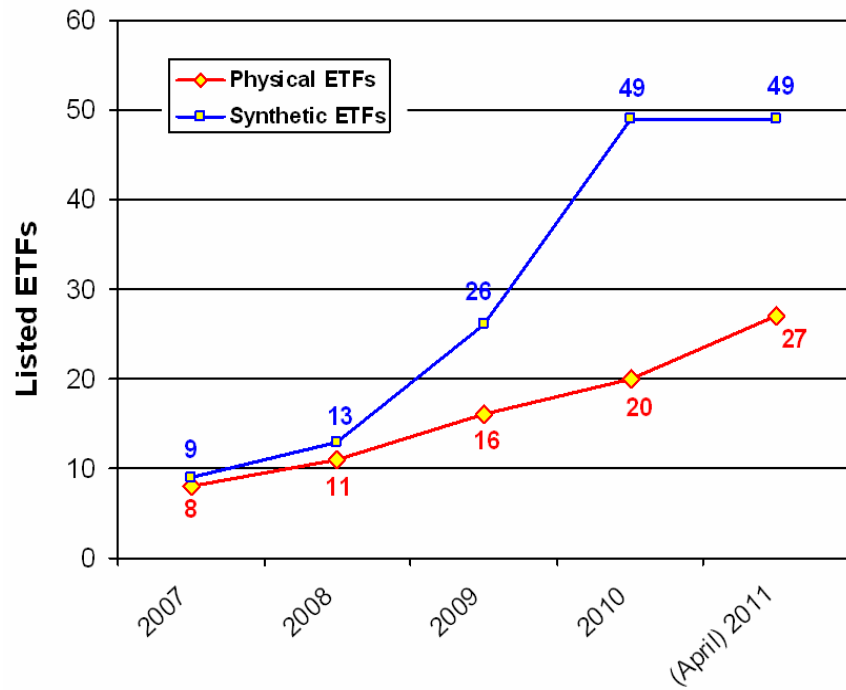
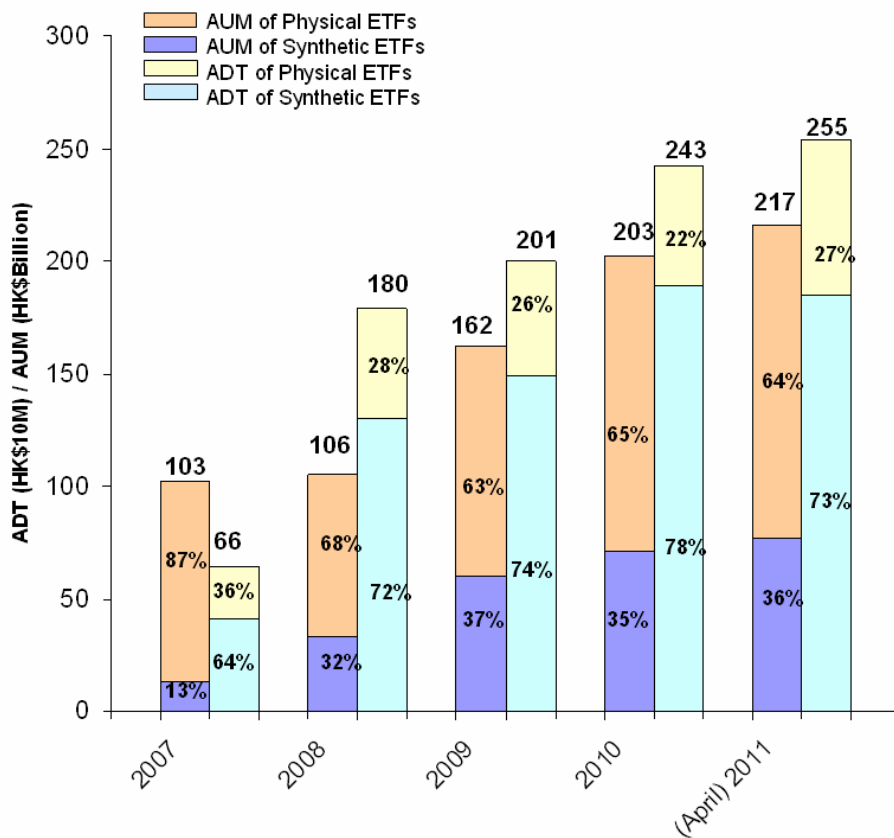
Hong Kong ETF Market

Synthetic ETFs have distinguished strategies and risks vis-à-vis physical ETFs

ETF	Strategy	Risk unique to product structure
Physical	Invest directly in underlying assets	Stock borrowing & lending risk (if applicable)
Synthetic	Use Swaps (for both restricted and freely accessible markets)	Counterparty risk
	Use Market Access Products (for restricted access markets)	Counterparty risk

Hong Kong ETF Market

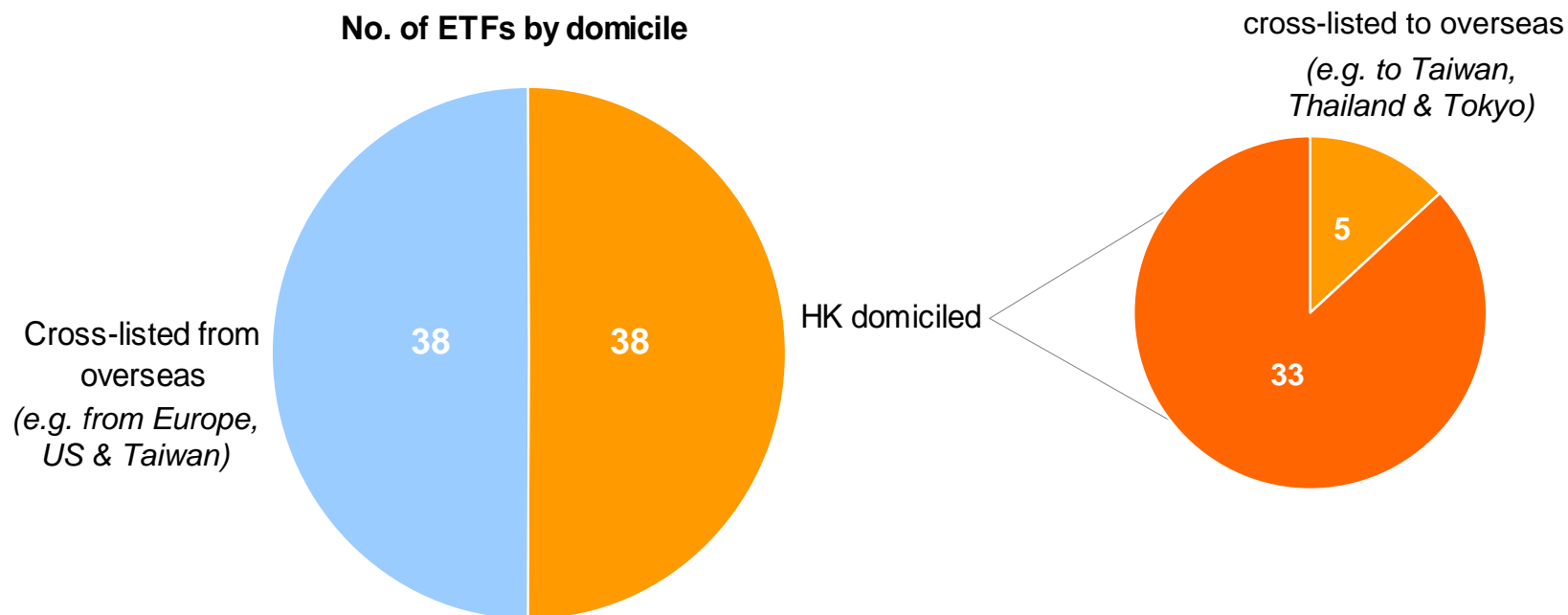
ETF listings, AUM and turnover have grown significantly in recent years



ADT – Average Daily Turnover
 AUM – Assets Under Management

Hong Kong ETF Market

Hong Kong is flexible to facilitate listing of HK domicile ETFs as well as cross-listing ETFs to and from overseas



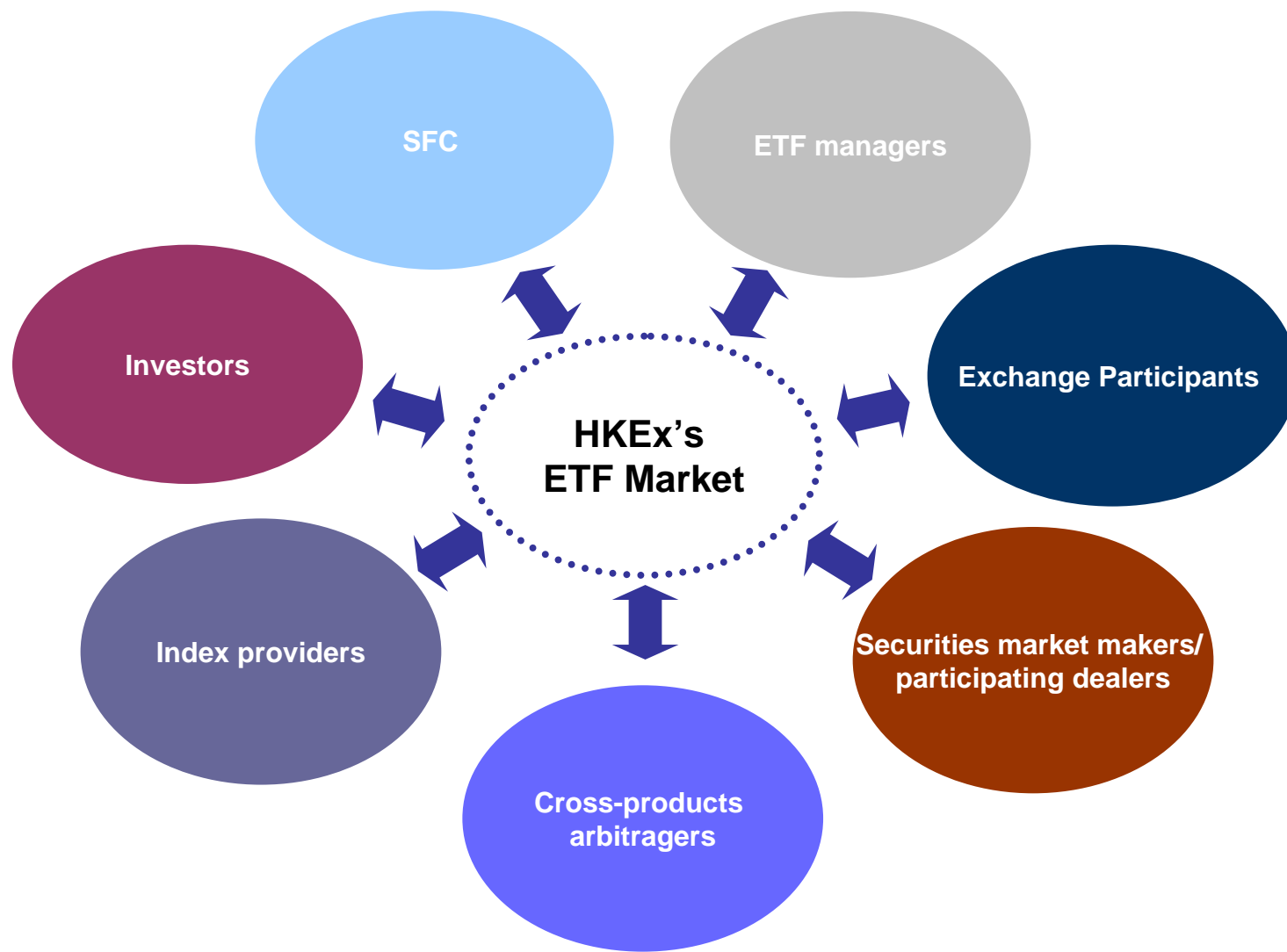
As of May 2011

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- **ETF Market Participants in Hong Kong**
- Future Challenges and Opportunities in ETF Market

ETF Market Participants in Hong Kong

Making Hong Kong a major ETF hub requires coordinated efforts of key players



ETF Market Participants in Hong Kong

Regulatory framework facilitates listing of ETFs with different structures and types of underlying assets

2007

- The **first UCITS compliant ETFs** cross-listed from Europe by Lyxor International Asset Management (on commodity index; regional and international equity indexes).

2008

- The **first single asset class ETF** cross-listed from the US (ie SPDR Gold Trust).

2009

- Hong Kong and Taiwan regulators announced **mutual recognition of ETFs**, paved for cross-listing of ETFs (ie Polaris Taiwan Top 50 Tracker Fund (H.K.)).

ETF Market Participants in Hong Kong

Efforts to enhance investor protection and awareness

2008/2009

Improve disclosure

- Prospectuses and marketing materials provide clear upfront risk disclosure box.

2008/2009

Diversification of derivatives issuers & Provision of collateral

- Synthetic ETFs with Market Access Products (i) increase issuers to diversify counterparty exposure; and (ii) collateral from issuers to limit each counterparty risk to no more than 10% of their NAVs.

2010

Introduction of Key Fact Statement

- All ETFs to have Key Fact Statement that summarizes the key features and risks by mid 2011.

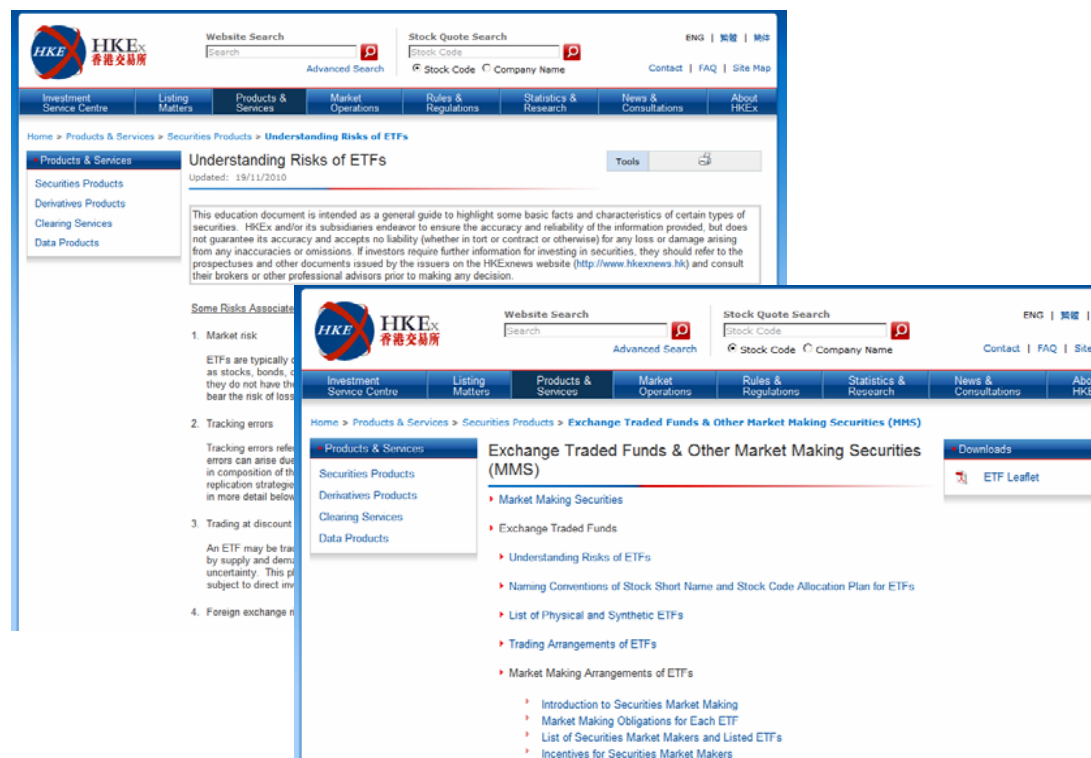
2010

More disclosure requirements for synthetic ETFs

- “X” markers on stock short names
- HKEx enhances ETF website to segregate synthetic ETFs from physical ETFs and to highlight product features and risks

ETF Market Participants in Hong Kong

Working with ETF managers to further promote to investors; including through HKEx's ETF website



The screenshot displays two pages from the HKEx website. The top page is titled "Understanding Risks of ETFs" and includes a navigation menu with categories like "Investment Service Centre", "Listing Matters", "Products & Services", "Market Operations", "Rules & Regulations", "Statistics & Research", "News & Consultations", and "About HKEx". The main content area contains an introduction to the document's purpose and a list of "Some Risks Associated with ETFs":

- Market risk**: ETFs are typically composed of stocks, bonds, and other securities, so they do not have the ability to bear the risk of loss.
- Tracking errors**: Tracking errors refer to the difference between the actual performance of the ETF and the performance of the underlying benchmark. Errors can arise due to the composition of the replication strategy or other factors.
- Trading at discount**: An ETF may be traded at a discount to its net asset value (NAV) due to supply and demand imbalances. This is subject to direct investment.
- Foreign exchange risk**: ETFs that invest in foreign securities are exposed to foreign exchange risk.

The bottom page is titled "Exchange Traded Funds & Other Market Making Securities (MMS)" and lists various resources:

- Market Making Securities
- Exchange Traded Funds
- Understanding Risks of ETFs
- Naming Conventions of Stock Short Name and Stock Code Allocation Plan for ETFs
- List of Physical and Synthetic ETFs
- Trading Arrangements of ETFs
- Market Making Arrangements of ETFs
 - Introduction to Securities Market Making
 - Market Making Obligations for Each ETF
 - List of Securities Market Makers and Listed ETFs
 - Incentives for Securities Market Makers



Understanding Exchange Traded Funds



Exchange Traded Funds (ETFs) are passively managed and open-ended funds which are traded on the securities market of Hong Kong Exchanges and Clearing Limited (HKEx). All listed ETFs are authorised by the Securities and Futures Commission (SFC) as collective investment schemes.

ETFs are designed to track the performance of their underlying benchmarks (eg 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. Similar to other securities, investors can buy or sell ETFs through their brokers anytime during the securities market's trading hours.

Key Features

Benchmark tracking

ETFs are passively managed funds which aim to track closely the performance of the underlying benchmarks.

Transparency

Each ETF has its own website operated by its ETF manager (a list of ETFs' websites can be found on the HKEx website). ETFs' websites provide key information such as the underlying benchmarks and the benchmarks' constituents, the ETF's Net Asset Value (NAV), the counterparty exposure and details of collateral from counterparties. The NAV of an ETF is the sum of marked-to-market values of the individual portfolio holdings plus the portion of the assets held in cash and cash equivalents, less all the accrued ETF expenses. The NAVs of ETFs are calculated intra-day during the trading hours and at the end of the trading day. The intra-day estimated NAVs, or iNAVs, are also known as RUPVs (Reference Underlying Portfolio Valuations) or IOPVs (Indicative Optimised Portfolio Values). The end-of-day NAV information may also be obtained on the HKEx website, in addition to the ETF's website. Real-time or delayed price quotes for ETFs are disseminated by information vendors and are available on the HKEx website.

Low transaction costs

Unlike unlisted funds, ETFs do not charge any subscription fees. The transaction costs for trading ETFs at HKEx are the same as those for trading other securities, which include brokerage commission, transaction levy, investor compensation levy (currently suspended), trading fee, trading tariff and stamp duty¹.

Low minimum investment

ETFs are traded in board lots and the minimum initial investment is usually set at an affordable level.

Liquidity

ETFs can be traded any time during the trading hours of HKEx's securities market. Listed ETFs usually have market makers, which are known as Securities Market Makers, to provide some liquidity. However, market making for the ETFs is available only during the Continuous Trading Session.

¹Some ETFs are exempted from stamp duty. Details are on the HKEx website at <http://www.hkex.com.hk/hongkongprod/prod/infocenter.htm>.

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 November 2010

HKEx received:

- 2011 award for "Best Asian Exchange for Listing ETFs" from *effexpress*; and
- 2010 award for No. 1 ETF website in Asia Pacific from *exchangetradedfunds.com*

ETF Market Participants in Hong Kong

In summary, key players in the ETF eco-system contribute to the success of the Hong Kong market

- 4 of the Top 5 Global ETF Managers by Assets have presence in Hong Kong and the number of ETF Managers is increasing
- 23 Securities Market Makers with diverse origin providing liquidity
- 493 Exchange Participants to act as intermediaries to distribute ETFs
- A quarter of retail investors invested in ETFs and is increasing

ETF Market Participants in Hong Kong

4 of Top 5 Global ETF Managers by Assets have presence in Hong Kong and the number of ETF Managers is increasing

North America Origin

ETF Manager	No. of ETFs
BlackRock Asset Management North Asia Ltd	14
State Street Global Advisors Asia Ltd	3
State Street Global Advisors Singapore Ltd	1

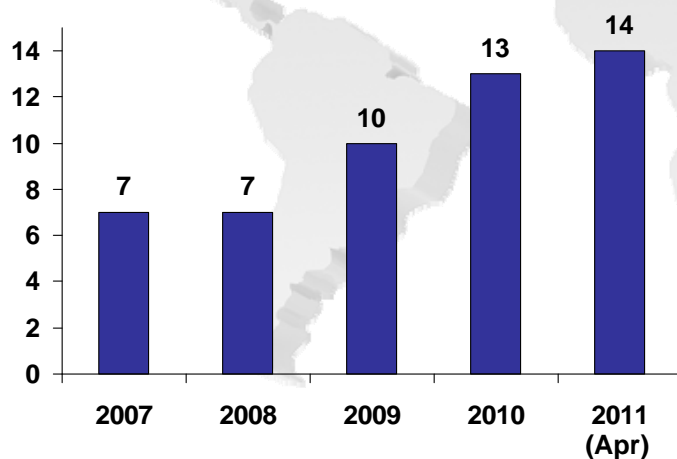
Europe Origin

ETF Manager	No. of ETFs
Deutsche Bank Group	24
Lyxor International Asset Management	12
HSBC Investment Funds (HK) Ltd	5

Asia Origin

ETF Manager	No. of ETFs
BOCI-Prudential Asset Management Ltd	5
Hang Seng Investment Management Ltd	3
Da Cheng International Asset Management Company Ltd	3
Sensible Asset Management Hong Kong Ltd	2
Polaris Securities (Hong Kong) Ltd	1
Ping An of China Asset Management (Hong Kong) Company Ltd	1
China International Capital Corporation Hong Kong Asset Management Ltd	1
Mirae Asset Global Investments (HK) Ltd	1

No. of ETF Managers



ETF Market Participants in Hong Kong

Securities Market Makers are crucial for providing liquidity

North America Origin

Securities Market Maker	ETF No.
Citigroup Global Markets Asia Ltd	20
LaBranche Structured Products Hong Kong Ltd	9
Bluefin HK Ltd	8
Merrill Lynch Far East Ltd	5
Morgan Stanley Hong Kong Securities	4
Timber Hill Securities Hong Kong Ltd	3
J.P. Morgan Broking (Hong Kong) Ltd	1

Europe Origin

Securities Market Maker	ETF No.
Deutsche Securities Asia Ltd	31
UBS Securities Hong Kong Ltd	20
SG Securities (HK) Ltd	18
IMC Asia Pacific Ltd	15
Optiver Trading Hong Kong Ltd	13
Credit Suisse Securities (Hong Kong) Ltd	9
HSBC Securities Brokers (Asia) Ltd	4
BNP Paribas Securities (Asia) Ltd	3
HSBC Broking Securities (Hong Kong) Ltd	2
Tibra Trading Hong Kong Ltd	1

Africa Origin

Securities Market Maker	ETF No.
Standard Securities Asia Ltd	1

Asia Origin

Securities Market Maker	Origin	ETF No.
BOCI Securities Ltd	Mainland China	1
China Merchants Securities (HK) Co., Ltd	Mainland China	1
Phillip Securities (HK) Ltd	Singapore	3
Polaris Securities (Hong Kong) Ltd	Taiwan	3
Nomura Securities (Hong Kong) Ltd	Japan	5

ETF Market Participants in Hong Kong

493 Exchange Participants may act as intermediaries to distribute ETFs

North America Origin

Origin	No. of Exchange Participants
USA	21
Canada	2

Europe Origin

Origin	No. of Exchange Participants
UK	8
France	8
Netherlands	4
Switzerland	2
Germany	1
Luxembourg	1
Russia	1
South Africa	1

Asia Origin

Origin	No. of Exchange Participants
Hong Kong	358
Mainland China	32
Taiwan	22
Japan	13
Malaysia	6
Singapore	5
Australia	4
South Korea	2
Indonesia	1
Philippines	1

ETF Market Participants in Hong Kong

A quarter of retail investors invested in ETFs and is increasing

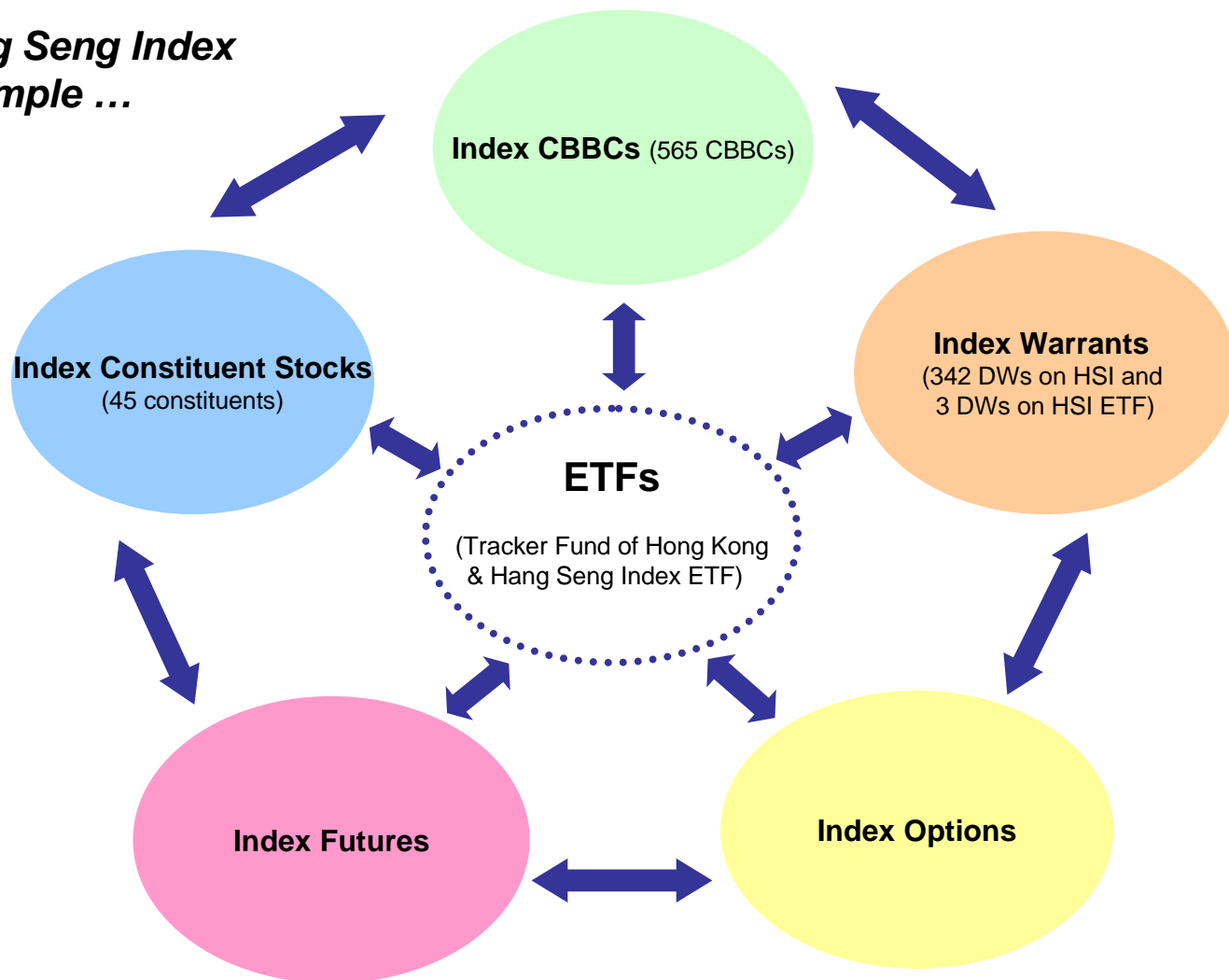
- Typical ETF retail investor was 47 years old, with matriculation or above education, a personal income of HK\$16,250 and a household income of HK\$35,000 (monthly)
- ETF investors tended to be older than those for other securities
- ETF investors tended to trade more frequently and have a relatively higher average value per transaction
- In 2009, 24% of stock investors invested in ETFs compared to 22% in 2007

(Source: Retail Investor Survey 2009 and 2007, HKEx)

ETF Market Participants in Hong Kong

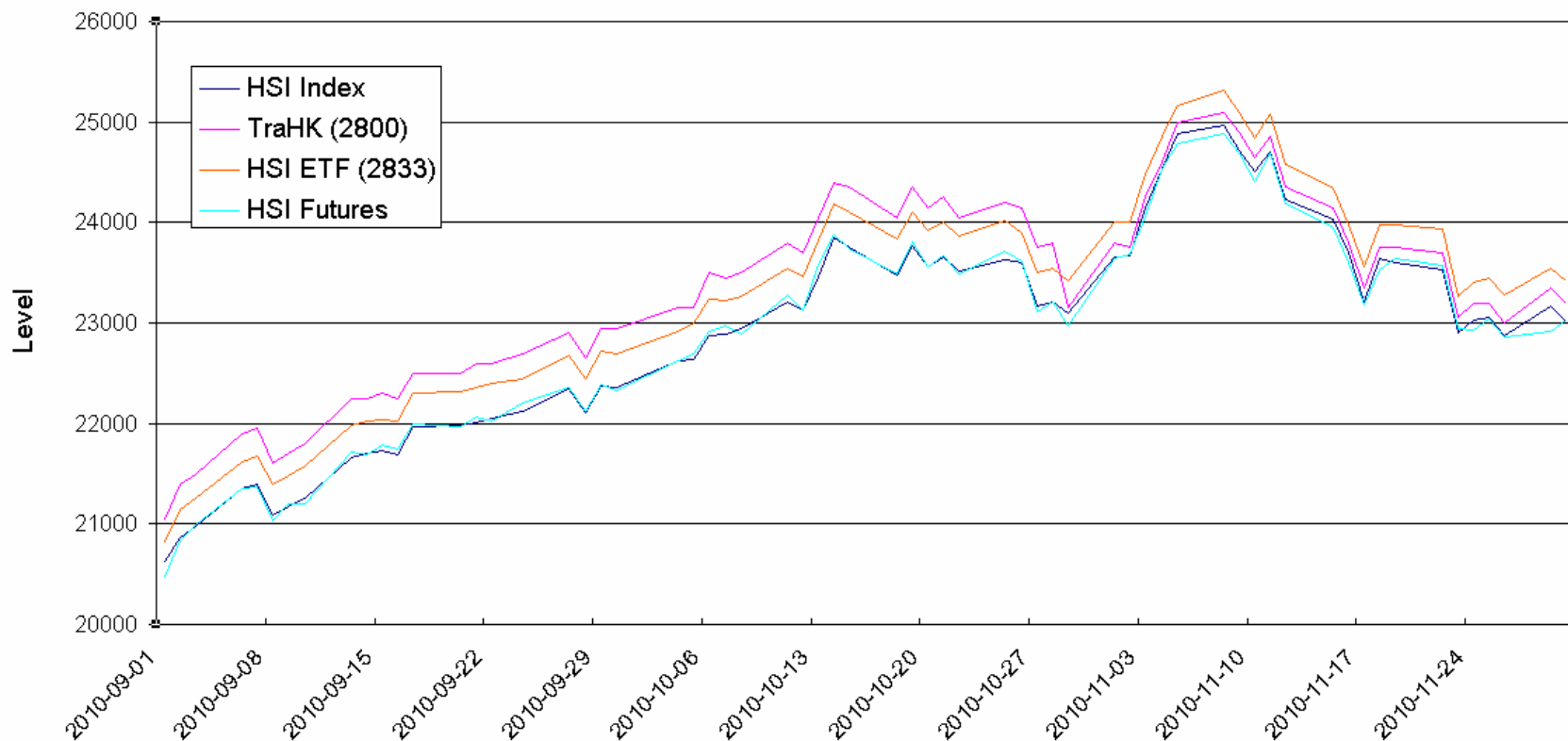
Arbitragers play an important role to pricing efficiency among different products

*Take Hang Seng Index
as an example ...*



ETF Market Participants in Hong Kong

ETFs may complement equities and index futures for cross-product arbitrage



Note: Prices of TraHK (2800) and HSI ETF (2833) have been adjusted to scale.

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Future Challenges and Opportunities

Major issues relating to the development of ETFs

Turnover concentrated on a few ETFs

- i. how to increase the liquidity for less actively traded ETFs?
- ii. role of securities market makers to provide liquidity of ETFs?

Global regulatory environment and media attention focuses on risks associated with synthetic ETFs

- i. how to help investors distinguish between physical and synthetic ETFs?
- ii. how the industry can work together to educate investors to understand risks of synthetic ETFs?

Contact us

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Thank you