

March 2017

## OVERVIEW

China is the fastest growing bond market in the world and is the third largest after the United States and Japan. International participation in China's bond market continues to increase, driven by the further opening up of China interbank bond market, broadening international acceptance of the RMB, inclusions in the emerging markets bond indices and yield differential compared to developed markets.

HKEX's 5-Year China Ministry of Finance Treasury Bond (MOF T-Bond) Futures contract is the world's first onshore interest rates product accessible to offshore players. It is an efficient, transparent and easy-to-access tool to manage against China interest rate risk exposure.

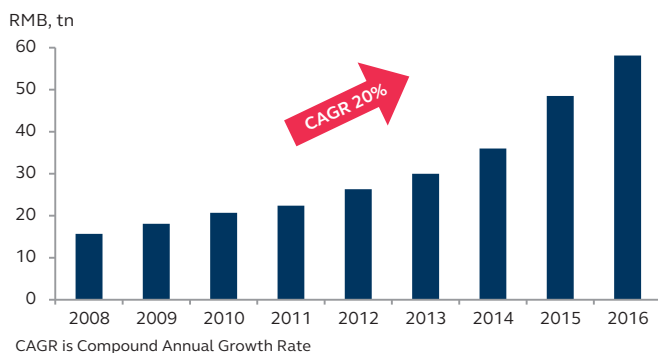
## ADVANTAGES

- First Chinese government bond futures on an offshore exchange
- Tool to manage RMB interest rate risk
- Transparency of exchange trading
- Cost benefits of central clearing

## HKEX's 5-Year China Ministry of Finance (MOF) T-Bond Futures vs China 5-Year T-Bond



## China Bond Market Outstanding Amount



Source: WIND, HKEX

Note 1: For more details, please refer to the MOF T-Bond Futures Contract Specifications on the HKEX website ([www.hkex.com.hk/mofft](http://www.hkex.com.hk/mofft)).

## KEY PRODUCT SPECIFICATIONS<sup>1</sup>

HKATS Code:	HTF
Contract Size:	RMB 500,000
Underlying Bond:	Onshore Five-Year China Ministry of Finance Treasury Bonds with 3% coupon rate and annual coupon payment
Contract Months:	The two nearest quarterly months
Price Quotation:	As a percentage of the Contract Size, quoted to 3 decimal places
Minimum Fluctuation:	0.002 per cent of the Contract Size, which is equivalent to RMB10
Trading Hours (Hong Kong time):	9:00 am – 12:00 noon and 1:00 pm – 4:30 pm
Settlement Method:	Cash settled contract for difference
Settlement Currency:	RMB
Last Trading Day:	The second Friday of the Contract Month
Final Settlement Day:	The second Hong Kong Business Day after the Last Trading Day
Final Settlement Price:	Onshore Five-Year China MOF T-Bond basket reference price rounded to three (3) decimal places provided by China Central Depository & Clearing Co., Ltd. at approximately 6:00 pm on the Last Trading Day

## BOND BASKET AND PRICING DETERMINATION<sup>1</sup>

The date of basket determination is defined as five working days before the listing date of the futures contract. Bonds in the bond universe shall fulfill the following conditions:

- Issued by the China Ministry of Finance;
- RMB denominated;
- Tradable in China interbank bond market;
- With fixed coupon rates annually; and
- With the remaining term to maturity of no less than four years and no more than seven years as of the Last Trading Date of the futures contract

China Central Depository & Clearing Co., Ltd., or ChinaBond, selects the top three most liquid bonds to construct the bond basket and calculates and sends the Daily Reference Price of the bond basket and MOF T-Bond Futures to Hong Kong Futures Exchange Limited on each working day from the listing day till the Last Trading Day.

## CHINA CENTRAL DEPOSITORY & CLEARING CO., LTD.

ChinaBond is a fully state-owned non-bank official financial institution authorised by the China MOF to develop and operate the national treasury bond depository system. ChinaBond is jointly regulated by the China Banking Regulatory Commission, People's Bank of China and MOF. ChinaBond provides integrated services of bond issuance, registration, depository, settlement and redemption. It also provides technical support for the Open Market Operation system, bond auction system and treasury cash management system. ChinaBond is an important channel for offering cross-border settlement services and supporting bond market opening-up.

## MARKET STRATEGIES – Hypothetical Examples<sup>1</sup> for Illustration Only

<p><b>Example 1</b> <b>Hedging against Interest Rate Movement</b></p>	<p>A fund manager, concerned about a potential tightening of monetary conditions in China, wants to hedge against the interest rate risk.</p> <table border="0"> <tr> <td data-bbox="368 174 938 300"> <p><b>Now</b></p> <p>On 31 Oct 2016, the fund manager holds RMB100m nominal value of treasury bond 160014.IB @101.813, with a duration of 5.901</p> </td> <td data-bbox="1038 174 1453 300"> <p><b>Later</b></p> <p>By 26 Jan 2017, the yield has gone up and the value of the bond has decreased to 98.439 (-3.374), recording a loss of RMB3.4m</p> </td> </tr> <tr> <td data-bbox="368 309 938 371"> <p>On 31 Oct 2016, MOF T-Bond Futures Mar-17 contract is traded at 102.282, with a duration of 4.80</p> </td> <td data-bbox="1038 344 1453 448"> <p>On 26 Jan 2017, the price of MOF T-Bond Futures Mar-17 drops to 99.480 (-2.802). The portfolio manager closes the position, gaining RMB3.4m</p> </td> </tr> <tr> <td colspan="2" data-bbox="368 380 938 495"> <p><b>Strategy</b></p> <p>On 31 Oct 2016, with the objective of neutralising the dollar duration, he hedges his holding by selling 245 contracts of MOF T-Bond Futures Mar-17</p> </td> </tr> </table> <p><b>The loss of RMB3.4m from the cash bond holding is covered by RMB3.4m profit from MOF T-Bond futures positions</b></p>	<p><b>Now</b></p> <p>On 31 Oct 2016, the fund manager holds RMB100m nominal value of treasury bond 160014.IB @101.813, with a duration of 5.901</p>	<p><b>Later</b></p> <p>By 26 Jan 2017, the yield has gone up and the value of the bond has decreased to 98.439 (-3.374), recording a loss of RMB3.4m</p>	<p>On 31 Oct 2016, MOF T-Bond Futures Mar-17 contract is traded at 102.282, with a duration of 4.80</p>	<p>On 26 Jan 2017, the price of MOF T-Bond Futures Mar-17 drops to 99.480 (-2.802). The portfolio manager closes the position, gaining RMB3.4m</p>	<p><b>Strategy</b></p> <p>On 31 Oct 2016, with the objective of neutralising the dollar duration, he hedges his holding by selling 245 contracts of MOF T-Bond Futures Mar-17</p>	
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<p><b>Example 2</b> <b>Duration Management</b></p>	<p>An insurance company hopes to meet relative short-term liabilities, with duration of 1 year, arising from expected payouts from insurance plans.</p> <table border="0"> <tr> <td data-bbox="368 638 938 842"> <p><b>Now</b></p> <p>On 31 Oct 2016, the insurance company holds a portfolio of three treasury bonds, namely (i) RMB100m nominal value of 160006.IB@100.582, (ii) RMB90m nominal value of 160014.IB@101.813 and (iii) RMB80m nominal value of 160020.IB@100.520. Portfolio market value is RMB273m and duration is 5.892</p> </td> <td data-bbox="1038 638 1453 842"> <p><b>Strategy</b></p> <p>The insurance company wants to reduce the asset duration to 1 to match the liabilities' duration</p> <p>On 31 Oct 2016, the insurance company sells 543 contracts of MOF T-Bond Futures Mar-17</p> </td> </tr> <tr> <td colspan="2" data-bbox="368 851 938 913"> <p>On 31 Oct 2016, MOF T-Bond Futures Mar-17 contract is traded at 102.282, with a duration of 4.80</p> </td> </tr> </table> <p><b>The portfolio duration matches the duration of the short-term liabilities; the insurance company has neutralised a possible effect of interest rate movement</b></p>	<p><b>Now</b></p> <p>On 31 Oct 2016, the insurance company holds a portfolio of three treasury bonds, namely (i) RMB100m nominal value of 160006.IB@100.582, (ii) RMB90m nominal value of 160014.IB@101.813 and (iii) RMB80m nominal value of 160020.IB@100.520. Portfolio market value is RMB273m and duration is 5.892</p>	<p><b>Strategy</b></p> <p>The insurance company wants to reduce the asset duration to 1 to match the liabilities' duration</p> <p>On 31 Oct 2016, the insurance company sells 543 contracts of MOF T-Bond Futures Mar-17</p>	<p>On 31 Oct 2016, MOF T-Bond Futures Mar-17 contract is traded at 102.282, with a duration of 4.80</p>			
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<p><b>Example 3</b> <b>Duration Management</b></p>	<p>A portfolio manager has a diversified bond portfolio, and has the flexibility to adjust duration either up or down by 10% under the fund's stated investment objectives. The manager expects rates to fall.</p> <table border="0"> <tr> <td data-bbox="368 1057 938 1238"> <p><b>Now</b></p> <p>The portfolio manager holds a portfolio of RMB300m market value with duration of 7.00</p> <p>MOF T-Bond Futures contract is currently traded at 102.282, with a duration of 4.80</p> </td> <td data-bbox="1038 1057 1453 1205"> <p><b>Strategy</b></p> <p>The portfolio manager intends to increase duration to 7.70. He buys 86 contracts of MOF T-Bond Futures</p> </td> </tr> </table>	<p><b>Now</b></p> <p>The portfolio manager holds a portfolio of RMB300m market value with duration of 7.00</p> <p>MOF T-Bond Futures contract is currently traded at 102.282, with a duration of 4.80</p>	<p><b>Strategy</b></p> <p>The portfolio manager intends to increase duration to 7.70. He buys 86 contracts of MOF T-Bond Futures</p>				
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<p><b>Example 4</b> <b>Synthetic Bond</b></p>	<p>A foreign institutional investor does not have access to China's onshore bond market, but wishes to gain proxy bond exposure due to the China market's yield differential.</p> <table border="0"> <tr> <td data-bbox="368 1326 938 1451"> <p><b>Now</b></p> <p>The investor intends to create a synthetic cash bond position</p> </td> <td data-bbox="1038 1326 1453 1451"> <p><b>Strategy</b></p> <p>He buys 100 contracts of MOF T-Bond Futures, creating a proxy bond position with notional value of RMB50m</p> </td> </tr> </table>	<p><b>Now</b></p> <p>The investor intends to create a synthetic cash bond position</p>	<p><b>Strategy</b></p> <p>He buys 100 contracts of MOF T-Bond Futures, creating a proxy bond position with notional value of RMB50m</p>				
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<p><b>Example 5</b> <b>Credit Spread Trade</b></p>	<p>An investor expects the yield of a corporate bond to diverge from the yield of the MOF T-Bond Futures.</p> <p>If the investor expects the credit spread (the yield of a corporate bond minus the yield of the MOF T-Bond Futures) to narrow, he could consider buying the corporate bond and selling the MOF T-Bond Futures.</p> <p>Alternatively, if the investor expects the credit spread to widen, he could consider selling the corporate bond and buying the MOF T-Bond Futures.</p>						

Note 1: Transaction cost is not considered in the examples

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