



HKEx
香港交易所

DEBT SECURITIES

債務證券



Debt Securities listed on The Stock Exchange of Hong Kong Limited (Stock Exchange), a wholly-owned subsidiary of Hong Kong Exchanges and Clearing Limited, include bonds and notes which represent loans to an entity (such as a government or corporation) in which the entity promises to repay the bondholders or note-holders the total amount borrowed. That repayment in most cases is made on maturity although some loans are repayable in instalments. Unlike shareholders, holders of bonds and notes are not owners of an entity, but its creditors.

In return for the loan, the entity will usually compensate the bondholders or note-holders with interest payments during the life of the bond or note. The interest rate on bonds and notes can be a fixed or floating rate.

FEATURES OF A DEBT SECURITY

Issuer: An entity such as a listed company, government or supranational organisation like the Asian Development Bank or the World Bank that borrows the money.

Principal: The par value or the face value of the debt security payable at maturity.

Coupon rate: The stated annual rate of interest that the issuer pays on the principal to the holder of the debt security. Coupon rates can be divided into three main categories:

Fixed rate	There is a fixed rate of interest over the life of the debt security.
Floating rate	The interest rate is adjusted periodically according to a predetermined benchmark.
Zero-coupon	There are no periodic interest payments. The debt security is usually issued at a discount to its par value. On maturity, investors receive a payment comprising principal and interest.

Term: The period of time, usually stated in years, over which the issuer of a debt security has promised to meet its obligations.

Other conditions: A debt security may be *callable* meaning that the issuer may redeem the debt security before it matures. A debt security may also be *convertible* which gives the holder the right to convert the debt security into a specified number of shares in a company. In certain cases, issuers may have the right to convert a debt security if certain pre-determined conditions are met.

Guarantor: A debt security may be guaranteed by a third party called a guarantor which agrees to repay the principal and/or interest to holders of the debt security if the issuer defaults.

BENEFITS OF INVESTING IN DEBT SECURITIES

Stable and Predictable Interest Payments

Investment in debt securities provides a return of capital on a fixed date and usually periodic interest payments that tend to be higher than the interest payments available on bank deposits.

Flexibility and Convenience

Debt securities listed in Hong Kong are traded on or off the Stock Exchange and investors may buy or sell them according to their financial needs.

POINTS TO NOTE

Price of a Debt Security

If investors wish to buy and sell their debt securities prior to maturity, they should be aware of the potential fluctuations in debt prices. Similar to other types of securities, debt prices fluctuate in response to the forces of supply and demand. These forces are in general associated with interest rates, time to maturity, degree of certainty of repayment (reflected in the credit rating), yield and overall economic conditions.

In addition, investors should also be aware of the exchange rate risk (if applicable), liquidity risk and the terms of the debt issue when investing in debt securities.

When the price of a debt security increases above its face value, it is said to be selling at a premium. When a debt security sells below its face value, it is said to be selling at a discount.

Interest Rate

The price of a fixed rate debt security usually moves in the direction opposite of market interest rates. If interest rates go up, the price of the debt security will, other factors being equal, go down, thereby increasing the current yield (the annual interest payment divided by the price of the debt security) and bringing it into line with the higher coupon rates offered by new debt issues. If interest rates go down, the price of the debt security will increase, thereby reducing the current yield and bringing it into line with the lower coupon rates offered by new debt issues. The price of the debt security, therefore, may be higher or lower than the original investment if it is sold before maturity.

For example, if you have purchased a debt security with a coupon rate of 6% at par and the prevailing interest rate for newly issued debt securities of similar terms and credit rating increases to 8%, the debt security would be worth less than par if you were to sell it. To put it another way, if the coupon rate on a newly issued debt security stands at 8%, the holder would get paid \$80 annually for each \$1,000 investment in the debt security. The holder of the 6% debt security would receive \$60 annually for each \$1,000 investment. The attractiveness of the 6% debt security will diminish and the price will go down accordingly thereby increasing the current yield.

Time to Maturity

As a general rule, when there is a long time to maturity (the date on which the borrower must pay back the principal), the price of the debt security is likely to be more volatile because the longer the time, the greater the risk. In general, the market price of a long-term debt security will change more with a given change in market interest rates than the market price of a short-term debt security.

Credit Rating

Investors should note that the payment of the interest and the repayment of the principal are subject to the credit risk associated with the issuer or the guarantor. For issuers that have credit ratings, the credit risk is indicated in the rating of the issuer or the debt security itself. The credit rating agencies usually base their ratings on the financial condition of a debt issuer, the likelihood of it repaying the principal amount at maturity and its ability to meet the scheduled interest payments.

A credit rating not only indicates an issuer's ability to repay the debt, it also influences the return on a debt security. In the marketplace, investors generally demand greater returns as risk increases. For example, an issuer of highly rated bonds will, generally, be able to offer those bonds at a lower coupon rate than those rated less highly.

Yield to Maturity

The yield to maturity on a debt security is the internal rate of return an investor will receive by holding the security to maturity. It takes into account the sum of the interest payments, the redemption value at maturity and the purchase price. In general, the longer the life of a debt security and the lower the credit rating of the issuer, the higher will be the yield to maturity. The yield to maturity on a debt security moves in the opposite direction to the price. When the price goes up, the yield to maturity will fall, and vice versa. Generally, the relationship between yield to maturity and price is as follows:

Price = Par	Yield = Coupon rate
Price > Par	Yield < Coupon rate
Price < Par	Yield > Coupon rate

Overall Market Conditions

As with all investments, returns on a debt security are influenced by factors such as the rate of inflation, unemployment rate, economic growth, balance of payments data, retail sales, industrial production and political changes.

Exchange Rate Risk

For a debt security denominated in a currency other than Hong Kong dollars, investors may suffer losses due to changes in exchange rates.

Liquidity Risk

In Hong Kong, investors tend to buy and hold debt securities. Therefore, liquidity for many debt securities in the secondary market may be low.

Bond Issue Terms

It is important that investors pay attention to the terms of the issue, e.g. a debt security may be redeemed/called before maturity.

SOME EXAMPLES OF DEBT SECURITIES TRADED ON HKEx

Corporate Bonds

Corporate bonds are debt securities issued by private and public corporations, e.g. listed companies or their subsidiaries may issue corporate bonds. When buying a corporate bond, investors are lending money to the corporation that issued it. The issuing corporation promises to return the principal on a specified maturity date to the bondholders. Until that time, the issuing corporation may pay the bondholders a stated rate of interest periodically, e.g. semi-annually.

Convertible Bonds

Convertible bonds have investment characteristics of both debt and equity securities. A convertible bond gives its holder the right to convert the bond into a fixed quantity of shares at a set conversion price during a conversion period or at conversion dates.

Convertible bonds have a coupon rate and a definite date upon which the principal must be repaid. They also offer possible capital appreciation through the right to convert the bonds into shares at the holder's option at set prices over certain periods.

Due to their conversion feature, convertible bonds usually offer a slightly lower coupon rate than corporate bonds. As the price of the issuer's shares increases, the convertible bond price also increases because the option to convert becomes more valuable.

Exchange Fund Notes (EFN)

EFN are Hong Kong dollar debt instruments issued by the Hong Kong Special Administrative Region Government on behalf of the Exchange Fund under the Exchange Fund Ordinance and listed by the Hong Kong Monetary Authority (HKMA) on the Stock Exchange. Whenever the HKMA lists a new issue of EFN, investors may participate in the tendering for the new issue. Investors should contact their brokers regarding the tendering arrangements.

EFN trading is similar to stock trading and investors may trade EFN through their usual stock accounts. Like all debt securities (traded on the Stock Exchange), EFN are quoted in units of \$100 of their nominal value. The buyer of EFN has to pay to the seller the accrued interest calculated from the last interest payment date to the settlement date.

FREQUENTLY ASKED QUESTIONS

1. What are the transaction costs for trading debt securities on HKEx?

Major transaction costs include:

- Brokerage commission
- Transaction levy
- Investor compensation levy
- Trading fee
- Charges for clearing, settlement and nominee services

Investors should check with their brokers the current details on charges.

2. Will I receive a certificate for the debt securities purchased?

A debt security can be issued with or without a certificate. For debt securities which are scripless and admitted into HKEx's Central Clearing and Settlement System, or CCASS, such as EFN, investors' holdings will be credited to or debited from their accounts with CCASS, or the CCASS accounts of their designated custodians or brokers, upon settlement.

3. What is Accrued Interest?

Most bonds, including EFN, pay interest semi-annually. The interest earned by the seller from holding the bond from the last interest payment date until the disposal date is called Accrued Interest.

By convention, EFN are bought and sold at a price that excludes Accrued Interest. A buyer of EFN has to pay to the seller the purchase price plus an amount equal to the interest accrued from the last interest payment date to the settlement date.

OTHER INVESTMENT PRODUCTS TRADED ON HKEX

Listed Equity Linked Instruments (ELI)

In general, the performance of an ELI with standard features is linked to the market performance of the underlying security. For standard Bull ELI, currently the most popular kind of ELI, when the closing price of the underlying security is at or above the strike price on expiry day, investors will receive a cash payment for the total par value (in general, equivalent to the strike price) of the ELI (total investment plus yield); otherwise, investors will receive a predetermined quantity of the underlying security (in general, one ELI for one underlying share), except for cash settled ELI. ELI with standard features listed on the Stock Exchange have stock codes between 1800 and 1899. ELI with exotic features or ELI related to underlying assets other than single stocks may be available on the Exchange. For the latest information on ELI, please visit the HKEx website.

Exchange Traded Funds (ETF)

An ETF represents a portfolio of securities designed to track the performance of an index, offering investors an innovative way to get cost-effective exposure to a specific market or sector. The ETF traded on the Stock Exchange (stock codes are in brackets) include the Tracker Fund (2800), China Tracker (2801), A50 China Tracker (2823), Hang Seng H-Share Index ETF (2828) and Hang Seng HSI ETF (2833). For new issues and the latest information on ETF, please visit the HKEx website.

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