

Press release

LCQ8: Regulation of the trading of warrants

Wednesday, March 16, 2011

Following is a question by the Hon Chim Pui-chung and a written reply by the Secretary for Financial Services and the Treasury, Professor K C Chan, in the Legislative Council today (March 16):

Question:

An investor complained to me that on January 18, 2011 he had bought the equity call warrants known as DB-HSBC@EC1104B (stock code 25315), of which the trading volume was very large on that day and the traded price was around \$0.14 each, but on the following day the liquidity provider of that warrant suddenly stopped providing bid and ask quotes for that warrant. Regarding the protection of warrant investors, will the Government inform this Council if it knows:

- (a) the restrictions imposed by the regulatory authorities on the qualifications of warrant issuers, and whether their qualifications have been vetted;
- (b) whether the regulatory authorities regulate the responsibility of warrant liquidity providers to provide quotes on a daily basis and how large the permissible price range is; and
- (c) whether the regulatory authorities have assessed if the aforesaid incident involved an act of deceiving investors, and whether such an act has violated the policy and principles of investor protection?

Reply:

President,

My reply to the three parts of the question is as follows:

(a) Derivative warrants are a form of structured product. The requirements for listing structured products, including eligibility of issuers, are set out in Chapter 15A of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited (Listing Rules), which are administered by the Stock Exchange of Hong Kong Limited (SEHK), under the oversight of the Securities and Futures Commission (SFC).

The Listing Rules require issuers to have net assets of at least HK\$2 billion, and to be regulated by the SFC or the Hong Kong Monetary Authority or have a credit rating that is one of the top three investment grades. Issuers should also have experience and risk management capability to manage issues of structured products.

(b) Issuers are required to provide liquidity for each structured product that they list on the SEHK. In normal circumstances an issuer shall provide liquidity from five minutes after the market opens until it closes.

That liquidity may be provided by continuously inputting orders into the SEHK's trading system or by entering orders into the trading system in response to requests for quotes.

The method of liquidity provision is to be described in the listing document for an issue. This should also indicate the minimum quantity of the structured product for which liquidity will be provided which must be at least ten board lots. The maximum spread shall also be specified in the relevant listing document.

(c) Warrant 25315 is a call warrant over the shares of HSBC Holdings plc and was listed on October 5, 2010 and will expire on April 11, 2011. The exercise price is HK\$96.

From the listing date until January 2011, the daily turnover in the warrant was relatively low. On January 13-18, 2011, trading in the warrants increased significantly. At the close of business on January 18, 2011, investors held 122,644,000 warrants. On January 19, 2011, turnover in the warrant dropped significantly. Nevertheless, the issuer provided continuous bid and offer quotes throughout the day. All the quotes provided met the maximum spread specified in the listing document.

The SFC will continue its investor education efforts on derivative warrants and explain to investors the risks associated with trading derivative warrants, especially out of the money warrants.

Ends