Risk Explanation for Exchange-Traded Derivatives

The below risk explanation is provided pursuant to Hong Kong regulatory requirements relating to trading in exchange-traded derivatives. This notice supplements the CLSA Terms of Business (as defined in the account application form as amended and/or supplemented from time to time but shall generally be referring to all applicable terms of business, services annex, market terms, schedules, disclosures, notices and/or policies of the respective member of the CLSA Group as set out on the website at https://www.clsa.com/terms-of-business/) where exchange traded derivatives are offered for trading by the relevant CLSA entity but does not seek to introduce, and should not be seen as imposing, any obligation or liabilities on us (be it in contract or tort) beyond those defined in the CLSA Terms of Business, except as otherwise imposed on us by operation of law. This risk explanation is modelled on sampled risk disclaimers adopted by certain exchanges and is not meant to be exhaustive. The information herein has been obtained from sources we believe to be reliable, but we do not guarantee or warrant the accuracy or completeness of the information. Clients must not rely on this risk explanation but must refer to the relevant product documents for the detailed risk factors of the specific product before commencing trading. Where there is any contradiction or inconsistency between this risk explanation and the relevant product document of the specific product, the latter shall prevail.

Except as otherwise agreed with you in writing, we do not provide investment advice and the risk explanation herein is for your reference only. Though we are happy to provide further information in relation to this risk explanation upon your request on a best effort basis, it is your responsibility to consider whether the specific exchange-traded derivative is suitable for your particular circumstances and to fully understand the relevant risks associated with the products which you want to trade and, if appropriate, to seek professional advice, including without limitation tax advice.

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	Risk factor (please refer to the relevant sections below for further explanation)	Derivative products traded on various exchanges that CLSA offers for trading (collectively referred as "Derivative Products")					
		Callable bull/bear contracts/ Knock-out Barrier	Contract for difference	Derivative warrants	Exchange traded fund ("ETF")	Futures contract	Options contracts
1.	Commission and other charges	X	X	X	X	X	X
2.	Collateral risk				X		
3.	Counterparty risk	X	X	X	X	X	X
4.	Early termination or expiry	X		X			
5.	Electronic trading facilities	X	X	X	X	X	X
6.	Expiry considerations	X		X		X	X
7.	Extraordinary price movements	X	X	X	X	X	X
8.	Foreign exchange risk	X	X	X	X	X	X
9.	Funding costs	X					
10.	Gearing risk	X	X	X		X	X
11.	Hedging imperfections					X	
12.	Issuer default risk	X		X			
13.	Liquidity risk	X	X	X	X	X	X
14.	Mandatory call risk	X					
15.	Market risk	X	X	X	X	X	X
16.	Off-exchange transactions				X	X	X
17.	Property and risk					X	X
18.	Statutory fund for investor protection	X	X	X	X	X	X
19.	Suspension or restriction of trading	X	X	X	X	X	X
20.	Terms and conditions of contracts	X	X	X	X	X	X
21.	Tracking errors				X		
22.	Trading strategies		X			X	X
23.	Transactions in other Jurisdictions	X	X	X	X	X	X
24.	Uncollateralised product risk	X		X			
25.	Volatility risk			X			

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I. Risk Factors Description

The following, as well as the risk factors set out in the "Product Features Description" in connection to the inherent risks of certain product types are not meant to be exhaustive and cannot disclose all the risks in respect of the products you are trading. Before you trade, you should ensure you understand the nature of such products as well as the extent of your exposure to risk and potential loss.

1. Commission and other charges: Please note that trading of Derivative Products is / may be subject to commission, fees and other charges. These charges will affect your net profit (if any) or increase your loss. Please contact us for details of commission, fees and other charges before you begin to trade.

2. Collateral risk: Certain Derivative Product may require swap/derivative provider to pledge collateral as a mitigating measure against counterparty risk (as explained below). Even where collateral is obtained by the Derivative Product, 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 Derivative Product.

3. Counterparty risk:

   (a) For trading of Derivative Product, you should familiarize yourself with the protections over the money or other property that you deposit for domestic and foreign transactions, particularly in the event of insolvency or bankruptcy of the financial intermediary. The extent to which you may recover your money or property may be governed by specific legislation or local rules. In some jurisdictions, property which had been specifically identifiable as your own will be pro- rated in the same manner as cash for purposes of distribution in the event of a shortfall.

   (b) For ETF, some ETFs which utilise a synthetic replication strategy use swaps or other derivative instruments to gain exposure to a benchmark. Synthetic replication ETFs can be further categorized into two forms:

   - ❖ For swap-based ETFs, total return swaps allow ETF managers to replicate the benchmark performance of ETFs without purchasing the underlying assets. These are exposed to counterparty risk of the swap dealers and may suffer losses if such dealers are in default or insolvent or fail to honor their contractual commitments.

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Net asset value per share of the ETF may be adversely affected and investors may sustain a loss in their investment in the ETF.

- For derivative embedded ETFs, ETF managers may use other derivative instruments issued by third party (typically participatory notes which are usually unsecured obligations of the issuer) to synthetically replicate the economic benefit of the relevant benchmark. The derivative instruments may be issued by one or multiple issuers. Derivative embedded ETFs are subject to counterparty risk of the issuers and may suffer losses if such issuers are in default or insolvent or fail to honour their contractual commitments. As a consequence, you could lose the corresponding value of their investment in the ETF.

4. Early termination or expiry: In certain circumstances a Derivative Product may be terminated or lapse before the expiry date. Issuers may have reserved the right to nominate extraordinary events which may result in the early expiry of the Derivative Product with the consent of the exchange. These events may vary depending on the terms of the issue. The expiry date may be brought forward or the Derivative Product may simply lapse with a payment in certain circumstances.

5. Electronic trading facilities: Derivative Product may be traded on the proprietary trading platform of the exchange. Undertaking such transactions may expose you to risks associated with the system including without limitation the failure of hardware and software. The result of any system failure may be that your order is either not executed according to your instructions or is not executed at all. Electronic trading facilities are supported by computer-based component systems for the order-routing, execution, matching, registration or clearing of trades. As with all facilities and systems, they are vulnerable to temporary disruption or failure.

6. Expiry considerations: Derivative Products have an expiry date after which the issue may become worthless and can no longer be exercised. Clients should be aware of the relevant expiry time horizon and choose a product with an appropriate lifespan for your trading strategy so as for your market views to be realised. Not all Derivative Products can be viewed as long term investments. All things being equal, the value of a Derivative Product will decrease over time as it approaches its expiry date. Upon expiry, the value remaining will be the intrinsic value. In certain market such as Australia, if the warrant is not sold or exercised prior to its expiry but has intrinsic value, the issuer is required to provide the holder with an "assessed value payment", while in other market such as Hong Kong, the derivative warrants that are in-the-money on the expiry day may be exercised automatically and then the warrant

holders are then paid a positive cash settlement amount according to the terms and conditions of the listing documents.

7. Extraordinary price movements: The price of Derivative Product may not match its theoretical price due to outside influences such as market supply and demand factors, liquidity or high volatility and uncertainty. As a result, the actual trading prices can be higher or lower than the theoretical price. For ETF, ETF may be traded at a discount or premium to its net asset value. This phenomenon may also be observed for ETFs tracking specific markets or sectors that are subject to direct investment restrictions. For futures and options contract, normal pricing relationships between the underlying assets and the futures/options contract also may not exist. This can occur when, for example, the futures contract underlying the options contract is subject to price limits while the options contract is not. The absence of an underlying reference price may make it difficult to judge or assess 'fair' value.

8. Foreign exchange risk: The profit or loss in transactions in foreign currency-denominated Derivative Product (whether they are traded in your own or another jurisdiction) will be affected by fluctuations in currency rates where there is a need to convert from the currency denomination of the Derivative Product to another currency. Clients trading the Derivative Product with underlying assets not denominated in local currency of the market are also exposed to exchange rate risk. Currency rate fluctuations can adversely affect the underlying asset value and therefore also affect the price.

9. Funding costs: The issue price of Derivative Product includes funding costs. Funding costs are gradually reduced over time as the Derivative Product moves towards expiry. The longer the duration of the Derivative Product, the higher the total funding costs. In the event that a Derivative Product is called, investors will lose the funding costs for the entire lifespan of the Derivative Product. The formula for calculating the funding costs are stated in the listing documents.

10. Gearing risk:

    (a) Derivative Products are leveraged and can change in value rapidly according to the gearing ratio relative to the underlying assets. Clients should be aware that the value of a Derivative Product may fall to zero resulting in a total loss of the initial investment.

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(b) For futures contracts, futures contract is a legally binding agreement to buy or sell the underlying at the agreed price, no matter what the price level is at the time of maturity of the contract. Both the buyer and the seller of a futures contract face potentially unlimited losses and hence transactions in futures contract carry a high degree of risk. The amount of initial margin is small relative to the value of the futures contract. A relatively small market movement will have a proportionately larger impact on the funds you have deposited or will have to deposit. If the market moves against your position or margin levels are increased, you may be called upon to pay substantial additional funds on short notice to maintain your position. If you fail to comply with a request for additional funds within the time prescribed, your position may be liquidated at a loss and you will be liable for any resulting deficit.

11. Hedging imperfections: You may use futures contract to hedge against the risk of either a price rise or a fall in the underlying. By selling futures contract you can protect the value of the underlying. By buying futures contract you can lock in the purchase price of the underlying at a future date. The principle behind using futures contract to hedge is that a profit in one market will offset a loss in the other market. The success of any hedging strategy depends in part on how close the futures market and market of the relevant underlying move.

12. Issuer default risk: In the event that the issuer of the Derivative Product is in default or insolvent, investors may be considered as unsecured creditors and will have no preferential claims to any underlying assets held by the issuer. Clients should therefore pay close attention to the financial strength and credit worthiness of the issuers.

13. Liquidity risk: This is the risk that you may not be able to trade the Derivative Product for a reasonable price in the market. This could be because there are insufficient orders in the market, or the price spread at which other investors are prepared to trade them is very large. In some cases a lack of liquidity of the Derivative Product may be due to a lack of liquidity of the underlying asset. Issuers of certain Derivative Products may have appointed a liquidity provider/market maker or the issuer itself may have committed to make a market. Generally speaking, the role of liquidity providers/market makers is to provide two way quotes to facilitate trading of their products and there is no assurance that active trading will be maintained. In the event that a liquidity provider/market maker defaults or ceases to fulfill its role, investors may not be able to trade the Derivative Product until a new liquidity provider/market maker is appointed.

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14. Mandatory call risk: Clients trading Derivative Product should be aware of their intraday "knockout" or mandatory call feature. A Derivative Product 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 Derivative Product as calculated by the product issuer in accordance with the listing documents. Investors should also note that the residual value can be zero.

15. Market risk:

(a) Market price of Derivative Product is affected by demand and supply which are subject to the same risks that affect all stock market or the market of underlying assets (such as movements in domestic and international markets, the present and anticipated economic environment, market sentiment, interest rates, exchange rates and volatility). Principally if the direction of the underlying asset does not fulfil your expectations, the Derivative Product will not perform and may lead to losses compared to holding the underlying asset.

(b) For ETFs, ETFs are typically designed to track the performance of certain indices, market sectors, or groups of assets such as stocks, bonds, or commodities and hence this is subject to the day-to-day fluctuation in the ETF's net asset value and the ETF's trading price in response to market movements of underlying assets. Market fluctuation may erode or increase investment returns on the ETF. Besides, 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 assets.

16. Off-exchange transactions: Off-exchange transactions may be allowed in some jurisdictions under certain circumstances. It may be difficult or impossible to liquidate an existing position, to assess the value, to determine a fair price or to assess the exposure to risk. Off-exchange transactions may be less regulated or subject to a separate regulatory regime. Before you undertake such transactions, you should familiarize yourself with applicable rules and attendant risks.

17. Property and risk: Some Derivative Products allow physical delivery of the underlying assets. Where you choose or are required to deliver (or to be delivered) the underlying assets in physical form, you should refer to the contract specification about mode of delivery and the concerned requirement or arrangement. You should also take note how and when the

property and risk of the underlying assets will be transferred during the course of delivery as defined in the contract specification.

18. Statutory fund for investor protection: Some markets may have set up a pool of assets that is available to meet valid claims arising from dealings with financial intermediary in certain circumstances. Under certain circumstances you may be able to claim against the fund in relation to the trading but only to the extent covered under the local rules.

19. Suspension or restriction of trading: Market conditions and/or the operation of the rules of certain markets may increase the risk of loss by making it difficult or impossible to effect transactions or liquidate/offset positions. For example, some market such as Australia may suspend the related derivative warrants automatically if the underlying share is suspended. Also the exchange may expire and delist the product in accordance with its rules and power.

20. Terms and conditions of contracts: You should refer to the terms and conditions of the specific Derivative Product which you are trading and associated obligations (e.g. the circumstances under which you may become obliged to make or take delivery of the underlying asset of a futures contract and, in respect of options contract, expiration dates and restrictions on the time for exercise). Under certain circumstances the specifications of outstanding contracts (including the exercise price of an options contract) may be modified by the exchange or clearing house to reflect changes in the underlying assets.

21. Tracking errors: Tracking errors refer to the disparity in performance between the Derivative Product and its underlying assets. Tracking errors can arise due to factors such as the impact of transaction fees and expenses incurred to the Derivative Product, changes in composition of the underlying assets, and the replication strategy. This may affect performance return.

22. Trading strategies:

(a) For futures contract and contracts for difference

For a holder of a short position, a continuing adverse market price movement (e.g. market price rise), can result in theoretically unlimited losses being accumulated.

The placing of certain orders, which are intended to limit losses to certain amounts, may not be effective because market conditions may make it impossible to execute such orders. Strategies using combinations of positions, such as 'spread' and 'straddle' positions may be as risky as taking simple 'long' or 'short' positions.

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(b) For options contract

Transactions in options contract carry a high degree of risk. Purchasers and sellers of options contracts should familiarize themselves with the type of options contracts (i.e. put or call) which they contemplate trading and the associated risks. You should calculate the extent to which the value of the options contract must increase for your position to become profitable, taking into account the premium and all transaction costs.

(i) The purchaser of options contract may offset or exercise the options contract or allow the options contract to expire. The exercise of an options contract results either in a cash settlement or in the purchaser acquiring or delivering the underlying assets. If the options contract is on futures contract, the purchaser will acquire a futures position with associated liabilities for margin. If the purchased options contract expires worthless, you will suffer a total loss of your investment which will consist of the options premium plus transaction costs. If you are contemplating purchasing deep-out-of-the-money options, you should be aware that the chance of such options contract becoming profitable ordinarily is remote. Certain exchanges in some jurisdictions permit deferred payment of the options premium, exposing the purchaser to liability for margin payments not exceeding the amount of the premium. When the options contract is exercised or expires, the purchaser is responsible for any unpaid premium outstanding at that time.

(ii) Selling options contract generally entails considerably greater risk than purchasing options contracts. Although the premium received by the seller is fixed, the seller may sustain a loss well in excess of that amount. The seller will be liable for additional margin to maintain the position if the market moves unfavorably against him. The seller will also be exposed to the risk of the purchaser exercising the options contract and the seller will be obligated to either settle the options contract in cash or to acquire or deliver the underlying assets. If the options contract is on futures contract, the seller will acquire a position in futures contract with associated liabilities for margin. If the options contract is covered by the seller holding a corresponding position in the underlying assets, the risk may be reduced. If the options contract is not covered, the risk of loss can be unlimited.

23. Transactions in other jurisdictions: Transactions on markets in other jurisdictions, including markets formally linked to a domestic market, may expose you to additional risk. Such

markets may be subject to regulation which may offer different or diminished investor protection. Before you trade, you should enquire about any rules relevant to your particular transactions. Your local regulatory authority will be unable to compel the enforcement of the rules of regulatory authorities or markets in other jurisdictions where your transactions have been effected.

24. Uncollateralised product risk: Uncollateralised Derivative Products are not asset backed. In the event of issuer insolvency, investors can lose their entire investment. Clients should read the listing documents to determine if the Derivative Product is uncollateralised.

25. Volatility risk: Prices of Derivative Product can increase or decrease in line with the implied volatility of the price of the underlying asset. Clients should be aware of the volatility of the underlying asset.

II. Product Features Description

The following are introductive descriptions of certain derivative products for your reference. These are not exhaustive and may not reflect the terms of the specific product you intend to trade. You should read the terms and conditions of the specific product that you intend to trade before trading.

1. Callable Bull/ Bear Contracts ("CBBC")

CBBC are a type of structured product that tracks the performance of an underlying asset without requiring investors to pay the full price required to own the actual asset. They are issued either as bull or bear contracts with a fixed expiry date, allowing investors to take bullish or bearish positions on the underlying asset. CBBC are issued by a third party, usually an investment bank, independent of the exchange and of the underlying asset.

CBBC are issued with the condition that during their lifespan they will be called by the issuers when the price of the underlying asset reaches a level (known as the "**Call Price** ") specified in the listing document. If the Call Price is reached before expiry, the CBBC will expire early and the trading of that CBBC will be terminated immediately. The specified expiry date from the listing document will no longer be valid. CBBC may be issued with a lifespan of three months to five years and are settled in cash only.

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.

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.

2. Contract for Difference

A contract for difference ("**CFD**") is a margin traded product to exchange the difference between the opening value and the closing value of an instrument. These contracts can only be settled in cash. Transactions in CFDs can also contain contingent liability where you will or may be liable to make future payments (other than charges) and you should be aware of the implications of these risks.

A contingent liability transaction is a transaction under the terms of which you will or may be liable to make further payments (other than charges). For example, if the market moves against you, you may be called upon to pay substantial additional margin at short notice to maintain the position. If you fail to do so within the time required, your position may be liquidated at a loss and you will be responsible for the resulting deficit. Even if a transaction is not margined, it may still carry an obligation to make further payments in certain circumstances over and above any amount paid when you entered into the contract. You may also sustain a total loss of the margin you deposit to establish or maintain a position.

3. Derivative Warrants

Derivative warrants are an instrument that gives an investor the right (but not the obligation) to "buy" or "sell" an underlying asset at a pre-set price prior to a specified expiry date. They may be bought and sold prior to their expiry in the relevant market. At expiry settlement is made in cash rather than a purchase or sale of the underlying asset. Derivative warrants can be issued over a range of assets, including stocks, stock indices, currencies, commodities, or a basket of securities. They are issued by a third party, usually an investment bank, independent of the issuer of the underlying assets. Derivative warrants traded in Hong Kong normally have an initial life of six months to two years and when trading in the market each derivative warrant is likely to have a unique expiry date. Derivative warrants could be illiquid. Liquidity provider of derivative warrants is not obligated to provide a bid quote if it has been determined that the fair value of the relevant derivative warrant has fallen below a certain value. Derivative warrants can also become valueless upon expiry. You can lose all your investment capital.

Derivative warrants are also subject to time decay and volatility risk.

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.

4. Exchange Traded Fund (“ETF”)

An Exchange Traded Fund (“**ETF**”) is an open-end fund that can be bought and sold on a stock exchange. ETF may invest in stock index future contracts, bonds, commodities and other derivatives. It can be actively managed, seeking to outperform a market index; or passively managed, seeking to match the performance of a market index

As derivatives have a high degree of price variability and are subject to occasional rapid and substantial changes, compared to conventional securities, derivatives can be more sensitive to changes in interest rates or to sudden fluctuations in market prices due to both the low margin deposits required, and the extremely high degree of leverage involved in derivative products. As a result, a relatively small price movement in the derivative product may result in immediate and substantial loss (or gain) to the ETF. An ETF’s losses may be greater if it invests in derivatives than if it invests only in conventional securities. In addition, many derivatives are not traded on exchanges. As a result, an ETF that engages in transactions involving derivatives is subject to the risk of the inability or refusal to perform with respect to such contracts on the part of any counterparties with which that ETF trades and as such may also expose the ETF to additional liquidity risks. This risk is also affected by the fact that over-the-counter derivatives markets are generally not regulated by government authorities and participants in these markets are not required to make continuous markets in the contracts they trade.

5. Futures

Futures transactions involve the obligation to make, or to take, delivery of the underlying asset of the contract at a future date, or in some cases to settle the position with cash. They carry a high degree of risk. The gearing or leverage often obtainable in futures trading means that a small deposit or down payment can lead to large losses as well as gains. It also means that a relatively small movement in the price of the underlying asset can lead to a proportionately much larger movement in the value of your investment, and this can work against you as well as for you. Futures transactions have a contingent liability, as with CFDs. You should be aware of the implications of this, including the relevant margining requirements entailed.

6. Options

An option is a financial derivative which represents a contract sold by one party (the one writing the option) to another (the one buying the option). The option buyer has the right, but not the obligation, to buy or sell a security or other financial asset at an agreed-upon price during a certain period of time or on a specific date.

You should inform yourself of exercise and expiration procedures and your rights and obligations upon exercise or expiry. The risk of loss in trading options can be substantial and you may sustain losses in excess of your initial margin funds or payment. Placing contingent orders, such as “stop-loss” or “stop-limit” orders, will not necessarily avoid loss. Market conditions may make it impossible to execute such orders. You may also be called upon at short notice to deposit additional margin funds. If the required funds are not provided within the prescribed time your position may be liquidated and you will liable for any resulting deficit in your account. You should therefore study and understand options before you trade and carefully consider whether such trading is suitable in the light of your financial position and investment objectives.

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