SECURITIES AND FUTURES COMMISSION 證券及期貨事務監察委員會
12th Floor, Edinburgh Tower, The Landmark, 15 Queen's Road Central, Hong Kong
香港中環皇后大道中十五號置地廣場公爵大廈十二樓

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The Honourable Legislative Council Member,

<u>Updated Educational Leaflet -"Invest Wisely"</u>

The Securities and Futures Commission has recently updated its investor leaflet "Invest Wisely" to explain the principles underlying equity-linked instruments (ELIs) and the risks of investing in them.

The Commission first published "Invest Wisely" in November last year to discuss the nature of equity-linked notes. Taking account of recent market developments and the listing of ELIs on the Stock Exchange of Hong Kong, the leaflet has been updated to acknowledge the diversity of ELIs, which can take the form of notes, deposits, contracts or other structures.

Enclosed please find the leaflet in English and Chinese for your reference. Should you wish to obtain additional copies for distribution to members of public in your constituency, please do not hesitate to contact Miss Karen Heung at 2842 7711.

Yours faithfully,

Ivy Lai
Associate Director
Investor Education and Communications

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So, what are the risks and considerations?

- You may suffer a capital loss should the price of the underlying shares go against your view. In extreme cases, you may lose your ENTIRE investment.
- The return on investment is predetermined by the terms specified in the ELI. So even if your view of the direction of the underlying stock price is correct, you will not gain more than the specified amount.
- The return of the ELI is determined at a specified time on the valuation date, irrespective of the fluctuations in the underlying stock price before that time.
- Unlike traditional time deposits, there is NO guarantee that you will get a return on your investment or any yield.

ELIs can take the form of notes, deposits and contracts. They work on a similar basis. To make the right choice, read and understand the information memorandum or prospectus before you invest.

For more details, please visit the SFC-operated Electronic Investor Resources Centre (eIRC) at www.hkeirc.org.

SECURITIES AND FUTURES COMMISSION
12/F Edinburgh Tower, The Landmark,
15 Queen's Road Central, Hong Kong
Tel: 2840 9333 Fax: 2524 3718
Website: www.hksfc.org.hk

Invest Wisely

"When you buy EQUITY-LINKED INSTRUMENTS for potentially higher returns, you must be prepared to take higher risks."

SFC
證監會

In a low interest rate environment, Joe was eager to find alternative investment opportunities. As he pondered his choices, Joe came across an advertisement for equity-linked instruments (ELIs). Attracted by the apparently high rate of return, he switched his savings to a bull ELI. One month later, Joe was shocked to find that instead of cash, he got a few thousand shares of the company underlying the ELI.

What exactly is an ELI?

An ELI is an instrument with embedded "short" positions in options which allow an investor to take a bull (rising), bear (falling), or range (fluctuating within a specific price range) view on the underlying asset. The return of an ELI is usually determined by the performance of a single stock, a basket of stocks, or an equity index. The "yield" of the ELI is produced mainly by the premium from writing the option.

In the case of a bull ELI, you are buying a structured instrument containing an embedded short position in a put option in favour of the issuer, in the expectation that the price of the underlying asset will be higher than the instrument's strike price on the valuation date. The following demonstrates how a bull ELI works and when profits or losses occur.

Example of a bull ELI on company A's share

- Face value: $200,000
- Issue price: 98.77% ($197,531)
- Term: 1 month
- Annualised yield: 15% p.a.
- Strike price: $20

If, on the valuation date, company A's share price is at or above $20, you will receive a predetermined cash amount of $200,000 ($197,531 + $197,531 x 15% / 12) .

HOWEVER, if the price is below $20 on the valuation date, you will receive a predetermined number of shares of company A, namely $200,000 / $20 = 10,000 shares. You will have necessarily also assumed the price risk of the shares. If, for example, the share price of company A is now $15, the market value of the shares received would be $15 x 10,000 = $150,000, that is 24% below your original investment of $197,531.

A bear ELI is the opposite, with the investor expecting that the underlying stock price will be lower than the strike price on the valuation date. You buy a structured instrument with an embedded short position in a call option in favour of the issuer. The following demonstrates how a bear ELI works and when profits or losses occur.

Example of a bear ELI on company A's share

- Face value: $200,000
- Issue price: 98.77% ($197,531)
- Term: 1 month
- Annualised yield: 15% p.a.
- Strike price: $20
- Number of underlying shares: 10,000 ($200,000 / $20)

If, on the valuation date, the share price of company A is at or below $20, you will receive a predetermined cash amount of $200,000 ($197,531 + $197,531 x 15% / 12).

HOWEVER, you may suffer a loss if the share price of company A rises above $20. The return in such case will be calculated by:
Face value - [number of shares x (market price - strike price)]

If the shares have reached $40 on the valuation date:
$200,000 - [10,000 shares x ($40-20)] = 0

You will lose your ENTIRE investment!