

Frequently Asked Questions About Exchange Fund Notes (EFNs)

About the Features of EFNs

Q1: What are Exchange Fund Notes?

Exchange Fund Notes are Hong Kong dollar fixed-income debt securities issued by the Hong Kong Special Administrative Region Government for the account of the Exchange Fund.

Q2: What is the minimum lot size of the Exchange Fund Notes?

The minimum lot size of Exchange Fund Notes is HK\$50,000. Tenders above this minimum must be in integral multiples of HK\$50,000.

Q3: When will holders of Exchange Fund Notes be paid the interest?

Exchange Fund Notes bear a fixed rate of interest, known as the coupon rate. Interest will be calculated based on the coupon rate and will be payable semi-annually. The first interest period shall be the period from and including the issue date to but excluding the first interest payment date. Thereafter interest periods run from and including each interest payment date to but excluding the next interest payment date.

Q4: What is the difference between coupon and yield?

Each issue of Exchange Fund Notes bears a fixed coupon rate at the time of issuance. Interest payable to the holder of the Notes will be calculated based on the coupon rate. While the coupon rate is fixed throughout the life of the Notes, the market price of the Notes may go up or down to equilibrate the return on investment in the Notes, that is the yield fluctuates with the moving market interest rate.

Q5: What are the benefits of investing in Exchange Fund Notes?

Issued by the Hong Kong Special Administrative Region Government, the Exchange Fund Notes are secured investments. The Notes bear a fixed rate of interest and offer a steady stream of income to investors. The interest payable on Notes may, depending on market conditions, exceed bank deposit interest rates. The Notes are offered for sale by tender regularly and there exists an active secondary market for Notes among Recognized Dealers. Indicative pricing for Notes are published daily on the HKMA website. Investors may apply for Exchange Fund Notes through tender in the primary market or from the secondary market in small lot sizes (minimum HK\$50,000).

Q6: What are the risks of investing in Exchange Fund Notes?

From the time when the Notes were issued until the maturity date, its price will vary depending on many factors including, but not limited to, the prevailing market interest rates. In general, the price of Notes will fall when interest rate rises, and vice versa. Investors should therefore be aware that the value of Notes could be higher or lower than the original face value when selling the Notes before maturity.

In addition to interest rate movements, other factors affecting the return on Notes include the term to maturity and overall market conditions:

- Term to maturity - Risk increases with the life of Notes, as price volatility increases for Notes with longer maturity.

■ Overall market conditions - As with other investments, returns on Notes could be affected by various market factors, for examples interest rate movements, inflation, exchange rates, and political changes.

Investors are advised to seek independent professional advice from a financial consultant, legal adviser, professional accountant or other professional adviser, as appropriate, on the risks of investment in the Notes before making their investment decisions.

About Exchange Fund Notes tenders

Q7: When will tenders for Exchange Fund Notes be held?

Investors may find the list of the Exchange Fund Notes to be tendered in the coming quarter in a tentative issuance schedule published in the second month of each quarter on the HKMA website.

Q8: How can investors obtain detailed information about specific new issue of Exchange Fund Notes?

The HKMA will announce on the HKMA website the issue number, issue date, maturity date, tenor, coupon, and the amount of a new Exchange Fund Notes on offer for competitive and non-competitive tenders in advanced.

Q9: Which issues of Exchange Fund Notes are available for subscription by retail investors?

All Exchange Fund Notes are available for subscription by retail investors through Eligible Market Makers by competitive tender. The HKMA may reserve a portion of any issue of Notes for retail offer by non-competitive tender through the Hong Kong Securities Clearing Company Limited.

Q10: What is the difference between competitive and non-competitive tender?

Investors submitting bids for competitive tender have to indicate the quantity applied for and the bid price. Competitive tenders accepted will normally be allotted in descending order of bid price. Investors may submit competitive bids only through Eligible Market Makers appointed by the HKMA.

Investors submitting bids for non-competitive tender only need to indicate the quantity applied for. Successful bids will be allotted Notes at the lowest accepted price at the competitive tender for the same issue. Bids for non-competitive tenders open to the Hong Kong Securities Clearing Company Limited (HKSCC) must be submitted through the HKSCC via Stock Exchange Participants or, for investors holding Investor Accounts with the HKSCC's Central Clearing and Settlement System (CCASS), CCASS.

Q11: How is the allocation of the Exchange Fund Notes to investors submitting non-competitive bids through the Hong Kong Securities Clearing Company Limited (HKSCC) made if the portion for?

Investors should refer to the allotment arrangements determined by the HKSCC.

Q12: What is the difference between Recognized Dealer, Market Maker and Eligible Market Maker?

Recognized Dealers are financial institutions appointed by the HKMA to assist in the development of the Exchange Fund Bills and Notes market. Recognized Dealers can maintain

securities accounts with the HKMA for holding Notes on behalf of their customers. Most Recognized Dealers are authorised under the Banking Ordinance and are subject to the prudential supervision of the HKMA.

A number of Recognized Dealers have been appointed as Market Makers by the HKMA to maintain a liquid secondary market in the institutional (professional) market of Exchange Fund Bills and Notes. Based on criteria determined by the HKMA, only the most active Market Makers appointed by the HKMA as Eligible Market Makers are invited to participate in the primary market for Exchange Fund papers.

Q13: What kinds of fees are charged by Eligible Market Makers and the Hong Kong Securities Clearing Company Limited (HKSCC) for providing the tender service?

The HKMA does not set standards for the type and level of fees that Eligible Market Makers may charge for providing the competitive tender service. Individual Eligible Market Makers may set such fees at their own discretion. Likewise, the HKMA does not set standards for the type and level of fees that HKSCC may charge for providing the non-competitive tender service. For submitting non-competitive tender bids through HKSCC channel via Stock Exchange Participants and CCASS, investors should consult their stock brokers and refer to the charging scheme of CCASS.

Investors should familiarise themselves with the respective charging scheme before submitting tender bids.

Q14: How can investors determine the bid price for competitive tender?

The announcement by the HKMA before the tender day of an upcoming issue of Notes contains a price-yield conversion table. Investors may refer to the table to convert their own estimation of the yield on the issue into a price. Investors, however, should perform independent checks to verify the correctness of the price-yield conversion contained in the table before submitting tender bids.

The yield on Notes is market determined. Generally speaking, the yields on Notes of similar remaining maturity will be close to each other. The prevailing yields and prices of all outstanding Notes derived from the Exchange Fund Notes Benchmark Indicative Pricings are announced daily on HKMA website.

Q15: What are the detailed procedures for subscribing to Exchange Fund Notes in tenders?

Different Eligible Market Makers may have different arrangements for accepting and processing application instructions, for example the means for submitting application, operating hours, deadline for accepting application, payment and settlement method and arrangements for making refunds, if any. Normally, investors need to open a bank account and an investment account with the Eligible Market Makers to which they give their application instructions. Investors should familiarise themselves with the subscription procedures of specific submission channel through which he/she intends to submit the tender bids.

For non-competitive tenders submitted via the Hong Kong Securities Clearing Company Limited (HKSCC), investors with or without an Investor Account in CCASS may submit their non-competitive tender applications through Stock Exchange Participants. Investors should consult their own stock brokers for the details of application procedures and fees. Investors who have opened Investor Accounts in CCASS may submit their tender via HKSCC without going through any Stock Exchange Participants. Investors may refer to the relevant rules published by CCASS for the details of application procedures and fees.

Q16: At what price will the Exchange Fund Notes be allotted to successful bids in

non-competitive tender?

Successful bids at non-competitive tender will be allotted Notes at the lowest accepted price at the competitive tender for the same Notes.

Q17: When will the results of the Exchange Fund Notes tenders be available?

Eligible Market Makers and Hong Kong Securities Clearing Company Limited (HKSCC), whose tenders have been successful in whole or in part will be notified of their allotment and the amount payable as soon as practicable after the allotment. The Eligible Market Makers and HKSCC will then inform individual investors through the channels agreed between them.

The Average Accepted Price and the lowest price at which Notes have been allotted in the tender will be announced on the tender day on Reuters, Bloomberg, and on HKMA website.

About secondary market trading in Exchange Fund Notes

Q18: What are Benchmark Exchange Fund Notes?

Benchmark Exchange Fund Notes are the most actively traded issues of Notes among all outstanding issues.

From time to time and in accordance with established rules, Notes of maturity nearest to the benchmark tenor are chosen as the benchmark issue to represent that tenor. The existing benchmark issues may be seen in the [Exchange Fund Notes Indicative Pricings](#) announced daily on the HKMA website.

Q19: How can investors know the prevailing price and yield of Exchange Fund Notes?

Investors may refer to the [Exchange Fund Notes Indicative Pricings](#) for the prevailing mid-price and mid-yield of all issues of Notes in the wholesale market

For indicative bid and offer prices of Notes in retail market, investors may refer to the quotes provided by major banks in Hong Kong at the CMU Bond Price Bulletin website developed by the HKMA's Central Moneymarkets Unit (www.cmu.org.hk).

Q20: What are Exchange Fund Notes Indicative Pricings?

The HKMA has established a set of Indicative Pricings for Exchange Fund Bills and Exchange Fund Notes. The Indicative Pricings are calculated on a mid-price basis and are compiled daily by Reuters based on quotes provided by the Eligible Market Makers designated by the HKMA. They indicate the price of Notes prevailing in the wholesale (professional) market at the respective time of the day. The Indicative Pricings for both times are published on HKMA website by the end of each trading day.

Q21: How can retail investors purchase and sell Exchange Fund Notes in the secondary market?

Retail investors can purchase and sell Notes in the secondary market through Recognized Dealers.

The Notes are also listed on the Stock Exchange. Retail investors may trade the Notes on the Stock Exchange through their stock brokers.

Q22: Why might the quotes provided by Recognized Dealers differ from the Exchange

Fund Notes Indicative Pricings?

Exchange Fund Notes Indicative Pricings are indicative mid-prices calculated from quotes of Eligible Market Makers in the institutional market, which may differ from the quotes obtained by retail investors from Recognized Dealers due to factors which are heterogeneous to different Recognized Dealers and Market Makers, such as bid-ask spread and embedded transaction fees.

Q23: What is Accrued Interest?

Accrued interest is the interest earned by the seller from holding the bond from the last interest payment date until the disposal date.

By convention, the Notes are bought and sold at a clean price, which is exclusive of accrued interest. A buyer of Notes 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.

Q24: What kinds of fees are charged by Recognized Dealers for providing the secondary market trading service?

The HKMA does not set any standards for the type and level of fees that Recognized Dealers may charge for providing secondary-market trading service. Individual Recognized Dealers may set such fees at their own discretion.

Regarding the fees for trading Exchange Fund Notes on the Stock Exchange, investors should consult their stock brokers.

Investors should familiarise themselves with the charging schemes of service providers before entering into Exchange Fund Notes transactions.

Q25: What are the detailed procedures for trading Exchange Fund Notes?

Different Recognized Dealers and the HKSCC (via Stock Exchange Participants and the CCASS) may have different arrangements for accepting and processing trading instructions, including operating hours, and payment and settlement methods. Normally, investors need to open a bank account and an investment account with a Recognized Dealer before they can enter into transactions. Investors should familiarise themselves with trading procedures of the specific channel through which they intend to trade Exchange Fund Notes.

Others

Q26: What is custody fee?

Exchange Fund Notes are issued in computerised book entry form only. Investors can only hold Notes through a Recognized Dealer's securities account with the HKMA. A custody fee is the fee charged by the Recognized Dealer for providing the safe custody service.

Investors should familiarise themselves with the charging scheme of a Recognized Dealer before subscribing to its service.

Q27: Can an investor transfer its Exchange Fund Notes from one Recognized Dealer to another?

Different Recognized Dealers may have different policies on allowing transfer of Notes. Recognized Dealers allowing transfer usually charge a transfer fee.

Investors should familiarise themselves with the transfer policy and charging scheme of a Recognized Dealer before subscribing to its service.