IB-HK Bond Risk Disclosure

Interactive Brokers ("IBKR") is furnishing this disclosure to clients to provide additional information regarding the characteristics and risks associated with fixed income securities ("bonds"). This disclosure should not be construed as an invitation or solicitation to undertake any transaction in, or a recommendation of, any bond.

Before trading bonds, client is advised to consider consulting a financial advisor, who can provide advice on whether particular investments suit their financial situations and goals.

IBKR provides execution and clearing services and does not provide specific trading or investment advice or recommendations.

Before trading any particular bond, you should understand the terms and conditions of the bond, including its credit rating, its maturity, its rate and yield, whether it is callable, and other relevant information.

1. **Characteristics of Bonds**

   What is a bond?
   A bond is a loan an investor makes to a corporation, government, federal agency or other organization in exchange for interest payments over a specified term plus repayment of principal at the bond's maturity date.

   What are the types of bonds?
   Examples of bonds include:

   a. *U.S. Government Bonds*

      Bonds issued by the U.S. government are called Treasuries. These are grouped into three categories: (1) Treasury bills; (2) Treasury notes; and (3) Treasury bonds. They each have a different length of time until maturity. Income earned on Treasuries is exempt from state and local taxes, but taxable by the federal government. Treasuries are considered the safest bond investments since the U.S. government backs them and it is highly unlikely that a situation of default will occur. However, Treasuries with longer maturities generally have higher interest rate and credit risk.

b. *Municipal Bonds*

Municipal bonds are debt obligations of state or local governments. The funds may be used to support general governmental needs or special projects. Municipal bonds are considered riskier investments than Treasuries. They generally are exempt from federal taxation, and state or local government issuers often exempt their own citizens from taxes. However, municipal bonds often pay a lower interest rate because of their favorable tax treatment. When considering an investment in municipal bonds, bear in mind that no two municipal bonds issues are exactly alike, so it is important to carefully evaluate up-to-date information about both the bond and its issuer.

c. *Corporate Bonds*

Companies issue corporate bonds (or corporates) to raise money for capital expenditures, operations and acquisitions. Corporates are issued by all types of businesses. Corporate bonds are debt instruments issued by private corporations. There are many types of corporate bonds, and investors have a wide range of choices with respect to bond structures, coupon rates, maturity dates and credit quality, among other characteristics.

Corporate bonds tend to be categorized as either investment grade or non-investment grade. Non-investment grade bonds are also referred to as "high yield" bonds because they tend to pay higher yields than Treasuries and investment-grade corporate bonds. However, with this higher yield comes a higher level of risk. High yield bonds also go by another name: junk bonds.

Par value, or face amount, is usually $1,000, but bond prices are quoted in $100. For example, a quote of 80 is a bond selling for $800. Amounts less than $10 are quoted in eighths ($1.25). Therefore, a quote of 80 1/8 is equal to $801.25.

Most corporate bonds trade in the over-the-counter (OTC) market. The OTC market for corporates is decentralized, with bond dealers and brokers trading with each other around the country over the phone or electronically.

Convertible Bonds are bonds that may be converted into another form of corporate security, usually shares of common stock. Conversion only occurs at specific times at specific prices under specific conditions and this will all be detailed at the time the bond is issued.

d. *Zero-Coupon Bonds*

These are bonds that do not pay interest periodically, but instead pay a lump sum of the principal and interest at maturity. Investors, however, must pay taxes on the interest as it accrues, not when they receive it.

e. Sovereign Bonds

A sovereign bond is a specific debt instrument issued by a government outside of the United States. They can be denominated in both foreign and domestic currency. Similar to other bonds, these generally pay the buyer a certain amount of interest for a stipulated number of years and repay the face value on maturity.

How are Bonds Rated?
Bonds are rated by rating agencies (such as Standard & Poor's or Moody's Investors Service) who assign credit ratings to governments and corporations which help determine the amount of interest paid. The below table sets the ratings codes used by Standard & Poor's and Moody's and represent greater default risk as you read down the chart (see Section 2 and 3 for credit and other risks associated with bonds).

Quality	Moody's	Standard & Poor's
Best Quality	Aaa	AAA
High Quality	Aa	AA
Upper-medium grade	A	A
Medium Grade	Baa	BBB
Junk Bonds/Speculative/High Yield	Ba, B, Caa, Ca	BB, B, CCC, CC
Default	-	D

Bond ratings are subject to change by factors that affect the bonds issuers credit.

The ratings that appear for the bonds IBKR makes available are from sources it believes to be reliable; however, IBKR cannot guarantee their accuracy.

2. **Risks of trading Bonds**

Most Bonds remain 100% principal protected upon maturity subject to the credit risk of the Issuer and/or the Guarantor (if applicable).

Bonds are not an alternative to ordinary savings or time deposits.

The price of bonds may fluctuate during its tenor and may even become valueless.

Trading bonds may not be suitable for all investors. Although bonds are often thought to be conservative investments, there are numerous risks involved in bond trading. <u>If you are uncomfortable with any of the risks involved, you should not trade bonds.</u>

a. **Key Product Risks**

It is crucial to understand the specific risks mentioned in the relevant offering documents (if applicable) before investing. Key risks include, but are not limited to, the following:

Credit Risk: The investor assumes the risk that the issuer/ guarantor's promise to repay principal and pay interest on the agreed upon dates and terms will be upheld. Any changes to the credit rating of the issuer will likely affect the price and value of the bonds. Bonds are subject to the risk of the Issuer defaulting on its obligations, i.e. an Issuer fails to make principal and interest payments when due. In the event that the Issuer/ Guarantor declares bankruptcy, the investor could risk losing their entire investment. Credit ratings assigned by credit rating agencies do not guarantee the creditworthiness of the issuer.

Prepayment risk: Prepayment or "call" risk involves the scenario where an issuer "calls" a bond. If this happens, the client's investment will be paid back early and may not be able to locate an alternative bond with similar terms. Certain bonds are callable and others are not, and this information is detailed in the prospectus. If a bond is callable, the prospectus will detail a "yield-to-call" figure. Corporations may call their bonds when interest rates fall below current bond rates.

A "put" provision allows a bondholder to redeem a bond at par value before it matures. Investors may do this when interest rates are rising and they can get higher rates elsewhere. The issuer will assign specific dates to take advantage of a put provision. Prepayment risk is figured into the pricing of bonds.

Inflation Risk: Inflation risk is the risk that the rate of the yield to call or maturity of the bond will not provide a positive return over the rate of inflation for the period of the investment. In other words, if the rate of inflation for the period of an investment is six percent and the yield to maturity of a bond is four percent, the client will receive more money in interest and principal than originally invested, but the value of that money returned is actually less than what was originally invested in the bond. As the inflation rate rises, so do interest rates. Although the yield on the bond increases, the price of the actual bond decreases.

Liquidity Risk: The bond may have limited liquidity and may not be actively traded and/or quoted by brokers in the market. As such:

i. The value of bond and/or indicative bid/offer price will depend on market liquidity and conditions which may not be available at all times;
ii. It may take a longer time or it may be impossible to sell the bond at prevailing market conditions; and
iii. The executable sale price may differ unfavourably by large amounts from the indicative bid price quoted.

Interest Rate Risk: The price of bonds are more susceptible to fluctuations in interest rates and generally prices of bonds will fall when interest rates rise. Accordingly, the longer the tenor of the bond, the greater the interest rate risk that the investor is exposed to.

Market Risk: The value of investments may fluctuate due to changing political, legal and, economic conditions and changes in interest rates. This is common to all markets and asset classes. An investor's return may be substantially less than the initial investment due to one or more of these factors.

Currency Risk: For bonds denominated in a foreign currency, there may be an exchange loss when converting the redemption amount back to the local or base currency.

For Products denominated in Renminbi (RMB) or with underlying assets that are denominated in RMB only: Conversion between RMB and foreign currencies, including Hong Kong dollar, is subject to PRC regulatory restrictions - RMB is currently not freely convertible and conversion of RMB through banks in Hong Kong is subject to certain restrictions. The PRC government regulates conversion between RMB and foreign currency both in Hong Kong SAR and mainland China, which as a result may affect the liquidity.

b. **Additional risks of high yield bonds and complex bonds**

In addition to the risks listed above, high-yield bonds and complex bonds are subject to additional risks such as:

i. <u>High-yield bonds</u>

Higher Credit Risk: Since high-yield bonds are typically rated below investment grade or are unrated, they are often subject to a higher risk of issuer default.

Vulnerability to Economic Cycles: During economic downturns high-yield bonds typically fall more in value than investment grade bonds as (i) investors become more risk averse and (ii) default risk rises.

3. **Risks of Trading Bonds Electronically**

IBKR is an online, direct access brokerage firm that executes virtually all trades on electronic market centers. IBKR will post bids and offers for bonds from various information sources and markets and will allow clients to execute trades against those electronically-displayed bond quotes.

Unlike the practice of many other brokers, IBKR typically does not make telephone calls to various bond dealers in seeking to execute client's bond orders. Rather, IBKR will provide client with direct access to electronic bond trading platforms.

Electronic trading has a number of inherent advantages (such as speed, low cost, and a clear audit trail) but it also has certain inherent disadvantages. Client should be aware that electronic bond trading platforms may have less liquidity or less advantageous prices than could be offered telephonically by a bond dealer. In addition, electronic trading platforms are inherently vulnerable to technical errors and outages.

Please note that many bond dealers place quotes to buy or sell the same bond position on multiple bond trading venues (e.g., 10 bonds on Market A and 10 bonds on Market B). If an IBKR client order executes against both of the quotes (e.g., an order to buy 20 is filled 10 at Market A and 10 at Market B), the dealer may request that one of the trades be busted (reversed). IBKR reserves the right to grant such requests without consent of client if IBKR, in its discretion, believes that the dealer is acting in good faith.

4. **Risks Specific to Distressed Bonds**

Distressed bonds are generally bonds of a company which has either defaulted, is under bankruptcy protection, or is in financial distress and moving toward bankruptcy or default in the near future. Distressed bonds frequently trade "flat," meaning that the buyer of the bond is not responsible for paying the interest that has accrued since the last payment. In effect, a flat bond is a bond that is trading without the accrued interest. The price of a flat bond is referred to as the "flat price" or "clean price." Typically, flat prices are quoted so as not to misrepresent the daily increase in the dirty price (bond price plus accrued interest) since accrued interest does not change the yield to maturity (YTM) of the bond.

On the Settlement Date, the buyer must pay to seller only the agreed upon price, without any payment in respect of interest. The person holding the bond on the Record Date receives any and all interest payments whenever made. If a Record Date occurs before the Settlement Date, seller will get any interest paid on a bond that is trading Flat. If there is a change in the Record Date, the party that was a bondholder with respect to the prior Record Date loses any rights they may have had to receive any related payment of principal or interest.

If a bond that was sold with accrued interest begins trading Flat after the trade date, but before Settlement date, the buyer remains responsible for paying the accrued interest to the seller, even though the buyer may not receive interest from the bond issuer. If the accrued interest payment is not made on the actual Payment Date, but is made during the Grace Period, any interest payments will accrue to the seller. If accrued interest is paid after the Grace Period, it will belong to the buyer when paid.

Bankruptcy courts can issue broad orders at the request of a bankruptcy debtor that halt or seriously restrict trading in all of the debt and equity of the debtor corporation for the protection of the bankruptcy debtor's net operating loss ("NOL") carryovers and other tax attributes of the debtor.

"Minimum denomination transfer requirements" are generally found in the Indenture and the offering documents and provide that a transfer of a bond whether in physical or book- entry form be made in certain minimum denominations.

Please be aware that bonds may begin trading flat before a legal default occurs. In this scenario, brokers anticipate the default occurring and the market and dealers will trade bonds without Accrued Interest even though the issuer has not missed an interest payment.

5. **Risks of Utilizing the IBKR Bond Desk**

If you utilize the IBKR bond desk, you should be aware of the risks inherent with trading bonds in the traditional (non-electronic) manner. The bond desk provides clients with assisted bond trading where a designated bond trader works with clients to find liquidity that is not available on IBKR's electronic bond trading platforms. To identify the liquidity, the trader will communicate with other bond dealers to find bonds and/or pricing that align with the client's request.

When the bond desk agrees to work a client's order, we are only indicating a willingness to attempt to identify a counterparty to the trade requested by the client and are not obliged to enter into any transaction or guaranteeing the full or partial execution of such order.

IBKR's experienced bond traders will exercise their discretion in deciding whether to work the order, which orders we are willing to execute and when and how to execute all or any part of an order. When IBKR agrees to work an order over a period of time or otherwise to accept an order involving the exercise of discretion, IBKR will attempt to exercise this discretion reasonably and fairly, but, unless otherwise agreed, IBKR is not committed to executing all or any part of the order in any particular way. Clients requesting that IBKR work orders in foreign markets should be aware that bond traders may work orders outside of U.S. trading hours.

6. **Margin**

When a broker-dealer lends a client part of the funds needed to purchase a security, such as a bond, the term "margin" refers to the amount of cash, or down payment, the client is required to deposit. Bonds, like equity securities, may be traded on margin. Trading on margin is inherently more risky than trading in fully-paid-for securities. For risks associated with margin trading, please see Interactive Brokers Hong Kong Limited Disclosure of Risks of Margin Trading.

7. **Commissions and Mark-Ups**

Clients will be charged a commission for bond trades executed through IBKR. IBKR may execute clients' bond trade through or against an affiliate of IBKR, which may charge a markup on trades such affiliate executes as principal against the client's bond order.