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**FUNDAMENTALS OF FINANCIAL MARKETS**  
HONG KONG | THURSDAY, 5 SEPTEMBER 2024



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**C H A N C E**

**INTRODUCTION TO DERIVATIVES AND STRUCTURED FINANCE**

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HONG KONG | THURSDAY, 5 SEPTEMBER 2024

# AGENDA



01

What is Derivatives and Structured Finance

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02

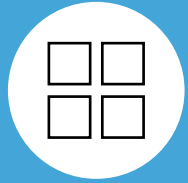
Derivatives and Structured Finance – Structures and Application

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03

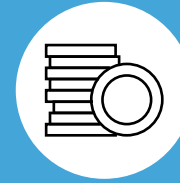
Derivatives and Structured Finance in Practice

# WHAT IS STRUCTURED FINANCE?



## What Does it Cover?

Structured finance is a sector of finance that manages financing, leverage and risk. Strategies may involve secured financing, leverage, risk management, balance sheet management, investment strategies, legal and corporate restructuring, off balance sheet accounting, and the use of financial instruments.



## Forms of Structured Finance

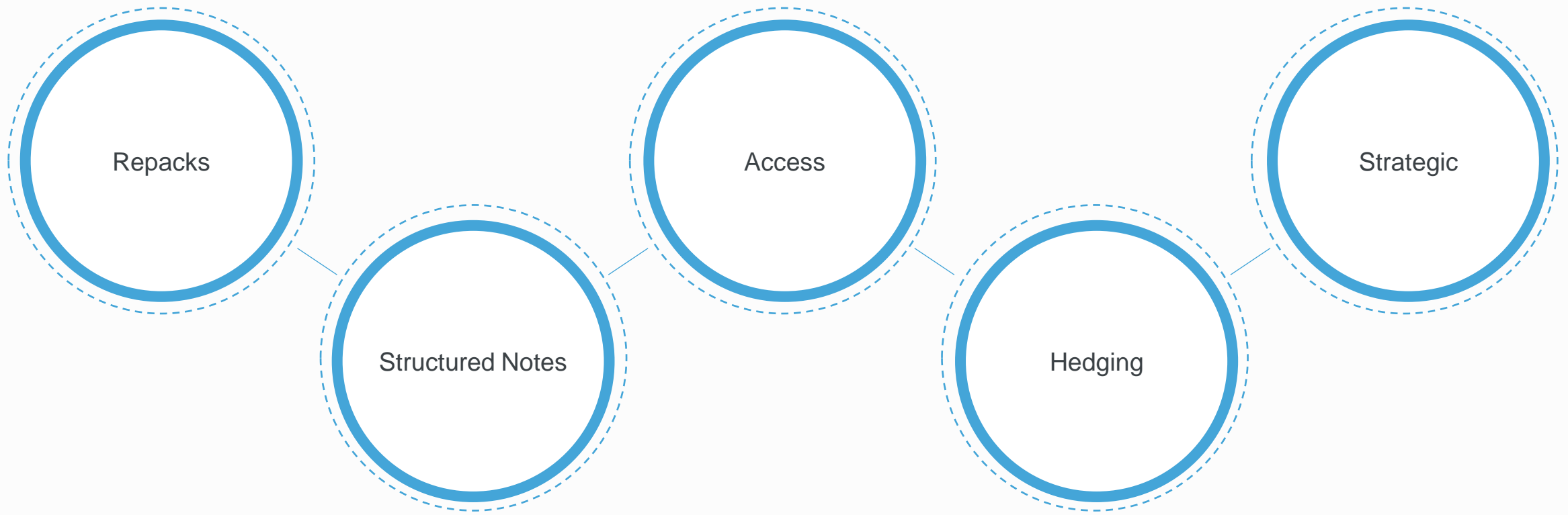
May include securitisation, loans, bonds/notes, derivatives, funds and customised agreements.



# OVERVIEW

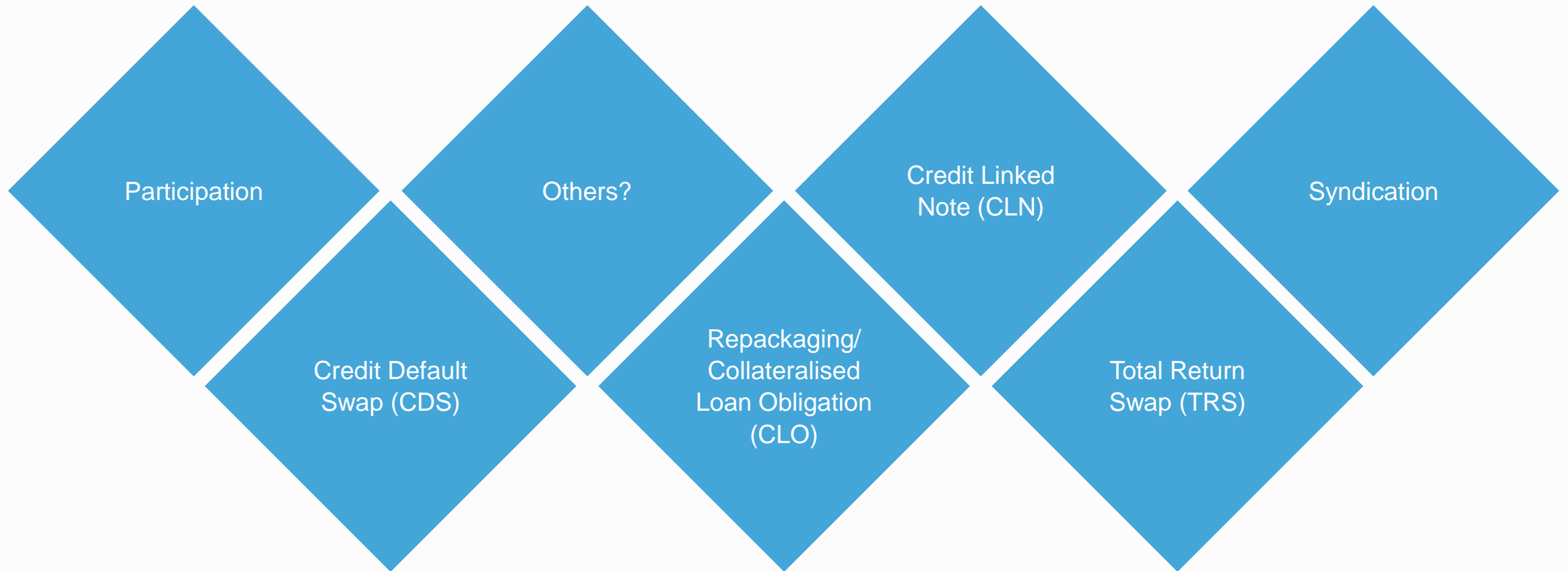
## RELEVANCE OF DERIVATIVES AND STRUCTURED FINANCE TO GLOBAL FINANCIAL MARKETS

### Examples of Common Structures



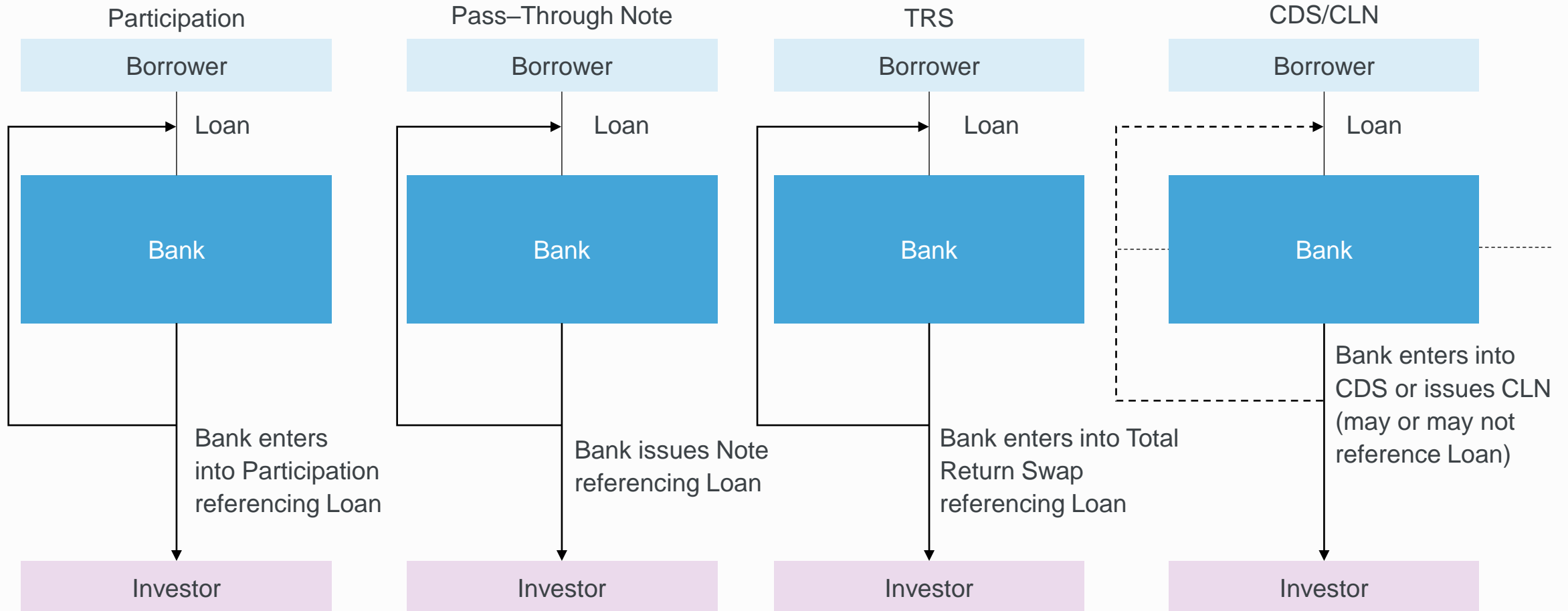
# STRUCTURED FINANCE EXAMPLES

## DISTRIBUTION OPTIONS FOR LOANS



# STRUCTURED FINANCE BASICS

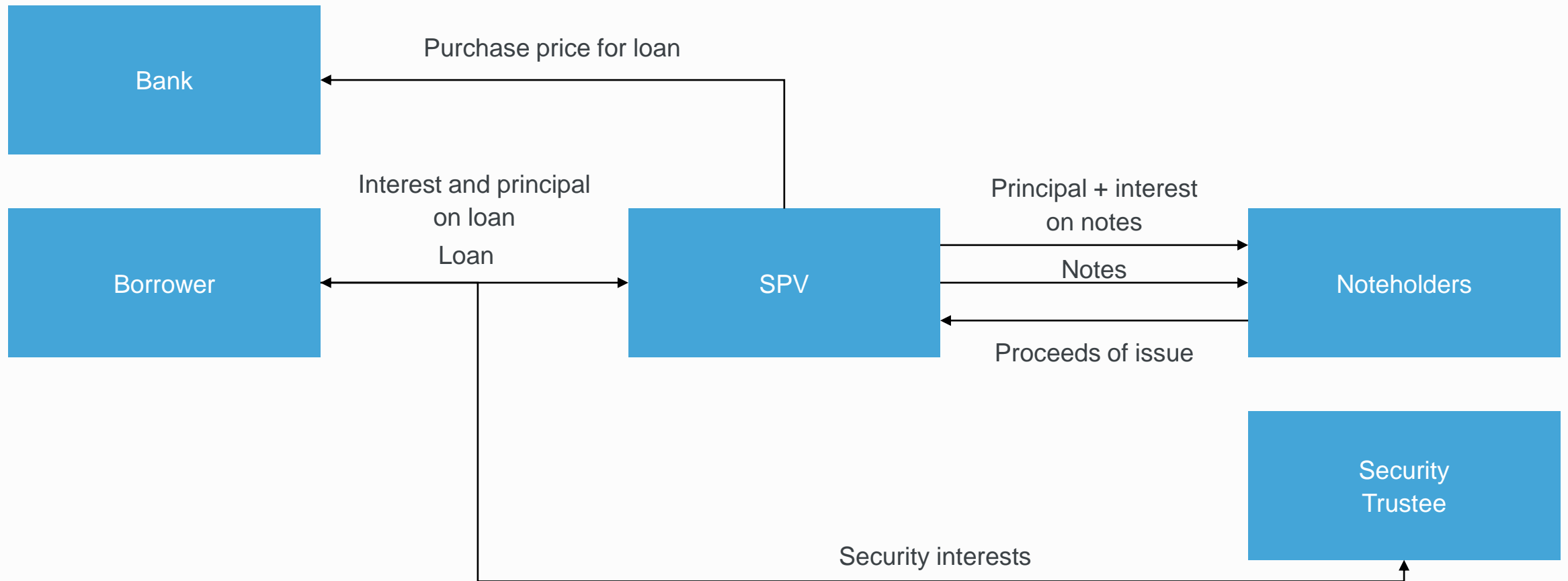
## ON BALANCE SHEET STRUCTURES



# STRUCTURED FINANCE BASICS

## OFF BALANCE SHEET

### Traditional Repackaging Structure

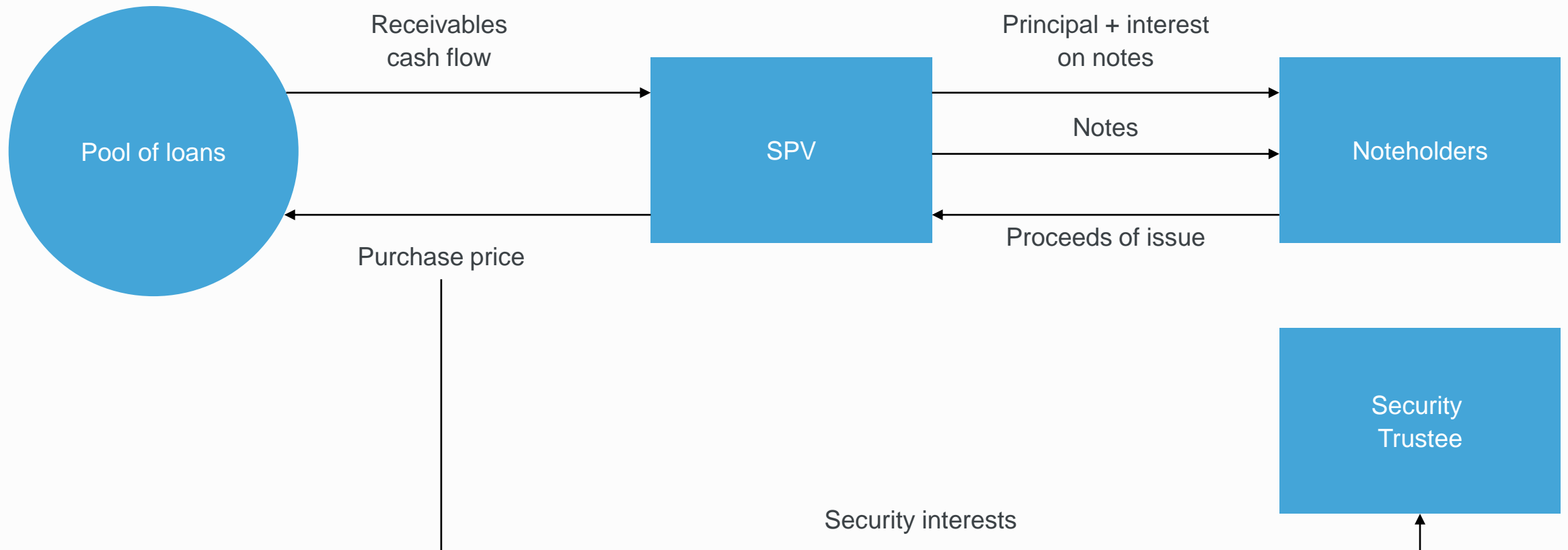




# STRUCTURED FINANCE BASICS

## OFF BALANCE SHEET (CONTINUED)

### Collateralised Loan Obligations (CLO)



# STRUCTURED FINANCE EXAMPLES

## TYPES OF CORPORATE EQUITY DERIVATIVES/EQUITY FINANCING TRANSACTIONS

Margin Lending

Total Return Swaps

Collar Financing

Equity Options

Equity Forwards

Pre-IPO Financing

Loan plus equity option

Call Spread

Title Transfer Collateral

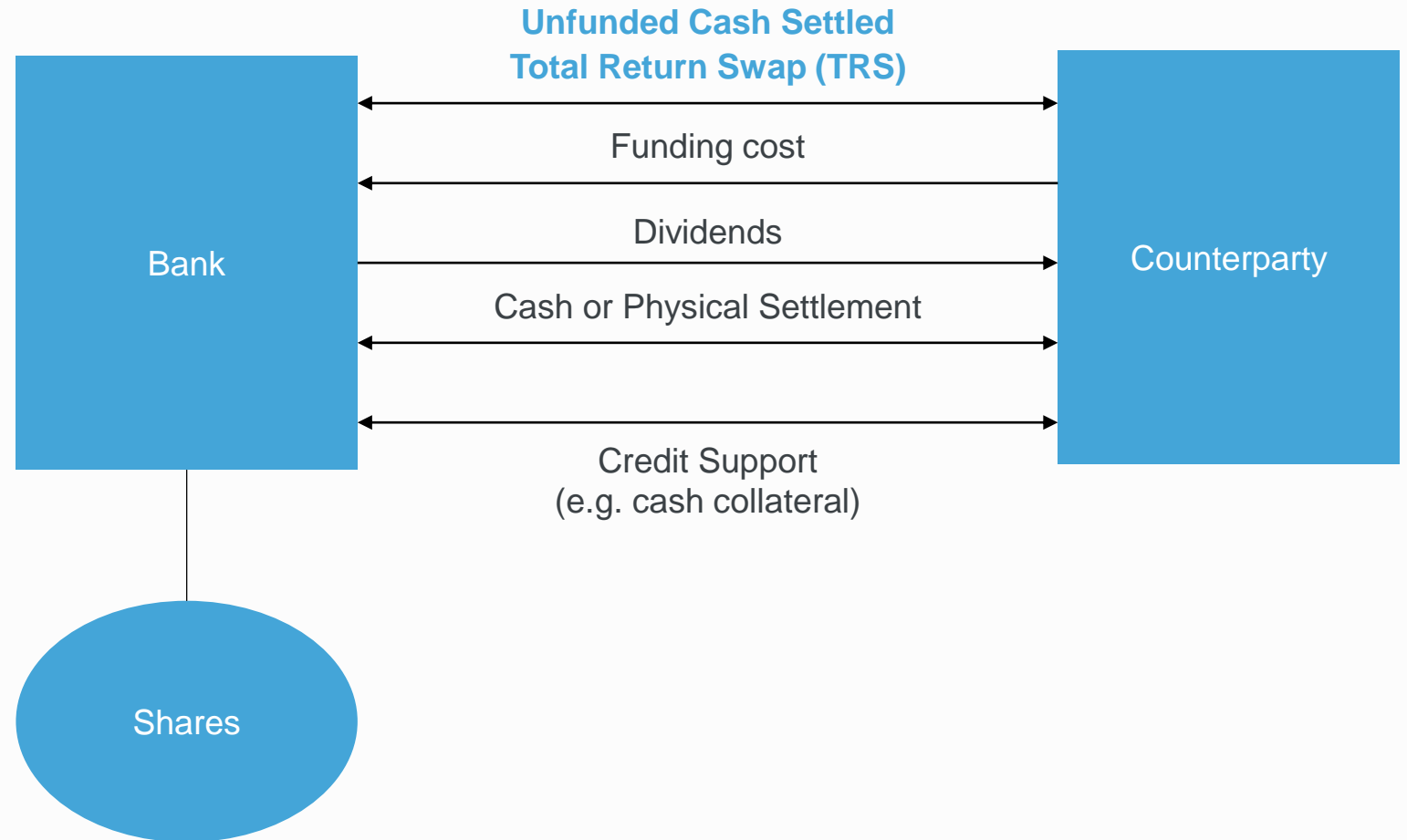
Securities Lending

Equity Repo

Synthetic Buy-Backs

# ACCESS TO INVESTMENT/STAKEBUILD/LEVERAGE

Examples: (1) A fund wishes to invest in a restricted market but is unable to do so due to local regulations or (2) a shareholder wants to increase its shareholding without physically acquiring the shares or (in some jurisdictions) disclosing its interest in the shares.

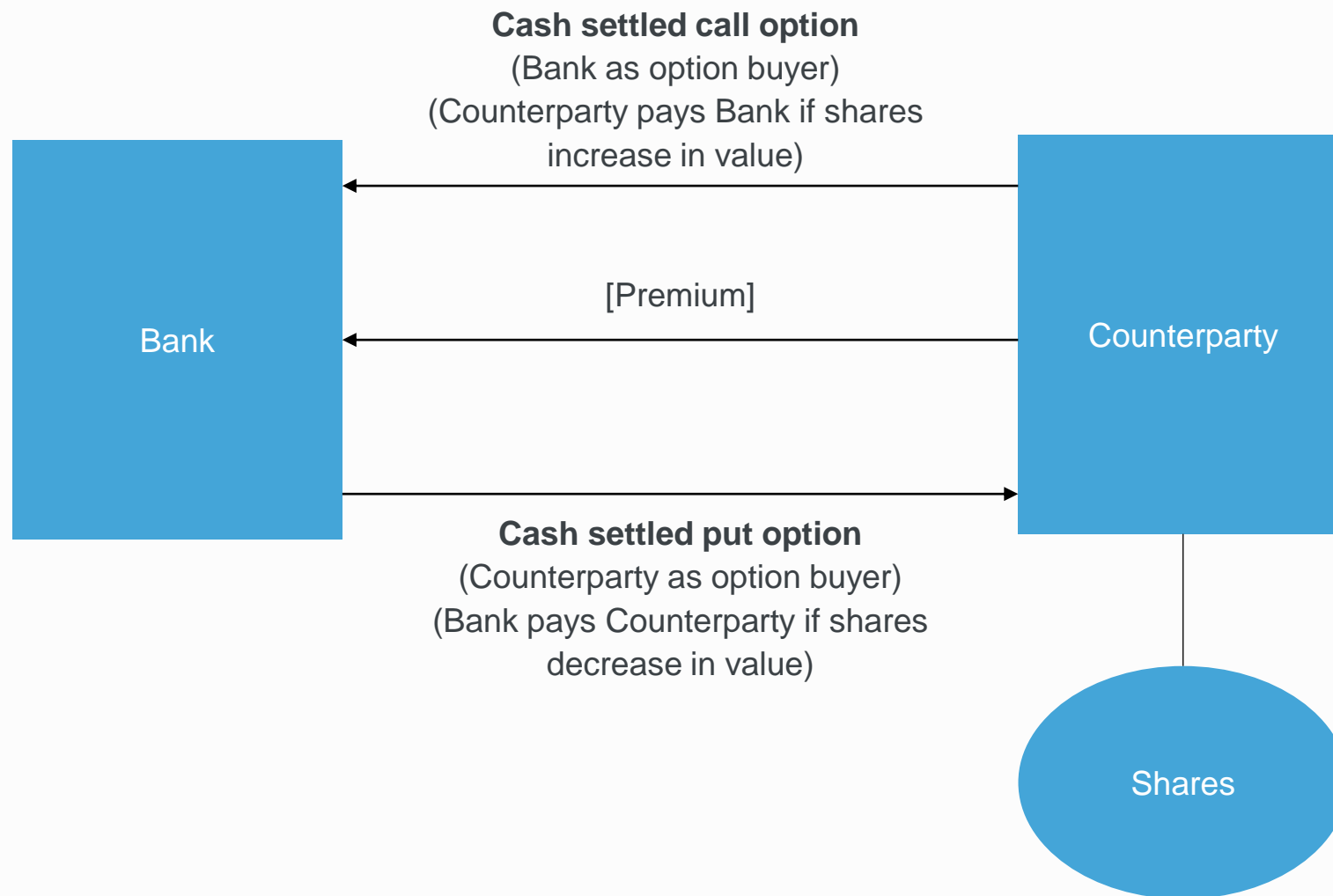


# HEDGING EQUITY PRICE RISK

Example: A counterparty wishes to hedge its equity position through a collar transaction.

## N.B.

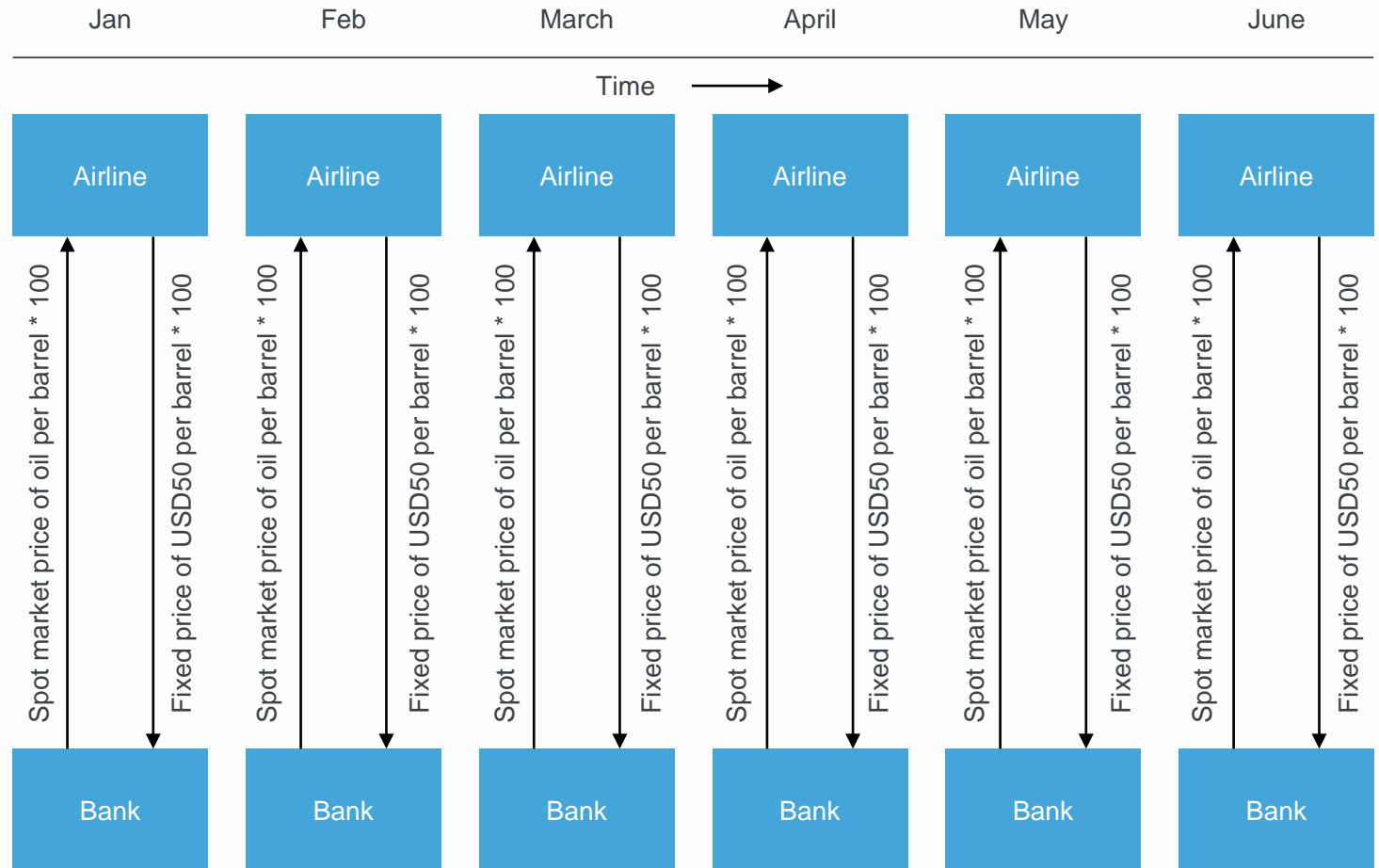
- Client buys protection on downside and sells benefit of upside.
- Cash settled.
- “Costless collar” – CP offsets premium cost of out-of-the-money put by selling out-of-the-money call priced at offsetting premium.
- Stock loan to assist Bank hedging?



# DERIVATIVES BASICS

## SWAPS

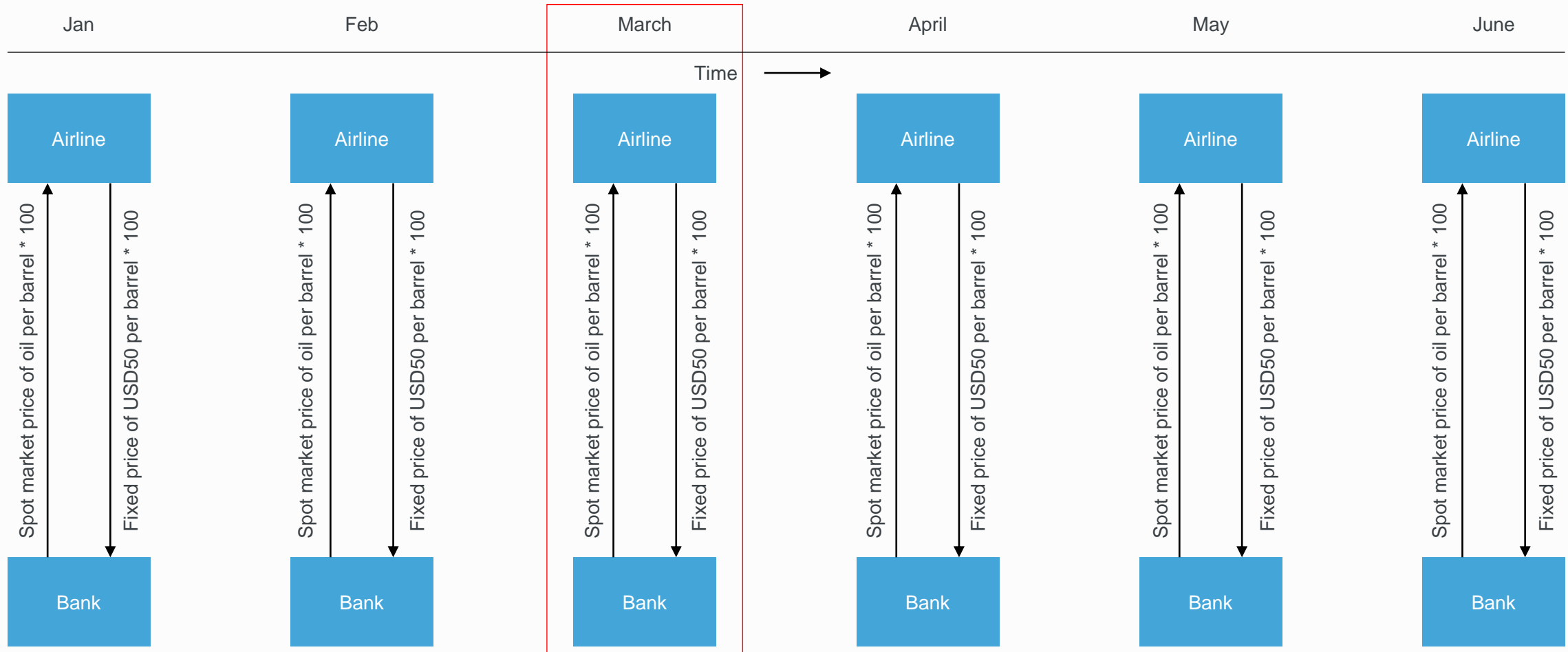
- an exchange of cash flows
- a series of forwards (NB: no optionality)
- Airline needs 100 barrels of oil per month, wants to fix price @ USD 50 per barrel
- Each month:
  - Airline pays fixed amount of USD50 \* 100
  - Bank pays floating amount of spot market price of oil \* 100



# DERIVATIVES BASICS

## SWAPS (CONTINUED)

### March – Spot Market Price of Oil – USD 25 Per Barrel

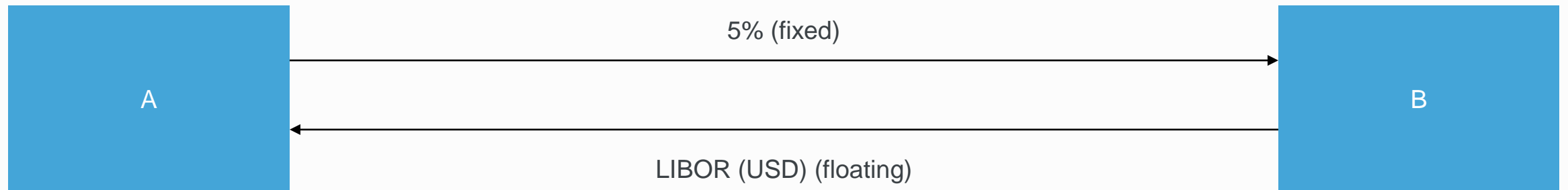




# DERIVATIVES BASICS

## INTEREST RATE SWAP

Most Common Type of Swap:  
Interest Rate Swap:



Amounts to be paid are calculated by reference to a notional amount e.g. 5% of USD10,000,000

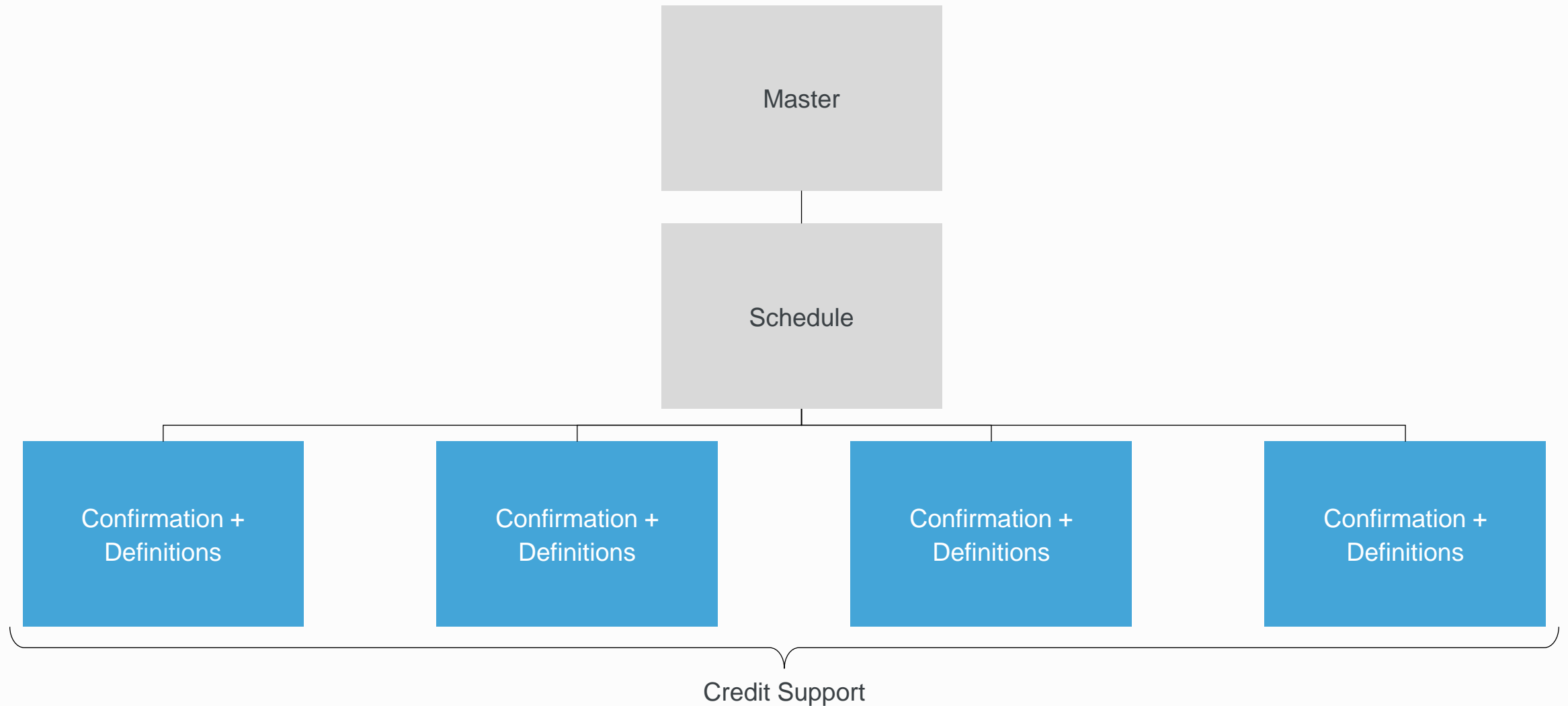
# DERIVATIVES BASICS

## INTEREST RATE SWAP (CONTINUED)



# HOW ARE DERIVATIVES DOCUMENTED?

## ISDA ARCHITECTURE



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