

University of Macau
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**Callable Bull Bear Contracts, Liquidity and Stock Price
Manipulation: Evidence from HK**

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Abstract	1
1. Introduction	2
2. Literature Review and Hypothesis Formulation	5
2.1 Stock Price Response to Financial Innovations and Stock Price Manipulation	6
2.2 Causal Relationship between Volume Impacts and Price Impacts	8
2.3 Market Liquidity and Derivatives Trading	9
2.4 Hypotheses Formulation	11
3. Institutional Setting	15
4. Data and Methodology	19
4.1 Data	19
4.2 Methodology	20
4.2.1 Abnormal Return and Cumulative Abnormal Return	20
4.2.2 Abnormal Volume	22
4.2.3 Liquidity and Spread	23
5. Empirical Results	24
5.1 Descriptive Statistics	24
5.2 Systematic Risk and Total Risk	26
5.3 Abnormal Return and Cumulative Abnormal Return	29
5.4 Abnormal Volume	38
5.5 Liquidity	39
6. Conclusion and Implications	41
7. References	44
Tables and Figures	47
Appendix - A Typical CBBC Supplemental Listing Document (First Page)	74

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Abstract

This study examines the issuance, expiry and Mandatory Call Events (MCE) of Callable Bull Bear Contracts (CBBC) on the stock market. We analyze these effects on price, volume, systematic risk and liquidity of underlying assets. We find that 67.71% single stock CBBCs are called back before expiry through 2006 and 2010, and CBBC investors lost about 33% of their investment value. Our results show that systematic risks and total risk of the underlying stocks decrease during both CBBC issuance and termination (expire or MCE). We find significant abnormal returns and volumes before the MCE of CBBCs which may imply impact of unwinding of hedged positions. This can also be explained by the potential stock price manipulation from the issuers to trigger the MCEs, since there are pecuniary benefits to retrieve the contracts earlier. Consistent with prior studies, we find that there are no abnormal price effects around the announcement or the listing of the CBBCs. However, we find abnormal volume around the announcement of CBBC listing, suggesting there are significant impact to the underlying stock liquidity. Our findings suggest that CBBC trading reduce the liquidity and increase the effective spread for the underlying stocks. Our study suggests that restricting issuers from unwinding before CBBC termination could enhance CBBC investors protection. Financial innovation may create new incentives for institutions to manipulate the market, and thus create significant impact on the stock liquidity and transaction costs.