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A threshold model for the Hong Kong warrant prices

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Abstract

This article examines the factors that are not considered in the Black–Scholes model in determining the price of warrants. Using the outstanding percentage as a threshold variable, we test for the existence of threshold effect in warrant prices. It is shown that for warrants with a low outstanding percentage, an increase in the outstanding percentage will lower the call price. On the other hand, for warrants with high outstandi...   ...ercentage.

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[1]A warrant is a listed option. Readers may refer to McGuinness ([1999]) for details of difference between stock options and derivative warrant.

[2]HKEx Securities and Derivatives Markets Quarterly Report.

[3]See, for example, Chan and Wei ([2001]), Chen and Wu ([2001]), Chow et al. ([2003]), Draper et al. ([2001]).

[4]According to Chapter 15A.52 of Listing Rules, issuer may issue additional options once outstanding quantity of the options is more than 50%.

[5]A Healthy Market for Informed Investors – A Report on derivative warrants market in Hong Kong, Securities and Futures Commission, November 2005.

[6]The outstanding percentage of a warrant is the percentage of that issue held by the general public, while the rest is held by the issuer.

[7]Sources of data: Warrant Supermarket, Hang Seng Bank (http://www.hangseng.com); Hong Kong Exchanges and Clearing Ltd. (http://www.hkex.com.hk/dwrc/download/dnfile.asp); Yahoo!Finance (http://hk.finance.yahoo.com).

[8]The sample date is 11 October 2006.

[9]In obtaining the Black-Scholes model price, volatility of the underlying stock is estimated from the daily volatility in past 90 days. A 5% risk-free rate is used.

[10]Using   a conclusion.

Table

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