

17 April 2020

Circular to management companies and market makers of SFC-authorized exchange traded funds

ETF market making

1. This circular is directed to all management companies and market makers of SFC-authorized exchange traded funds (“ETFs”)¹.
2. Market makers play an important role in ETF trading by providing secondary market liquidity. We note that recently, the sole market maker of an ETF temporarily suspended its market making functions for such ETF because some of its traders were under mandatory quarantine due to COVID-19 outbreak. This has raised concerns as to whether the management company and market maker(s) of an ETF are sufficiently prepared to manage this risk.
3. The overall responsibility of a management company of an ETF is to manage the ETF in the best interests of investors, including the duty to closely monitor the operations and activities (including secondary market trading and liquidity) of the ETF. To ensure the trading of SFC-authorized ETFs is conducted in a fair and orderly manner, the management company of an ETF is reminded to:
 - (i) conduct due diligence on and regular monitoring of market maker(s)² with whom the management company³ has engaged and be reasonably satisfied that such market maker(s) remain(s) competent and properly resourced to duly discharge the market making functions (including having appropriate business contingency plans in place);
 - (ii) closely monitor the secondary market trading and liquidity of the ETFs under its management, including the market making activities and performance of the market maker(s) of its ETFs;
 - (iii) maintain a close dialogue with each market maker with whom the management company has engaged and make appropriate arrangements to ensure that such market maker will inform the management company immediately if it experiences or foresees that it will experience any operational difficulties or disruptions that may affect the proper discharge of its market making functions;
 - (iv) properly manage the risk of reliance on a single market maker to provide secondary market liquidity for an ETF. This may include, for example, procuring more than one market maker for an ETF or securing appropriate

¹ The term “ETF” used in this circular shall cover SFC-authorized passive ETF, active ETF and listed unit/share class(es) of unlisted SFC-authorized fund.

² The term “market maker” used in this circular shall include Securities Market Maker and Designated Specialist as defined in the Rules of the Exchange.

³ According to 8.6(p) of the Code on Unit Trusts and Mutual Funds, the management company of an ETF is generally expected to use its best endeavours to put in place arrangements so that there is at least one market maker for the units/shares (traded in each counter) of the ETF.

arrangement for an alternative market maker to readily step in with short notice in the event of cessation, disruption or suspension of market making activities of the last market maker;

- (v) be fully aware of and comply with the administrative arrangements and other requirements associated with the listing of ETFs on The Stock Exchange of Hong Kong Limited (“SEHK”), including the procedures of the publication of announcements or notices on the SEHK’s website such as the publication windows cut-off times;
- (vi) in the event of cessation, disruption or suspension of market making activities⁴ or upon notice of such an event happening:
 - (a) report to the SFC immediately the cessation, disruption or suspension;
 - (b) assess whether the cessation, disruption or suspension of market making activities for units/shares (traded in any counter) of an ETF under its management could adversely affect the interests of investors;
 - (c) keep investors informed as required under 8.6(q) of the Code on Unit Trusts and Mutual Funds; and
- (vii) give the SFC early alerts of any untoward circumstances relating to the ETFs under its management, including without limitation, any issues which may adversely affect the operations and secondary market trading and liquidity of its ETFs (including receipt of any resignation notice of the last market maker).

4. Market makers of ETFs should ensure compliance with applicable laws, rules, regulations and conduct requirements administered or issued by the SFC (including the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission) and the applicable rules of SEHK when conducting their business activities (including the Securities Market Maker Regulations). In particular, they are reminded to:

- (i) establish and maintain appropriate internal controls and risk management measures, including an effective business continuity plan appropriate to the size of the firm⁵, to protect their key business functions of market making. The plan should identify likely scenarios involving disruptions, appropriate backup facilities or alternative arrangements, as well as adequate personnel for the continuity of market making activities;
- (ii) invoke contingency measures in a timely fashion in anticipation of potential operational disruptions to maintain the key business functions; and
- (iii) alert the management company of the ETFs, the SFC and the HKEX immediately if they experience or foresee that they will experience any

⁴ For details, please refer to FAQ12 of the Frequently Asked Questions on Exchange Traded Funds and Listed Funds.

⁵ For details, please see paragraph 36 of the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission.



operational difficulties or disruptions that may affect the proper discharge of their market making functions for ETFs.

5. Management companies and market makers of SFC-authorized ETFs are welcome to contact the SFC in case of any questions on the above.

**Investment Products Division
Securities and Futures Commission**

**Intermediaries Supervision Department
Intermediaries Division
Securities and Futures Commission**