

16 December 2019

## **Circular on streamlined requirements for eligible exchange traded funds adopting a master-feeder structure**

### **Background**

1. Currently, index tracking exchange traded fund (ETF) adopting a master-feeder structure is permitted under the Code on Unit Trusts and Mutual Funds (UT Code) provided that both the feeder ETF and the master ETF are authorized by the SFC. Recently, the SFC has received a number of requests to allow more flexibility in the master-feeder ETF structure so that an SFC-authorized feeder ETF may invest its assets in an overseas-listed master ETF without SFC authorization. This would facilitate the development of ETF product line-up in a more cost-effective manner, offering more investment choices to investors.
2. In response to the requests received, the SFC has prepared the following requirements under which it would consider authorizing such feeder ETF.

### **General principles**

3. Balancing the needs for investor protection and market development, the SFC is prepared to consider authorizing an index tracking feeder ETF that invests in an overseas-listed master ETF without SFC authorization on a case-by-case basis, having regard to the following principles:
  - a) there are satisfactory safeguards and measures in place to address investor protection concerns; and
  - b) there are demonstrable benefits to the Hong Kong market, taking into account factors such as the size and significance of the master ETF, its track record and whether its underlying index is widely accepted.

### **Requirements**

#### Master ETF

4. The master ETF should, at a minimum, meet the following key requirements:
  - a) the master ETF must be a scheme regulated in a recognized jurisdiction<sup>1</sup> managed by a management company in an acceptable inspection regime<sup>2</sup> or a scheme eligible under a mutual recognition of funds arrangement;
  - b) the master ETF, together with its management company and trustee/custodian, must have a good compliance record with the rules and regulations of its home jurisdiction and (in the case of master ETF) the listing venue;

<sup>1</sup> A list of recognized jurisdictions is published on the SFC's website.

<sup>2</sup> A list of acceptable inspection regimes is published on the SFC's website.

- c) the master ETF must have a fund size of not less than USD 1 billion and a track record of more than 5 years at the time of the feeder ETF's listing on the Stock Exchange of Hong Kong;
- d) the master ETF must adopt physical replication of the underlying index through either a full replication or a representative sampling strategy; and
- e) the master ETF's engagement in securities financing transactions should not exceed 50% of its total net asset value unless there are comparable safeguards and disclosure.

### Feeder ETF

5. Index tracking feeder ETF seeking SFC authorization for public offering in Hong Kong should comply with the applicable requirements in the Overarching Principles Section and the UT Code in the SFC Handbook for Unit Trusts and Mutual Funds, Investment-Linked Assurance Schemes and Unlisted Structured Investment Products and all other applicable regulatory requirements and guidelines as may be issued by the SFC from time to time.
6. In addition, the feeder ETF should meet the following requirements:
  - a) the feeder ETF must be a Hong Kong-domiciled ETF authorized by the SFC;
  - b) the feeder ETF must be managed by a management company which is licensed or registered for Type 9 regulated activity and has a good compliance record;
  - c) the management company of the feeder ETF should report to the SFC as soon as practicable if the master ETF ceases to comply with the requirements set out in this circular and take appropriate remedial action to promptly rectify the situation; and
  - d) the management company of the feeder ETF should put in place appropriate arrangements to inform Hong Kong investors of any material change to, or event that has a significant adverse impact on, the master ETF in a timely manner.
7. The SFC may consider introducing additional requirements or conditions as deemed necessary or appropriate in the discharge of its functions.

### **Application**

8. If you wish to seek clarification of any aspects of this circular, please contact the team supervisor or case officer of the Investment Products Division who is responsible for overseeing the SFC-authorized funds of your fund group or client.

### **Investment Products Division Securities and Futures Commission**