

## Frequently Asked Questions on Exchange Traded Funds and Listed Funds

This FAQ is prepared by the Investment Products Division and aims to provide basic information to market practitioners in respect of exchange traded funds (“ETFs”) and listed funds, which are subject to the SFC Handbook for Unit Trusts and Mutual Funds, Investment-Linked Assurance Schemes and Unlisted Structured Investment Products (the “Handbook”), including the Code on Unit Trusts and Mutual Funds effective on 1 January 2019 (“UT Code”). Applicants are encouraged to contact the relevant case team in the Investment Products Division of the Securities and Futures Commission (the “SFC”) if in doubt on any specific issues arising from the application/interpretation of the Handbook or this FAQ. Please note that each application for authorization is considered on a case-by-case basis.

The information set out below is not meant to be exhaustive. This FAQ may be updated and revised from time to time. This FAQ is only for general reference. Compliance with all the requirements in this FAQ does not necessarily mean an application will be accepted or authorization will be granted. The SFC reserves the rights to exercise all powers conferred under the law.

*Notes: (1) For ease of reference, collective investment schemes that are generally known as unit trusts or mutual funds are referred to as “funds” in the following FAQ.*

*(2) Unless otherwise specified, the term “ETF” used in this FAQ shall cover SFC-authorized passive ETF, active ETF and listed unit/share class of unlisted fund.*

	Question	Answer
<b>Authorization of SFC-authorized ETFs/Listed Funds</b>		
1.	Are the participating dealers (“PDs”) of SFC-authorized ETFs obliged to process subscription and redemption orders from third party investors?	An efficient creation/redemption mechanism is key to an effective arbitrage/pricing mechanism which enables an ETF to trade at a market price close to its Net Asset Value (“NAV”). 10.6 of the UT Code provides that suspension of dealings may be provided for by the management company in consultation with the trustee/custodian, having regard to the best interests of holders. That said, the

	Question	Answer
		<p>SFC would generally seek to require the PDs to process creation/redemption requests from third party investors save for the following:</p> <ul style="list-style-type: none"> <li>• suspension of dealing or determination of NAV of the ETF;</li> <li>• where in the opinion of the manager, acceptance of the application will have an adverse effect on the ETF;</li> <li>• suspension of trading on any of the shares constituting the relevant index basket;</li> <li>• the ETF is not able to acquire further investments due to trading restrictions/limits in the market; or</li> <li>• acceptance of the application will be in breach of laws or regulations or internal compliance or control requirements of the PDs which are for the purpose of ensuring compliance with laws or regulations.</li> </ul> <p>The procedures/conditions in respect of the creation/redemption mechanism should be clearly disclosed in the ETF's prospectus/constitutive documents. In particular, any restrictions in creation/redemption of units and the circumstances under which investors' orders may be refused should be prominently disclosed in the prospectus/constitutive documents. In addition, any fees and charges incurred by the PDs in executing investors' orders or any factors which may reduce the amount of redemption proceeds to investors should also be clearly disclosed in the prospectus.</p> <p>Consultation with the Investment Products Division is encouraged if in doubt with the specific circumstances.</p>
2.	What is the key responsibility of an ETF manager regarding the pricing/arbitrage mechanism of the SFC-authorized ETF?	The overall responsibility of an ETF manager is to manage the ETF in the exclusive interest of investors, including the duty to closely monitor the operations (e.g. pricing/arbitrage mechanism) of the ETF. For instance, should an ETF trade at a substantial premium/discount to the NAV, the manager should investigate the matter and take appropriate action promptly.

	Question	Answer
3.	Who would be eligible to manage an SFC-authorized physical A-share ETF through the “Renminbi Qualified Foreign Institutional Investor (RQFII) scheme”?	The content is no longer applicable. Relevant requirements are set out in Chapter 5 of the UT Code.
4.	Can an RQFII management company manage an SFC-authorized RQFII physical A-share ETF if it does not have a Mainland parent company with the relevant experience and expertise in, and the necessary infrastructure and systems for, managing and operating physical A-share ETFs in the Mainland as required by FAQ 3?	The content is no longer applicable. Relevant requirements are set out in Chapter 5 of the UT Code.
5.	Does the listing agent of an SFC-authorized ETF need to be licensed/registered for Type 6 regulated activity (advising on corporate finance)?	<p>The performance of the functions of a listing agent of SFC-authorized ETFs may amount to carrying on of Type 6 regulated activity (advising on corporate finance) as defined under Schedule 5 to the Securities and Futures Ordinance (“SFO”) and consequentially trigger licensing obligations under Part V of the SFO except where exempted. For instance, advice given by a solicitor who gives such advice wholly incidental to his practice as such would be exempted.</p> <p>It is noted that some ETF managers may wish to act as listing agents of the ETFs under their management as part of their services provided to the ETFs. ETF managers who intend to act as listing agents should pay particular attention to the licensing requirements stipulated under Part V of the SFO and make sure that they are properly licensed for their intended activities, if necessary. Depending on specific circumstances, the SFC may, upon grant of a licence, impose licensing conditions where appropriate, for example, to restrict the ETF manager’s activities to acting as a listing agent only for the listing of ETFs managed by it or to restrict it from giving advice on any listing that involves initial public offering contemplated under the Corporate Finance Adviser Code of Conduct.</p>

	Question	Answer
		<p>For the avoidance of doubt, persons appointed as listing agents in relation to the listing of real estate investment trusts or initial public offers of interests in collective investment schemes on the Stock Exchange of Hong Kong (“SEHK”) under Chapter 20 of the Listing Rules will be regarded as carrying out sponsor work and are thus required to have the requisite licences and qualifications to act as sponsors.</p> <p>Persons who intend to act as listing agents should seek professional legal advice regarding the application of the SFO if in doubt.</p>
6.	What are the authorization conditions of listed closed-ended funds?	Relevant requirements are set out in 8.11 of the UT Code.
<b>Disclosure of information to investors regarding securities lending, sale and repurchase (repo) and reverse repurchase (reverse repo) transactions (collectively, “securities financing transactions”)</b>		
7.	What should ETFs managers note regarding securities financing transactions?	<p>SFC-authorized ETFs may engage in securities financing transactions to earn additional income. In this connection, managers of ETFs should note the following:</p> <ul style="list-style-type: none"> <li>(i) Details of the arrangements regarding securities financing transactions, including at a minimum the information referred to in C2 of Appendix C to the UT Code, should be disclosed in the offering documents of the ETF. Managers of ETFs are also expected to comply with the principles as referred to in 7.32 to 7.35 of the UT Code.</li> <li>(ii) To enhance the level of transparency in view of the nature of ETFs, where securities financing transactions undertaken by an ETF exceed 50% of its total NAV, the ETF should make available, at a minimum, the following information through the ETF’s own website or other acceptable channels on an ongoing basis to investors (updated monthly): <ul style="list-style-type: none"> <li>a) summary of policy regarding the ETF’s use of the securities financing transactions and its risk management policy in relation to securities</li> </ul> </li> </ul>

	Question	Answer
		<p>financing transactions, including haircut policy, selection criteria for counterparties, collateral policy etc;</p> <p>b) information on the counterparties of each type of securities financing transactions and their relevant exposures;</p> <p>c) amount of securities on loan as a proportion of the ETF's total lendable assets and NAV;</p> <p>d) net return to the ETF relating to each type of securities financing transactions (at least over the past 12 months);</p> <p>e) collateral information, preferably pictorial presentation by way of pie charts, showing a breakdown by asset type, e.g. equity, bond and cash and cash equivalents;</p> <p>f) top 10 largest collateral issuers across all securities financing transactions with details on the amounts of collateral received by the ETF; and</p> <p>g) fee split (in percentage terms) between the ETF and the ETF manager/any other operating parties on the income derived from the securities financing transactions.</p>
<b>Waivers from compliance with certain provisions of the UT Code granted since 1 April 2005</b>		
8.	Are SFC-authorized close-ended funds listed on the SEHK subject to the dealing requirement under Chapter 6.13 of the UT Code whereby there must be at least one regular dealing day per month?	Relevant requirements are set out in 8.11 of the UT Code.
<b>Disclosure of the ongoing charges figure</b>		
9.	In light of the disclosure requirement of ongoing charges figure as set out in the Guidelines, is an	Relevant requirements are set out in the Circular to Management Companies of SFC-authorized Funds – Disclosure of the ongoing charges figure and past

	Question	Answer
	<p>SFC-authorized ETF still required to disclose the estimated total expense ratio (“TER”) of the scheme in its offering documents in accordance with paragraph 21A of the Appendix I to the UT Code?</p>	<p>performance information in the Product Key Facts Statements.</p>
<p><b>Prior notice to investors regarding dividend distribution</b></p>		
<p>10.</p>	<p>What should management companies of SFC-authorized listed collective investment scheme (CIS) products (including ETFs, leveraged and inverse products and listed closed-ended funds) note on giving prior notice to investors regarding dividend distribution?</p>	<p>In view of the on-going disclosure requirements in 11.1B of the UT Code and taking into account the nature of SFC-authorized listed CIS products, management companies of SFC-authorized listed CIS products should inform investors by way of public announcement information on dividend distribution as soon as reasonably practicable. Management companies of SFC-authorized listed CIS products are also reminded that they should keep such information strictly confidential before public announcement is made.</p> <p>Furthermore, sufficient time should be allowed for investors to act in light of the information disclosure relating to distribution. Taking into account the requirements in Rule 13.66 of the Rules Governing the Listing of Securities on the SEHK and prevailing market practices, it is generally expected that a management company of a SFC-authorized listed CIS product should inform investors details of dividend distribution by way of public announcement:</p> <ul style="list-style-type: none"> <li>(i) at least 10 business days before the record date; and</li> <li>(ii) where there is an alteration of the record date, at least five business days before the announced record date or the new record date, whichever is earlier.</li> </ul> <p>Where it is not practicable for a management company to provide the amount of dividend payment 10 business days before the record date, the management</p>

	Question	Answer
		<p>company should issue a separate announcement on the amount of dividend payment at least one business day before the ex-dividend date.</p>
<b>ETFs with listed and unlisted unit/share classes</b>		
11.	<p>What should ETF managers note regarding an SFC-authorized ETF with listed and unlisted unit/share classes?</p>	<p>ETF managers managing ETFs with listed and unlisted unit/share classes should ensure that the dealing arrangements and risks associated with both classes are clearly disclosed in the offering documents and investors of both classes are treated fairly.</p> <p>If an ETF manager would like to offer an ETF in Hong Kong with listed and unlisted unit/share classes, it should consult the SFC in advance.</p>
<b>Market making arrangement</b>		
12.	<p>What should ETF managers note if the sole market maker for units/shares (traded in any counter) of an SFC-authorized ETF were to resign?</p>	<p>To minimise the impact to the secondary market liquidity due to the abrupt cessation of market making activities, management companies of ETFs are generally expected to use their best endeavours to put in place arrangements so that:</p> <ul style="list-style-type: none"> <li>(a) there is at least one market maker for the units/shares (traded in each counter); and</li> <li>(b) at least one market maker for (each counter of) the ETF will give not less than three months' notice prior to terminating the market making arrangement.</li> </ul> <p>The cessation of market making activity (including the resignation of the last market maker) for units/shares (traded in any counter) of the ETF could adversely affect the interest of investors and be information disclosable within 11.1B of the UT Code.</p>

	Question	Answer
		<p>In view of the above, if the last market maker for units/shares (traded in any counter) of an ETF were to resign, the management company of the ETF should as soon as practical:</p> <ol style="list-style-type: none"> <li>1. notify the SFC about the resignation and discuss with the SFC on how to fulfil the disclosure obligations; and</li> <li>2. provide a plan to the SFC setting out the steps that the management company plans to take to ensure that investors are able to exit their investments in the ETF in a fair and orderly manner, and that investors' interests are safeguarded.</li> </ol> <p>If the management company has determined to terminate the ETF, it should ensure that the termination process is carried out timely, fairly and in compliance with the constitutive documents and all applicable laws and regulations. To allow for sufficient processing time, the management company should submit the notice of termination for SFC's prior approval as soon as practicable.</p> <p>The above principles are also applicable to SFC-authorized leveraged and inverse products.</p> <p>Consultation with the Investment Products Division is encouraged if in doubt.</p>
12A.	Can ETF manager provide remunerations and/or incentives to market makers for providing liquidity in the secondary market trading of SFC-authorized ETFs?	It is incumbent on ETF manager to comply with all applicable laws and regulations including where applicable the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission ("Code of Conduct"). The Code of Conduct provides that a licensed person should act with due skill, care and diligence, and in the best interests of the integrity of the market. There are also provisions in the SFO for the purpose of preserving market integrity and combating market misconduct.



	Question	Answer
		<p>There are risks associated with incentives schemes or commission rebate arrangements, including risk that such activities may contribute to conditions which facilitate manipulative behaviour or market misconduct and create a distorted market. There were cases in the past where SFC took regulatory actions against parties involved in commission rebate schemes as well as the related improper trading activities. As such, we strongly urge ETF manager to exercise caution in engaging in any incentives schemes or commission rebate arrangements relating to the trading of ETFs and take appropriate professional legal advice to ensure any such scheme or arrangement is not prejudicial to market integrity and is in compliance with all applicable laws and regulations.</p> <p>The above principles are also applicable to SFC-authorized leveraged and inverse products.</p>
12B	<p>HKEX's Designated Specialist (DS) programme permits liquidity providers who are not exchange participants to take part in market making activities of ETFs (including leveraged and inversed products) in Hong Kong.</p> <p>Does SFC consider having a DS for an ETF as its liquidity provider/market maker as satisfying the market making requirement under 8.6(p) of the UT Code?</p>	<p>Considering that market makers and DS for ETFs are generally subject to the same rights and obligations under HKEX's market making rules, having a DS for an ETF as its liquidity provider/market maker will be regarded as satisfying the market making requirement under 8.6(p) of the UT Code.</p> <p>The above principles are also applicable to SFC-authorized leveraged and inverse products.</p>
12C	<p>We note that under the revised market making rules of HKEX, each of market maker and DS is effectively required to give not less than three months' written notice to HKEX before cessation</p>	<p>The policy intention of 8.6(p) of the UT Code is to minimise the impact of an abrupt cessation of market making activities on secondary market liquidity of an ETF. In view of the recent amendments to the market making rules of HKEX, where there is a market maker or a DS (as recognised by HKEX) for an ETF, the management</p>

	Question	Answer
	<p>of their market making activities for ETFs (including leveraged and inversed products).</p> <p>Does it have any implications on how management company of ETF complies with 8.6(p) of the UT Code?</p>	<p>company of an ETF is not obliged to separately secure an arrangement with the market maker or DS for a three months' notice prior to terminating their market making activities.</p> <p>The above principles are also applicable to SFC-authorized leveraged and inverse products.</p>
<b>Termination of an SFC-authorized ETF</b>		
13.	<p>Pursuant to 8.6(t) of the UT Code, where an SFC-authorized ETF ("Terminating ETF") ceases trading on the SEHK as a result of proposed termination and/or deauthorization and delisting, the requirements in 6.1, 8.6(u)(i) and (ii), 10.7 and 11.1B of the UT Code may be modified and/or not be applicable depending on the specific circumstances of each case and subject to such conditions and requirements as may be imposed by the SFC. What are the conditions and requirements that the SFC may impose?</p>	<p>Where a Terminating ETF ceases trading on the SEHK as a result of proposed termination, deauthorization and delisting, they may still maintain its SFC authorization status for a period of time until outstanding assets or liabilities are settled and the completion of the proposed termination, deauthorization and delisting.</p> <p>Given the Terminating ETF will no longer be marketed to the public and have limited operations when it ceases trading, pursuant to 8.6(t) of the UT Code, the Terminating ETF may continue to maintain its authorization status without strictly complying with certain provisions of the UT Code provided that certain conditions and requirements imposed by the SFC are satisfied. Set out below are the conditions and requirements imposed by the SFC. Please note that the ETF manager is expected to disclose the applicable conditions and requirements in the termination announcement of the Terminating ETF.</p> <p><b>10.7 of the UT Code – Suspension of dealings</b></p> <p>Under 10.7 of the UT Code, the ETF manager is required to immediately notify the SFC if dealing in units/shares ceases or is suspended; and publish the fact that dealing is suspended immediately following the decision to suspend and at least once a month during the period of suspension in an appropriate manner.</p>

	Question	Answer
		<p>The ETF manager may continue to manage the Terminating ETF without strict compliance with 10.7 of the UT Code, subject to the condition that a statement shall be posted in a prominent position of the ETF's own website from the date the Terminating ETF ceases trading ("Trading Cessation Date") until the deauthorization date to notify investors that the units/shares of the Terminating ETF have ceased trading on the SEHK from the Trading Cessation Date, and draw investors' attention to the termination announcement and all other relevant announcements.</p> <p><b>8.6(u)(i) and (ii) of the UT Code – Real time or near-real time indicative NAV and last NAV</b></p> <p>Under 8.6(u)(i) and (ii) of the UT Code, the Terminating ETF is required to provide real time or near-real time indicative NAV per unit/share (updated at least every 15 seconds during trading hours) and last NAV per unit/share and last NAV of the Terminating ETF (updated on a daily basis) on the ETF's own website or such other channels as the SFC considers appropriate.</p> <p>The ETF manager may continue to manage the Terminating ETF without strict compliance with 8.6(u)(i) and (ii) of the UT Code, subject to the following conditions:</p> <ul style="list-style-type: none"> <li>(A) the NAV per unit/share of the Terminating ETF as of the last trading day, which is the latest NAV per unit/share of the Terminating ETF, will be published on the ETF's own website; and</li> <li>(B) the ETF manager shall update the latest available NAV per unit/share of the Terminating ETF on the ETF's own website as soon as practicable should there be any other change to the NAV of the Terminating ETF.</li> </ul>

	Question	Answer
		<p>The ETF manager should list out the applicable examples of the events which may cause the NAV of the Terminating ETF to change in the termination announcement. For example:</p> <ul style="list-style-type: none"> <li>(i) interim distribution;</li> <li>(ii) final distribution;</li> <li>(iii) any further distribution;</li> <li>(iv) any change in the market value of any scrip dividend receivable by the Terminating ETF concerned;</li> <li>(v) dividend from suspended stocks; and</li> <li>(vi) any deduction of transaction costs or taxes relating to the realization of the assets of the Terminating ETF.</li> </ul> <p><b>6.1 and 11.1B - Updating of offering documents</b></p> <p>Under 6.1 and 11.1B of the UT Code, the offering documents of the Terminating ETF must be up-to-date.</p> <p>The ETF manager may continue to manage the Terminating ETF without updating the offering documents of the Terminating ETF as required under 6.1 and 11.1B of the UT Code from the Trading Cessation Date provided that the ETF manager would:</p> <ul style="list-style-type: none"> <li>(A) promptly notify investors of any changes to the Terminating ETF or to the offering documents (including the KFS) by means of publishing further announcement(s) on its and the HKEX's websites;</li> <li>(B) ensure that each further announcement shall include a statement to refer investors to read the termination announcement together with the offering documents (including the KFS), and any other further announcement(s); and</li> </ul>

	Question	Answer
		(C) issue an updated offering document to remove all references to the Terminating ETF upon deauthorization of the Terminating ETF (applicable if the same offering document is also used for other existing SFC-authorized funds).
<b>Disclosure of information of investors of SFC-authorized synthetic passive ETFs</b>		
14.	<p>According to 8.6(v) of the UT Code, if an SFC-authorized passive ETF's net derivative exposure [see Note to 7.26 of the UT Code] exceeds 50% of its total NAV, the passive ETF shall make available, through the passive ETF's own website or other acceptable channels, the information on financial derivative instruments ("FDIs") acquired by the passive ETF (such as counterparty exposure and collateral information) to investors on an ongoing basis. The offering document should direct investors to the website or other channels where this information is published.</p> <p>What information relating to FDIs is expected to be disclosed in relation to the passive ETF?</p>	<p>Below are examples of information which is expected to be disclosed through the ETF's own website or other acceptable channels on an ongoing basis to investors:</p> <ul style="list-style-type: none"> <li>(i) overall collateralization level / total invested assets (expressed as a percentage of the ETF's NAV);</li> <li>(ii) hyperlinks to the websites of derivative issuers and their guarantors (where applicable);</li> <li>(iii) pictorial presentation of collateral/invested assets information by way of pie charts showing the following: <ul style="list-style-type: none"> <li>a) a breakdown by asset type, e.g. equity, bond and cash and cash equivalents;</li> <li>b) for equity, further breakdown by (1) primary listing (i.e. stock exchanges), (2) index constituents, and (3) sector;</li> <li>c) for bond, further breakdown by (1) types of bonds, (2) countries of issuers/guarantors, and (3) credit rating; and</li> </ul> </li> <li>(iv) top 10 holdings in the collateral/invested assets (including name, percentage of the ETF's NAV, type, primary listing for equities, country of issuers).</li> </ul> <p>Item (i) above will be updated on a daily basis and uploaded onto the websites or other acceptable channels. Items (ii), (iii) and (iv) above will be updated on a weekly basis and uploaded onto the websites or other acceptable channels within three working days of the end of each week.</p>

	Question	Answer
<b>Authorization of SFC-authorized futures-based passive ETFs</b>		
15.	What are the requirements for an SFC-authorized ETF which invests in futures contracts to achieve its investment objective?	The SFC generally expects futures-based passive ETFs to comply with 8.8 of the UT Code. 8.8 of the UT Code shall apply to scheme, known as structured fund, which is passively managed and seeks to achieve its investment objective primarily through investment in FDIs, for example futures, swap or market access products or similar arrangements, with its net derivative exposure [see Note to 7.26 of the UT Code] exceeding 50% of its total NAV.
<b>ETFs with multiple listed share classes</b>		
16.	What should ETF managers note regarding an SFC-authorized ETF with multiple listed share classes?	<p>If an ETF manager would like to offer a new listed share class in relation to an SFC-authorized ETF, the manager should take note of the consultation and/or approval requirements in Question 27B of <a href="#">Frequently Asked Questions on the Code on Unit Trusts and Mutual Funds</a>. In general, the offering of an accumulating share class by an ETF in addition to its existing distributing share class, or vice versa would not be subject to the SFC's prior approval.</p> <p>To provide clarity to investors, ETF managers managing ETFs with multiple listed share classes should ensure that information relating to each listed share class is clearly disclosed in the offering documents. The ETF managers should note the following:</p> <p><b><u>Product KFS</u></b></p> <p>A separate KFS should be prepared for each listed share class of the ETF to set out information specific to that listed share class, including but not limited to product name, stock code, trading currency, distribution policy, ongoing charges, tracking difference, and past performance information.</p>

	Question	Answer
		<p><u>Prospectus</u></p> <p>The relevant sections of the ETF's prospectus shall be updated to include enhanced disclosure on multiple listed share classes and the associated risks.</p> <p><u>Website disclosure</u></p> <p>The ETF's website should disclose information of each listed share class separately.</p>

*Last update: 19 September 2019*