



## 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 (“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.

*Note: 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.*

	Question	Answer
<b>Authorization of ETFs/Listed Funds</b>		
1.	Are the participating dealers (“PDs”) of 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 NAV. Chapter 10.6 of the UT Code provides that suspension of dealings may be provided for only in exceptional circumstances, having regard to the interests of holders. As such, the SFC would generally seek to require the PDs to process creation/redemption requests from third party investors save for exceptional circumstances, such as:

	Question	Answer
		<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 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”?	<p>Under section 4 of the SFO, the SFC is to provide protection for members of the public investing in or holding financial products. Under section 104(5) of the SFO, the SFC is duty bound, in its authorization of collective investment schemes, to refuse authorization where it is not satisfied that the authorization is in the interest of the investing public. Under Chapter 5.1 of the UT Code, every collective investment scheme for which authorization is requested must appoint a management company acceptable to the SFC. In assessing acceptability, the SFC will take into consideration, amongst others, the management company’s operational experience, infrastructure, systems and capability necessary for the smooth and efficient management and operation of the product proposed.</p> <p>Under current Mainland rules and regulations, only those SFC-licensed management companies who have RQFII licences and quotas are eligible to launch RQFII physical A-share ETFs in Hong Kong. RQFII physical A-share ETF is the first RMB physical A-share ETF issued outside mainland China that seeks to track an A-share index by channelling the RMB raised outside mainland China through the RQFII quota to directly invest in a portfolio of A-shares in the Mainland market which replicates the performance of the underlying A-share index. Given that RQFII physical A-share ETF is in its initial stage of development, the SFC has to be satisfied for the purpose of investor protection that in addition to handling the cross-border nature of this product, the management company has the operational experience, infrastructure, systems and capability to implement the relevant physical index replication strategies of an A-share index in the Mainland in a smooth and efficient manner. In this regard, the experience and expertise of the management company’s Mainland parent company in managing and operating physical A-share ETFs listed and traded on the Mainland stock exchanges and the related physical index replication strategies are important as the management company could tap into its Mainland parent company’s relevant infrastructure and expertise to support its management and operation of the RQFII physical A-share ETF in Hong Kong.</p> <p>In view of the novelty and the technical complexity of RQFII physical A-share ETF and in the interests of protecting investors as well as Hong Kong listed market’s</p>

	Question	Answer
		<p>integrity and order, at the initial stage of development of the RQFII physical A-share ETF, the SFC would require the management company of such ETF to meet all the following key criteria in assessing the acceptability of the management company:</p> <ul style="list-style-type: none"> <li>▪ the management company is licensed by the SFC for Type 9 regulated activity with sufficient experience in managing public funds;</li> <li>▪ the management company has a valid RQFII licence from China Securities Regulatory Commission;</li> <li>▪ the Mainland parent company of the management company has sufficient experience and expertise in managing and operating physical A-share ETFs listed and traded in the Mainland;</li> <li>▪ the management company has in place the necessary operating systems for smooth and efficient cross border money-flow, creation/redemption and operation, and there is a smooth and efficient use of its Mainland parent company's expertise and systems, to enable the ETF's operations in the A-share market to support a listed and daily traded product in Hong Kong which directly invests and operates in the Mainland A-share market;</li> <li>▪ the management company's Mainland parent company must have good standing and a good track record, considerations to be taken into account include whether there are records of past disciplinary actions or proceedings and such other similar or relevant matters in the past 5 years which may reasonably affect its good standing and competence; and</li> <li>▪ the necessary RQFII quota granted by State Administration of Foreign Exchange.</li> </ul> <p>The SFC will keep in view the above criteria as the RQFII physical A-share ETF market in Hong Kong further develops.</p>
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	First and foremost, a management company of an SFC-authorized RQFII physical A-share ETF is required to meet all of the criteria and requirements set out in Chapter 5 of the UT Code and FAQ 3.

	Question	Answer
	<p>necessary infrastructure and systems for, managing and operating physical A-share ETFs in the Mainland as required by FAQ 3?</p>	<p>In all cases, as explained in FAQ 3, the management company must have sufficient human and technical resources and capability plus adequate infrastructure, systems, operational experience and processes, controls and procedures in place to the satisfaction of the SFC, in order to ensure the smooth and efficient management and operation of the RQFII physical A-share ETF.</p> <p>Subject to the foregoing, where the management company does not have a Mainland parent company with the qualifications as required by FAQ 3, the following additional minimum requirements, subject to any additional requirements required by the SFC as the circumstances may warrant in the interest of market order and investor protection, will apply:</p> <ul style="list-style-type: none"> <li>▪ the RQFII physical A-share ETF must adopt a full physical replication strategy and no representative sampling should be conducted;</li> <li>▪ the management company must have at least one key personnel with at least 2 years' physical A-share ETF portfolio management experience;</li> <li>▪ the management company must retain a reputable Mainland, Hong Kong or international firm acceptable to the SFC as its investment adviser for at least 1 year after listing of the RQFII physical A-share ETF. The investment adviser must be of good repute and have solid experience and good track record in managing ETFs in Mainland, Hong Kong or other major ETF markets. The investment adviser shall provide support for the following activities / functions in respect of the operation of the RQFII physical A-share ETF: <ul style="list-style-type: none"> <li>▪ cash management;</li> <li>▪ procedures of handling corporate / other special events;</li> <li>▪ portfolio composition file generation and checking;</li> <li>▪ reference underlying portfolio value or estimated net asset value checking and monitoring;</li> <li>▪ tracking error management; and</li> </ul> </li> </ul>

	Question	Answer
		<ul style="list-style-type: none"> <li>▪ any other matters considered appropriate by the SFC; and</li> <li>▪ such other requirements or conditions as deemed necessary or appropriate by the SFC in the interest of market order / investor protection.</li> </ul> <p>Where the management company has a proven track record in managing ETFs in reputable markets, the SFC may consider modifying and/or not requiring strict compliance with any of the above requirements, on a case-by-case basis, where it considers appropriate.</p>
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> <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 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>

	Question	Answer
		Persons who intend to act as listing agents should seek professional legal advice regarding the application of the SFO if in doubt.
6.	What are the authorization conditions of listed closed-ended funds?	<p>As a general policy, closed-ended funds would be acceptable under the UT Code subject to the additional conditions and requirements in view of the closed-end nature of the funds while the closed-ended funds will seek listing on the Main Board of the Stock Exchange of Hong Kong (“SEHK”) and the listing platform will effectively provide liquidity to the closed-ended funds.</p> <p>In light of the above, authorization of a closed-end fund will generally be granted on condition that:</p> <ul style="list-style-type: none"> <li>a) the fund will remain listed on the SEHK;</li> <li>b) the fund’s last closing Net Asset Value (“NAV”) will be published on the fund’s website daily;</li> <li>c) potential risk factors regarding the closed-end nature of the fund will be fully and prominently disclosed to investors; and</li> <li>d) the fund will seek unitholders’ approval on the following matters: <ul style="list-style-type: none"> <li>(i) retirement of the Manager and appointment of the replacement manager;</li> <li>(ii) change of investment objective and/or policy;</li> <li>(iii) request for delisting or de-authorization; and</li> <li>(iv) new issue or units following listing at a price below NAV per unit (save for the issue of units pursuant to any exercise of the over-allotment option as described in the offering circular).</li> </ul> </li> </ul> <p>The SFC reserves the power to impose additional conditions.</p>

	Question	Answer
<b>Disclosure of information to investors regarding securities lending, repo and reverse repo transactions</b>		
7.	<p>What should ETFs managers note regarding securities lending, repo and reverse repo transactions (collectively, “securities financing transactions”)?</p>	<p>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 FAQ 21 on the Code of Unit Trusts and Mutual Funds, 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 FAQ 21 on the Code of Unit Trusts and Mutual Funds.</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, managers are generally expected to make available, at a minimum, the following information on the ETFs’ websites 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 financing transactions, including haircut policy, selection criteria for counterparties, collateral policy etc;</li> <li>b) information on the counterparties of each type of securities financing transactions and their relevant exposures;</li> <li>c) amount of securities on loan as a proportion of the ETF’s total lendable assets and NAV;</li> <li>d) net return to the ETF relating to each type of securities financing transactions (at least over the past 12 months);</li> <li>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;</li> <li>f) top 10 largest collateral issuers across all securities financing transactions with details on the amounts of collateral received by the</li> </ul> </li> </ul>

	Question	Answer
		<p>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.	<p>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?</p>	<p>In principle, Chapter 6.13 of the UT Code aims to ensure that there are adequate redemption windows available to investors such that they may exit from their investments in a SFC-authorized fund within a reasonable period. The SFC generally considers that the listing platform on the SEHK will effectively provide liquidity to a close-ended fund, as such trading on the SEHK allows investors to purchase and sell units of the fund in a manner similar to other publicly traded securities. The SFC has, therefore, granted a waiver from compliance with Chapter 6.13 of the UT Code with respect to a close-ended fund listed on the SEHK after taking into account that, among others, the fund manager would have procedures and mechanism in place to ensure that the fund would be widely held at the point of listing – no single unitholder would hold more than 30% of the fund and there would be a minimum of 300 investors, which was in line with the basic requirement regarding public spread of investors for listings of investment companies under Chapter 21 of the Listing Rules.</p> <p>The above waiver was granted subject to the following conditions:</p> <ul style="list-style-type: none"> <li>(i) the fund would remain listed on the exchange;</li> <li>(ii) the fund's last closing NAV would be published at such times and in such manner acceptable to the SFC (e.g. the closing NAV would be published on the management company's website on a daily basis);</li> <li>(iii) potential risk factors regarding the close-ended nature of the fund would be fully and prominently disclosed to investors; and</li> <li>(iv) the fund would seek unitholders' approval on the following matters: <ul style="list-style-type: none"> <li>• retirement of its management company and appointment of the</li> </ul> </li> </ul>

	Question	Answer
		<p>replacement management company;</p> <ul style="list-style-type: none"> <li>• change of investment objective and/or policy;</li> <li>• request for delisting or de-authorization; and</li> <li>• new issue of units following listing at a price below NAV per unit.</li> </ul> <p>The requirement relating to payment of redemption proceeds under Chapter 6.14 of the UT Code would not be applicable to a listed close-ended fund which has been granted a waiver from Chapter 6.13.</p>
<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 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?	Given that there is now a clear guidance on the calculation of ongoing charges figure and that the ongoing charges figure and TER are effectively the same, we expect that, for consistency purpose, the term “ongoing charges figure” be used in substitution of “TER” in paragraph 21A of the Appendix I to the UT Code.
<b>Prior notice to investors regarding dividend distribution</b>		
10.	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>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</p>

	Question	Answer
		<p>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 company should issue a separate announcement on the amount of dividend payment at least one business day before the ex-dividend date.</p>

*Last update: 21 November 2017*