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 (ñETFsò) 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 ñHandbookò), including the Code on Unit Trusts and Mutual Funds effective on 1 January 2019 (ñUT Codeò). Applicants are encouraged to contact the relevant case team in the Investment Products Division of the Securities and Futures Commission (the ñSFCò) 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

(2) -authorized passive ETF, active ETF and listed unit/share class of unlisted fund.

	Question	Answer
	Authorization of SFC-authorized ETFs/Listed Funds	
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 (ñNAVò). 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

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		SFC would generally seek to require the PDs to process creation/redemption requests from third party investors save for the following: suspension of dealing or determination of NAV of the ETF; where in the opinion of the manager, acceptance of the application will have an adverse effect on the ETF; suspension of trading on any of the shares constituting the relevant index basket; the ETF is not able to acquire further investments due to trading restrictions/limits in the market; or 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. 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. Consultation with the Investment Products Division is encouraged if in doubt with the specific circumstances.
2.	What is the key responsibility of an ETF manager regarding the pricing/arbitrage mechanism of the SFC-authorized	

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		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): 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; b) information on the counterparties of each type of securities financing transactions and their relevant exposures; c) amount of securities on loan as a proportion of the ETF's total lendable assets and NAV; d) net return to the ETF relating to each type of securities financing transactions (at least over the past 12 months); 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; f) top 10 largest collateral issuers across all securities financing transactions with details on the amounts of collateral received by the ETF; and 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.
	Waivers from compliance with certain provisions of the UT Code granted since 1 April 2005	
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.

	Question	Answer
		(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. 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.
	ETFs with listed and unlisted unit/share classes	
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	Question	Answer
	in the secondary market trading of SFC-authorized ETFs?	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. 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. The above principles are also applicable to SFC-authorized listed structured funds (including leveraged and inverse products).
12B.	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. 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?	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. The above principles are also applicable to SFC-authorized listed structured funds (including leveraged and inverse products).

	Question	Answer
12C.	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 monthsôwritten notice to HKEX before cessation of their market making activities for ETFs (including leveraged and inversed products). Does it have any implications on how management company of ETF complies with 8.6(p) of the UT Code?	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 company of an ETF is not obliged to separately secure an arrangement with the market maker or DS for a three monthsônotice prior to terminating their market making activities. The above principles are also applicable to SFC-authorized listed structured funds (including leveraged and inverse products)

	Question	Answer
		Under 10.7 of the UT

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		investors to read the termination announcement together with the offering documents (including the KFS), and any other further announcement(s); and (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).
	Disclosure of information of investors of SFC-authorized synthetic passive ETFs	
14.	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	

	Question	Answer
		(v) top 10 holdings in the collateral/invested assets (including name, percentage of the ETF's NAV, type, primary listing for equities, country of issuers, credit rating). Item (i) and (ii) above will be updated on a daily basis and uploaded onto the websites or other acceptable channels. Items

	Question	Answer

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	Reporting Council (ñFRCò) for the recognition of its overseas auditor. Pursuant to the FRCO, the FRC will not grant a recognition application unless the Listed Overseas CIS has obtained a statement of no objection (ñSNOò) from the SFC for the appointment of an overseas auditor to carry out a PIE engagement[2] for it and such SNO has not been subsequently withdrawn. What steps should a Listed Overseas CIS take if it wishes to obtain an SNO from the SFC for lodging a r	

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		For the avoidance of doubt, the issuance of an SNO by the SFC does not imply that a recognition application of the overseas auditor will be granted by the FRC nor does it mean its fund application will be accepted, or authorization will be granted by the SFC. The SFC will consider and review each fund application individually taking into account the compliance with all applicable requirements under the Handbook, UT Code and other guidance published by the SFC from time to time. Pursuant to the FRCO, an overseas auditor can only undertake a PIE engagement[2] for a Listed Overseas CIS after the recognition approval is granted by the FRC. Accordingly, authorization of a Listed Overseas CIS will be granted by the SFC subject to the condition that the overseas auditor recognition is granted by the FRC and remains in force. Such condition is required to be fulfilled before the SFC's authorization becomes effective. Accordingly, a Listed Overseas CIS seeking SFC's authorization is reminded to plan its application ahead to allow sufficient time to obtain an SNO from the SFC as well as FRC's approval for recognition of its overseas auditor.

	Question	Answer
		Nevertheless, the feeder ETF shall still prepare and publish such bilingual announcements to inform Hong Kong investors as soon as practicable after an announcement has been made by the master ETF.