SECURITIES AND FUTURES COMMISSION
證券及期貨事務監察委員會

Consultation Conclusions on the Draft Guidelines for Regulating Index Tracking Exchange Traded Funds under the Code on Unit Trusts and Mutual Funds

《單位信託及互惠基金守則》的跟蹤指數交易所買賣基金監管指引草擬本的諮詢總結

Hong Kong
October 2003

香港
2003 年 10 月

Executive Summary

1. The Securities and Futures Commission ("SFC") issued a Consultation Paper on the Draft Guidelines for Regulating Index Tracking Exchange Traded Funds under the Code on Unit Trusts and Mutual Funds (the "Code") on 18 March 2003 for an initial consultation period of 4 weeks. The consultation period was extended by 2 weeks in response to requests from market participants and industry practitioners that they be given more time to analyse the Draft Guidelines. The consultation ended on 2 May 2003.

2. The SFC received a total of 12 responses comprising comments from fund management companies, professional bodies and other market participants. The submissions are currently posted on the SFC's website at www.hksfc.org.hk. A list of the respondents is set out in **Appendix A** to this conclusion paper. The SFC also organised informal meetings with various market participants to better understand their comments.

3. In general, the respondents are supportive of the initiative to revise the Code to provide a regulatory framework that is conducive to the development of ETFs in Hong Kong. The respondents considered the overall regulatory approach proposed in the public consultation for regulating ETFs acceptable and also pointed out specific areas that would require fine-tuning.

4. After reviewing the comments from the respondents and the unique features of ETFs as a popular trading and arbitraging tool among institutional investors and an investment product for retail investors, the SFC has decided to adopt a principles-based and market facilitative approach in the Guidelines for Regulating ETFs ("ETF Guidelines").

5. The ETF Guidelines aim to facilitate ETF providers in seeking authorisation from the SFC in three ways. First, requirements in Chapter 8.6 of the Code which regulate index funds are streamlined by way of granting general relief to all SFC authorised ETFs from strict compliance with certain investment restrictions and risk disclosure requirements. Certain on-going reporting requirements in Chapter 11 are also modified to facilitate the streamlined regime. Secondly, the SFC recommends that SFC authorised ETFs are to provide suitable disclosure of trading information that would facilitate trading and investments by investors. Thirdly, overseas ETFs that meet the core structural and operational requirements in the Code and are regulated in an Acceptable ETF Regime may seek authorisation from the SFC under a streamlined process.

6. One significant change to the Draft ETF Guidelines in the Consultation Paper is that the SFC has essentially converted some of the earlier prescriptive proposals into a set of best practice recommendations. The participation of institutional and retail investors in ETF products, as seen in other international financial centres, may well encourage ETFs to adopt a disclosure and compliance framework that meets the standards expected by the market. Therefore, the ETF Guidelines' principles-based approach is expected to

support the evolution of new ETF products without being overly prescriptive on specific regulatory issues.

7. It is worth noting that respondents also commented on infra-structural and market issues that were neither related to the revision of the Code nor the contents of the Draft ETF Guidelines. The respondents, who are key players in the international and local ETF markets, made a point that the success of an ETF market in Hong Kong depends not only on having a suitable product regulatory framework, but also on there being in place a wide range of market incentives and infra-structural support including concessions on stamp duties chargeable on trading and hedging activities of ETFs, reduction in transaction costs, potential increase in liquidity through market making activities and others.

8. The SFC considers these comments to be relevant in order to better understand market participants' views on how best to develop the ETF market. Accordingly, the SFC has set out a summary of these comments in this conclusion paper and has shared the relevant comments with the appropriate authorities.

9. The text of the ETF Guidelines with the new revisions marked up is set out in **Appendix B**. The SFC extends its appreciation to all respondents who have provided their views on the proposals in the Consultation Paper.

Introduction

10. After reviewing the responses to the Consultation Paper, the SFC has identified two broad categories of comments from respondents. The first category of comments is responses to the specific provisions in the Draft ETF Guidelines. The second category relates to comments on market infrastructure, costs and taxation issues relating to the creation, trading and redemption of ETFs.

11. Based on these two broad categories of comments, this conclusion paper is structured into two parts:

- Part A sets out a summary of the key comments from the public to the specifics of the Draft ETF Guidelines and the SFC's response to these comments; and
- Part B sets out non-regulatory issues raised by respondents for the better development of the ETF market in Hong Kong, for example, stamp duties issues and establishment and transaction costs in setting up ETFs.

In general, the SFC is supportive of any market infra-structural changes that enhance investor protection and further the development of Hong Kong into a regional centre for ETFs.

Regulatory Approach

12. The SFC believes that the ETF Guidelines should be formulated to have the ability to adapt to the rapidly evolving nature of ETFs. After carefully reviewing the public responses and international experience and regulatory frameworks concerning the development of the ETF market, the SFC considers it appropriate to adopt a set of streamlined requirements for regulating the product structure of ETFs and their related disclosure requirements. Before the ETF Guidelines were proposed, ETFs were approved following the same criteria laid down for unlisted index funds under the Code. As such, ETFs would be required to comply with specific investment restrictions in Chapter 8.6 and the prescriptive risk disclosure requirements. Chapter 8.6 does not contain provisions that would enhance real time or near-real time disclosure of trading information for ETFs that are essentially an exchange traded product.

13. With the launch of the ETF Guidelines, the SFC aims to introduce a regulatory framework that provides:

- *Streamlined requirements on investment restrictions and risk dsclosure requirements for all SFC authorised ETFs*: The ETF Guidelines now provide general relief from strict compliance with certain investment restrictions and risk disclosure requirements in Chapter 8.6 for both local ETFs and overseas ETFs authorised by the SFC. This is to ensure that new products are given sufficient flexibility for development without compromising investor protection. However, the core requirements that are generally applicable to all unit trusts and mutual funds under the Code (including the eligibility of fund managers, trustees/custodians, and continuous compliance requirements) are still applicable to ETFs except where there are specific exemptions given in the ETF Guidelines.

- *Suitable disclosure of trading information for ETFs:* The ETF Guidelines now lay down a set of best practices guidelines for real-time or near-real time disclosure of trading information for all ETFs. Local ETFs authorised by the SFC are required to comply with these best practices guidelines. Overseas ETFs authorised by the SFC are recommended but not mandated to follow these best practices due to the wide variety of ETF products and the differences in trading and information disclosure systems in other overseas jurisdictions. Investors will also benefit from these best practices, as they will be able to assess the transparency level and disclosure quality of individual ETFs before they decide to invest in them.

- *Streamlined recognition of certain overseas ETFs:* Overseas ETFs that meet the core requirements for authorised funds under the Code and are governed by a regulatory framework that has comparable or similar regulatory principles on ETFs as those in the Code may seek SFC authorisation by way of a streamlined process under the ETF Guidelines. Depending on the specific product type and the way they are governed in their home jurisdictions, overseas ETFs that seek authorisation from the

SFC may be deemed to have complied with the requirements in Chapter 8.6 of the Code in relation to investment restrictions and strategies, index acceptability and documentation requirements such as constitutive documents and the product disclosure documents in other parts of the Code.

Part A: Consultation Responses to Specific Issues

Streamlined Index Fund Provisions under Chapter 8.6 for all ETFs

14. *Public comments:* Respondents welcomed the availability of general relief to both local and overseas ETFs. All ETFs are now given general relief from provisions in Chapter 8.6 that are currently too restrictive on ETF investment strategies and too prescriptive regarding risk disclosure. Respondents also welcomed the idea of a streamlined listing process for ETFs under the listing rules of the Hong Kong Exchange and Clearing Limited ("HKEx") in order to make ETFs a more cost efficient product for retail and institutional investors.

    (a) Some respondents that have prior experience in launching ETFs commented that the proposal to make it a mandatory condition for all overseas ETFs to be cross-listed or cross-traded on the HKEx, will pose practical difficulties given the time zone differences, and the differences in clearing, trading and settlement systems between Hong Kong and overseas markets. These respondents also pointed out that there are also various other infra-structural issues that need to be resolved by market service providers so as to reduce the transaction costs of launching ETFs in the Hong Kong market. One respondent, however, believed that all overseas ETFs seeking SFC authorisation should be required to seek cross-listing on the Stock Exchange of Hong Kong Limited ("SEHK").

    (b) Some respondents suggested that as the Hong Kong ETF market is still in its infancy stage, the SFC should first consider focusing its efforts to increase investor awareness on how local or overseas ETFs may be used as effective investment and hedging tools. Some respondents commented that there are inherent market issues, such as clearing and settlement cycles between different time zones, that need to be resolved before overseas ETFs are required to have a mandatory cross-listing status in Hong Kong. In view of these market issues, some respondents commented that overseas ETFs should be allowed to obtain SFC authorisation without being required to seek a cross-listing status in Hong Kong. Some respondents believed that this move could enhance market awareness and investors' interest in ETFs. Being authorised funds, ETFs can be marketed and made publicly available to investors through local intermediaries.

    (c) Other comments focused on individual provisions in the ETF Guidelines and specific drafting issues. Some respondents also sought clarification as to whether the core requirements in the Code e.g. reporting of breaches, eligibility of fund managers etc. that are generally applicable to all unit trusts and mutual funds are equally applicable to ETFs.

15. *SFC's Response:* The SFC appreciates the support from the market regarding the initiative to review the existing provisions in the Code in regulating index funds and the comments on the practical and operational issues of ETFs. As mentioned in the Consultation Paper, ETFs are a unique investment tool that has the characteristics of a stock which can be traded on an exchange and in relation to which hedging activities can be carried out.

On the other hand, ETFs also take the form of an open-ended investment vehicle to facilitate arbitraging activities undertaken by market participants. The ability of ETFs to serve as an arbitraging tool when used in conjunction with the trading in their underlying securities, or related futures or options on indices, differentiate ETFs from conventional unit trusts and mutual funds.

From the perspective of an investment and trading tool, ETFs that replicate and track a securities index bear more resemblance to an index derivative than a conventional and unlisted unit trust and mutual fund. Accordingly, the SFC's responses to the key points on how to streamline the provisions in the Code, especially Chapter 8.6, are as follows:

(a) *Principles-based approach for implementation of the ETF Guidelines:* The ETF Guidelines are now drafted on the basis of a principles-based regime so that the Guidelines can be flexibly administered in specific circumstances so long as the general principles and the regulatory spirit of the Guidelines are complied with by an ETF. The SFC considers it impractical and overly prescriptive to try to exhaustively set out all possible situations under which a particular principle could apply. Very often, the interpretation and application of a particular principle to a product depends on the specific facts and circumstances in relation to that product. The SFC will adopt a fair and reasonable approach when viewing applications that involve the interpretation of such terms in the ETF Guidelines.

(b) *Local ETFs:* The SFC will be the home regulator of ETFs that are set up under the Code and primarily listed in Hong Kong. The listing and trading aspects of these ETFs will be governed by the rules of the HKEx. In short, these local ETFs have to comply with the same core operational and structural requirements applicable to all unit trusts and mutual funds under the Code except where the requirements are varied or substituted by the ETF Guidelines.

(c) *Streamlined listing process under Chapter 20 of the Listing Rules:* In response to the public request for a streamlined listing process for SFC authorised funds, the SFC and the SEHK have reached an agreement on the way forward in allowing SFC authorised collective investment schemes to be listed on the SEHK under the recently revised Chapter 20 of the Listing Rules of the SEHK. ETFs that are authorised by the SFC will therefore be able to list under this streamlined listing process under the new Chapter 20.

Chapter 20.06 allows an ETF provider to be a listing agent for an authorised collective investment scheme. However, an ETF provider that intends to act as a listing agent should pay particular attention to the licensing requirements stipulated under Part V of the Securities and Futures Ordinance ("SFO"). The performance of the functions of a listing agent may amount to the carrying on of Type 6 regulated activity (advising on corporate finance) and/or Type 1 regulated activity (dealing in securities) as defined under Schedule 5 to the SFO, hence the respective licensing requirements may apply. Depending on specific circumstances and subject to any licensing conditions the SFC considers appropriate to impose, the SFC may grant a licence in relation to Type 6 regulated activity to an ETF provider for the sole purpose of its acting as a listing agent for the index tracking ETFs managed by it provided it does not carry out activities that amount to dealing in securities.

(d) *Cross-listing or cross-trading of overseas ETFs optional*: After considering the unique features of ETFs and the respondents' observations regarding operational difficulties that an ETF would face in the Hong Kong market during its start-up phase, the SFC agrees that applying the same regulatory approach used for conventional unit trusts and mutual funds towards the regulation of ETFs may not be the best approach in developing an ETF market in Hong Kong.

Hence, the ETF Guidelines now contemplate the possibility that ETFs may be developed as a hybrid type of listed funds with the distinctive feature of being an index derivative. The SFC has therefore revised the initial proposals in the Consultation Paper so that cross-listing on the SEHK is no longer a pre-condition for authorisation of overseas ETFs, and the daily publication of NAV in local newspapers is dispensed with for all ETFs.

Recommended Best Practices: Use of Key Features Summary and its Content Requirements

16. *Public Comments*: Most respondents commented that the use of Key Features Summary would be useful to investors. They also found that the proposed format and suggested contents of the Key Features Summary set out in the Consultation Paper are helpful in succinctly describing an ETF. However, some respondents did not agree with the proposal that it should be a mandatory requirement for all ETFs to distribute the Key Features Summary including the requirement to follow the same format as prescribed in the Consultation Paper.

17. *SFC's Response*: After carefully considering the comments from the industry and having reviewed the international practices in other overseas ETF markets, the SFC agrees that it is best to leave the disclosure of key features of an investment product to the ETF providers who are more familiar with the

characteristics of their own products. The ETF Guidelines therefore make it a recommended best practice, rather than a mandatory requirement for an SFC authorised ETF, to distribute a Key Features Summary to investors. If a Key Features Summary is distributed to investors, ETF providers should ensure that the information in the Key Features Summary is reviewed and, if necessary, updated regularly to maintain factual accuracy.

While the SFC does not intend to comment on the channels through which the Key Features Summary should be distributed, the SFC believes that it would facilitate the efficient flow of information of an SFC authorised ETF if the Key Features Summary is posted on the ETF's own website or via the website of the exchanges on which it is traded.

Disclosure of Trading Information on a Real or Near-real time Basis and other Information

18. *Public Comments*: Respondents generally felt that, in principle, investors should be given access to certain basic information to facilitate their trading in ETFs. However, there were diverse opinions as to the specific type of information that an ETF must disclose to investors on a real or near-real time basis. Some respondents who have experience in the creation of ETFs commented that for overseas ETFs that are cross-listed or cross-traded in Hong Kong, the difference in time zones and the trading hours render the disclosure of real time trading information in the principal overseas market less useful to local investors in Hong Kong. Below are respondents' views on the availability of the following types of information:

    (a) *Previous NAV at closing of market*: One respondent did not consider it a problem to disclose such information. Another respondent considered that previous NAV is historical and may be less useful to investors. The same respondent, however, commented that real time trading information is very useful to investors undertaking arbitraging activities.

    (b) *Estimated NAV or R.U.P.V.*[1]: There is no unanimous view on the way this figure should be calculated and how this should be disclosed to the public. Some respondents commented that disclosure of the R.U.P.V. of an ETF is feasible but only goes to serve as a reference for investors only and that there should be a clear set of rules prescribing the way this figure is calculated. There is also a proposal that in order to overcome the difficulties in arriving at a unified standard for disclosure and calculation of R.U.P.V., ETFs could be structured in such a way that its unit price is a multiple of the underlying index such that there is no need to rely on the calculation of R.U.P.V. as the unit price of the ETF would be reflective of the movement of the underlying index.

[1] R.U.P.V. in respect of ETFs listed on the SEHK as used on the information pages of information vendors stands for "Reference Underlying Portfolio Value" which is updated at 15-second intervals during trading hours and is equivalent to the aggregate of the total value of the Index Basket Shares per Creation Unit (which is calculated by multiplying the nominal price of the Index Basket Share by the number of the respective Index Basket Shares) and the prior day estimated total cash component per Creation Unit divided by the number of Units in a Creation Unit.

(c) *Performance of ETF vs. Performance of underlying index:* There was a general consensus among respondents that the requirement of an ETF to produce this comparison on a real time basis would pose practical difficulties. Some respondents commented that it could be misleading to make this comparison when the underlying portfolio of an ETF does not fully replicate the index, or when the ETF and the underlying index are each denominated in a different currency. Distortion may also occur in the comparison as the NAV of an ETF may contain dividend accrued, and that preparing this comparison would be adding costs to ETF providers.

(d) *Disclosure of premiums and discounts of ETF trading prices vs. NAV in semi-annual and annual financial reports*: Some respondents who are market participants commented that this requirement may create more confusion than add value for investors, especially retail investors. Retail investors are generally more focused on the trades conducted on the exchanges, however, the largest volume of creation and redemption for ETFs by institutional investors is commonly experienced in off-the-market situation. Given that these large volumes of trades are not reflected through the trading prices on the exchanges, market participants believed a comparison of only the trading prices against the NAV of an ETF might create further confusion in respect of the actual trading pattern and prices of an ETF.

Respondents also identified suitable channels through which trading information and other relevant information of ETF could be distributed, such as the ETF's own website, information vendors like Reuters or Bloomberg, the website of the HKEx or the relevant overseas exchange or the brokers' website.

19. *SFC's Response*: The SFC believes that in order to facilitate trading of SFC authorised ETFs by investors in Hong Kong, certain basic trading data and information should be made available. However, the SFC also recognises that cross-listed overseas ETFs may face practical hurdles in disclosing certain types of information due to differences in time zones and regulatory requirements for disclosure.

20. The SFC has therefore decided that instead of one standardized requirement for all ETFs, the ETF Guidelines now contain a tiered approach in the way trading information should be disseminated which is summarised as follows:

(a) By virtue of their primary listing and trading status in Hong Kong, local ETFs authorised by the SFC are required to provide timely disclosure of information of the type stated in paragraphs 18(a) and (b) unless waived by the SFC. A local ETF may elect to disseminate such trading information on a real time or near-real time basis via its own website, a hyperlink to its website on the HKEx's website, information vendors like Reuters or Bloomberg or any other channels that are considered acceptable by the SFC.

(b) Overseas ETFs authorised by the SFC and cross-listed or cross-traded on the SEHK, should also disclose local trading information in relation to their trading on the SEHK including notices for suspension and resumption of trading on a real time or near-real time basis. Cross-listed or cross-traded overseas ETFs are also recommended, but are not obliged, to provide disclosure of their own overseas trading information of a similar nature to that stated in paragraphs 18(a) and (b) on a real time or near real-time basis during the period where the trading hours of the local and the overseas markets overlap.

(c) Overseas ETFs authorised by the SFC but not cross-listed or cross-traded on the SEHK, should endeavour to comply with the best practices by providing disclosure of similar overseas trading information when their own principal market is open. Overseas ETFs authorised by the SFC, whether cross-listed or cross-traded, may choose the channels through which they can efficiently disseminate such information on a timely basis.

(d) Local or overseas ETFs will be required to disclose in the Hong Kong Offering Document / Product Description Document, the type of trading information to be disclosed on a real time or near-real time basis to investors in Hong Kong and the dissemination channels used.

(e) In response to the comments from the market, information described in paragraphs 18(c) and (d) will not be required to be disclosed by local or overseas ETFs.

Streamlined Recognition of Overseas ETFs and the Application of the Concept of "Acceptable ETF Regime"

21. *Public Comments*: Most respondents welcomed the move to adopt the concept of an "Acceptable ETF Regime" to facilitate the recognition of overseas ETFs. However, some respondents considered that the regulatory principles set out in the Consultation Paper may be too restrictive and therefore hinder the development of ETF market in Hong Kong. Other respondents submitted that there should be more flexibility in applying the Acceptable ETF Regime to specific markets and there were comments that there should be some clarification of how this Acceptable ETF Regime works to facilitate recognition of overseas ETFs.

22. *SFC's Response:* The SFC wishes to clarify the streamlined recognition process for overseas ETFs as follows:

(a) An overseas ETF that wishes to seek authorisation would first be assessed as to whether it meets certain core structural and operational requirements such as the eligibility of managers and trustees as those commonly applied to unit trusts and mutual funds under the Code. If it is at the same time listed in, and governed by a regulatory framework of, an Acceptable ETF Regime, it may then seek to undergo a streamlined recognition process to enable it to rely on the specific relief given in the

ETF Guidelines. This specific relief would deem an overseas ETF to have complied with certain requirements in the Code, for example, acceptability of index, financial reporting and disclosure requirements.

(b) In some circumstances, due to the differences in regulatory requirements between an Acceptable ETF Regime and the Code, the scope of the specific relief granted in the ETF Guidelines may be adjusted to cater to the regulatory needs of a particular case.

(c) It should be emphasized that the basic regulatory principles set out in the Consultation Paper for considering whether a jurisdiction is an Acceptable ETF Regime only act as references and will be applied in a fair and reasonable manner in recognising the acceptability of a particular overseas regime.

Specific Relief for Overseas ETFs Primarily Listed in an Acceptable ETF Regime

23. *Public Comments:* Some respondents raised specific issues relating to the scope of the specific relief and how it is applied:

(a) One respondent took the view that because of the regulatory oversight by an overseas securities regulator, there should be complete exemption for ETF managers from compliance with the fund management experience and the eligibility requirement in Chapter 5.1 and 5.5 of the Code.

(b) Some respondents highlighted the difficulties and costs incurred by overseas ETFs that are cross-listed or cross-traded in Hong Kong. The main difficulties arise due to the differences between the opening and trading hours of Hong Kong and those of other overseas markets and the differences in regulatory requirements in overseas markets. Cross-listed or cross-traded overseas ETFs would find it cumbersome if they are required to give prior disclosure of the possible circumstances that might affect an index or notice for the possible change of the underlying index that an overseas ETF is tracking because the index is usually constructed by a third party provider and overseas ETFs may not be in a position to seek prior clearance of any notices to Hong Kong investors if the index is to be changed or replaced.

24. *SFC's Response:*

(a) *Core requirements for overseas ETFs authorised by the SFC:* The SFC believes that the core requirements in the Code that assess the eligibility of fund operators such as fund managers and trustees should be applied generally to all types of funds including ETFs. Therefore, the SFC considers that in the best interests of investors, ETFs should adopt the same eligibility test for fund management experience and expertise in assessing the eligibility of fund managers seeking to launch ETFs under the ETF Guidelines.

(b) *Prior approval by the SFC on certain ETF related matters*: The SFC accepts that there are practical difficulties in mandating overseas ETFs authorised by the SFC to seek the SFC's prior approval each time some changes or modification is made to the underlying index. Therefore, before a particular jurisdiction qualifies as an Acceptable ETF Regime, the SFC will take into account whether the regulatory framework of this jurisdiction provides sufficient safeguards to ensure the acceptability of the index and steps that have been taken to enhance the transparency of the circumstances under which the index is replaced or reconstituted.

Language Requirements for Notices and Announcements of Overseas ETFs Authorised by the SFC

25. *Public Comments:* Some respondents strongly opposed the proposal that overseas ETFs that are authorised by the SFC should prepare their notices or announcements to holders in Hong Kong in both English and Chinese. In particular, these respondents argued that overseas ETFs are already regulated principally by their overseas regulators and given that they are actively traded on overseas exchanges, information about such ETFs is highly transparent. Additionally, the preparation and publication of dual language notices would add financial costs and administrative burden to ETF providers. Such costs would then be transferred to investors. However, some respondents took the view that if overseas ETFs are cross-listed or cross-traded on the SEHK, these ETFs should, at the minimum, inform local investors of material changes occurred to ETFs in English and Chinese.

26. *SFC's Response:* The SFC believes that it is important that investors in ETFs are able to access sufficient information regarding an ETF that is material to help them make informed investment decisions. However, having regard to the highly transparent index tracking or replication nature of an ETF, it would be sufficient if investors are notified of material incidents in a timely manner. On the basis that overseas ETFs authorised by the SFC have already met the core structural and operational Code requirements and are regulated in an Acceptable ETF Regime, the SFC considers it acceptable to streamline the notification requirements to investors.

Accordingly, the ETF Guidelines only require an overseas ETF authorised by the SFC to publish notices of any material changes to their offering and constitutive documents and, where applicable to cross-listed or cross-traded ETFs, notices that are required by the SEHK to be published pursuant to the listing rules or other applicable rules of the HKEx. Such notices will have to be in both English and Chinese and published via either electronic means or other appropriate channels to investors in Hong Kong. In all other situations, it is a recommended best practice for cross-listed or cross-traded ETFs authorised by the SFC to publish bilingual notices.

Disclosure of Interests under Part XV of the SFO

27. *Public Comments:* Most respondents supported the granting of exemption to holders of corporate form ETFs from the disclosure of interests requirements in Part XV of the SFO on the basis that these corporate form ETFs are open-ended funds that invest in fungible and liquid securities in the market. It would be unduly burdensome if investors were required to report on their holdings in ETFs that have a constantly changing number in the total outstanding shares due to the frequent creation and redemption by investors. On the other hand, if an ETF takes the form a unit trust, it is not affected by the disclosure requirements of Part XV of the SFO.

28. *SFC's Response:* In view of the open-ended nature of ETFs, the contents of their portfolios, their similar trading characteristics to listed stocks or derivatives and their investment strategies that passively track the performance of indices, ETFs have an inherently strong index derivative element. The SFC intends to conduct a review of the current framework on Part XV of the SFO and its policies towards exemptions for listed ETFs following the release of the ETF Guidelines.

Miscellaneous

29. *Public Comments:* A few respondents raised the question whether SFC would consider alternative structures of ETF products such as feeder funds or fund of funds based on overseas ETFs of an Acceptable ETF Regime. The SFC has also, in the meantime, received various enquiries about using SFC authorised ETFs as underlying investments for various types of collective investment schemes.

30. *SFC's Response:* The SFC welcomes enquiries on potential product types using ETFs as either listed investment products or derivatives for indices. Given the wide variety of possible products that could be created using ETFs, the SFC would consider applications for authorisation of specific ETF related products on a case-by-case basis with reference to the general principles governing ETFs and index tracking products.

Part B: Summary of Key Comments on Infra-structural Issues

In addition to specific comments on the Draft ETF Guidelines, the SFC has received general comments on market structural issues and how these may affect the development of a local ETF market. As these are not regulatory issues, the SFC has accordingly conveyed these comments and related suggestions by the market respondents to the relevant authorities for consideration. For completeness, the key comments on these infra-structural issues are summarised as follows.

Stamp Duty Related Issues

31. The first key market structural issue that respondents identified is the charging of stamp duty at various operational levels of ETFs in Hong Kong. International and local ETF providers have expressed the view that stamp duty relief should be made available to ETFs and certain related transactions. ETFs are principally structured as an index derivative which provides arbitrage opportunities. Thus it would be crucial to maintain a cost efficient structure for both institutional and retail investors.

    (a) Some respondents suggested that ETFs should be recognised as a tax neutral index derivative on a par with index futures or options thus rendering any trading in the units of ETFs to be exempt from stamp duty. They pointed out that the Korean and Taiwanese governments have granted stamp duty concession to ETFs in their respective market. Some respondents argued that due to the tax incentives offered by these jurisdictions, there has been active trading of ETFs and an increase in the trading volume of the constituent securities of the index against which these ETFs are tracking.

    (b) In addition, some respondents suggested that stamp duty relief should also be granted to market makers of ETFs in respect of their related transactions in the underlying securities to hedge against ETF positions arising from market making activities. Such relief would allow market makers to conduct their activities in a relatively cost efficient environment so that they would be able to quote a tighter bid/offer spread to investors.

Tick Rule – Short selling

32. While short selling of ETFs are exempt from the tick rules implemented by the HKEx, short-selling activities on the underlying securities of ETFs conducted by market makers in the course of hedging their market making positions are not exempt from the tick rule.

Other Observations on Market Structure

33. Apart from the specific structural issues mentioned above, some market practitioners commented that the availability of a market with large market capitalisation and high liquidity are also key factors contributing to the success in developing ETFs in Hong Kong.

Way Forward

34. The issuance of ETF Guidelines represents one of the first steps towards the development of Hong Kong into a regional ETF market. The SFC believes the outlook for enhancing the current market structure is positive in view of the response from the public and the SFC's commitment to work closely with the relevant authorities and service providers involved in market enhancement initiatives for ETFs. The SFC will keep in view the developments of the international ETF market and the need to update the ETF Guidelines as circumstances require.

List of Respondents (in alphabetical order)

Category A – Respondent has no objection to publication of name and contents of submission

Clifford Chance
Deacons
FTSE International (Hong Kong) Limited
HSI Services Limited
The Law Society of Hong Kong
Lyxor International Asset Management
Mr Nathan Most
Simmons & Simmons[2]

Category B – Respondent requested submission to be published on a "no-name" basis

Three submissions

[2] Two submissions have been made by Simmons & Simmons.

Appendix B

Guidelines for Regulating Index Tracking Exchange Traded Funds

Introduction

1. These guidelines apply to passively managed index tracking exchange traded funds (which will be referred to as "Exchange Traded Funds" or "ETFs" throughout these guidelines)[3] authorized pursuant to the Code on Unit Trusts and Mutual Funds (the "Code"). These guidelines form part of Chapter 8.6 of the Code and are to be read in conjunction with the Code for an overall view of the regulatory framework for ETFs. In case of doubt, an applicant should consult the SFC at the earliest possible time on the application of these guidelines to an Exchange Traded Fund seeking authorization under the Code.

2. These guidelines are devised on the basis that ETFs, whether established in Hong Kong or overseas, should comply with common principles for safeguarding investors' interests if they seek to be authorized by the SFC. Local and overseas ETFs may seek to rely on the general relief granted in these guidelines from strict compliance with certain Code requirements including investment restrictions, prescribed risk warnings and certain prior approval procedures for notices or announcements.

3. Overseas ETFs that meet the core requirements for authorized schemes under the Code and are governed by a regulatory framework considered acceptable in these guidelines may seek the SFC authorization by way of a streamlined process. Depending on the specific product type and the way they are governed in their home jurisdictions, overseas ETFs may be deemed to have complied with some or all of the requirements in Chapter 8.6 of the Code in relation to investment restrictions and strategies, index acceptability and the documentation requirements such as constitutive documents, product disclosure documents and financial reports in other parts of the Code.

4. These guidelines also require ETFs that are primarily listed on the local exchange of Hong Kong to adopt an enhanced disclosure regime for real time or near-real time trading information. Overseas ETFs that are primarily listed on overseas exchanges are recommended but are not obliged to comply with this enhanced disclosure regime for real time or near-real time overseas trading information.

[3] An "index tracking ETF" means an index fund (as defined in Chapter 8.6) and whose units/shares are traded on a securities exchange. For avoidance of doubt, the term "ETF" used in these guidelines does not cover actively managed non-index tracking funds.

Basic Requirements for ETFs

5. ETFs, whether local or overseas, must comply with the structural, operational and core investment requirements under the Code. They must also abide by the on-going compliance and reporting requirements under the Code subject to the applicable relief laid down in these guidelines if they seek authorization from the SFC.[4]

6. ETFs that do not conduct initial public offerings or any forms of public sales or subscriptions are not obliged to produce a Hong Kong Offering Document as stated in Chapter 6.1 of the Code. Instead, they must prepare a Product Description Document in both English and Chinese. The term "offering document" shall be replaced by the term "Product Description Document" wherever the former appears in the Code (see Paragraph 10 below) in relation to this type of ETFs.

7. The general principles set out in Chapter 8.6 (a) to (e) of the Code are broadly applicable to ETFs, whether local or overseas, unless otherwise stated in these guidelines.

8. It is a condition for authorizing an ETF that intends to be primarily traded in Hong Kong and authorized under the Code (referred to as "Local ETFs" in these guidelines), that it must be either listed or traded on the Stock Exchange of Hong Kong Limited (the "SEHK").

Streamlined Regulatory Regime for ETFs

9. ETFs must comply with the Code requirements not otherwise modified or waived by these guidelines.

10. Except as provided in paragraph 24(e) below, an ETF that is not conducting initial public offerings, or any forms of public sales or subscriptions in Hong Kong need not prepare a Hong Kong Offering Document in accordance with Chapter 6.1 of the Code. This ETF must prepare a Product Description Document in both English and Chinese that meets the content requirements in Appendix C of the Code (as modified by these guidelines) which is more particularly set out in Annex (I) to these guidelines.

General Relief from Chapter 8.6

Unless otherwise stated in these guidelines, ETFs, whether local or overseas, must comply with all the applicable provisions governing index funds in Chapter 8.6 of the Code.

4 For avoidance of doubt, the term "ETFs" in these guidelines shall, where the context applies, mean ETFs authorized under the Code.

11. *Relief from Chapter 8.6(h)*: Investment restrictions in Chapter 8.6(h)(i) and (ii) do not apply if:

   (a) an ETF adopts a representative sampling strategy which does not involve the full replication of the constituent securities of the underlying index in the exact weightings of such index;

   (b) the strategy is clearly disclosed in the Product Description Document/Hong Kong Offering Document of the ETF (as the case may be);

   (c) the excess of the weightings of the constituent securities held by the ETF over the weightings in the index is caused by the implementation of the representative sampling strategy;

   (d) any excess weightings of the ETF holdings over the weightings in the index must be subject to a maximum limit reasonably determined by the ETF after consultation with the SFC. In determining this limit, the ETF must consider the characteristics of the underlying constituent securities, their weightings and the investment objectives of the index and any other suitable factors;

   (e) limits laid down by the ETF pursuant to paragraph 11(d) above must be disclosed in the Product Description Document/Hong Kong Offering Document (as the case may be);

   (f) disclosure must be made in the ETF's semi-annual and annual reports as to whether the limits imposed by the ETF itself pursuant to paragraph 11(d) have been complied with in full. If there is non-compliance with the said limits during the relevant reporting period, this must be reported to the SFC on a timely basis and an account for such non-compliance should be stated in the report relating to the period in which the non-compliance occurs or otherwise notified to investors; and

   (g) nothing in paragraphs 11(d), (e) and (f) above applies to an overseas ETF governed by an Acceptable ETF Regime or by the relevant overseas jurisdiction (see the Note to paragraph (d) in **Annex (III)** to these guidelines).

12. *Disclosure of Risk Warnings under Chapter 8.6(j)*: Provisions relating to disclosure of index funds information in Chapter 8.6(j) do not apply where **Annex (I)** does not require the same. In particular, where proper risk warnings are disclosed, provisions relating to disclosure of risk warnings in Chapter 8.6(j)(iv), (v), (vi), (vii), (x), (xi), (xii) and (xiv) need not be strictly adhered to.

13. *Name of the ETF under Chapter 8.6(m)*: Chapter 8.6(m) does not apply if the name adopted is not misleading or deceptive as to the nature of the ETF and its investment objectives and strategy.

Modified Post-Authorization Notification and Approval Procedures

14. The notification and approval requirements under Chapters 11.1, 11.3, 11.7 and 11.11 of the Code are modified to the following extent:

(a) *Changes to Documentation in Chapter 11.1*: Chapter 11.1 applies only to material alterations or additions to the Product Description Document/Hong Kong Offering Document (as the case may be), constitutive documents and other applicable product documentation, such as changes to investment objectives or investment risk profile, replacement of management companies or trustees, termination and mergers of ETFs. Immaterial changes to such documentation or events relating to an ETF, for example, legislative or regulatory changes, typographical or stylistic changes and dividend notices may be effected without prior approval of the SFC.

(b) *Increase in Fees in Chapter 11.3*: The requirements to issue a three months' prior notice and to seek the SFC's prior approval for such notice under Chapter 11.3 does not apply to adjustments in management fees if:

(i) the proposed adjustments in management fees do not require holders' approval; and

(ii) either a notice for the fee adjustments is published as stated in paragraph 14(e) (which notice may be shorter than 3 months) or where the ETF is governed by an Acceptable ETF Regime or in the relevant overseas jurisdiction (see the Note to paragraph (d) in **Annex (III))**, there is no notification requirement for this type of fee adjustments in that jurisdiction;

(c) *Publication of NAV in Local Newspapers in Chapter 11.7*: On the basis that information is available to investors in accordance with paragraphs 17 to 21 in these guidelines (where applicable), the obligation under Chapter 11.7 to publish NAV in local newspapers is dispensed with. The management company must immediately notify the SFC as soon as practicable if dealing in units/shares on the SEHK ceases or is suspended.

(d) *Prior Approval of Public Announcements in Chapter 11.11*: Chapter 11.11 applies to marketing materials that are targeted at the investing public of Hong Kong. Public announcements, not being marketing materials, made by ETFs pursuant to the applicable listing rules, the regulatory requirements of the relevant Acceptable ETF Regime or SEHK, or other applicable rules need not be subject to the approval procedures under Chapter 11.11. All public announcements and notices issued by an ETF should be filed with the SFC following publication unless otherwise waived.

(e) Unless otherwise waived or provided for in paragraph 24(g) below, all notices and public announcements made by ETFs in accordance with the Code and these guidelines must be prepared in both English and Chinese.

Note: For avoidance of doubt, nothing in paragraph 14 shall exempt an ETF from compliance with Chapters 11.4 and 11.5 of the Code.

Recommended Best Practice for the Publication of Key Features Summary by ETFs

15. ETFs, whether local or overseas, may publish and distribute a Key Features Summary to investors in the following manner:

    (a) The first Key Features Summary should be made available at or before the first date of trading in the Hong Kong market or the first date of initial public offering of the ETF in Hong Kong (whichever is earlier or applicable);

    (b) Subsequent to the first Key Features Summary, an ETF should, at least, review and (if necessary) update its Key Features Summary on a half-yearly and yearly basis. It should also update the Key Features Summary whenever there are material changes to the information contained in it. The Key Features Summary should be made available at the same time as the publication of each semi-annual and annual report of the ETF.

16. The use of Key Features Summary is a recommended best practice for ETFs. ETFs should consider the following when preparing the Key Features Summary:

    (a) ETFs may at their discretion adopt their own format and make disclosure of their key information;

    (b) ETFs may also consider using a single document to contain the product summary of various ETFs managed by the same management company;

    (c) The recommended contents for a Key Features Summary are set out in **Annex (II)**. A Key Features Summary should be written in plain English and Chinese.

    (d) If an ETF decides to issue a Key Features Summary (whether following the recommended contents in **Annex (II)** or not), the first Summary must be submitted for authorization by the SFC. For subsequent updates of data and figures in a Key Features Summary, these may be made without prior approval of the SFC. An ETF should file its Key Features Summary with the SFC each time it is published unless otherwise waived.

Dissemination of Trading Information by ETFs

Local ETFs

17. In addition to information commonly available for stocks during the trading hours of the SEHK (e.g. bid/ask prices and queuing displays), local ETFs must

provide the following trading information to the public on a real time or near-real time basis unless otherwise waived, via any suitable channels in paragraph 18 below:

(a) Estimated NAV or R.U.P.V.[5];
(b) Last closing NAV;
(c) Notices for suspension and resumption of trading; and
(d) Composition of constituent securities (where practicable).

18. Information in paragraphs 17(a) to (d) above may, where applicable, be made available to investors in Hong Kong through one or more of the following means:

(a) ETF' s own website; or
(b) A hyperlink of (a) to the website of Hong Kong Exchange and Clearing Limited ("HKEx"); or
(c) Information pages of information vendors which disseminate trading information of ETFs in their ordinary course of business and whose information is accessible by retail brokers in Hong Kong (whether as paid services or not); or
(d) Any other channels that the SFC considers acceptable.

Overseas ETFs that have Cross-listing or Cross-trading Status on the SEHK

19. Overseas ETFs authorized by the SFC that are cross-listed or cross-traded on the SEHK must provide local trading information in relation to their trading on the SEHK. Local trading information includes notices for suspension and resumption of trading on the SEHK. It is a recommended best practice for such overseas ETFs to provide their overseas markets' trading information that is of the same nature as described in paragraphs 17(a) to (d) above where trading hours of the relevant overseas market and those of the SEHK overlap.

20. Information provided to investors according to paragraph 19 may be made available via any of the channels stated in paragraph 18 or via the website of overseas exchanges on which such ETFs are traded.

Prior disclosure in the Product Description Document/Hong Kong Offering Document

21. ETFs, whether local or overseas, must make prior disclosure of the types of trading information and channels through which such information is made available to investors in their Product Description Document/Hong Kong Offering Document (as the case may be). An ETF should also disclose the type of trading information (falling within the recommended best practices in these

[5] R.U.P.V. as used on the information pages of information vendors in relation to ETFs listed on the SEHK stands for "Reference Underlying Portfolio Value" which is updated at 15-second intervals during trading hours and is equivalent to the aggregate of the total value of the Index Basket Shares per Creation Unit (which is calculated by multiplying the nominal price of the Index Basket Share by the number of the respective Index Basket Shares) and the prior day estimated total cash component per Creation Unit divided by the number of Units in a Creation Unit.

guidelines) that is not made available to investors in its Product Description Document/Hong Kong Offering Document (as the case may be).

Publication of ETFs' Materials in Hong Kong

22. An ETF, whether local or overseas, must ensure that the following documents are made readily available to Hong Kong investors through any of the ETF's own website or such other channels as the SFC considers appropriate:

    (a) Product Description Document/Hong Kong Offering Document (as the case may be);
    (b) The ETF's offering document or prospectus (as the case may be) prepared in accordance with the regulations of the Acceptable ETF Regime or the relevant overseas jurisdiction (see the Note to paragraph (d) in **Annex (III))** ("ETF's Overseas Offering Document") (where applicable);
    (c) Key Features Summary (where applicable);
    (d) Latest version of the semi-annual and annual financial reports of the ETF; and
    (e) All notices and public announcements issued by the ETF in either the Acceptable ETF regime or the relevant overseas jurisdiction (see the Note to paragraph (d) in **Annex (III))** and in Hong Kong.

    Note: Where an ETF is listed or traded on the SEHK, it may, but is not required to, make available the abovementioned documents to investors in Hong Kong by way of hyperlinks to the HKEx website.

Streamlined Recognition Process for Overseas ETFs Listed in an Acceptable ETF Regime

23. An overseas ETF that meets the core structural and operational requirements in the Code and is regulated in an Acceptable ETF Regime, may be authorized through a streamlined recognition process. The specific relief in paragraph 24 applies to this type of overseas ETF such that they will be deemed to have complied with certain Code requirements including constitutive documentation requirements, index acceptability and the prescribed contents for financial reports.

    *Note: In determining whether a regime is an Acceptable ETF Regime, the regulatory principles set out in **Annex (III)** would be considered.*

24. An overseas ETF that complies with the conditions set out in **Annex (IV)** may rely on the following specific relief for a streamlined process for authorization in addition to the general relief in paragraphs 11 to 14:

    (a) *Acceptability of Index in Chapter 8.6(e)*: The index that such an overseas ETF tracks will be deemed to have complied with Chapter 8.6(e)(i) to (v) except where such index or its methodology contradicts the fundamental principles of a representative, diversified, investible and transparent index.

(b) *Reporting Requirements in Chapter 8.6(f)*: Chapter 8.6(f) only applies to (i) any significant events relating to the index that might affect the authorization or listing status of an overseas ETF in an Acceptable ETF Regime; and (ii) any other events in relation to the index that the Acceptable ETF Regime would require notification to investors. Notification of these events must be published in Hong Kong in both English and Chinese and notified to the SFC on a timely basis. No prior approval of such notices by the SFC would be required.

(c) *Replacement of Index in Chapter 8.6(k)*: Subject to paragraphs 24(a) and 24(g) of these guidelines, Chapter 8.6(k) does not apply to the replacement of index. Any replacement of index must be notified to investors and the SFC on a timely basis.

(d) *Disclosure in Financial Reports in Chapter 8.6(l) and Appendix E*: ETFs that have prepared their semi-annual and annual financial reports in accordance with their own governing overseas regulations, which reports are not qualified by their auditors, will be relieved from full compliance with the content requirements of Chapter 8.6(l) and Appendix E.

(e) *Product Description Document:* Notwithstanding paragraph 10 above, the Product Description Document for an ETF from an Acceptable ETF Regime does not have to set out all the details of the information stated in **Annex (I)** to these guidelines if:

(i) The Product Description Document takes the form of a summary of the salient features of the ETF including appropriate risk warnings as to the level of disclosure contained in it. This Product Description Document has to be prepared in both English and Chinese;

(ii) The ETF's Overseas Offering Document is available to investors in Hong Kong via the ETF's own website, the website of the overseas exchange on which it is primary listed or the HKEx website (if applicable); and

(iii) The ETF's Overseas Offering Document mentioned in paragraph 24(e)(ii) may be made available in either English or Chinese.

(f) *Constitutive Documents:* The constitutive documents will be deemed to have complied with Appendix D of the Code in so far as these are related to the structural and operational aspects of the ETF.

Note: ETFs fall within the categories of Specialized Schemes under Chapter 8 of the Code and the concept of Recognized Jurisdiction Schemes is not directly applicable. However, in considering whether the constitutive documents of an ETF from an Acceptable ETF Regime is in compliance with the Code requirements, for example, Appendix D, the SFC would consider whether the home regulations in the Acceptable ETF Regime share similar principles *in providing structural safeguards for investor protection. Accordingly, strict compliance with Appendix D and other operational requirements may not be required.*

(g) *Notification and Language Requirement in respect of Notices under Chapters 11.1 and 11.2*: Notices for material alterations or additions to the offering document or constitutive document of an ETF that is primarily regulated in an overseas jurisdiction have to be published or made generally available to investors in Hong Kong. Unless otherwise waived, these notices must be in both English and Chinese, and be published on a timely basis and in such manner as the ETF considers appropriate. Immaterial changes to such documentation or events relating to an ETF, for example, legislative or regulatory changes, typographical or stylistic changes and dividend notices may be effected without prior approval of the SFC.

Note: Examples of material changes include but are not limited to the following: - changes to investment objectives or investment risk profile, replacement of management companies or trustees, termination and mergers of ETFs.

Miscellaneous

25. These guidelines do not apply retrospectively to index tracking exchange traded funds already authorized on or before the effective date of these guidelines.

26. With respect to ETFs that have been submitted to the SFC for approval pursuant to the Code but have not been authorized before the effective date of these guidelines, they may elect to comply with the Code as amended by these guidelines.

27. These guidelines do not preclude the right of the SFC to impose any conditions for the authorization of an ETF as may be reasonable in the circumstances.

Information to be Disclosed in the Product Description Document

This list is not intended to be exhaustive. The SFC may require further information to be disclosed which may be necessary for investors to make an informed investment decision.

Summary of Information to be Disclosed	**Sections under Appendix C and Chapters of the Code and Other Relevant Information for ETFs Authorized Pursuant to the ETF Guidelines**
Constitution of the ETF	C1
Investment Objectives and Restrictions	C2
Description of Underlying Index	• 8.6(j)(i) • 8.6(j)(ii)
Other Information regarding the Index	8.6(j)(xiii)
Means by which investors may obtain relevant information regarding the ETF and the index	• Types of real time or near-real time information of the ETF that is made available and the sources from which these information could be obtained, e.g. stock code, ticker symbol, website of the ETF etc. • 8.6(j)(viii) • 8.6(j)(ix)
Operators and Principals	• C3 + any other relevant operators such as participating dealers etc.
Characteristics of Units/Shares	• C4 (if applicable) + trading lot size • C5 • C6 • C7
Creation and Redemption Procedures	• C9 (if applicable) + procedures for buying/selling units/shares on the stock exchange + creation and redemption procedures of the underlying basket of stocks by participating dealers • C10 (if applicable) • C11 • C12
Distribution Policy	• C13
Fees and Charges	• C14(a) (if applicable) • C14(b) (see 6.16 and 6.18) • Fees borne by investors trading on the stock exchange, e.g. brokerage fee, transaction levy, stamp duty etc. • C14(c) (as amended by these guidelines) *Note: Fees should be clearly presented in tabular form*

Connected Party Transaction	C15
Taxation	C16
Reports and Accounts	• C17 • C18 or the website address on which the financial reports are published
Warnings	• C19 • Proper risks warnings suitable for index tracking ETFs, including those for tracking errors, liquidity of underlying securities, circumstances that may affect the accuracy and completeness in the calculation of the index etc. *Note: With proper risk warnings, 8.6(j)(iv)- (vii), (x) – (xii) and (xiv) need not be strictly adhered to.*
General Information, e.g. date of publication of the Product Description Document, constitutive documents available for inspection etc.	• C20 • C21 • C22 • C23 • 6.15 • Provisions on stock lending
Termination of the ETF	C24 (see 11.4 and 11.5)
Authorization conditions and Waivers Granted to the ETF	• Self-imposed limits for any excess weightings of the ETF holdings over the weightings in the index • Waivers granted from compliance with the Code and/or any authorization conditions imposed on the ETF

Annex (II)

Recommended Contents for the Key Features Summary

[Name of the ETF] [Date]

Important – This is only a summary of the key features of [the name of ETF] and is not intended to be or to replace the Product Description Document/Hong Kong Offering Document/ETF's Overseas Offering Document (as the case may be). **You should read the Product Description Document/Hong Kong Offering Document/ETF's Overseas Offering Document (as the case may be) carefully before you invest.** The Product Description Document/Hong Kong Offering Document/ETF's Overseas Offering Document (as the case may be) is available from your broker free of charge upon your request [or (where applicable), may be downloaded via the website of the HKEx (*Website link: HKEx*)].

You should consult your professional advisers if you have doubts about the contents of this summary and/or the Product Description Document/Hong Kong offering document/ETF's Overseas Offering Document (as the case may be).

1. ***What is the ETF's objective and what index does it track?***
A: Describe the investment objective of the ETF and name the underlying index.

2. ***Where is the ETF traded?***
A: State the exchange(s) on which the ETF is traded and whether it is fungible between markets.

3. ***What is the index comprised of?*** *[Note: Information may be presented in tabular form where appropriate]*
A: Describe the objective of the index, e.g. the sector/market it seeks to reflect.

4. ***What is the strategy or methodology employed by the ETF in order to track the index?***

5. ***How can I obtain market and trading information about the ETF and the underlying index?***
A: State the relevant information that investors should be aware of and provide the corresponding website addresses. For example:

- ETF's own website (if any);
- Latest index information and news *(Website Link: index provider*);
- HKEx announcement *(Website Link: HKEx) (where applicable);*
- Announcements/notices posted on the overseas exchange on which primary listing of the ETF takes place *(Website Link: the primary overseas exchange where the ETF is being traded) (where applicable);* and
- Sources where additional trading information could be found, e.g. names of information vendors.

A statement to alert investors that they should actively check the above information on a regular basis since the above information may materially impact on their investment holdings.

6. ***Quick Facts*** *[Note: Information may be presented in tabular form where appropriate], e.g.*
   - Stock code;
   - Sources where the NAV, R.U.P.V, the underlying index level are published;
   - Ticker symbol;
   - Trading lot size;
   - Main operators – e.g. management company, participating dealers, Hong Kong representative etc.; and
   - Top 10 holdings of the ETF as of the date of the Key Features Summary.

7. ***What are the risks associated with the ETF?*** *[Note: Insert proper risk warnings depending on the nature of the ETF and the index, including but not limited to the following suggested items]*
   - Liquidity risks;
   - Tracking error risks and the circumstances under which tracking errors may occur;
   - Trading risks – e.g. disruptions to the creation and redemption process, suspension of trading etc.;
   - Risks and constraints arisen from the employment of certain strategies; and
   - Applicable risk warnings required under Appendix C19 of the Code.

8. ***How can I purchase and sell the ETF?***

9. ***What are the fees and charges involved in this investment?*** *[Note: Fees of the ETF should be clearly presented in tabular form]*

A: State all the fees and charges involved and divide them into at least the following four categories:

a) Fees and charges payable by investors trading the ETF via the stock exchange
b) Brokerage commission paid by investors in trading the ETF
c) Fees payable by participating dealers in dealing directly with the ETF e.g. block creation and redemption
d) Fees borne by the ETF

10. ***Will I receive any income or dividend from the investment?***

11. ***Who can I contact for enquiries or to obtain further information?***

<u>Annex (III)</u>

General Principles for an Acceptable ETF Regime

In determining whether a regime is an Acceptable ETF Regime, the following regulatory principles would be considered:

(a) The availability of a mutual co-operation and assistance agreement for fund management activities between the principal securities regulator of the Acceptable ETF Regime and the SFC;

(b) The similarity or comparability of the overall securities regulatory framework provided by the overseas jurisdiction where there is substantial interest in the ETF and in which it is primarily listed. The SFC will consider the extent to which these overseas jurisdictions' structural and operational requirements and disclosure standards on ETFs are comparable or equivalent to the principles adopted by the SFC for regulating collective investment schemes;

(c) The overall and combined effect of the rules and regulations, the regulatory infrastructure of an Acceptable ETF Regime where the ETF is primarily listed and in which there is substantial interest and the effectiveness of the administration of these rules and regulations, should be able to afford comparable investor protection to that provided under the Hong Kong regulatory framework; and

(d) The overseas stock exchange on which primary listing of the ETF takes place should provide a system for efficient public dissemination of trading and other information relevant to the trading of ETFs. Information about the index which the ETF tracks is either published generally or otherwise made readily available to the public in electronic or other means.

*Note: It is acknowledged that the regulatory framework for ETFs in some overseas jurisdictions may meet substantially but not all of the above principles in **Annex (III)** for recognition as an Acceptable ETF Regime. In these circumstances, the SFC would consider on a case-by-case basis the extent to which these ETFs may be granted partial relief under these guidelines and if any corresponding or alternative safeguards for investor protection should be imposed in consideration of the relief being granted.*

Once it is established that an overseas ETF is regulated in an Acceptable ETF Regime, such ETF must also comply with the conditions in **Annex (IV)** in order to be eligible for the specific relief in paragraphs 23 and 24 of the guidelines.

Annex (IV)

Compliance Conditions for Overseas ETFs

An overseas ETF that seeks to rely on the specific relief in paragraphs 23 and 24 of the guidelines must comply with the following conditions:

(a) Compliance with the applicable laws and regulations of the relevant Acceptable ETF Regime;

(b) Compliance with the applicable listing rules and trading rules of the overseas exchange on which the ETF is primarily listed;

(c) There are no changes in the laws and regulations of the Acceptable ETF Regime and the relevant overseas listing rules governing the offering and the listing of the ETF that would materially affect the Acceptable ETF Regime's comparability with that of Hong Kong. Where any material changes would be made to the securities regulations or the applicable listing rules of the Acceptable ETF Regimes thereby affecting their comparability with those of Hong Kong, the ETF or its management company must inform the SFC as soon as practicable; and

(d) The ETF complies in full with the applicable provisions in the guidelines.