



HONG KONG PROVIDES FLEXIBILITY IN MASTER-FEEDER ETF STRUCTURES

The Securities and Futures Commission of Hong Kong (the SFC) have announced that they will provide streamlined requirements for eligible exchange traded funds (ETFs) adopting a master-feeder structure.

Current practice

Index tracking ETFs adopting a master-feeder structure are already permitted under the Code on Unit Trusts and Mutual Funds (UT Code) provided that both the feeder ETF and the master ETF are authorized by the SFC.

However, the industry has been asking the SFC to provide additional flexibility in this regard, so that an SFC-authorized feeder ETF may invest its assets in an overseas-listed master ETF without SFC authorization.

In the circular, issued on 16 December 2019, the SFC details the requirements under which it would consider authorizing such feeder ETF.

General principles

SFC consideration would be given on a case-by-case basis, taking into account the following principles:



The diagram below provides a list of the SFC minimum requirements for both master and feeder ETFs.



Master ETF minimum requirements

Must be a scheme regulated in a recognized jurisdiction* managed by a management company in an acceptable inspection regime** or a scheme eligible under a mutual recognition of funds arrangement.

Master ETF, along with its management company and trustee/custodian, must have a good compliance record with the rules and regulations of its home jurisdiction and (in the case of a master ETF) the listing venue.

Must have a fund size of not less than USD 1 billion and a track record of more than 5 years at the time of the feeder ETF's listing on the Stock Exchange of Hong Kong.

Must adopt physical replication of the underlying index through either a full replication or a representative sampling strategy.

Engagement in securities financing transactions should not exceed 50% of its total net asset value unless there are comparable safeguards and disclosure.

* A list of recognized jurisdictions is published on the SFC's website.

** A list of acceptable inspection regimes is published on the SFC's website.



Feeder ETF

An index tracking feeder ETF seeking SFC authorization for public offering in Hong Kong should comply with the applicable requirements in the Overarching Principles Section and the UT Code in the SFC Handbook for Unit Trusts and Mutual Funds, Investment-Linked Assurance Schemes and Unlisted Structured Investment Products and all other applicable regulatory requirements and guidelines as may be issued by the SFC from time to time.

In addition the feeder ETF should meet the following requirements:

Must be a Hong Kong-domiciled ETF authorized by the SFC.

Must be managed by a management company which is licensed or registered for Type 9 regulated activity and has a good compliance record.

Management company of the feeder ETF should report to the SFC as soon as practicable if the master ETF ceases to comply with the requirements set out in the circular and take appropriate remedial action to promptly rectify the situation.

Management company of the feeder ETF should put in place appropriate arrangements to inform Hong Kong investors of any material change to, or event that has a significant adverse impact on, the master ETF in a timely manner.



The SFC may also consider introducing additional requirements or conditions as deemed necessary or appropriate in the discharge of its functions.

Other materials issued alongside the circular

Two sets of frequently asked questions (FAQs) were also issued on the same day. These covered the following topics:

FAQ's on Exchange Traded Funds and Listed Funds

Question 19 has been added which explains how the management company of the feeder ETF should inform the Hong Kong investors of a material change to, or event that has a significant adverse impact on, the master ETF.

The SFC advises that as the master ETF is not authorized by the SFC, it cannot be offered to the public in Hong Kong unless an exemption under section 103 of the SFO applies. The manager of the feeder ETF should exercise caution and where appropriate take professional legal advice to ensure that marketing materials of the feeder ETF are in compliance with all applicable laws and regulations. In particular, the management company of the feeder ETF should take note of the following when they market the feeder ETF to Hong Kong investors:

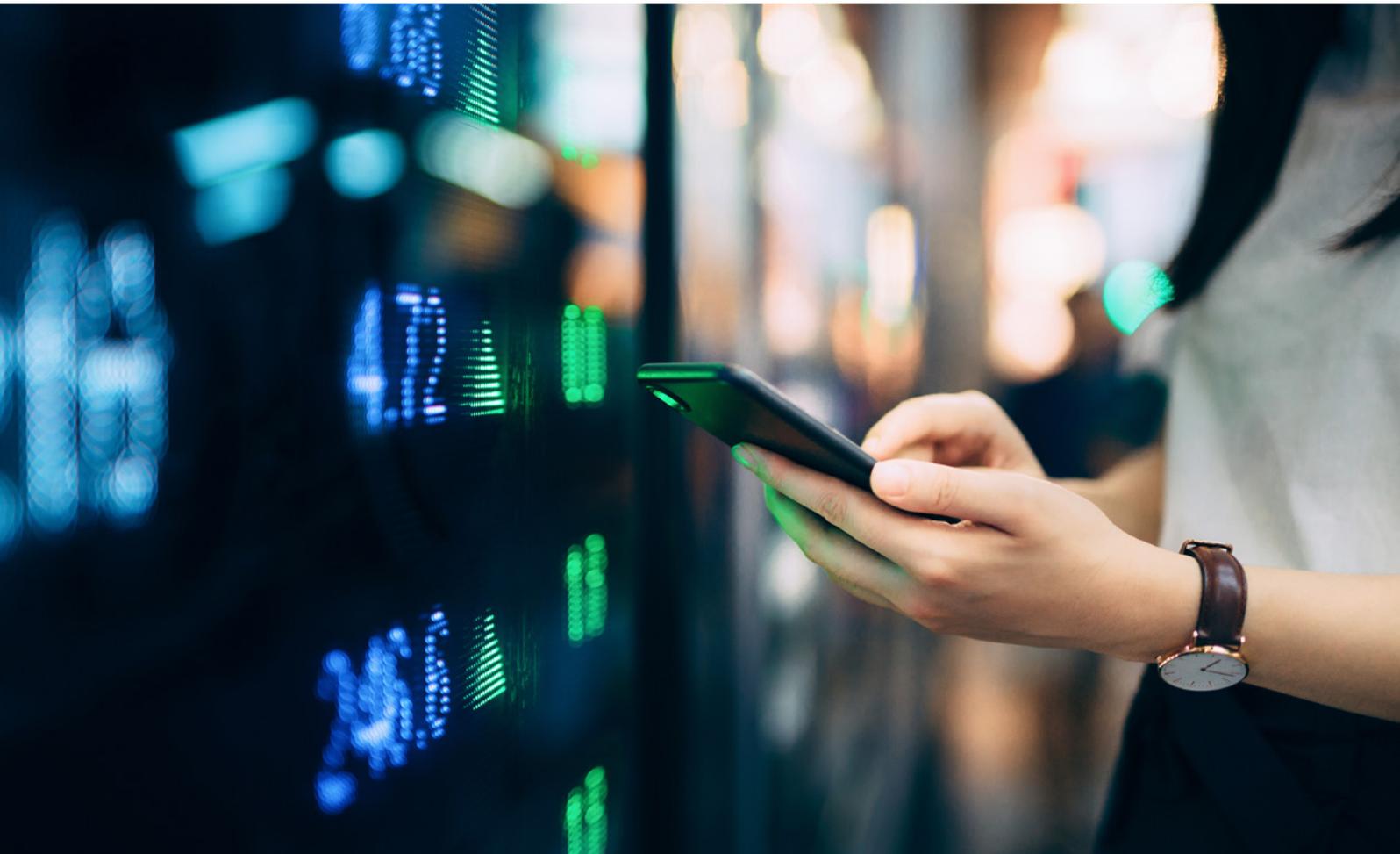
- a) All the marketing materials should be for the purpose of promoting the feeder ETF, and not the master ETF;
- b) If the master ETF is being mentioned in any marketing materials, the marketing materials must not contain any language which suggests an invitation to the public to invest in the master ETF;
- c) Only the factual information about the master ETF can be disclosed in the marketing materials; and
- d) There should be a prominent warning statement in the marketing materials that the master ETF is not authorized by the SFC and is not available to the public in Hong Kong.

FAQ's on advertising materials of collective investment schemes authorized under the Product Codes

Question 40 has been added which asks if the marketing materials of the SFC-authorized feeder ETF are allowed to contain information of the master ETF.

The SFC advises that the management company of the feeder ETF shall inform the SFC and holders by way of public announcements and publish as soon as reasonably practicable any information concerning the feeder ETF pursuant to the





requirements under 8.6(q) of the UT Code. Because the feeder ETF is investing substantially all of its assets in the master ETF, the disclosure and reporting obligations under 8.6(q) would include material changes to or events that have a significant adverse impact on the master ETF.

So that Hong Kong investors can be informed in a timely manner, the management company of the feeder ETF should put in place appropriate arrangements, for example, by providing a link to the master ETF's website in the feeder ETF's website.

In addition, the feeder ETF must still prepare and publish bilingual announcements to inform the Hong Kong investors as soon as practicable after an announcement has been made by the master ETF.

Further points for consideration

There are certain questions, which may remain unanswered in terms of the latest publications. We list some of our thoughts below:

Fees: Will there be any restriction on the level of fees charged and at which point in the feeder route? Is there a limit or any other clarification which might be forthcoming?

Proportion invested: There is no reference to there being any requirements on the proportion invested into the master from the feeder i.e. does the feeder need to be invested at 100%, all of the time?

Whilst not explicitly stated by the SFC in the latest updates, Chapter 7.12 of the SFC's Code on Unit Trusts and Mutual Funds may apply, such that 90% or more of its NAV is invested in the underlying fund?

Dealing and trading activity: Will there be more coordination on dealing and trading activity?

For reference to the original source documentation on which this e-briefing is based, please find further details in the attachments below.

[Link to full Circular here](#)

[Link to updated information checklist for authorization of unit trusts and mutual funds under the streamlined process here](#)

[Link to ETF FAQs here](#)

[Link to advertising FAQs here](#)

Should you have any questions, or wish to discuss this topic in more detail, please don't hesitate to contact us on the details listed below:

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