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Hong Kong SFC Broadens Exemption for Master-Feeder ETFs

The Securities and Futures Commission (**SFC**) has published a revised [Circular on streamlined requirements for eligible exchange-traded funds adopting a master-feeder structure](https://apps.sfc.hk/edistributionWeb/gateway/EN/circular/doc?refNo=24EC24) to allow SFC-authorised feeder Exchange-traded funds (**ETFs**) to invest in overseas-listed master ETFs – including actively managed ETFs - subject to meeting specified conditions. The changes extend the streamlined requirements for master ETFs to actively managed ETFs and are aimed at broadening the range of investment products available to Hong Kong investors and boosting Hong Kong's status as an international fund management hub.

Position under the SFC's Code on Unit Trusts and Mutual Funds

Previously, paragraph 7.12 of the SFC's Code on Unit Trusts and Mutual Funds (**UT Code**) allowed a feeder fund to invest 90% or more of its total net asset value in a master fund provided that both the feeder ETF and the master ETF were authorised by the SFC.[1](#footnote-643-1) However, this prevented SFC-authorised feeder ETFs from investing in overseas-listed master ETFs, limiting the investment products available. Additionally, the procedures for obtaining SFC authorisation are onerous and expensive, especially when the master ETF is listed offshore.

With the increased popularity of ETFs, the SFC received a number of requests to allow SFC-authorised feeders to invest in overseas-listed master ETFs without SFC authorisation. According to the SFC, the global ETF market's assets under management increased to US$12.7 trillion at the end of the first quarter of 2024, while actively managed ETFs have grown much faster than ETFs generally since 2019.

In December 2019, the SFC implemented a [Circular on streamlined requirements for eligible exchange-traded funds adopting a master-feeder structure](https://apps.sfc.hk/edistributionWeb/gateway/EN/circular/doc?refNo=19EC73) (**2019 Circular**) allowing passively managed SFC-authorised feeder ETFs to invest in eligible overseas-listed master ETFs without the master ETF needing separate SFC authorisation. This framework was updated in February 2022 by the SFC's [Supplemental Circular on streamlined requirements for eligible exchange traded funds adopting a master-feeder structure](https://apps.sfc.hk/edistributionWeb/gateway/EN/circular/doc?refNo=22EC16) (**Supplemental Circular**), which relaxed the fund size and track record requirements for eligible master ETFs.

Revisions to the Circular on Streamlined Requirements for Eligible ETFs adopting a Master-Feeder Structure

Under the revised Circular, the SFC will authorise a feeder ETF that invests in an overseas-listed master ETF, whether the master ETF is passively or actively managed, on a case-by-case basis. The key requirements are that the master ETF must:

1. have satisfactory safeguards and measures in place to provide investor protection that is substantially the same as for SFC-authorised ETFs, taking into account its underlying assets, investment strategy, applicable rules and regulations in home jurisdiction;
2. have sizeable assets under management - the SFC has removed the limitation on the application of the streamlined requirements to particular types of schemes (essentially recognised jurisdiction schemes managed by a management company in an acceptable inspection regime or schemes eligible under a mutual recognition of funds arrangement); and
3. together with its management company and trustee/custodian, have a good compliance record with the rules and regulations of its home jurisdiction and, in the case of the master ETF, its listing venue.

The revised Circular also removes the specific fund size and track record requirements of the 2019 Circular and Supplemental Circular.

Feeder ETF Requirements

Feeder ETFs seeking SFC authorisation for public offering in Hong Kong need to meet the following requirements:

1. the feeder ETF must be a Hong Kong-domiciled ETF authorised by the SFC;
2. the feeder ETF must be managed by a management company which is licensed or registered for Type 9 regulated activity and have a good compliance record;
3. the 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; and
4. the management company of the feeder ETF should put in place appropriate arrangements to inform Hong Kong investors of any material changes to, or events that have a significant adverse impact on, the master ETF in a timely manner.

The SFC may consider introducing additional requirements or conditions if it deems it necessary or appropriate.

Feeder ETFs must also comply with the relevant requirements in the Overarching Principles Section and the UT Code of the SFC Handbook for Unit Trusts and Mutual Funds, Investment-Linked Assurance Schemes and Unlisted Structured Investment Products, and all other applicable SFC regulatory requirements and guidelines.

The SFC has emphasised its intention to balance the needs for investor protection and market development in amending the master-feeder ETF requirements. It believes the relaxation will improve Hong Kong's competitiveness in attracting overseas ETFs.

The SFC's revised circular is available on the SFC website [here](https://apps.sfc.hk/edistributionWeb/gateway/EN/circular/doc?refNo=24EC24).

[1](#footnote-643-1-backlink) SFC. Code on Unit Trusts and Mutual Funds, paragraph 7.12

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