

Implementation of ETF Connect in Hong Kong

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Introduction

On 27 May 2022, the Hong Kong Securities and Futures Commission ("**SFC**") and the China Securities Regulatory Commission ("**CSRC**") published a joint announcement¹ (the "**Joint Announcement**") on the inclusion of eligible exchange-traded funds ("**ETFs**") as part of the mutual stock market access arrangement between Mainland China and Hong Kong ("**Stock Connect**") ("**ETF Connect**").

The decision to include ETFs as tradeable products in Stock Connect stems from the SFC's and CSRC's intention to broaden the scope of investment opportunities for domestic and overseas investors. The inclusion of ETFs in Stock Connect will allow Hong Kong and Mainland investors (both individual and institutional) to trade eligible ETFs listed on their respective exchanges via local securities firms and/or brokers.

Eligibility of ETFs

Under ETF Connect, only Mainland and Hong Kong ETFs which satisfy their respective Northbound or Southbound regulatory requirements (as the case may be) will be eligible to be included in Stock Connect ("**Eligible Northbound ETFs**" or "**Eligible Southbound ETFs**", and collectively, "**Eligible ETFs**"). The eligibility of Mainland and Hong Kong ETFs will be determined based on several criteria², including but not limited to the following:

- The ETF must be traded in the requisite currency (i.e., RMB for a Mainland ETF, HKD for a Hong Kong ETF) and meet the minimum threshold of daily average assets under management ("**AUM**") in the last six months (being at least RMB1.5 billion for a Mainland ETF and at least HKD1.7 billion for a Hong Kong ETF);
- The ETF must be listed (on the Hong Kong Stock Exchange ("**HKEX**"), Shanghai Stock Exchange ("**SSE**") or Shenzhen Stock Exchange ("**SZSE**"), as the case may be) for at least six months;
- The respective benchmark indexes tracked by the Mainland ETF or Hong Kong ETF must have been launched for at least one year;
- The respective benchmark indexes must satisfy certain criteria in relation to the composition of stocks that are eligible for trading under Stock Connect; and
- The respective benchmark indexes must satisfy certain criteria in relation to the weighting of its constituents.

Eligible ETFs will be subject to regular review, and where an Eligible ETF falls below certain thresholds³, it will be designated as a "sell-only" security, meaning that investors may sell existing holdings but will be restricted from buying such an ETF. The thresholds include, but are not limited to:

- The ETF's daily average AUM in the last six months fall below a specific threshold (being RMB1 billion for an Eligible Northbound ETF and HKD1.2 billion for an Eligible Southbound ETF);
- The relevant benchmark index no longer satisfies the minimum requirements in relation to the composition of stocks that are eligible for trading under Stock Connect, or in relation to the weighting of its constituents; or
- The ETF fails to satisfy any other criteria specifically applicable to an Eligible Northbound ETF or Eligible Southbound ETF.

For individual and institutional Hong Kong investors looking to invest in Mainland ETFs through ETF Connect, regular reviews will be performed to determine Eligible Northbound ETFs every six months⁴. SSE-listed and SZSE-listed ETFs will be included or excluded (as the case may be) from the list of Eligible Northbound ETFs on the basis of relevant data as at the regular review data cut-off dates, being the first trading day after the second Friday of each of June and December each year⁵. Upon implementation of ETF Connect, the list of Eligible Northbound ETFs will be made available on the HKEX website.

Investment quotas

Trading ETFs under ETF Connect will be subject to the existing daily quotas prescribed under Stock Connect. The northbound daily quota is currently set at RMB52 billion for each of Shanghai Connect and Shenzhen Connect⁶, while the southbound daily quota is currently set at RMB42 billion for each of Shanghai Connect and Shenzhen Connect. For Hong Kong investors, the Northbound daily quota will be shared amongst China A-shares⁷ and Eligible Northbound ETFs in Stock Connect⁸.

Trading arrangements to be formalized

While it is proposed that ETF Connect will largely follow existing operational models of the Mainland and Hong Kong markets, the final launch of ETF Connect will be subject to further formulation and/or amendments to related trading and clearing rules as agreed between the relevant stock exchanges, securities registration and clearing houses in Mainland China and in Hong Kong. The relevant stock exchanges, securities registration and clearing houses will develop and test technical and operational systems and will also determine and implement the necessary cross-border regulatory and enforcement arrangements and investor education measures.

Formal implementation of ETF Connect is anticipated to take place approximately two months from the date of the Joint Announcement⁹.

Footnotes

1) For further details on the Joint Announcement, please refer to:

<https://www.sfc.hk/en/News-and-announcements/Policy-statements-and-announcements/Joint-Announcement-of-the-CSRC-and-the-SFC>.

2) On 27 May 2022, the HKEX published a circular on Further Update on the Inclusion of ETFs in Stock Connect (the "HKEX Circular"), which contains the full list of criteria that a Northbound ETF or Southbound ETF must fulfill in order to be recognized as an Eligible ETF. For further details, please refer to: <https://www.hkex.com.hk/-/media/HKEX-Market/Services/Circulars-and-Notices/Participant-and-Members-Circulars/SEHK/2022/CT05922E.pdf>.

- 3) The full list of thresholds that trigger a designation of an Eligible ETF as "sell-only" securities can be found in the HKEX Circular. For further details, please refer to the weblink above.
- 4) For further details, please refer to the HKEX FAQ on Inclusion of ETFs for Northbound Trading in Stock Connect, dated 27 May 2022: https://www.hkex.com.hk/-/media/HKEX-Market/Mutual-Market/Stock-Connect/Reference-Materials/Inclusion-of-ETFs-in-Stock-Connect/Inclusion_of ETFs in Stock Connect FAQ Eng.pdf.
- 5) See footnote 4 above. For details on the respective regular review data cut-off dates for Eligible Southbound ETFs, please refer to: https://www.hkex.com.hk/-/media/HKEX-Market/Mutual-Market/Stock-Connect/Reference-Materials/Inclusion-of-ETFs-in-Stock-Connect/Inclusion_of ETFs in Stock Connect SB Regular Review Eng.pdf.
- 6) See footnote 4 above. For the latest information on daily quotas, please visit the HKEX website.
- 7) China A-shares are RMB-denominated shares of Chinese companies which trade on the SSE and/or SZSE.
- 8) See footnote 4 above.
- 9) See footnote 1 above.