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Client Alert

Financial Services

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ETF Connect: Implementation details announced

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The Securities and Futures Commission (**SFC**) and the China Securities Regulatory Commission (**CSRC**) jointly announced on 27 May 2022 details for the implementation of the long-waited connect scheme for trading of exchange-traded funds (**ETFs**) between Mainland China and Hong Kong (**ETF Connect**). On the same day, the Stock Exchange of Hong Kong (**SEHK**) also issued a circular to provide the industry with details of the eligibility criteria.

The ETF Connect will be implemented by way of inclusion of eligible ETFs into the existing Stock Connect framework and infrastructure for mutual access. By including ETFs in Stock Connect, Mainland and Hong Kong investors will be able to trade eligible ETFs listed on each other's exchanges through local brokers.

At the initial stage, ETFs primarily regulated by SFC and listed on the SEHK that satisfy all of the following criteria will be accepted as eligible ETFs:

1. The ETF must be traded in HKD and have a daily average assets under management in the last six months of no less than HKD 1.7 billion;

2. The ETF must be listed for no less than six months;

3. The benchmark index must be launched for no less than one year;

4. The ETF must not be synthetic ETFs or Leveraged and Inverse Products;

5. The total weighting of SEHK-listed stocks in the benchmark index must not be less than 90%;

6. The total weighting of Stock Connect Southbound eligible constituents in Hang Seng Index (HSI), Hang Seng China Enterprises Index (HSCEI), Hang Seng TECH Index (HSTECH) and Hang Seng Hong Kong-Listed Biotech Index (HSHKBIO) must not be less than 70% and the total weighting of Stock Connect Southbound eligible constituents in other benchmark indices must not be less than 80%; and

7. The benchmark index or the index methodology of the benchmark index must be broadly based or be able to satisfy certain thresholds in terms of concentration of its constituent stocks.

Similar eligible requirements are applicable for Mainland ETFs listed on the Shanghai Stock Exchange (**SSE**) or Shenzhen Stock Exchange (**SZSE**) that could be traded via Hong Kong brokers. In particular, the SSE/SZSE-listed ETFs must be traded in RMB and have a daily average assets under management in the last six months of no less than RMB 1.5 billion, and the total weighting of SSE-listed and SZSE-listed A shares in benchmark index must not be less than 90% and the total weighting of Stock Connect Northbound eligible constituents in the benchmark index must not be less than 80%. Additional requirements on track records and index constituent weighting also apply.

Under ETF Connect, investors may trade ETFs only on secondary markets and no subscriptions or redemptions are allowed. The official implementation date of ETF Connect is to be announced, but it is expected to be launched soon.

While there may not be a lot of eligible ETFs falling within the scope of ETF Connect at the initial stage, it is hoped that eligibility will be relaxed as the ETF Connect scheme gains traction. Fund houses are encouraged to review their existing ETFs offering, and get prepared for the opportunity ahead for cross-border trading.

Deacons' investment funds team has substantial experience in advising our clients on Mainland China access schemes and the setting up of cross-border funds. We are delighted to have assisted with the successful Hong Kong listing of one of the first ETFs under the Mainland-Hong Kong cross-listing scheme and the listing of the first ETF in Hong Kong which participates in the trading of Mainland Chinese commodity futures.

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