

LCQ18: Management of the Tracker Fund of Hong Kong

Following is a question by the Hon Luk Chung-hung and a written reply by the Secretary for Financial Services and the Treasury, Mr Christopher Hui, in the Legislative Council today (February 3):

Question:

The objective of the Tracker Fund of Hong Kong (TraHK) is to provide investment results that closely correspond to the performance of the Hang Seng Index (HSI). As provided in the prospectus of TraHK, its manager seeks to achieve the investment objective by investing all, or substantially all, of TraHK's assets in shares in the constituent companies of HSI in substantially the same weightings as they appear in HSI. However, State Street Global Advisors Asia Limited (SSGA), the manager of TraHK, issued a notice on the 11th of last month to inform unitholders that, as affected by the executive order signed by the President of the United States, TraHK would not make any new investments in those constituent companies of HSI which were sanctioned entities (the companies concerned) with immediate effect (the decision). Two days later, SSGA issued another notice stating that it would resume investments in the companies concerned on the next day. Some investors have pointed out that the tracking error occurred during the period when TraHK ceased making investments in the companies concerned may affect the Fund's investment returns. In this connection, will the Government inform this Council:

(1) whether it has assessed if the decision has gone against the investment objective of TraHK;

(2) whether it knows if the regulatory authorities have gained an understanding and requested an explanation from SSGA immediately after the decision was made, and assessed the impacts of the decision on the securities market and investors; and

(3) whether it will request the Hong Kong Monetary Authority and TraHK Supervisory Committee to review the aforesaid incident, including considering (i) if SSGA's making the decision constitutes an act of misconduct and has violated the relevant codes/professional conduct, (ii) if SSGA can still effectively perform its duties and responsibilities as a manager, and (iii) if there is a need to replace the manager to ensure effective management of TraHK, thereby restoring investor confidence?

Reply:

President,

In 1999, the Government disposed of the shares it acquired in the stock

market operation in 1998 in the form of a unit trust scheme, i.e. the "Tracker Fund of Hong Kong" (TraHK). TraHK, a product which has been authorised by the Securities and Futures Commission (SFC) for sale to the public in Hong Kong and is listed on the Stock Exchange of Hong Kong, is a popular passive fund among the public. As a licensed corporation regulated by the SFC, the State Street Global Advisors Asia Limited (SSGA) has been the fund manager of TraHK (the Manager) since 1999. A Supervisory Committee has been set up for TraHK to supervise the trustee and manager in relation to the management and administration of TraHK.

SSGA announced on January 11, 2021 that TraHK would, with effect from the same date, not make any new investments in the Hang Seng Index constituent stocks that were sanctioned by the United States (US) and that TraHK would no longer be appropriate for US person to invest. Subsequently, the company announced on January 13, 2021 that TraHK would resume investment in the sanctioned Hang Seng Index constituent stocks.

Having consulted the SFC and the Hong Kong Monetary Authority (HKMA), my reply to the three parts of the question is as follows:

(1) According to the prospectus of TraHK, "TraHK's investment objective is to provide investment results that closely correspond to the performance of the Hang Seng Index (Index)..... The Manager seeks to achieve TraHK's investment objectives by investing all, or substantially all, of TraHK's assets in shares in the constituent companies of the Index in substantially the same weightings as they appear in the Index..." If there is any significant deviation between the TraHK's portfolio and the composition and weighting of the Index, the Manager will, having considered the transaction costs and the impact, if any, on the market, adjust the TraHK's portfolio when it considers appropriate. Under the "risk disclosure" part of the prospectus, it is also suggested that TraHK's return may deviate from that of the Index due to the tracking strategy adopted by the Manager.

If the Manager does not invest in certain constituent stocks of the Hang Seng Index on a long-term basis, there is a chance that the investment objective of TraHK would be compromised. The extent of the impact would vary depending on various factors, for example, the number of constituent stocks that the Manager no longer invests in, their shares in the Hang Seng Index, the price movement of different constituent stocks and the adjustments to the Manager's investment strategies, etc.

Investors who participate in the trading of TraHK generally expect that the fund can closely resemble the performance of the Hang Seng Index. The hasty announcement by the Manager about its investment decision, and that such decision was then altered within a short period of time have inevitably caused confusion to the public. Although the announcements did not bring any material impact on the investors of TraHK, they have given rise to unnecessary market chaos. The Government has expressed deep concern over the situation and requested the HKMA and the Supervisory Committee of TraHK to take follow-up actions seriously to address the public concern.

(2) The SFC and the HKMA have, as soon as they were informed of such investment decision, contacted the Manager to understand the justifications and specific arrangements of its decision. Since the Manager is a licensed corporation regulated by the SFC, it has to comply with the Fund Manager Code of Conduct (the Code). The Code has prescribed certain restrictions and requirements for fund managers in relation to investment management, including making adequate disclosure of information (as well as any material changes to the information) on the fund which is necessary for investors to be able to make an informed decision about their investment in the fund.

The SFC has maintained effective regulatory communication with the Manager, and has urged the Manager to comply with the Code and make all decisions in an honest, fair and diligent manner taking into account investor protection and market integrity. The SFC will continue to closely monitor the situation to ensure that the market would operate in an orderly manner and that investors would be adequately protected.

(3) Once the HKMA and the Supervisory Committee of TraHK were informed of the decision of the Manager, they have immediately got in touch with the Manager and requested it to explain the reasons of the decision, adopt measures to mitigate the impact to investors, and review their decision. Since SSGA announced resumption of relevant investment on January 13, 2021, the HKMA has continued to closely follow up with the Supervisory Committee of TraHK and that company. The HKMA understands that the follow-up work by the Supervisory Committee of TraHK is still ongoing.