

LCQ4: Management of Tracker Fund of Hong Kong

Following is a question by the Hon Christopher Cheung and a written reply by the Secretary for Financial Services and the Treasury, Mr Christopher Hui, in the Legislative Council today (February 24):

Question:

State Street Global Advisors Asia Limited (SSGA), the manager of the Tracker Fund of Hong Kong (TraHK), issued a notice on the 11th of last month to the unitholders of TraHK stating 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 the Hang Seng Index which were sanctioned entities (the companies concerned) with immediate effect (the decision). Two days later, SSGA issued another notice stating that TraHK would resume investments in the companies concerned on the next day. Some investors consider that by contradicting itself within a short period of time and acting recklessly, SSGA has made people lose confidence in its capability to manage TraHK. In this connection, will the Government inform this Council:

- (1) as the Government stated in response to the incident that the decision "did not bring any material impact on the investors of TraHK", of the justifications for such a statement;
- (2) whether it has reviewed if SSGA's making the decision constitutes an act of misconduct and has violated the relevant codes/professional conduct; if it has reviewed and the outcome is in the affirmative, whether it will request the Supervisory Committee of TraHK to replace the manager, so as to ensure that TraHK is managed effectively; if the review outcome is in the negative, of the justifications for that; and
- (3) as the Government indicated early this month that the Hong Kong Monetary Authority was closely following up the incident with the Supervisory Committee of TraHK and SSGA, of the progress of the follow-up work?

Reply:

President,

State Street Global Advisors Asia Limited (SSGA) announced on January 11, 2021 that the Tracker Fund of Hong Kong (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 suitable 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.

Such announcements have given rise to unnecessary market chaos. The Government has earlier expressed deep concern over the situation and immediately requested the Hong Kong Monetary Authority (HKMA) and the Supervisory Committee of TraHK to seriously follow up on the incident. Having consulted the Securities and Futures Commission (SFC), the HKMA and the Mandatory Provident Fund Schemes Authority (MPFA), the Government's 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 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.

TraHK is an exchange-traded fund which currently invests in 52 constituent stocks of the Hang Seng Index. According to the information provided by the regulators, the sanctioned entities which SSGA has earlier announced that it would not make further investments in accounted for around 2.6 per cent of the Hang Seng Index. The tracking error recorded during January 11 to January 13, 2021 was around one basis point each day.

Investors who participate in the trading of TraHK generally expect that the fund can closely resemble the performance of the Hang Seng Index. The Government considers that the hasty announcement by SSGA about its investment decision, and that such decision was then altered within a short period of time have inevitably caused confusion to the public. The Government considers the situation highly unsatisfactory and would take follow-up actions seriously.

(2) and (3) 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 SSGA 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 to enable investors to make informed decisions about their investment in the fund.

The SFC has maintained regulatory communication with SSGA, and has urged the company 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 enquiry about the incident by the SFC is still ongoing. 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.

Separately, 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 company and requested it to explain the reasons of the decision, adopt measures to mitigate the impact to investors, and review its 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 follow-up work by the Supervisory Committee of TraHK is still ongoing.

As for the Mandatory Provident Fund (MPF) schemes, there are currently three index-tracking constituent funds (constituted respectively under three MPF schemes) which appoint SSGA as investment manager and invest wholly in TraHK. The total net asset value of these three funds amounts to HK\$3.6 billion or 0.32 per cent of the total MPF scheme assets. The MPFA has requested relevant trustees to review whether SSGA, as their MPF investment manager, has continued to perform its functions and invested in accordance with the fund's original investment objectives. If the relevant trustees consider that SSGA is no longer suitable to act as an investment manager, they should make necessary arrangements and adopt risk management measures to protect the interests of MPF scheme members. The MPFA will continue to monitor the situation and maintain close communication with trustees.