July 2022

ETF Spotlight

Tapping into China's bond market through Hong Kong-listed ETFs

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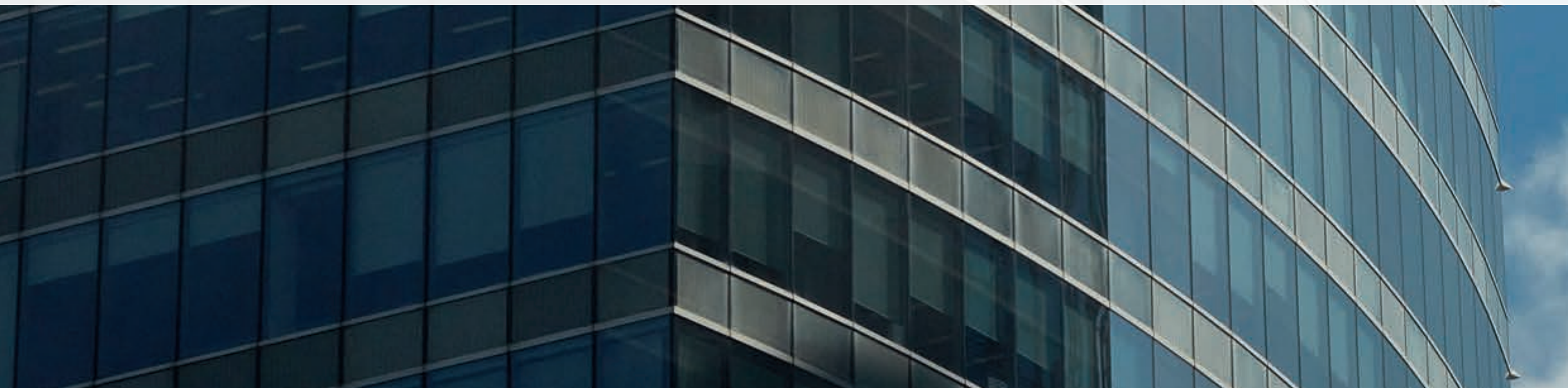


Hong Kong’s ETF market

First-half recap of 2022

Building on the momentum gathered in 2021, Hong Kong's Exchange Traded Funds (ETFs) market attained multiple record highs in fund flows and market capitalisation in the first half of 2022 while average daily turnover (ADT) remained elevated throughout the period.

The first half of the year also saw HKEX provide investors with unprecedented access to new markets and thematic exposures with a number of groundbreaking initiatives. Hong Kong's first metaverse ETF was listed in February, followed by the launch of the city's first carbon futures ETF in March and the first blockchain ETF in June.

For the rest of 2022, we expect the momentum to continue buoyed by further enhancements in the ETF market, such as the inclusion of ETFs in the Stock Connect programme that began on 4 July 2022. The enhanced market accessibility broadened the breadth of choices available to investors around the world, providing them with a low-cost and convenient platform to capture opportunities in China's vast and fast-growing capital markets.

HK$443 billion[1]
market capitalisation

HK$11.8 billion[2]
average daily turnover

HK$56 billion[3]
fund flow

New listings

A total of 10 new products were launched in first half of 2022. Among them were eight thematic products, making this category one of the fastest-growing segments in recent years.

Of these, the most notable were the first metaverse ETF – CSOP Metaverse Concept ETF (3034); the first carbon futures ETF – CICC Carbon Futures ETF (3060 / 83060 / 9060); and the first blockchain ETF – Samsung Blockchain Technologies ETF (3171). The first batch of pure-play Hong Kong ESG ETFs – HSI ESG Enhanced Select Index ETF (3136) and Global X Hang Seng ESG ETF (3029) – were also listed during this period.

The continued increase in the number and variety of thematic listings reflects growing investor demand for these products. As of June 2022, there are over 50 thematic ETFs listed in Hong Kong, covering exposures including but not limited to themes such as ESG, fintech, electric vehicle and metaverse.

Full list of ETF listings in first half of 2022:

Stock code	Currency	Product name	Issuer	Listing date
3021	HKD	Fubon FTSE Taiwan RIC Capped Index ETF	Fubon Fund Management (Hong Kong) Limited	13 January 2022
3076	HKD	Fubon ICE FactSet Taiwan Core Semiconductor Index ETF	Fubon Fund Management (Hong Kong) Limited	13 January 2022
3034	HKD	CSOP Metaverse Concept ETF	CSOP Asset Management Limited	21 February 2022
3136	HKD	HSI ESG Enhanced Select Index ETF	Hang Seng Investment Management Limited	24 February 2022
3006	HKD	Global X Metaverse Theme Active ETF	Mirae Asset Global Investments (HK) Limited	21 March 2022

1 Source: HKEX, as of 30 June 2022
2 Source: HKEX, from 1 January 2022 to 30 June 2022
3 Source: ETFGI, as of 31 May 2022

Stock code	Currency	Product name	Issuer	Listing date
3029	HKD	Global X Hang Seng ESG ETF	Mirae Asset Global Investments (HK) Limited	21 March 2022
3139	HKD	Global X Electric Vehicle and Battery Active ETF	Mirae Asset Global Investments (HK) Limited	21 March 2022
3060 | 83060 | 9060	HKD | RMB | USD	CICC Carbon Futures ETF	China International Capital Corporation Hong Kong Asset Management Limited	23 March 2022
7234	HKD	Bosera SZSE ChiNext Daily (2x) Leveraged Product	Bosera Asset Management (International) Co., Limited	12 May 2022
3171	HKD	Samsung Blockchain Technologies ETF	Samsung Asset Management (Hong Kong) Limited	23 June 2022

Fund flows and market capitalisation

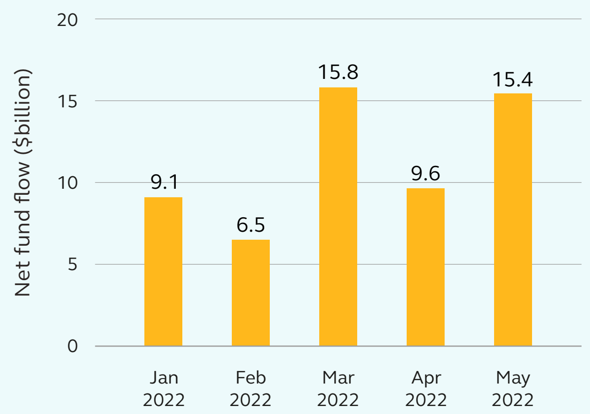
Hong Kong-listed ETFs were a bright spot in the market amid an uncertain economic backdrop. This was demonstrated by a record inflow of HK$56 billion[4] during the first five months of 2022, a figure that was 14 times the amount recorded in the same period last year.

After a relatively muted first two months, Hong Kong-listed ETFs saw HK$41 billion[4] of strong inflows between March and May as investors made use of this window of opportunity to buy low-priced stocks with the potential for strong growth over the long term.

Equity ETFs saw renewed investor interest in Hong Kong and across major markets. Hong Kong-listed equity ETFs helped drive a large portion of the overall inflows and broad-based Hong Kong index ETFs, with net inflows of HK$39 billion, remained a popular choice. This trend is an attestation of investor confidence in Hong Kong's capital markets and the appeal of ETFs as a long-term investment vehicle. Looking ahead, as a potential acceleration of Fed rate increases and geopolitical risks add further strain to the market, ETF, as a low-cost diversification tool, will only become more important in investment portfolios.

Driven by both strong net inflows YTD and new listings, Hong Kong's ETF market capitalisation stood at a record high of HK$443 billion, up 3% y-o-y from HK$429 billion.[5]

Net fund flow[4]



4 Source: ETFGI, as of 31 May 2022
5 Source: HKEX, a comparison of data as of 31 December 2021 and as of 30 June 2022

Average daily turnover

ADT of the Hong Kong ETF market increased to HK$11.8 billion in the first half of 2022, up 53% y-o-y.[6] The high ADT was supported by an especially strong performance in March and June, which saw ADT of HK$14.8 billion and HK$14.0 billion respectively.[7]

By category, Hong Kong Equity ETFs recorded the highest turnover in the first half of 2022, at HK$7.6 billion, followed by leverage and inverse products and thematic ETFs. In fact, Hong Kong Equity ETFs saw a more than 1.5 time increase in ADT compared to the whole of 2021.[8]

The high turnover, especially in March, was the result of a number of factors. On the one hand, sellers rushed to the market as share prices came under pressure in the face of market volatility, which typically contributes to high ADT.

On the other hand, buyers outnumbered sellers as reflected in fund flow growth as a sizable contingent of investors have come to view Hong Kong Equity ETFs as a safe-haven alternative in the face of a number of challenges, including rising US interest rates aimed at combating high inflation and global geopolitical tensions, all of which have contributed to growing macroeconomic uncertainty.

Average daily turnover and market capitalisation[9]

What's next: Bridging borders and linking markets

The inclusion of ETFs in the Stock Connect programme effective from 4 July 2022 opens a new chapter in the city's storied reputation as a global financial centre and further strengthens the link between international investors and Mainland China markets.

The move comes at a time when market participants are demanding better connectivity and wider access. Along with broadening investor base and facilitating fund flows from global markets, the inclusion of ETFs in Stock Connect will contribute to the continued and sustainable growth of capital markets in both Mainland China and Hong Kong. Furthermore, we believe this development will enhance the Hong Kong ETF market's competitiveness and further strengthen the city's status as Asia's leading financial market.

The first phase of the Stock Connect programme will include 4 Hong Kong listed ETFs and 83 Mainland China listed ETFs. With the expectations of further expanding the product eligibility as the programme develops, we expect to further broaden our products to meet both Mainland and international investors demand.

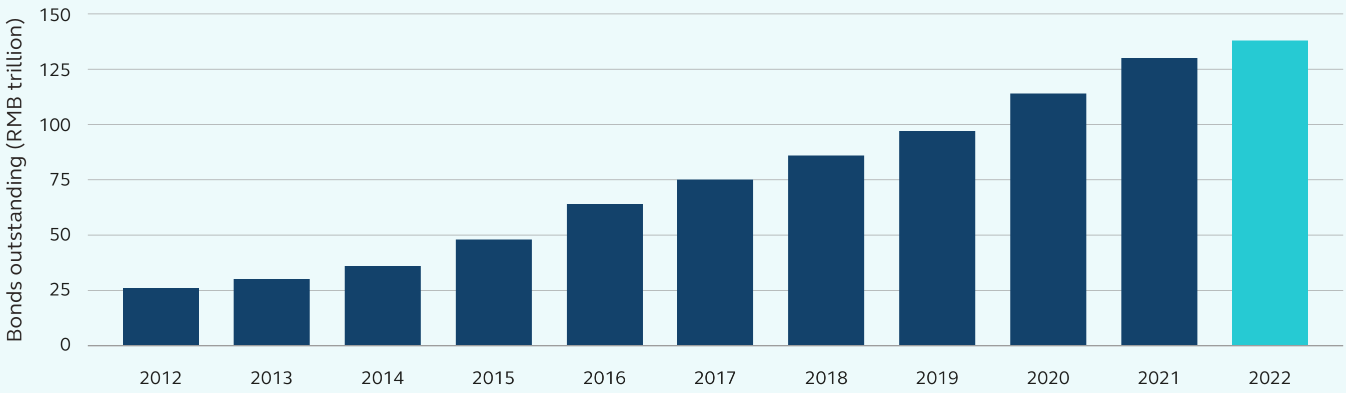
6 Source: HKEX, a comparison of data in the period of 1 January 2021 to 31 December 2021 and of 1 January 2022 to 30 June 2022
7 Source: HKEX, from 1 January 2022 to 30 June 2022
8 Source: HKEX, a comparison of data in the period of 1 January 2021 to 31 December 2021 and of 1 January 2022 to 30 June 2022
9 Source: HKEX, June 2021 to June 2022

Unleash the potential of China bonds through Hong Kong ETFs

An overview

China's onshore bond market is growing at an exponential speed. The market, currently valued at RMB 138 trillion,[10] offers unprecedented growth opportunities to global institutional investors. Hong Kong, as a leading international financial centre with a long history of connecting China and the world, is the ideal gateway for offshore investors to access the opportunities on the Mainland through ETFs.

Growth of China's onshore bond market over the past decade[10]



A number of factors contributed to the rapid growth in China's bond market including policy-driven reasons. China's policymakers have opened up its domestic markets as part of an agenda to make structural reforms to the financial sector, diversify financing sources and reduce the role of bank loans as the main engine of financing to the real economy.

Indirect financing, such as bank and shadow-bank lending, was for long the mainstay of debt financing in China until the embrace of bonds by financial institutions and government agencies in recent years. As a result, China's bond market – which has grown 431% over the past 11 years – has evolved to offer a diverse range of products. So much so that the ratio of outstanding volume of bonds to loans grew from 36% at the end of 2007 to 68% by end-2020.[11]

Another reason is that the development of the municipal and corporate bond markets have enabled a wider range of issuers to tap China's onshore bond market. As of June 2021, the five largest categories of bond type were financial bond (including policy bank bond), municipal bond, central government bond (CGB), negotiable certificate of deposit (NCD), and corporate bond. Together, these categories accounted for 82% in aggregate of total outstanding amount of onshore bonds.[12]

Capital market liberalisation in China over the past two decades has also boosted foreign participation in onshore Chinese bonds, contributing to the growth of China's onshore bond market. As of end-Mark 2022, foreign holdings accounted for a total of RMB3.96 trillion of onshore bonds. Representing 2.9% of the total amount of outstanding bonds compared to just 1.3% 10 years ago.[13]

10 Source: Wind, as of 30 June 2022
11 Source: "Investing in China's Interbank Bond Market: A Handbook", published on International Capital Market Association's website, September 2021
12 Source: "Broadening International Investor Participation in the Mainland Bond Market", published on HKEX's website, February 2022
13 Source: Wind, People's Bank of China, as of 31 March 2022

Reasons to invest in China's onshore bond market

The attractiveness of China's bond market is especially significant in a global low-yield environment. The market's low correlation with major global counterparts, coupled with the inclusion of China bonds in global indexes, means that the instruments are a key source of diversification for any investment portfolio.

Portfolio diversification

Offering a healthy mix of steady returns and low volatility over the years, onshore RMB bonds have proven to be a valuable addition to investor portfolios.

China bonds have historically proven to demonstrate low correlation with other major bond markets due to the monetary policy divergence between the PBOC and major central banks and low foreign participation in China's bond market. Because of this unique feature, volatility in global markets poses relatively less impact for onshore bonds, which gives investors a way to achieve diversification.

Furthermore, Chinese government bonds enjoy high credit ratings of A+ on average,[14] which means that investing in Chinese Government bonds can provide good credit quality and attractive yields at the same time.

Correlation coefficients of daily return of selected bond indices (2011 – May 2022)[15]

	China	Global	United States	Europe	United Kingdom
China	-	0.18	0.01	0.04	0.17
Global	0.18	-	0.62	0.46	0.76
United States	0.01	0.62	-	0.51	0.44
Europe	0.04	0.46	0.51	-	0.42
United Kingdom	0.17	0.76	0.44	0.42	-

14 Source: "9 things to know about China's bond markets", published on Allianz Global Investors' website, June 2021
15 Source: Bloomberg, from 2011 to May 2022, where 10-year annualised return volatility is calculated as the standard deviation of daily returns times the square root of 252 (the assumed number of trading days in a year), with:
- China: Bloomberg Barclays China Aggregate Index (USD unhedged)
- Global: Bloomberg Barclays Global Aggregate Index (USD unhedged)
- United States: Bloomberg Barclays US Aggregate Index (USD unhedged)
- Europe: Bloomberg Barclays Euro Aggregate Index (USD unhedged)
- United Kingdom: Bloomberg Barclays UK Aggregate Index (USD unhedged)

Index inclusion

In the last few years, onshore Chinese government bonds have been included in major global benchmark indexes, such as the FTSE World Government Bond Index, Bloomberg Barclays Global Aggregate Index and JP Morgan Government Bond Index-Emerging Markets (GBI-EM) Global Diversified Index. These index inclusions, which are a reflection of the confidence placed by global investors in the long-term prospects of China's economy and its capital markets, could result in total investment flows worth as much as US$300 billion.[16] Additionally, efforts by China's central bank to facilitate the participation of and trading by foreign investors have contributed to enhancing liquidity in the country's bond markets.

By bond type, foreign holdings of onshore bonds were concentrated on CGBs and policy bank bonds, which accounted in aggregate for more than 86% of international investors' total onshore bond holdings as of end-July 2021.

China's onshore bonds have been included into three global bond indices[17]:

- FTSE World Government Bond Index (WGBI): In March 2021, FTSE Russell confirmed that CGBs will be included into the WGBI. FTSE estimated that China's weight will be around 5.25%, based on the latest available data then. The inclusion has officially started from 29 October 2021, with a 36-month phase-in period.
- Bloomberg Barclays Global Aggregate Index (GAI): In March 2018, Bloomberg announced that it will add RMB-denominated CGBs and policy bank bonds to the GAI. Initial projections estimated that China's weight will be 5%-6% upon full inclusion. The inclusion started from April 2019 with a 20-month phase-in period and completed in November 2020.
- JP Morgan Government Bond Index-Emerging Markets (GBI-EM) Global Diversified Index: In September 2019, JP Morgan stated that the bank will start a phased inclusion of CGBs into its benchmark emerging-market indices. China's weight will be capped at 10% of the GBI-EM global diversified and narrow diversified indices. The inclusion started from 28 February 2020 with a 10-month phase-in period and completed December 2020.

Tax benefits

Lowering the cost of investment further is China's decision to extend a tax exemption scheme whereby overseas institutional investors in the onshore bond market are exempt from paying Corporate Income Withholding Tax and Value Added Tax until 2025.

16 Source: "Four Reasons to Consider Increasing China Bond Exposure", published on Goldman Sachs Asset Management's website, July 2021
17 Source: "Broadening International Investor Participation in the Mainland Bond Market", published on HKEX's website, February 2022

Building exposure to China bonds: Why ETFs make sense

ETF liquidity sleeves offer protection from market volatility

When credit markets are under stress, they pose a significant challenge to raising capital, regardless of the duration or quality of bonds being issued. A spotlight was cast on this problem in March 2020 when the pandemic hit, triggering exits from bond holdings and draining the market of liquidity. Notably, when markets turn volatile and roil sentiment, the resultant loss of liquidity presents a greater problem to institutional investors than any drop in the price of an asset.

ETFs can address this issue by offering an effective way to provide an extra layer of liquidity. This “liquidity sleeve” enveloping the underlying holdings replicates the asset allocation of a portfolio to help reduce the burden of constant inflows and outflows on funds. Along with helping investors meet urgent or unforeseen needs and enabling them to adjust portfolio exposures without impacting longer-term holdings, the extra liquidity cushion provided by the sleeves also allow for a rapid recalibration of investment styles and portfolio positions.

Furthermore, because ETFs are traded on an exchange throughout the day their prices tend to quickly achieve equilibrium, and offer real-time, actionable and transparent rates, even in the face of market shocks that could potentially impact the underlying bonds. This makes ETFs a highly effective tool for investors trading in a highly dynamic and competitive market.

Additionally, ETFs are now in a position to play a larger role in the insurance sector as insurers begin to gain a better understanding of the ETF market structure and the benefits it offers - such as transparency regarding underlying holdings, easy liquidity and the ability to gain exposure to a wide range of asset classes,[18] as well as overall cost advantages. Indeed, cost-conscious institutional investors are reassessing the stated management fees, the costs involved in executing and unwinding trades, rebalancing portfolios, and managing the multiple layers of securities lending, as well as factors such as improvements to tracking error at scale - in order to accurately calculate the total cost of ownership of various investment wrappers.

Cost-effective and versatile

ETFs, which hold multiple underlying bonds, offer investors a cost-effective option to build exposure to a variety of Chinese onshore bonds and diversify their portfolios. According to analysts, institutional investors increasingly focus on the ‘total costs of ownership’ of investment wrappers, assessing rebalancing costs, the costs of executing and unwinding trades, and tracking errors, among other factors.[19]

Another major benefit of trading through Hong Kong-listed ETFs is that our market offers a diverse range of China bond ETFs that goes beyond Chinese government bonds. Our market currently also offers property bond ETFs, short-duration policy bank bond ETFs, as well as other less-liquid exposures compared to government bonds. Furthermore, investors need not worry about the underlying bond market’s liquidity in the process of creation and redemption, as this responsibility is transferred to both the issuers and participating dealers (PDs) to secure the underlying bonds for transactions. Thus, ETFs mitigate problems faced by investors when they source less-liquid bonds – which can be the case when they directly invest in individual China Bonds. Investing in ETFs is also a better and more convenient choice than managing a portfolio of individual bonds, especially for non-sophisticated investors.

18 Source: “Why fixed-income ETFs present opportunities for insurers”, published on Insurance Business Magazine’s website, 17 June 2022
19 Source: “InsuranceTalks: How Do Insurance Companies Use Fixed Income ETFs?”, published on S&P Global’s website, 27 July 2020

ETFs vs mutual funds

Compared to actively managed bond mutual funds, ETFs that track bond indices have lower expense ratios. For instance, in 2020, the asset-weighted average expense ratio for bond mutual funds was 0.42%, compared to only 0.13% for bond ETFs.[20] Moreover, ETFs are tradable in the secondary market and are therefore more liquid. They are also more transparent as they disclose daily the composition of their portfolio. ETFs that are listed and traded on HKEX also contribute to the price discovery of underlying bonds.

While offshore bond ETFs returned on average one percentage point less than bond mutual funds, the average expense ratio of the former was much lower - by about 37 basis points - than that of offshore mutual funds.[19] Bond mutual funds may also require additional fees (called "loads") at about 1%-2% of the investment value[19] as they are typically traded in the primary market through subscriptions and/or redemptions. Additionally, compared to bond mutual funds, the development of bond ETFs appears to be faster in the offshore market than in the onshore market. This means that not only do offshore investors have more Chinese bond ETFs to choose from than onshore investors, they can also enjoy the better cost-return profiles of ETFs compared to offshore bond mutual funds.

Average gross investment return and average expense ratio of bond mutual funds and ETFs in onshore and offshore markets[20]

	Onshore			Offshore		
	Bond ETFs	Bond mutual funds	Difference	Bond ETFs	Bond mutual funds	Difference
Average gross investment return (%)	9.43	11.58	-2.15	9.78	10.69	-0.91
Average expense ratio (%)	0.50	0.67	-0.17	0.55	0.92	-0.37

Growth and development of Hong Kong's ETF market

Hong Kong offers investors access to a highly diversified array of China bond ETFs. From government bonds, property bonds to policy bank bonds, the expanding range of the city's China bond ETFs are well-suited to satisfy investors' ever-changing needs.

Among the most diverse China bond ETF suites offered by global exchanges, Hong Kong-listed ETFs boast a number of key benefits, such as low trading costs and ease of trading, with multiple counters available (HKD, USD and RMB). These advantages continue to attract global investors who have helped Hong Kong's China bond ETF market capitalisation and ADT grow by over 13 times[21] and over 8 times[22], respectively, over the last 5 years.

20 Source: "Broadening International Investor Participation in the Mainland Bond Market", published on HKEX's website, February 2022
21 Source: HKEX, as of 30 June 2022
22 Source: HKEX, from 1 July 2021 to 30 June 2022

Implementation shortfall: An underestimated element in ETF trading

An introduction

While the concept of a transaction cost analysis (TCA) for ETFs is widely known to investors, often overlooked within the TCA are the implicit cost components, which include specifically the opportunity costs, or as we will refer to them in this report: the implementation shortfall.

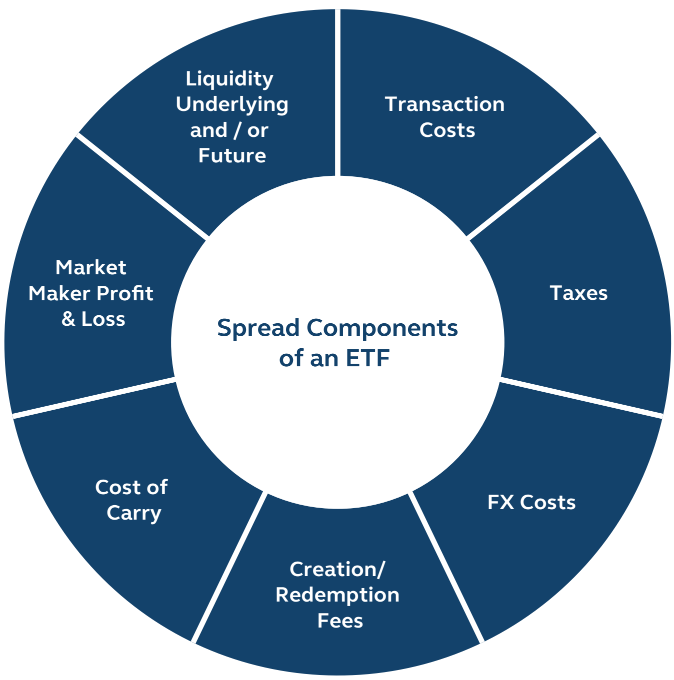
In general, we can define the implementation shortfall as the difference between the price of an ETF at the time of the investment decision and the realised execution price. Of all implicit cost components, it is fair to say that the implementation shortfall is one of the hardest to measure ahead of a trade because it depends on the speed of execution as well as the market's movement, which is not known in advance. Because of the difficulty in measuring the implementation shortfall, it is often underestimated in the overall context of the TCA but, in this section, we will focus on this very component to better understand its importance. Specifically, we compare the implementation shortfall between a live market price and a volume weighted average price (VWAP) execution of the Tracker Fund of Hong Kong (2800), the biggest Hong Kong-listed ETF.

Spread components of an ETF

Before we can look at some empirical data with reference to the implementation shortfall, it is important to revisit some basic features of ETFs and highlight the key aspects in which they differ from single stocks, especially from a liquidity perspective.

The spread of an ETF depends on multiple factors, as shown below:

Spread Components of an ETF[23]



23 Source: Flow Traders, where the diagram above does not show each component in proportion of its trading cost and cost of each component will vary across different ETFs

At the centre of the ETF spread is the liquidity derived from its underlying holdings. The fundamental difference here is that the price of a single stock is determined by supply and demand. Conversely, we can calculate a theoretical value of an ETF using the fund's holdings. From a liquidity viewpoint, we can hence argue that an ETF is at least as liquid as its underlying holdings, which is a key feature of an ETF's structure.

Implementation shortfall and over-the-counter (OTC) trading

Looking more granularly at Hong Kong-listed ETFs, another important way they differ from single stocks is that not every ETF OTC bilateral transaction needs to be reported to HKEX and therefore will not be included in the average traded volume (ADV).

With these important distinctions in mind, let's take a look at the ADVs of the 247 ETFs listed on the HKEX summarised below[24]:

ADV of Hong Kong-listed ETFs[24]

ADV	Number of ETF listings	Percentage of ETF listings
More than US$100 million	3	1.2%
US$10 million - US$100 million	12	4.9%
US$1 million - US$10 million	27	10.9%
Less than US$ 1 million	205	83.0%

In the table above, we note that for more than 90% of ETFs, the ADV is less than US$10 million per day. Considering an investor who wants to deploy US$10 million of capital and does not want to trade more than 30% of the ADV using a VWAP strategy, the applicable ETF universe on the HKEX shrinks from 247 to merely 9 ETF listings, which is less than 4% of the total universe.

However, it is crucial to note here that because of the unique mechanics of ETFs, it is fairly simple to trade a bigger notional than US$10 million in a less-traded ETF by moving to an OTC live market price. By utilising the full liquidity of an ETF and trading OTC, investors are able to trade multiples of an ETF's ADV at competitive spreads. By using this trade type, investors also minimise their implementation shortfall because the full size of the order will be executed in one trade.

24 Source: HKEX, from 1 January 2022 to 30 April 2022

We will quantify the implementation shortfall using historical data with the example of the Tracker Fund of Hong Kong (2800). Explicitly, we compare a US$10 million order executed at 10am Hong Kong local time (HKT) at a live market price vs a VWAP execution[25,26]:

Daily price difference(s) between a 10am HKT live market price and a VWAP execution[25, 26]

Average price difference	Maximum price difference	Minimum price difference
0.63%	3.40%	0.02%

An average price difference of 0.63% in the context of a low-cost vehicle such as the Tracker Fund of Hong Kong (2800) is a considerable figure in relation to the overall transaction cost. This is considering that a US$10 million order could be executed at a live market price at a spread of less than 10 basis points[27].

There is arguably little reason to spread the order over the day via a VWAP execution as this would artificially increase the implementation shortfall, which adds uncertainty to the execution.

Therefore, we conclude that for the majority of Hong Kong-listed ETFs, a VWAP is often not the most efficient execution method when considering the implementation shortfall and, for the majority of ETFs, may not even be possible without a considerable on-exchange participation rate (over 30%).

Furthermore, even for the most liquid Hong Kong-listed ETFs, such as the Tracker Fund of Hong Kong (2800), a live market price is an ideal alternative for investors to reduce the implementation shortfall to a minimum while maintaining tight spreads.

Overall, a live market execution can be seen as an efficient way to execute Hong Kong-listed ETFs regardless of the ADV of an ETF.

25 Source: HKEX, from 1 January 2022 to 30 April 2022
26 Source: Bloomberg, VWAP execution from 9:30AM - 4:00PM HKT, from 1 January 2022 to 30 April 2022
27 Source: Flow Traders, indicative spread

Product list

China bond ETFs

Stock code	Currency	Product name	Underlying index
2813 | 82813 | 9813	HKD | RMB | USD	ChinaAMC Bloomberg China Treasury+Policy Bank Bond Index ETF	Bloomberg China Treasury + Policy Bank Index
2817 | 82817 | 9817	HKD | RMB | USD	Premia China Treasury and Policy Bank Bond Long Duration ETF	ICE 10+ Year China Government & Policy Bank Index
2829 | 82829 | 9829	HKD | RMB | USD	iShares China Government Bond ETF	FTSE Chinese Government Bond Index
3001 | 83001 | 9001	HKD | RMB | USD	Premia China USD Property Bond ETF	ICE 1-5 Year USD China Senior Real Estate Corporate Constrained Index
3079 | 83079	HKD | RMB	CICC Bloomberg China Treasury 1-10 Years ETF	Bloomberg China Treasury 1-10 Years Index
3080	HKD	Ping An of China CSI 5-10Y CGB ETF	CSI 5-10y Liquid CGB Index
3125 | 83125 | 9125	HKD | RMB | USD	iShares Short Duration China Policy Bank Bond ETF	FTSE Chinese Policy Bank Bond 6 Months-3 Years Index
3199 | 83199	HKD | RMB	ICBC CSOP FTSE Chinese Government & Policy Bank Bond Idx ETF	FTSE Chinese Government and Policy Bank Bond Index

For the full list of Hong Kong-listed ETFs, visit

FAQ

Trade Asia. In Asia.

What are the benefits of trading Hong Kong-listed ETFs?

There are a number of advantages to trading ETFs listed in Hong Kong. They offer investors the opportunity to diversify their portfolios with exposure to a range of geographies and asset classes, including but not limited to commodities, fixed income, sector-based, thematic (e.g. ESG, technology) and smart beta funds. These qualities have aided the rapid expansion of the market, which has grown to 162 ETFs[28] and HK$443 billion in market capitalisation[28] in 2022 from 128 ETFs[29] and HK$338 billion in market capitalisation[29] in 2019.

And because they trade in the same time zone as their underlying securities such as Asia, Hong Kong-listed ETFs move within a much narrower band of premiums and discounts compared to their US-listed counterparts. This means they do not deviate from their fair values as much, making them an ideal choice for trading in the secondary market. Further, investors opting for a Hong Kong-listed ETF also benefit from the city's simple and low tax regime, where the tax rate is up to 30% lower than their US-listed counterparts.[30]

Can Hong Kong-listed ETFs be traded in USD?

Investors have the choice of trading in multiple currency counters, i.e. HKD, RMB or USD, a convenience that has been available since we launched the first multiple trading counter ETFs in 2012. The USD counter, which is available for specific products, eschews the need for currency exchange, and allows investors the same level of flexibility and familiarity they enjoy trading in US-listed ETFs while reducing FX costs and risks.

The cost advantage

How will Hong Kong's ETF market be affected by the government's decision to raise stamp duty on stock transactions from 0.1% to 0.13%?

The stamp duty for trading ETFs in the secondary market in Hong Kong has been waived since 2015; this stamp duty waiver on ETFs will continue to take effect after the stamp duty on stock transactions is raised. In other words, when trading Hong Kong-listed ETFs in the secondary market, investors do not incur stamp duty.

Additionally, in the primary market, since August 2020, ETF market makers enjoy zero stamp duty in stock transactions when they create and redeem ETF units in Hong Kong, resulting in a lower creation and redemption costs for market makers.

As a whole, all stamp duty waivers reduce transaction costs for trading ETFs.

28 Source: HKEX, as of 30 June 2022
29 Source: HKEX, as of 31 December 2019
30 Source: HKEX, ETF Tax Calculator, based on the index constituents data and the applicable tax rates as of 31 December 2021

China bond ETFs

What is the latest development of Hong Kong's China bond ETF market?

2021 had been a banner year for China bond ETFs listed in Hong Kong. Market capitalisation reached a new height of HK$12 billion and our market welcomed 4 new products.[31] Underscoring the surge in market capitalisation and ADT is the growing variety of China bond ETFs in Hong Kong, which has broadened over the past year to incorporate government bonds, property bonds and policy bank bonds.

On top of growing product diversity, Hong Kong-listed China bond ETFs offer additional advantages including multiple currency counters (HKD, RMB and USD), liquidity benefits of trading in Asian hours, and tax savings enabled by Hong Kong's favourable tax system. Furthermore, two new fee waivers for Hong Kong-listed bond ETFs, effective since 31 May 2021, are helping investors further reduce cost.

This year, the Legislative Council of Hong Kong has approved an amendment of MPF Schemes regulation to facilitate investments in Mainland government debt securities. Effective 10 June 2022, an MPF constituent fund could invest up to 30% of its total funds in debt securities of the same issue issued or unconditionally guaranteed by the Central People's Government, its central bank and the three Mainland policy banks (collectively referred as exempted authority). They can also choose to invest all of its funds in debt securities of the same issuer comprising of at least six different issues that are issued or unconditionally guaranteed by an exempt authority. The rule change will encourage MPF managers to increase allocation to China bonds, and we expect ETFs to become a popular channel for them to achieve such allocation, given the diversification benefits and low transaction costs of ETFs.

How do Hong Kong-listed China bond ETFs compare to ETFs listed on other exchanges?

Hong Kong offers one of the most diverse China bond ETF suites globally. With 8 ETFs from 6 different issuers, our products range from Chinese Government Bonds, short and long duration policy bank bonds to property bonds. The competitive total expense ratio (TER) – ranging from 0.18% to 0.85% – charged by these products, coupled with Hong Kong's stamp duty waiver for ETFs, can help investors reduce the transaction cost in their China fixed income portfolios.

On top of that, Hong Kong-listed ETFs are traded in the Asian time zone, when the underlying China bond market is open, allowing investors to react to news quickly and to optimise their intra-day price discovery.

31 Source: HKEX, as of 31 December 2021

Inclusion of ETFs in Stock Connect

What does the inclusion of ETFs in Stock Connect mean for HKEX?

The inclusion of ETFs in Stock Connect is the latest milestone in HKEX's landmark Mutual Market Access Programme with the Mainland exchanges. It will broaden the existing Connect product ecosystem and open up opportunities for investors. The recent enhancement of the Stock Connect scheme will not only support Mainland Chinese investors' diversification to offshore assets but will also serve as the global base for China-bound investments.

The expansion of Stock Connect coverage to include ETFs will also provide issuers an additional channel to access Mainland Chinese investors, thus encouraging more active ETF issuance and trading in Hong Kong. This can further expand HKEX's ETF product diversity and enhance liquidity.

What are the benefits of the inclusion of ETFs in Stock Connect for Hong Kong / international investors?

Investors will be able to access new pools of established liquidity across the border, and capture new investment opportunities that are uniquely available in the Mainland China market.

Why are ETFs being included now?

The inclusion of ETFs in Stock Connect follows a strong year for ETFs in Hong Kong and growing demand for ETFs due to:

- Growing investor demand for A-share products;
- Increasing diversification needs among Mainland Chinese investors;
- Continued RMB internationalisation; and
- Increased use of ETFs as an investment tool by investors

We expect these factors to drive a wider adoption of China-focused ETFs and further broaden their investor base.

Contact us

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