

Chapter 13

SPECIFIC REQUIREMENTS FOR EXCHANGE-TRADED FUNDS

13.01 The following information must be disclosed in the prospectus of an exchange-traded fund (ETF), in addition to that specified under Chapters 1 – 11 of these Guidelines, unless otherwise specified.

13.02 For the purposes of this Chapter–

- (a) the term “index” means an index or a benchmark as the context requires;
- (b) “creation unit” means the specified number of units determined by the management company, upon consultation with the trustee and clearly disclosed in the ETF’s prospectus, for creation of ETF units; and
- (c) “redemption unit” means the specified number of ETF units determined by the management company, upon consultation with the trustee and clearly disclosed in the ETF’s prospectus, for redemption of the ETF’s portfolio.

Introduction

Cover page

13.03 Paragraph 1.01(f) of Part III of these Guidelines is not applicable to an ETF.

Inside cover or first page

13.04 A prospectus must disclose the licensing condition pursuant to the licensing agreement entered into between index licensor and the management company, and the responsibilities and obligations of the index licensor and any other relevant party associated with the index, where applicable, for the error in the index.

Corporate directory

13.05 The information as required in paragraph 1.06 of Part III of these Guidelines may be incorporated in the prospectus by referencing the location on the ETF or management company's website on where the information can be found.

Information summary

13.06 The information summary section must also include information pertaining to creation or redemption of unit block size.

Details of offering

13.07 A prospectus must discuss the offering process prior to the listing of the ETF which must include—

- (a) how the investors can acquire units of the ETF; and
- (b) procedures in relation to application by participating dealers to create new units.

13.08 A prospectus must set out the critical events prior to the listing of the ETF.

Indicative optimised portfolio value

13.09 A prospectus should disclose information on the indicative optimised portfolio value (IOPV), including the basis of determination, frequency and means by which investors may obtain IOPV.

Risk factors

13.10 The disclosure of risk factors must also –

- (a) cover specific risks associated with the use of index; and
- (b) contains a description on liquidity risks and the associated impact on the ETF and unit holders, if any.

Information on the ETF

13.11 The information to be disclosed must include, but is not limited to, the following:

- (a) The investment objective of the ETF. There must also be a statement that any material change to the investment objective of the ETF would require unit holders' approval;
- (b) The investment policy and strategies used by an ETF to track the index. In describing the investment policy and strategies, the following information must be disclosed:
 - (i) Investment focus of the ETF (e.g. equities, debt securities, etc.), the characteristics of the securities or

instruments to be invested. Where applicable, the countries, markets or sectors which the index aims to represent (e.g. global, regional or country-specific, developed or emerging markets, etc.) and target sector or industry. For avoidance of doubt, an ETF that is established as a country-specific government bond or fixed income fund must contain prominent statement drawing attention to the government, government agency or supranational which the ETF intends to invest in; and

- (ii) Description of the strategies used – whether to invest in all (full replication) or a representative sample of constituents of the underlying index or synthetic replication of the constituents. Where a representative sample of constituents of the index is used, to disclose how such sample is constituted;
- (c) The risk management strategies, including liquidity risk management, if applicable, and techniques to be employed by the fund manager;

- (d) The ETF's index and where the information on the index can be obtained;
- (e) The permitted or authorised investments and investment limits and restrictions for the ETF;
- (f) Valuation basis for all types of assets invested or to be invested by the ETF, including treatment for suspended counters;
- (g) Policy in respect of valuation point to determine the NAV of the ETF, including policy in respect of timing for valuation of the ETF's foreign investments and frequency of valuation of the ETF's assets; and
- (h) Where the ETF is constituted or established in Malaysia, the details of the fund management company's policy in undertaking cross trades.

13.12 There must also be adequate disclosure on the underlying index including, but is not limited to, the following:

- (a) The underlying index in which the ETF intends to track or replicate, as well as a

description of the market or sector the index represents;

- (b) The characteristics and general composition of the index and, where applicable, concentration in any economic sector and/or issuer;
- (c) A brief description of the index methodology or rules and the means by which investors may obtain such information;
- (d) The means by which investors may obtain the latest index information and other important news of the index;
- (e) Circumstances which may affect the accuracy and completeness in the calculation of the index;
- (f) Circumstances which may lead to tracking errors, and strategies employed in minimising such errors;
- (g) The weightings of the top 10 constituents of the index;
- (h) In addition to paragraph 13.12(g), where a representative sample of constituents of the

underlying index is used to track or replicate the index, the weightings of the top components within the representative sample;

- (i) A statement on whether the index provider is a related corporation of the management company and if so, the means by which potential conflicts of interests are managed; and
- (j) Any licensing conditions for using the index, including contingency plan in the event of cessation of the availability of the index.

13.13 The prospectus must contain the following warning statements:

- (a) **“There is no guarantee or assurance of exact or identical replication at any time of the performance of the index.”;**
- (b) **“Index composition may change and securities may be delisted.”;**
- (c) **“There is a lack of discretion for ETF to adapt to market changes due to the inherent investment nature of ETFs and that falls in the index are expected**

to result in corresponding falls in the value of the ETF.”; and

- (d) Where applicable, a warning where the investments of the ETF may be concentrated in a particular issuer, market or sector.

Islamic ETF

13.14 For an Islamic ETF, the prospectus must also include—

- (a) a clear description of the Shariah approval process, including details of methodologies, screening process and rules on disposal of Shariah non-compliant investment or instruments;
- (b) a statement to the effect that the investment portfolio of the ETF will comprise instruments that have been classified as Shariah compliant by the SAC of the SC or the SAC of BNM. For instruments that are not classified as Shariah compliant by the SAC of the SC or the SAC of BNM, a statement stating that the status of the instruments has been determined in accordance with the ruling issued by the

Shariah adviser; and

- (c) for Islamic ETF based on gold or silver, a statement on the following:
 - (i) The units are backed by physical gold and silver bullion or bars with specified quantity and quality;
 - (ii) The units represent the unit holders' ownership of the gold and silver bullion or bars on a pro-rata basis;
 - (iii) The gold and silver bullion or bars with the correct quantity and quality as per the specification, are in existence;
 - (iv) The gold and silver bullion or bars are kept in a segregated and allocated manner; and
 - (v) The units may be redeemed by taking physical delivery of gold and silver bullion or bars or its equivalent value in cash.

Shariah pronouncement by Shariah Adviser

13.15 For an Islamic ETF, the Shariah pronouncement including detailed reasoning or justification from the Shariah adviser must be disclosed in the prospectus.

Leveraged ETF or inverse ETF

13.16 The name of the leveraged ETF or inverse ETF must include the following:

- (a) The term “daily” to emphasise the daily rebalancing aspect of such ETFs;
- (b) For a leveraged ETF, the term “(2x) Leveraged”; and
- (c) For an inverse ETF, the term “(-1x) Inverse”.

13.17 The prospectus must include the following upfront and prominent disclosure so that investors will not mistakenly assume leveraged ETFs or inverse ETFs share the buy-to-hold characteristics of plain-vanilla ETFs:

- (a) Important information to facilitate investors’ assessment of the unique daily reset features and the difference in risk profile of

the leveraged ETF or inverse ETF as compared to plain-vanilla ETFs;

- (b) The information must emphasise that the leveraged ETF or inverse ETF is meant for active investors who manage their portfolios on a daily basis and that it is not appropriate for long term investment;
- (c) That the performance of the leveraged ETF or inverse ETF may deviate from the underlying index. The disclosure must include examples to illustrate the performance of the leveraged ETF or inverse ETF and the underlying index under different market conditions, the associated risks and impact on investors. The following market conditions must be included in the illustration:
 - (i) In an upward trending market;
 - (ii) In a downward trending market; and
 - (iii) In a volatile market; and
- (d) A warning that investment in a leveraged ETF or an inverse ETF is subject to abnormal risks, a description of the risks involved, and

where appropriate, the risk management policy in place.

Investment in derivatives or embedded derivatives

13.18 Where an ETF invests or can invest in derivatives or embedded derivatives, a disclosure of the following:

- (a) The types and characteristics of derivatives or embedded derivatives;
- (b) The purpose of investing in derivatives, either for hedging or investment, including the method used to determine the ETF's exposure (i.e. commitment approach) and a description of the method;
- (c) A statement that the management company will ensure that it has in place the necessary risk management measures which would enable it to monitor, measure and manage the risks of the ETF position relating to the use of derivatives on an on-going basis and their contribution to the overall risk profile of the ETF; and

- (d) In the case of derivative on commodity, a statement that such transactions will be settled in cash.

Synthetic ETF

13.19 The following information must be disclosed:

- (a) The name of the ETF must include the term “synthetic”;
- (b) The structure of the ETF in plain language and supplemented by diagrams;
- (c) The counterparty of the transactions including identification of such a counterparty;
- (d) The costs of entering into the swap with the counterparty;
- (e) In respect of valuation of the OTC derivatives, the entity responsible for valuation and frequency of such valuation.
- (f) A description of the risks associated to-
 - (i) investments in over-the-counter (OTC) derivatives; and

- (ii) counterparty default and the effect on investor returns;
- (g) Risk management measures employed by the management company to effectively monitor, measure and manage the risks associated with the investments in OTC derivatives; and
- (h) Summary of the contingency plans regarding credit events such as downgrading of the credit rating and collapse of the counterparty.

Securities lending and repurchase transactions

13.20 Where the ETF participates in securities lending and repurchase transactions, the prospectus must disclose the following:

- (a) The purpose for the management company engaging in securities lending and repurchase transactions, as well as its policies and practices;
- (b) The percentage of the ETF's assets can be lent to third parties or involved in the ISSBNT (where applicable);

- (c) Risks associated with securities lending and repurchase transactions, including operational, liquidity, counterparty, custody and legal risk;
- (d) Description and nature of the collateral to be received by the ETF, including cash and non-cash collateral;
- (e) Any conflicts of interest and how they are mitigated, as well as whether the management company intends to participate in securities lending and repurchase transactions; and
- (f) The risk management policy and procedures to address the potential risks involved.

Collateral policy and criteria

13.21 Where the ETF intends to accept collateral, disclose the selection criteria, nature and policy of the collateral held by the ETF and description of the holdings of collateral, including the following:

- (a) Percentage of collateralisation in respect of the securities lending and repurchase transactions into which the ETF enters;

- (b) The nature and quality of the collateral, including asset type (e.g. cash, money market instruments, equity securities or debt securities), issuer, maturity and liquidity;
- (c) Criteria for selecting counterparties, including legal and regulatory status, country of origin and minimum credit rating;
- (d) Source and basis of valuation of collateral, including marked-to-market arrangements;
- (e) Description of haircut policy;
- (f) Collateral diversification and correlation policies, if any;
- (g) Policies on re-investment of cash collateral; and
- (h) Risks associated with collateral management and, if applicable, re-investment of cash collateral.

13.22 Where the ETF participates in securities lending or ISSBNT activities, the prospectus must disclose the following:

- (a) The purpose for the management company engaging in securities lending or ISSBNT activities, as well as its policies and procedures;
- (b) The percentage of ETF assets that can be lent to third parties or involved in the ISSBNT activities (where applicable);
- (c) Risks associated with securities lending or ISSBNT activities, including operational, liquidity, counterparty, custody and legal risk;
- (d) The revenue sharing arrangement between the ETF, lending agent and the management company if any of the income from securities lending or ISSBNT activities also accrues to the management company;
- (e) Description and nature of the collateral to be received by the ETF, including cash and non-cash collateral;
- (f) Any conflicts of interest and how they are mitigated, as well as whether the management company intends to lend the securities or buy and sell the securities under the ISSBNT framework of the ETF to

its related corporations; and

- (g) The risk management procedures to address the potential risks involved.

Key parties

13.23 Subparagraphs 7.06(a) and (d), paragraphs 7.07, 7.08 and 7.10 of Part III of these Guidelines are not applicable to an ETF.

13.24 The management company must include a statement to inform investors that further information on the management company, Shariah adviser and fund manager is provided in the management company or the ETF's website.

Related-party transactions or conflict of interest

13.25 Paragraph 8.03 of Part III of these Guidelines is not applicable to an ETF.

Additional information

13.26 Describe procedures for in-kind creation and redemption, including the suspension of in-kind creation and redemption.

13.27 Disclose fees and charges payable by the participating dealers in relation to creation and redemption of units.

13.28 Where there are material costs involved in acquiring or disposing an ETF's assets and the deed permits a management to–

(a) require the payment of a dilution fee or transaction cost; or

(b) make a dilution or transaction cost adjustment,

these information must be disclosed in the prospectus.