BLACKROCK

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Re: Soft consultation on the enhanced website disclosure requirements for ETFs

Dear Mr Raymond Hung and Ms Carmen Mak,

BlackRock welcomes the opportunity to respond to the soft consultation on enhanced website disclosure requirements for ETFs, and agrees with the principle of improving investor transparency, where such transparency is not likely to mislead investors. Considering that the Hong Kong ETF market is materially smaller and its ecosystem less developed than the US & European financial centres, BlackRock is concerned that several of the proposed metrics are inappropriate under the current market structure and will lead to investor confusion, whilst also acting against the promotion of a stronger international product line-up and the usage of multi-counter products in Hong Kong.

Additionally, the SFC will be aware that many topics being covered in this consultation have a strong reliance on the data and processes of the Hong Kong Exchange (HKEX), and it is in this light that BlackRock have answered many of the questions. The appropriateness of many of the metrics depends first and foremost on the HKEX improving several key processes, which was mentioned by BlackRock in our response to the July 2018 soft consultation, and is a matter we continue to work closely with the HKEX and market participants on.

We believe that focusing on enhancing the HKEX's processes around quotes from market makers, closing auctions, and low-liquidity products is the key to ensuring that the data being provided to Hong Kong investors is sufficient and meaningful. Until these fundamentals have been addressed, it is likely that any extra disclosure that relies on these metrics will risk confusing investors. Many of the points we raise below are currently the subject of an industry consultation with HKEX.[1]

Consultation

1. Do you have any comments on the proposed website disclosure on market price and premium / discount to NAV?

BlackRock already disclose exchange information, such as the closing price, percentage premium / discount to NAV and Exchange volume on our website. However, it is important to note that there are several key limitations that affect their usefulness. We are also actively considering whether or not to continue voluntarily disclosing some of this information. The following comments relate mainly to premium/discounts, but also apply to closing prices:

- **International ETFs:** These products will usually have a closing price that may be different to the NAV as a result of the ETF underlying markets closing after the Hong Kong Exchange does. The premium/discount in this case is likely not a 'real' premium/discount that indicates how well an ETF

[1] HKEX ETP Market Consultation, January 24 2019

tracks its index (as it may be for local ETFs), but simply reflects a price discovery mechanism in the ETF during periods in which the underlying markets are closed. In this case, presenting the difference between Closing Price and NAV as a premium/discount will be misleading, as the inference by investors is likely to be that there is something 'wrong' with these ETFs, compared to ETFs on Hong Kong or China equities where a premium/discount is more reflective of trading opportunities and liquidity (as it should be). The Australian authorities are cognizant of this aspect of international ETFs and hence in Australia it is market practice for premium/discount data to be presented only for local ETFs. In the US, we use an information disclaimer to highlight the potential misrepresentation of premium/discount for international ETFs[2]

- **Multi-Counter ETFs:** Multi-counter ETFs have been offered in Hong Kong first in RMB and then in USD in the past few years, as an enhancement to the ETF market. There are now a large number of products that offer investors the convenience of being able to track a benchmark, value and trade the ETF in their preferred reference currency (be it HKD, RMB or USD). Investors are able to switch between trading counters at will, by paying a nominal fee to CCASS. Due to the ease of switching between counters, ETF exchange trading usually concentrates on one trading counter, with limited on-exchange liquidity on the other trading counters. As such, presenting a closing price or a premium/discount on each trading counter could be quite misleading and not represent the actual price or liquidity of the ETF, nor the trading behaviour of investors. To address this, the SFC may consider only requesting the display of price data for the main trading line or of aggregate data information across trading lines (e.g. trading volume) on a given day.

- **Liquidity:** Many trading counters or even ETFs in Hong Kong have a very low liquidity, and as a result, closing prices can be stale for days because no trades have been executed. This low liquidity can lead to an apparent increased volatility in the premium/discount to the NAV, which itself changes each day, depending on the underlying securities' prices.

- **Market Makers:** There is currently no obligation for Market Makers of ETFs in Hong Kong to perform continuous quoting[3]. For instance, Market Makers are able to withdraw from market making activities near the close, leading to potentially misleading closing prices (no matter how they are measured) and misleading premium/discounts. Until the obligations of market makers are significantly increased and tested, caution has to be taken in respect of closing price and premium/discount information.

It is important to ensure that the above factors are adequately addressed before requiring ETF providers to publish additional data

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[2] From our US website:

"Note on international funds: The premiums and discounts shown for international funds may be less accurate due to the difference in closing times between US and international markets. NAVs for most international BlackRock funds are calculated by using closing securities prices from local markets and Reuters/WM FX rates at 4 p.m. London time. Therefore, during the second part of the US trading day, the NAVs for most international BlackRock Funds are frozen, yet the market prices for these funds continue to fluctuate to reflect new information. As a result, for most international BlackRock Funds, the traditional measure of premium/discount (market price / NAV) may be more reflective of different market hours than true trading premium/discounts."

[3] Current rules: https://www.hkex.com.hk/-/media/HKEX-Market/Products/Securities/Exchange-Traded-Products/Launch/HKEX_Market-Making-Arrangement-of-Exchange-Traded-Products.pdf?la=en

2. Do you have any comments on the proposed website disclosure on the historical information regarding day-end premiums and discounts?

For the same reasons as listed in the answer to Question 1, we believe that presenting historical premium/discount data for Hong Kong ETFs could be misleading to investors.

3. Do you have any comments on the proposed basis of determination of the market price of ETFs?

There are several upstream processes that need to be improved at HKEX to ensure that market prices of ETFs are a correct reflection of their real value:

- **Market Maker Obligations:** As explained in Question 1, Market Makers can currently withdraw from providing quotes, and as a result there is the distinct possibility (especially for thinly traded ETFs) that quotes are stale and not reflective of the real ETF value. As a result, any price dissemination that is using these stale or void quotes could lead to misleading outcomes for investors who trade based on that information.

- **Exchange Data:** We have observed several instances where the HKEX website does not provide a closing price, bid and/or ask for products, but provides a blank or stale value. In order to ensure that the data can be presented, this deficiency needs to be addressed at the HKEX. An example of missing data at the close is provided in the picture below on a randomly chosen trading day of 8 February 2019, on the iShares Core CSI 300 Index ETF (a bid price is missing, while trades occurred during the day as indicated by the positive volume).


ISHARESCSI300-U (9846)

US$3.120

+0.010 (+0.32%)

PREV. CLOSE*	US$3.110	BID	-
OPEN**	US$3.100	ASK	US$3.190
TURNOVER	US$73.45K	DIV YIELD	1.63%
VOLUME	23.60K	AUM	US$17.05M
LOT SIZE	100		(as at 4 Feb 2019)

	INTRA-DAY	52W
High	US$3.130	US$4.450
Low	US$3.100	US$2.970

* Prev. Close is the most recent non-zero closing value or settlement price.

** Open price is the first traded price of the day. The opening price is reported after 09:20:00 HKT.

Information is available after the market opens and is delayed by at least 15 minutes.

Updated: 08 Feb 2019 13:38 HKT

- **Closing Auction:** Closing Auctions are a mechanism that allows trades to be executed at the Closing Price[4]. As described by the Exchange, the way the Closing Price is then determined is based on the largest traded volume on a random closing of anytime between 16:08 and 16:10. If, however, market makers pull out prior to 16:00, and a relatively large trade gets executed at that time, the Closing Price will reflect the bid or offer for the last tranche of the trade prior to the market closing time, and such bid or offer may be very far from the best bid or offer provided prior to 16:00 or even from the average price effectively traded by the investor (who would have executed his trade, based on an average price). We observed some instances of this structural deficiency in our ETFs, which resulted in a Closing Price deviating by 0.5% or more from the best bid or offer available at 16:00 which has previously resulted in enquiries from the SFC.
- **Buy-In Exemption:** The closing price of the ETF depends not only on the presence of a market maker, but also on the ability for the market maker to provide good pricing, even on thinly traded ETFs. This ability usually relies on the market maker keeping some ETF units in inventory. For thinly traded ETFs, keeping such inventory may be costly, as market makers may not be able to recycle that inventory quickly. On the other hand, if market makers do not have enough inventory at the close, the offer price of the ETF may increase significantly in case a trade request comes in. The Buy-in Exemption is one of the mechanisms proposed by the Exchange to reduce the need for market makers to keep inventory in thinly traded ETFs, by accepting a delayed settlement on an ETF sales by a market maker in order to allow them to use the (primary and/or secondary) market on the following business day to facilitate the transaction. Such a mechanism (and other proposed enhancements to ETF market making) is not implemented yet, but if implemented, would help reduce the risk of closing price deviation associated with lack of inventory.

[4] The mechanism for Closing Auctions on the Hong Kong Exchange is presented in the following link: https://www.hkex.com.hk/cas/en/index.htm

4. Do you agree with the proposed implementation timeline? If not, please set out your reasons and what you think is an appropriate rollout period.

Given the previously-mentioned structural deficiencies, we believe that the timeline proposed by the SFC needs to be conditional on enhancements being made by the HKEX to improve the pricing data available. After the implementation of these enhancements we can revisit the appropriateness of the proposed disclosure metrics.

We would also like to stress the fact that, in more-developed ETF markets, exchange information is not required by the regulator to be presented on the ETF product pages themselves, and is provided there at the discretion of the ETF providers. For instance, Closing Prices, Premium and Discounts, Bid-Offer Spreads are not present on iShares UCITS ETF product pages, nor is the iNAV of the ETF, whilst such information is provided on our Hong Kong website. Even in the US, real time information such as prices or IOPVs ("Indicative Optimised Portfolio Value", the equivalent of Hong Kong's iNAV) are not provided on the ETF provider website. The rationale is that such information is not necessarily representative of the ETFs true value and that, by providing such information on the ETF product page itself, investors may be misled and the ETF provider may then be considered liable for the accuracy of what is essentially third party information. We believe that, if such information is required, it would be much preferred for the dissemination to be done on the Exchange website or on special market data provider pages, as in Europe or the US[5], failing which, if the information is required on the ETF product page, then the ETF provider should be allowed to disclaim liability for the data.
On the other hand, we believe that alternative measures and initiatives can help improve the Hong Kong ETFs transparency and investor disclosure, while providing factual information, which does not rely on third parties (be it the Exchange or market data sources). For example, BlackRock advocates the disclosure of the full underlying holdings of indexed ETFs on a daily basis, so that investors may know exactly what the fund holds on any given day. This carries the advantage of being completely objective, and investors may use this data (if so desired) to arrive at their own determination of the fair value of the ETF.

5. What are your current practices regarding the monitoring of the bid-ask spread of the ETFs? Are there any difficulties for ETF issuers to obtain and maintain the daily average bid-ask spread of the ETFs taken at 10-second intervals? If so, what are the difficulties?

Prudent market surveillance is conducted on ETFs by our dedicated Global Markets team, whom also facilitates primary market creations and redemptions. Investigations take place when warranted, for instance when a bid/offer spread goes over a predetermined level for what is seen as a prolonged period or when we observe unwarranted large swings in the premium or discount of the ETF. This is assessed on a balance of considerations taking into account the secondary market liquidity of the relevant ETF (for example, an ETF

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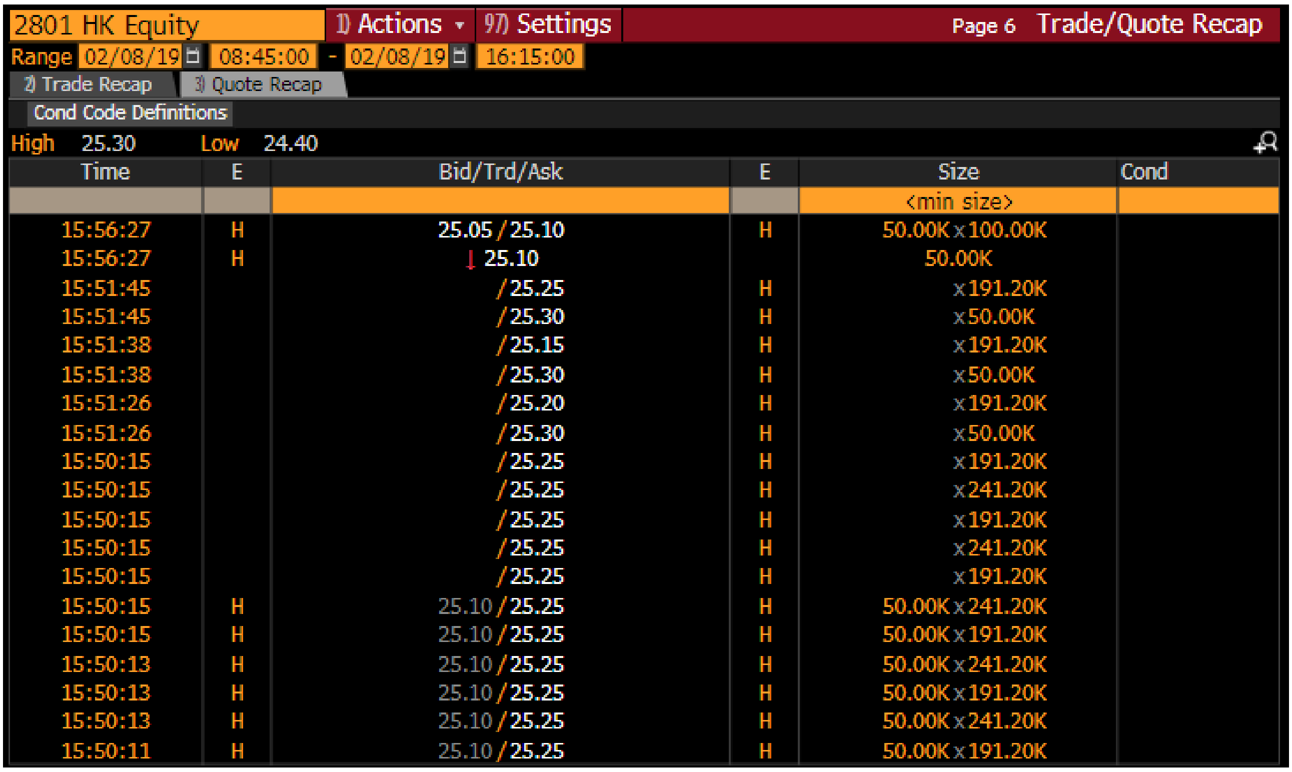
[5] Please find the paragraph associated with Share Prices in the Prospectus of our US iShares ETFs (a similar paragraph exists on our UCITS funds in regards to Indicative Net Asset Value):

"Share Prices. The trading prices of the Fund's shares in the secondary market generally differ from the Fund's daily NAV and are affected by market forces such as the supply of and demand for ETF shares and shares of underlying securities held by the Fund, economic conditions and other factors. Information regarding the intraday value of shares of the Fund, also known as the "indicative optimized portfolio value" ("IOPV"), is disseminated every 15 seconds throughout each trading day by the national securities exchange on which the Fund's shares are listed or by market data vendors or other information providers. The IOPV is based on the current market value of the securities or other assets and/or cash required to be deposited in exchange for a Creation Unit. The IOPV does not necessarily reflect the precise composition of the current portfolio of securities or other assets held by the Fund at a particular point in time or the best possible valuation of the current portfolio. Therefore, the IOPV should not be viewed as a "real-time" update of the Fund's NAV, which is computed only once a day. The IOPV is generally determined by using both current market quotations and price quotations obtained from broker-dealers and other market intermediaries that may trade in the portfolio securities or other assets held by the Fund. The quotations of certain Fund holdings may not be updated during U.S. trading hours if such holdings do not trade in the U.S. The Fund is not involved in, or responsible for, the calculation or dissemination of the IOPV and makes no representation or warranty as to its accuracy."

with lower liquidity would be expected to have wider spreads in general), as well as the benchmark index (for example, an ETF on an international exposure would be expected to have more volatile spreads than an ETF on Hong Kong equity).

BlackRock do not believe that it is appropriate or feasible to measure the bid/ask spread of Hong Kong ETFs, using data at 10-second intervals for several reasons similar to previous answers:

- **Liquidity:** Many of the ETFs in Hong Kong have relatively low liquidity, and quotes are not available on a continuous basis. Taking a poll of the bid/ask spread every ten seconds in these circumstances may include stale or void data and will not yield any meaningful information. The following screen gives an example of quotes provided on a randomly chosen trading day of 8th February 2019 on the iShares MSCI China ETF. Even on a relatively liquid ETF, we can observe a period of almost five minutes in which no quote exists on the ETF, and an even longer period in which an offer exists but not a bid. In our opinion, it would be more consistent if trading information of this kind were to be calculated and disseminated by the Exchange based on a methodology consistent across all products and ETF providers.



2801 HK Equity | 1) Actions | 97) Settings | Page 6 Trade/Quote Recap

Range 02/08/19 08:45:00 - 02/08/19 16:15:00

2) Trade Recap | 3) Quote Recap

Cond Code Definitions

High 25.30 Low 24.40

Time	E	Bid/Trd/Ask	E	Size	Cond
				<min size>	
15:56:27	H	25.05 / 25.10	H	50.00K x 100.00K	
15:56:27	H	25.10		50.00K	
15:51:45		/ 25.25	H	x 191.20K	
15:51:45		/ 25.30	H	x 50.00K	
15:51:38		/ 25.15	H	x 191.20K	
15:51:38		/ 25.30	H	x 50.00K	
15:51:26		/ 25.20	H	x 191.20K	
15:51:26		/ 25.30	H	x 50.00K	
15:50:15		/ 25.25	H	x 191.20K	
15:50:15		/ 25.25	H	x 241.20K	
15:50:15		/ 25.25	H	x 191.20K	
15:50:15		/ 25.25	H	x 241.20K	
15:50:15		/ 25.25	H	x 191.20K	
15:50:15	H	25.10 / 25.25	H	50.00K x 241.20K	
15:50:15	H	25.10 / 25.25	H	50.00K x 191.20K	
15:50:13	H	25.10 / 25.25	H	50.00K x 241.20K	
15:50:13	H	25.10 / 25.25	H	50.00K x 191.20K	
15:50:13	H	25.10 / 25.25	H	50.00K x 241.20K	
15:50:11	H	25.10 / 25.25	H	50.00K x 191.20K	

- **Resource Requirements:** Even if such information were deemed relevant, the real-time data needed to do the calculations would need to be obtained from the Hong Kong Exchange, and come with very high associated costs and operational build requirements.

As with the answer to previous questions, we believe that focusing on enhancing the HKEX's processes around quotes from market makers, closing auctions, and low-liquidity products is the key to ensuring that the data being provided to Hong Kong investors is sufficient and meaningful. Until these fundamentals have been addressed, it is likely that any extra transparency that relies on Exchange information will risk confusing investors.