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Hong Kong's ETF Framework for Enabling Investment in Islamic Compliant Corporations – An Analysis of Its Impact on Middle Eastern Investments

Hong Kong'un İslami Uyumlu Şirketlere Yatırımı Etkinleştirmeye Yönelik ETF Çerçevesi - Orta Doğu Yatırımları Üzerindeki Etkisinin Bir Analizi

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ANAHTAR KELİMELER

ETF
Hong Kong
Düzenlemeler
İslami finans
Orta Doğu

ÖZ

Çin önemli bir dönüşüm geçirmiş ve Orta Doğu ile artan işbirliği ve angajman örnek olarak gösterilmiştir. Finansal yatırımlar ve her iki finans piyasasının erişilebilirliğinin artması, karşılıklı angajman için bir köşe taşı teşkil etmiştir. Artan etkileşim ve karşılıklı yatırımların çekilmesine odaklanılmasıyla birlikte, Hong Kong'un Suudi Arabistan'a finansal sürdürülebilirliğe katkı potansiyeli olan ETF yatırımları için önemli bir ticaret merkezi olarak kurulması ve hem Hong Kong'daki hem de Çin anakarasındaki yatırımcıların Suudi Arabistan hisse senetlerine yatırım yapabilmeleri konusunda güçlü bir ivme oluşmuştur. Suudi Arabistan finansal sisteminin önemli bir bileşeni, tüm finansal değer zinciri boyunca Şeriat uyumluluğuna güçlü bir şekilde odaklanmasıdır ve bu, Suudi Arabistan hisse senetlerine yatırım için temel bir özelliği temsil etmektedir. Suudi Arabistan'da ETF türevi yatırım fırsatları sunan Hong Kong'un artan ilgisiyle birlikte, hem Hong Kong içinde hem de ETF Çin bağlantısı aracılığıyla yapılan tekliflerle ilgili düzenleyici sorular ortaya çıkmaktadır. ETF Çin bağlantısı aracılığıyla işlem görmesine izin verilen varlık türleri ve koşullar açısından hala kısıtlamalar olsa da, genel olarak Hong Kong'da listelenen Suudi Arabistan ETF'lerinin Çin anakara piyasasında sunulmasına hak kazandıracaktır.

KEYWORDS

ETF
Hong Kong
Regulations
Islamic Finance
Middle East

ABSTRACT

China has undergone a significant transformation and the growing engagement with the Middle East has been exemplified in the growing collaboration and engagement. Financial investments and the enhanced accessibility of both financial markets have represented a cornerstone for mutual engagement. With the growing engagement and focus on attracting mutual investments, there has been a strong impetus in establishing Hong Kong as a major trading center for ETF investments with potential to contribute to financial sustainability into Saudi Arabia and enable both investors in Hong Kong and mainland China to invest into Saudi Arabian equities. A crucial component of the Saudi Arabian financial system is its strong focus on Shariah compliance across the entire financial value chain and this represents a key characteristic for investment in Saudi Arabian equities. With the growing interest of Hong Kong providing ETF derived investment opportunities in Saudi Arabia, regulatory questions arise related to both the offering within Hong Kong as well as via the ETF China connect. While there are still restrictions in terms of the types of assets and conditions that are permitted to be traded via the ETF China connect, it would generally qualify Saudi Arabian ETFs that are listed in Hong Kong to be offered in the mainland Chinese market.

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1. Introduction

Saudi Arabia and China has undergone significant changes with a massive increase in investments between the two countries. Hong Kong has aimed at attracting new investors to its capital market and enable it to become an intermediary between China and Saudi Arabia. Given Chinese's governments strong suggestion on enhancing ties with the Middle East. The Hong Kong Exchanges and Clearing (HKEX) established an exchange-traded fund that follows Saudi Arabian stocks and initiated a cooperation agreement with Tadawul, the country's stock market operator. Among other recommendations made by a Hong Kong government task committee tasked with enhancing the stock market in the territory is a drive to draw in initial public offerings from Middle Eastern businesses in order to enhance liquidity levels and make the market more attractive (Guo, Wang, & Fan, 2022).

One of the first exchange-traded fund (ETF) tracking Saudi stocks debuted in Hong Kong, which is managed by CSOP Asset Management, a Hong Kong-based company, and is known as the CSOP Saudi Arabia ETF (2830.HK). Public Investment Fund (PIF), a Saudi sovereign wealth fund, is one of its anchor investors.

The fund mimics the performance of the FTSE Saudi Arabia Index, which at the end of October had 56 components with a combined market value of $276.8 billion. In the last three years, the index returned 45.3%, and the investors will be able to trade Saudi equities in Hong Kong dollars or Chinese yuan. With the growing investment in Saudi Arabia, Islamic finance becomes a major essential part in ensuring that the offered investment products support the investor base. With the growing engagement of Asian investors with the Middle East, in particular Saudi Arabia, Islamic finance will assume an even greater role in order to ensure alignment with their societal values and solid investment. Given the growing attractiveness of Exchange Traded Funds that enable investors to invest into these markets without any direct exposure or the ability to directly invest into these markets. ETFs can make significant contributions to financial sustainability. The basis for this is the benefits that ETFs can provide (investment diversification, accessibility, liquidity, transparency, cost effectiveness, etc.).

In this article, we will analyze the impact of ETF regulations in Hong Kong on investments in Saudi Arabia and the arising regulatory requirements related to Shariah compliant investments. Furthermore, we will investigate the ETF China connect, and the regulatory requirements when offering Shariah compliant ETFs for mainland China investors.

2. ETF regulations in Hong Kong

ETF regulations assume a significant role in Hong Kong with the Hong Kong government striving to become a major international ETF gateway for the industry. The Hong Kong Government's Tracker Fund of Hong Kong is the most widely traded ETF in the city and represented a cornerstone upon its introduction in 1999 for the entire ETF environment. Most of the ETFs that are actively traded within the city are based on stock, RQFII (Renminbi qualified foreign institutional investors A-share, and synthetic A-share ETFs. Additionally, more and more foreign ETF fund managers have listed in Hong Kong in recent years in order to access the market and offer their services. ETFs that are listed on the HKSE are generally open-ended, passively managed funds that mimic or follow the performance of an underlying index (Hwang, 2010). The index may be based on bonds, commodities, stock markets, or a subset of equities of stock markets. However, some Hong Kong-listed exchange-traded funds (ETFs) track the performance of a single commodity, such as gold, and provide investors with an effective means of gaining inexpensive exposure to the underlying assets. The main form for these investors is access these ETFs via their brokers. With the growing importance of a more diverse investment spectrum, a significant number of new ETFs, including leveraged and inverse products following US, Japanese, and South Korean benchmarks, as well as products tracking crude oil futures were introduced, and also the 2010s experienced the creation of the first ETF that tracked the real estate market (Abraham, 2007).

The ETFs that are listed on the HKSE are that most of them track benchmarks. This implies that the management of the funds is passively and mostly follow the performance of the benchmarks they are covering. Another key characteristic is transparency, and the ETF have disclosure requirements such as outlining the underlying benchmark, the net asset value (NAV) of the fund, and further compliance related information such as ownership and contact information. Pricing of the ETF, both in terms of intraday quotes and delayed price quotations play another important role (Chen, Liu, & Zeng, 2017).

Additionally, ETF have typically minimal transaction costs, which represent the conventional fees such as broker commissions, transaction levies and trading fees in case they are charged. However, ETF do not charge a subscription fee. Furthermore, the ETF investment is typically kept to a minimum in terms of its minimal requirements. A crucial part of the ETF is that liquidity has to be maintained during the trading hours, which requires market makers that provide such liquidity. Finally, the trades are settled conventionally on a T+2 basis, which is the same as for shares trading (Jares & Lavin, 2004).

The ETFs listed on the HKSE are either synthetic or physical, and full physical replication implies that the ETF replicates the underlying index via the investment in the components of the index. The quantities shall be approximately in the same quantities as the index. The ETF represents a high degree of correlation with the underlying index, and in the case the portfolio has the same characteristics as the index, then representative sampling is utilized in order to integrate some stocks in the portfolio that are not index constituents. Synthetic exchange traded funds invest in financial derivates instead of the components of the index, but it requires them still to have collaterals. Furthermore, the net risk exposure to a single counterparty has to be less than 10 % of the NAV (Cheng, Massa, & Zhang, 2019).

Under section 104 of the Securities and Futures Ordinance (SFO), ETFs must apply to the Securities and Futures Commission (SFC) for authorization as collective investment schemes (CIS) and to the HKSE for listing under Chapter 20 of the HKSE's Rules Governing the Listing of Securities. These are also called the Listing Rules. Previously, an application for SFC authorization had to be lodged first, and an official listing application for the ETF was then submitted to the HKSE following an approval in principle from the SFC.

The CIS must simultaneously file an application for authorization with the SFC and publish an Application Proof of its listing document on the HKSE website if a new CIS applicant has appointed a listing agent who is required to carry out the duties equivalent to those of a sponsor. These are encountered in paragraph 9 of Practice Note 22 to the Listing Rules and play a critical role for the listing process. Upon receipt of an acceptance in principle letter from the SFC along with a request to post a Post Hearing Information Pack (PHIP), this must be submitted for publication on the Exchange's website, which is listed in paragraph 12 of Practice Note 22 to the Listing Rules. The applications for CIS authorization must be submitted using the filled-out application form and information checklist found on the SFC website. Additional documents that the SFC may occasionally request also include the product key facts statement (KFS) and scheme offering and constitutive documents, as well as the application fee, which should be paid to the SFC by check (Chen & Xu, 2023). Furthermore, a written undertaking from the Hong Kong Representative in the case of non-Hong Kong-based schemes, meaning the management company is not incorporated or does not have a place of business in Hong Kong. Finally, a letter designating an individual to be approved by the SFC as an approved person has to be submitted. This serves the purpose of servicing notices and decisions relating to the scheme, advertisements and documents. This letter should include the individual's name, employer, position held, and contact details, including the address, phone number, and email address (Hong Kong Exchange, 2023).

Authorization plays a key role and there are several prerequisites. For the CIS to issue the authorization, several criteria have to be fulfilled. First, they have to designate a trustee or custodian who is independent of the management company and acceptable to the SFC. This can be a licensed bank, registered trust company, or banking institution/trust company incorporated outside of Hong Kong acceptable to the SFC. They must, among other things, register cash and registrable assets, take custody and control of scheme property on trust for holders and make sure that unit sales, redemptions, and cancellations are executed in accordance with the documents (Tao, 1999).

Furthermore, they have to issue reports to holders for inclusion in the annual report, and the fiduciary has the requirement to be overseen by the regulators and provide recurrent reviews of the internal systems and controls. If a current review is not adequate, then an independent audit may be performed. Additionally, the fiduciary has to possess non-distributable capital reserves and the minimum issues as well as a paid-up capital of 10 million Hong Kong Dollar. This may be also in an equivalent currency. The fiduciary also has the responsibility to designate a fund management that is on the approved list of the SFC. The company takes on responsibility for the management of CIS and has to keep accurate books and records, as well as prepare the reports and accounts. There is an exception if the fund is managed by a board of directors that do not deal with the CIS as principals and that can be removed by holders. The management enterprise has to be primarily focused on fund management business, and the sufficient financial, human and technical resources to conduct business. They have a minimum issued and a paid-up capital and capital reserves of more than 1 million Hong Kong Dollars. The fund has to ensure that it does not lend to a material extent and maintain positive net asset positions at all point in times. Finally, they need to have both directors, investment advisors and key personnel with adequate reputation and proper qualifications. Finally, the fund is required to release up-to-date offering documents in both Chinese and English, and the document has to contain information for investors in order to be able to evaluate the investment offered to them. A non-exhaustive list of the offering document components is found in the Appendix C of the code and focuses on the constitutive documents, as well as the investment objectives and restrictions. Furthermore, collateral policy and criteria as well as the property valuation and pricing, in addition to liquidity risk management (Hong Kong Exchange, 2023).

For the offering of index funds, there are certain additional requirements that have to be maintained related to the index. Specifically, the index needs to focus on a specific market, industry or sector of an economy that is well defined. The index also needs to have a wide base of holdings, requiring that a single constituent should not weigh more than 20 % of the index and there should be a sufficient composition. Finally, the index has to be investible, and components need to be able to have sufficient liquidity. The indices should be publishing information about the composition and there has to be transparency in the way the index is calculated. The index also needs to follow rules and achieve objective calculation. If there is an impact on the index’s acceptance, then this has to be discussed with the SFC. The index provider needs to have technical resources and the experience in order to create, update and review the index’s rules as well as methodology. This requires that the procedures and guidelines are both transparent and standardized, as well as recorded (Securities and Futures Commission, 2023).

There are several restrictions that do not apply to index funds, and which cap the CIS holding of securities of single issuer to no more than 10 % of the net asset value of the fund. In the case of the ETF's holding of the constituent securities do not exceed the index's weighting, and the constituent securities account for more than 10 %, then more than 10 % of the Nav may be invested into securities by a single issuer.

In the case the ETF utilizes a representative sampling technique, then they may hold constituent securities above the respective weightings in the index. There is a maximum that may be reached but this is in conjunction with the assessment with the SFC. The ETF has to provide information on the maximum limit in its offering documents, and this has to be disclosed in the ETFs interim and annual reports.

With respect to the name of the ETF, the terms related to index, tracking and tracker may appear in it. The ETF also requires extra disclosures that include the offering document's description of the market or sector of the index, and the index's general characteristics and compositions. This includes the concentration in economic sectors and the weightings of the top 10 largest index constituent securities. Furthermore, the fund has to outline that they will never exactly replicate the performance of the index, and outline situations in which the tracking may not be adequately performed. Furthermore, the ETF also has to indicate licensing requirements, such as indemnity payments to the index provider if necessary.

There are various other factors such as the ongoing disclosure requirements that the funds have to meet. The SFC has to be consulted before any proposed modifications, especially as it relates to constitutive documents, trustees, management companies and other investment objectives. If there are changes that the SFC requires consultation before any modifications, then the SFC will decide on how long the notification period will be and the management is required to give holders reasonable notice of any impending changes. The authorization may be withdrawn provided that it is presented to the SFC and approved prior to it. In the case that the fund has to wind down, or is merged with another fund, then the investors have to be given advanced notice well in advance. In doing so, the fund has to adhere to the SFC guidelines.

With respect to report, the fund is required to release a minimum of two reports every fiscal year. These interim reports have to be published and distributed with at most a two-month delay after the coverage period ended. For annual reporting, a maximum delay of four months is permitted.

Furthermore, the redemption prices or net asset value has to be disclosed on each transaction day, and this needs to be continuously performed. The financial reports have to be authorized by the SFC prior to reporting. When distinguishing between physical and synthetic ETFs, the synthetic ETF is required to have a name that starts with an x. Whenever the fund utilizes a synthetic ETF structure, then there has to be no relationship between the issuer of financial derivative instruments and the ETF management business. A crucial part is that the ETF has to provide collateral in order to reduce the counterparty risk exposure to no more than 10 % of the net asset value.

The ETF trustee in this instance has to hold the collateral and it has to be easily available as well as enforceable without the requirement of additional action by the issuer of the financial derivatives. The net and gross counterparty exposure has to be disclosed publicly. If the ETF invests into domestic market, then the collateral has to be at least 100 % to guarantee the use of financial derivatives to mimic the index performance. Additionally, if the equity assets are utilized as a collateral, then the market value has to be at least 120 % of the gross counterparty risk exposure.

For any listing on the HKSE, the application requires to submit a non-refundable deposit of 20,000 Hong Kong Dollars as the first listing charge. The formal application for listing may be also solely after the SFC verified the application.

A crucial part of the application is the availability of a qualified agent that assist in the handling of the listing process and ensures that it is complete timely and in an organized fashion. Another crucial requirement is that the securities have to be approved by the Hong Kong Securities Clearing Company Limited (HKSCC) for settlement and clearing.

The SFC requires liquidity for its ETF in order to list on the exchange. Hence, it requires a single market maker or a Securities Market Maker (SMM). While there are tick rules, that allows short selling below the current ask price, these may be waived for the ETF by the HKSE before the launch day. The Hong Kong stamp tax is not applied for the sale or transfer of shares or units of ETFs that are listed in Hong Kong and have a local records holder. This is based due to a Stamp Duty Amendment Ordinance in 2015 that extended the waiver to ETFs and that track an index that includes more than 40 % of Hong Kong stocks.

Hong Kong has a strict stock code allocation regiment, and these are within the range of 2800-2849 and 3000-3199. The only exception are the RMB-ETFs. The ETF managers have the voting option for a stock code as well as can select the preferred stock code via dedicated payment. Before the listing of the ETF, the manager of the ETF has to submit an application to be admitted as a qualified security for the deposit, clearing and settlement.

The next critical area is for ETFs that are established or redeemed outside of CCASS. The HK Conversion Agency Services Limited (HKCAS), which is a wholly owned subsidiary of Hong Kong Securities Clearing company Limited (HKSCC), may represent the service agent in order to allocate the deposits or withdraw the ETF units into or out of the CCASS. For this purpose, the ETF management, trustee, registrar and any participating dealers have to sign the service agreement.

3. ETF China Connect

In regard to an in-principle agreement between the CSRC and the SFC regarding the inclusion of eligible exchange-traded funds (ETFs) by Mainland Chinese and Hong Kong exchanges in the Mainland-Hong Kong Stock Connect arrangement (ET F Connect), the China Securities Regulatory Commission (CSRC) and the Securities and Futures Commission of Hong Kong (SFC) released a regular review document on the inclusion of ETFs in the Stock Connect. This inclusion for the northbound trading via the Mainland Hong Kong Stock Connect represents a critical connection for mainland investors to invest in Hong Kong stocks and ETFs and access stocks outside the mainland market. The ETF Connect is part of two separate stock connects that consist of the Shanghai-Hong Kong Stock Connect and the Shenzhen-Hong Kong Connect that were introduced in both 2014 and 2016. The connects enable mutual market access and increases liquidity across the entire Chinese stock and ETF market. The Stock Exchange of Hong Kong Limited (SEHK), Shanghai Stock Exchange (SSE) and Shenzhen Stock Exchange (SZSE) make up the stock connects and before the launch of the stock connects, investors from Hong Kong had to rely on Renminbi Qualified Foreign Institutional Investors and Qualified Foreign Institutional Investors regimes (QFI regime) to trade individual mainland Chinese stocks.

The main parties in the creation of the stock connect were the CSRC and the SFC that aims to facilitate market access between mainland China and Hong Kong. An additional factor is the internationalization of the Renminbi (RMB), with Hong Kong acting as the offshore hub for the RMB transactions. Trading utilizing the stock connect has been significant with both southbound and northbound trading experiencing significant increases. The ETF connect represents another major milestone to include ETFs under the mutual market access program.

ETFs listed on the SSE, SZSE, or SEHK must meet several requirements, including those related to fund size and index constituents, in order to be qualified for inclusion via ET F Connect. Depending on whether the ET F in question is going to be traded northward or southward, different restrictions apply.

The following inclusion requirements must be met for Hong Kong ETFs that are listed on the SEHK and principally governed by the SFC to be approved as qualified ETFs for "Southbound trading," or trading via ETF Connect out of Mainland China. It should be highlighted that an eligible ETF of this type must be principally listed on the SEHK, which implies it must have its domicile in Hong Kong and be managed by a fund manager regulated by the SFC and based in Hong Kong. Therefore, southbound trading will not be permitted for cross-listed ETFs on the SEHK. Additionally, there are quite stringent eligibility conditions, particularly regarding the weighting of constituents in the applicable benchmark indices.

Leveraged and inverse products, as well as synthetic ETFs, are not accepted for the ETF stock connect, and the ETF must trade in terms of Hong Kong Dollars in order to be acceptable. Another requirement for the ETFs to trade is that in the preceding six months, the daily average AUM has to be at least 0.7 billion Hong Kong Dollars, and the ETF has to be listed for a minimum of six months. The current requirements also indicate that the ETF benchmark index had to be introduced for a minimum of one year, in addition to 90 % of the weighting of the equities have to be listed in Southeast Asia. In the Hang Seng Hong Kong-Listed Biotech Index (HSHKBIO), Hang Seng China Enterprises Index (HSCEI), Hang Seng TECH Index (HSTECH), and Hang Seng Index (HSI), the total weighting of Stock Connect qualified members must be at least 70%. At least 80% of the overall weighting of Stock Connect qualifying constituents must be included in other benchmark indexes as per the requirement.

There are several requirements related to constituent stocks that have to be adhered for in the listing. For example, in broad-based indices, a member stock cannot account for more than 30% of the weighting of the relevant index. This bears resemblance to the pertinent provisions of the SFC's Code on Unit Trusts and Mutual Funds (UT Code), which prohibits the SFC from accepting an index that has few constituent stocks or a single constituent asset that weighs more than 20%. If any of the following exclusion criteria apply to any of the ETFs that meet the inclusion requirements, they will become "sell-only" securities and will be restricted from being purchased (Yang & Chi, 2023).

There are several exclusion standards, such as if an ETF transforms into a leverage and inverse product, as well as synthetic ETFs. Additionally, if the ETF’s daily average AUM is less than 0.2 billion Hong Kong Dollar, it has to be excluded as well.

In HSI, HSCEI, HSTECH, and HSHKBIO, the overall weighting of Stock Connect qualified constituents is less than 65%. The overall weighting of Stock Connect qualifying constituents for other benchmark indexes is less than 70%. There are several requirements related to constituent stocks. For example, when it comes to broad-based indexes, the exclusion criterion is satisfied when a constituent stock accounts for more than 30% of the weighting of the relevant index (Marszk, et al., 2019).

Northbound ETFs

For any northbound ETFs transactions, several requirements have to be met. A northbound trading implies that the trade is performed with the location of Hong Kong via the ETF connect, and the stocks have to be sufficiently liquid. This implies that the daily average AUM had to be at least 0.5 billion Renminbi. If the ETF is connected to a benchmark index, then the ETF benchmark index has to be launched at least for a year. However, SSE-listed and SZSE-listed A-shares have to make up 90 % of the benchmark index’s total weighting. Also, 80 % of the benchmark index is made up of qualifying members of the stock connect. The constituent stocks also need to ensure that a single member stock cannot assume more than 30% of the index's weighting.

In the case of an ETF not meeting anymore the inclusion requirements, the ETF will become sell-only and will experience purchase restrictions after review by the SEHK. The threshold may be lowered to 30 % when the index is considered to be a broad-based index. For an ETF to qualify for the northbound connect, the ETF has to be exchange on the exchange or via a secondary market. Similar to the existing stock connect, the ETF connect has a daily limit on the trading volume of the ETF. All of the stock connects experience daily quotas for both the northbound and southbound trading. When it comes to marketing ETFs, then the Securities and Futures Ordinance primarily governs this area, and any marketing has to authorized by the SFC.

Regarding listed securities, section 103(ii) of the SFO qualifies this section by stating that it does not apply to anything done by any person in relation to any interest in a collective investment scheme that is not authorized by the SFC, even though the section regarding advertisement mentioned above does not apply to the issuance of an advertisement, invitation, or document made by or on behalf of an intermediary licensed or registered for Type I, Type 4 or Type 6 regulated activity.

As a result, while professional investors may be approached about collective investment schemes like ET Fs without the need for SFC authorization, the SFC will only, in actuality, allow the public promotion of ETFs and other collective investment schemes that it has approved.

Thus, the same rules that apply to collective investment schemes generally will also apply to any marketing of qualifying Mainland Chinese ETFs under ETF Connect in Hong Kong. It is probable that such Mainland Chinese ETFs will need to be authorized by the SFC before they may be openly promoted in Hong Kong, even though the SFC has not yet addressed the regulations in this regard.

Note that under the UT Code, a relevant ETF may be authorized by the SFC as an index fund since Mainland Chinese ETFs eligible for inclusion under ETF Connect are passive index-tracking ETFs. Furthermore, physical index-tracking ETFs are eligible for MRF benefits under the mutual recognition of funds (MRF) agreement that has been in effect between Mainland China and Hong Kong since May 2015.

As a result, if the necessary conditions are satisfied, applications for authorization from the SFC from these Mainland Chinese ETFs may be handled like regular applications. In summary, despite ETF Connect, only SFC-approved eligible Mainland Chinese ETFs will be permitted to be publicly marketed in Hong Kong rather than only being accessible for trading through ETF Connect. This is regardless of whether the ETFs are registered on the SEHK or not.

If SSE or SZSE stocks are delisted due to the applicable mandatory delisting conditions, no delisting arrangement periods are applied to the existing Stock Connect securities. Nonetheless, a delisting arrangement term of 15 trading days applies to equities that are forcibly delisted for other reasons.

There are currently no delisting arrangement periods for ETFs eligible for northbound trading under the ETF Connect schemes. This means that if an eligible Mainland Chinese ETF is delisted from the SSE or the SZSE, it will be removed from the eligible ETF list as of the date on which new buy and sell orders for the delisted ETFs will not be accepted.

The SEHK may also delist an issuer immediately in appropriate circumstances or publish a delisting notice stating the SEHK's right to delist an issuer if the issuer fails to resume trading within the notice's specified period.

For an eligible ETFs to be formally added to Stock Connect, several conditions have to be met. The first is that all regulatory approvals must have been fulfilled, and that the trading and clearing rules and systems must have been finalized. Furthermore, market participants must have sufficiently adapted their operational and technical systems and have all necessary arrangements for cross-border regulatory and enforcement cooperation must be made. Finally, the investor education measures have to be addressed and arranged.

In contrast to earlier initiatives at financial integration between Hong Kong and the GBA, including the Cross-Listing Scheme, ETF Connect offers issuers a more affordable means of cross-border distribution of their ETFs. Because ETFs have minimal trading fees, ETF Connect encourages more people to make international investments and increase the liquidity of key ETF markets.

Since that different technology equities cannot be exchanged under the current Stock Connect program, the establishment of ETF Connect may permit additional trading of technology assets through investments in relevant ETFs.

Potential participants may be discouraged by the list of restrictions on operating procedures and thresholds related to qualified ETFs. Like other market mutual access programs, the range of investment options offered by ETF Connect may determine whether the launch of ETF Connect can attract significant interest and funding. Even while the SFC acknowledges that ETF Connect has a limited scope, if the pertinent qualifying restrictions are loosened, the program might become more popular amongst investors. The ETF connect has several benefits. In addition to offering a wider range of investment products than Stock Connect, ETF Connect is anticipated to significantly increase market connectivity between Mainland China and Hong Kong. Though ETF Connect shares many of the same essential features as Stock Connect's A-share trading, its stringent ETF eligibility requirements may deter many investors from using it.

Furthermore, until the Mainland Chinese ETFs are separately authorized by the SFC under MRF, the promotion of Mainland Chinese ETFs that qualify via ETF Connect in Hong Kong will be restricted by the regulatory framework under the SFO for marketing collective investment schemes.

4. Islamic compliant foreign investment in Saudi Arabia

Saudi Arabia has undergone some significant changes in the recent years, enabling foreign investors to more easily invest into the economy. Foreign investors, that are non-resident, may invest into Saudi securities in various forms. The first is if the investor qualifies as a foreign investor under the Rules of Qualified Foreign Financial Institutions Investment. This permits the investor to invest in the listed securities as an ultimate beneficiary in swap arrangements. Another permission is the investment in listed company equity in the form of a foreign strategic investor. These investments are conducted under the Guidelines for the Ownership of Foreign Strategic Investors in Listed Companies. If the investor qualifies as a direct investor, then the investments may not only be in investment funds but also in debt instruments and parallel market instruments (Albassam, 2015).

Within the parallel market, the categories of non-resident foreign investors eligible investments are not restricted, but there may be restrictions in the main market with respect to IPO investment participation unless they are explicitly permitted.

There are various classification regimes for non-resident foreign investors in the primary and secondary market. The first one is an investor that qualifies as a foreign investor under the rules of Qualified Foreign Financial Institutions Investment in Listed Securities. The investor must submit an application to the capital market institution that was granted a license by the Capital Market Authority. The capital market institution is required to conduct the custody and dealing with the investment activities. These investors may be financial institutions, securities and brokerage houses, insurance providers, government entities, investment funds, and authorities that are deemed qualified. The Financial Action Task Force (FATF) issues the respective regulations and standards for the monitoring of the financial institutions that may be located in non-compliant or non-cooperative countries without the contradiction of the relevant laws within Saudi Arabia (Alawi, 2019).

Affiliates of e-qualified overseas investors are allowed to make investments in the capital markets without the submission of a separate application. In order to determine whether a foreign investor qualifies as a qualified foreign investor, the capital market institution will perform the foreign investor assessment. Upon the acceptance of the qualifying application, the investor may purchase the listed shares subject to the investment limitations. These limitations are focused on any shares that are listed or are convertible debt instruments of the issuer and may not be owned by more than 10 % of a qualified foreign investor. Any foreign investor may own a maximum of 49 % of the shares that are listed or are in the form of convertible debt instruments.

In case the non-resident foreign investor does not meet the qualifications for the investment in listed securities may invest swap agreements via one of the licensed capital market institutions (CMA, 2023).

Another form of qualification is as a strategic foreign investor that permits to invest in listed businesses that permit strategic shareholdings. This is irrespective of whether they are financial or non-financial institutions, and the investment does not face any minimum or maximum amount restrictions. However, the strategic investor is not permitted to sell any shares acquired within the preceding two years. The foreign strategic investor has to establish a location or obtain a license in a nation that adheres to the Financial Action Task Force's (FATF) guidelines for anti-money laundering and counterterrorism financing or any authority that has to be approved. The approved nations have to be members of the International Organization of Securities Commissions (IOSCO) and apply sufficient regulatory and supervisory measures (CMA, 2023).

Direct investments differ from other investment funds. Non-resident foreign investors have to open an investment account at a capital market institution, and then the investor has to complete subscription and redemption forms. Debt market instruments are separate from equity investments, and non-resident foreign investors are able to participate in all kinds of debt market instruments with an opened account (Bajaher, Habbash, & Alborr, 2022).

The Vision 2030 has been a major driver for the enhancement of Islamic finance options within Saudi Arabia, an in 2021 the first commodity exchange-traded fund that is Shariah compliant was launched. The new ETF fund by Albilad holds 95 % of the assets in gold and this introduction has been a major impetus for enhancing market liquidity and transparency in the sector. The ETF arose as a collaboration between the Dubai Gold and Commodities Exchange (DGCX) and the Albilad Capital group.

5. Conclusion

There is significant engagement between Islamic world and China, with Hong Kong being a major gateway between these economies. Saudi Arabia has been a major emerging economy in recent years with the Vision 2030 actively promoting investment into the economy. With the growing engagement and focus on attracting mutual investments, there has been a strong impetus in establishing Hong Kong as a major trading center for ETF investments into Saudi Arabia and enable both investors in Hong Kong and mainland China to invest into Saudi Arabian equities. Thus, the possibility of ETFs contributing to financial sustainability emerged. A crucial component of the Saudi Arabian financial system is its strong focus on Shariah compliance across the entire financial value chain and this represents a key characteristic for investment in Saudi Arabian equities. With the growing interest of Hong Kong providing ETF derived investment opportunities in Saudi Arabia, regulatory questions arise related to both the offering within Hong Kong as well as via the ETF China connect. ETF regulations have significantly been broader in enabling investments across the world and offering it to investors in Hong Kong. The ETF regulations also permit investments into Shariah compliant companies, given that the regulations should actively promote the investments in non-speculative enterprises with a solid business, which actively supports Shariah compliant investments. Additionally, the establishment of the ETF China connect permits these ETF to be also traded within mainland China, thereby increasing general investor acceptance. While there are still restrictions in terms of the types of assets and conditions that are permitted to be traded via the ETF China connect, it would generally qualify Saudi Arabian ETFs that are listed in Hong Kong to be offered in the mainland Chinese market. Policy enhancements towards the enabling of Islamic finance on a much broader scale would significantly benefit financial markets in both countries.

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