



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
SPECIALISED COMPANIES DIVISION
POLICY, REGULATION AND DEVELOPMENT DEPARTMENT

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Minimum Requirements for Exchange Traded Funds to be managed by AMCs

In order to facilitate the launch of Exchange Traded Funds (ETFs) in Pakistan, the Securities and Exchange Commission of Pakistan ("the Commission"), in addition to the requirements as laid down in the Non-Banking Finance Companies (Establishment and Regulation) Rules, 2003 (the "NBFC Rules") and the Non-Banking Finance Companies & Notified Entities Regulations, 2008 (the "NBFC Regulations"), has decided to introduce a framework for regulation of Index Tracking Exchange Traded Funds.

Therefore, in exercise of the powers conferred under section 282B (3) of the Companies Ordinance, 1984, read with the NBFC Regulations, 2008 the Commission hereby prescribes the following minimum requirements for Index Tracking ETFs.

The requirements for ETFs encompass the following aspects:

- I. Eligibility
- II. Definitions
- III. Name of Scheme and Acceptability of Index
- IV. Investment Restrictions
- V. Issuance and Redemption of Creation units
- VI. Pricing and Dealing
- VII. Authorized Participants
- VIII. Dealing of ETF units on the Stock Exchange
- IX. Dissemination of Information
- X. Fee and Expenses
- XI. Non applicability of Regulation 41(k), 57 and 58(1)(1) of the NBFC Regulations



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I. ELIGIBILITY

A Non-Banking Finance Company licensed by the Commission to provide Asset Management Services, i.e. Asset Management Company (AMC) is eligible to launch index tracking ETFs. An AMC shall ensure that in addition to the provisions of the NBFC Rules and the NBFC Regulations pertaining to Collective Investment Schemes that are not otherwise modified, relaxed or waived, an ETF complies with all the requirements specified hereunder.

II. DEFINITIONS

- a) **Authorized Participant ("AP")** means the market maker as defined in the Stock Exchanges Regulations, and who is appointed by an AMC under the Authorized Participant Agreement.
- b) **Authorized Participant Agreement ("APA")** means an agreement entered into between the AP, Trustee and the AMC setting out the roles and responsibilities of each party and includes, among other things, the terms and procedures to be adopted by the AMC & AP for the issuance and redemption of Creation units. Minimum contents of the APA are specified in Annexure A.
- c) **Benchmark Index** means the Index approved by the Commission, is specified in the Constitutive Documents of the ETF (the "Constitutive Documents") and against which the performance of ETF is measured.
- d) **Cash component** means the difference between the applicable Net Asset Value (NAV) of a creation unit and the market value of the Portfolio Deposit. The Cash component will represent accrued dividend, accrued annual charges including management fees and residual cash in the scheme.
- e) **Creation unit means** the specified number of ETF units for issuance or redemption as determined by the AMC and disclosed in the Constitutive Documents.
- f) **ETF** means Exchange-Traded Fund, which is a listed index-tracking open end fund structured as a Collective Investment Scheme. The primary objective of the ETF is to mimic the return of a particular benchmark index by investing substantially all of its assets in the constituent securities of the benchmark index. ETF shall issue and redeem Creation units in-kind through APs only.
- g) **ETF unit** is a unit of open end scheme that tracks a benchmark index and is listed on the stock exchange and may be bought and sold like any other share on the stock exchange.



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- h) **INAV** means Intra-day Net Asset Value calculated on a current basis (with regular intervals) after incorporating the price change of underlying securities throughout a business day. INAV is indicative current basis Net Asset Value of an ETF unit that facilitates trading of ETF in the secondary market.
- i) **In-kind Creation** means a portfolio of securities and the cash component to be delivered to the AMC, by an AP either on its own account or on behalf of its clients for creation of ETF units.
- j) **Portfolio Deposit** means a pre-defined basket of securities that represents the benchmark index together with a cash payment (if applicable) for the purposes of issuance and redemption of Creation units and will be announced by the AMC, and composition of the Portfolio Deposit may change from time to time.
- k) **Tracking Error** means the difference between daily returns of an ETF and that of the underlying Benchmark Index for any given period.

Terms not defined here shall have the same meaning as assigned in the NBFC Rules, the NBFC Regulations, and Regulations of the Stock Exchanges.

III. NAME OF SCHEME AND ACCEPTABILITY OF INDEX

1. AMC shall ensure that in addition to compliance with the minimum disclosure in the Offering Document of a Collective Investment Scheme prescribed under the Regulations, it complies with the additional disclosure requirements in the Offering Document of an ETF, as specified in Annexure B to this Circular.
2. AMC shall ensure that name of the scheme appropriately reflects the nature of an ETF, i.e. the name of the ETF shall clearly specify the benchmark index it aims to track and 'index tracking' shall be appropriately stated in the name of the scheme.
3. The acceptability of a benchmark index which is to be tracked by an ETF shall be assessed on the basis of the following criteria:

It shall:

- a) have a clearly defined objective;
- b) be investible;
- c) appropriately reflect the characteristics of the relevant market or sector;
- d) be able to fairly reflect price movements of its component securities, and change the composition and weightings of the component securities;



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- e) be broadly based and be sufficiently liquid with no one component security constituting more than 20% of the total value of the ETF. However, such limit on an individual scrip shall not apply in case of well recognized indices;
- f) be transparent, shall conveniently be accessible by investors and published in an appropriate manner; and
- g) be based on securities listed and traded on a stock exchange in Pakistan.

Furthermore, the Commission may require an independent review of the proposed index by the Exchange or any other third party, to assess the criteria stated above.

- 4. AMC shall ensure that the underlying index to be tracked by the ETF shall fulfill all the eligibility requirements as stated in clause 3 above.
- 5. The Commission may withdraw registration of an ETF if its index no longer complies with the requirements of above stated clause 3.
- 6. AMC shall immediately notify the Commission, the stock exchange on which the ETF is listed and the underlying unit holders of the ETF in case of any event that may adversely affect the acceptability of the benchmark index in accordance with the above stated clause 3 and such adverse events include but are not limited to a change in the:
 - a) basis of composition or calculation of the benchmark index;
 - b) objective or characteristics of the benchmark index;
 - c) composition of the benchmark index such as, due to inclusion or deletion of any security; or
 - d) weightage of the benchmark index constituents such as due to corporate activities (e.g. mergers and acquisitions) or significant market movements.

IV. INVESTMENT RESTRICTIONS IN AN ETF

- 7. AMC shall ensure that the weightage of the component securities in the ETF are based on the entire component securities (full replication) of the benchmark index except where the ETF is unable to fully replicate the benchmark index due to market limitations, deviation of up to 15% is acceptable provided that such parameters and features are defined in detail in the Constitutive Documents. The Commission under special cases may allow partial replication of an index by an ETF subject to compliance with clause 3 above.
- 8. AMC shall ensure that at all times, at least 85% of the assets of the ETF remain invested in the component securities of the benchmark index being tracked by it, while the remaining assets may comprise of cash or cash equivalents.



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9. AMC shall ensure that per party, per group and sector exposure limits and restrictions in relation to the securities held by the ETF are in accordance with their weightage in the benchmark index. Any non-compliance or breach of such investment limits shall be rectified within 3 business days.
10. AMC, to ensure proper and efficient management of the ETF, shall define in the Constitutive Documents, the parameters for the level of cash and cash equivalents to be maintained by the ETF.

V. ISSUANCE AND REDEMPTION OF CREATION UNITS

11. AMC shall ensure that:
 - a) APA sufficiently covers details of the procedures to be adopted by the AMC, AP and Trustee for issuance and redemption of Creation units and shall submit copy of the same to the Commission for its record; and
 - b) All requests for issuance and redemption of Creation units are originated or routed through the AP only.
12. AMC may change the Creation Unit size of an ETF only if permitted by the Constitutive Documents and shall be subject to the prior approval of the trustee and the Commission. Any change approved in the Creation Unit size shall be intimated by the AMC in writing to the stock exchange where the ETF is listed at least 3 working days prior to the effective date of such change.
13. AMC shall ensure that the expenses and other charges are adequately disclosed in the Constitutive Documents and an estimate of the expenses and other charges shall be reviewed regularly and revised, if necessary.
14. AMC shall ensure that all provisions and procedures relating to issuance and redemption of Creation units are adequately and clearly disclosed in the Constitutive Documents.
15. The Trustee of an ETF shall issue or redeem Creation units only upon the instructions of AMC subject to compliance with the procedures specified in the NBFC Rules, the NBFC Regulations, the APA and the Constitutive Documents.
16. The Trustee of an ETF shall ensure issuance of Creation units upon completion of transfer of title of the portfolio deposit and cash component in the name of the ETF.



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VI. PRICING AND DEALING

17. AMC shall issue or redeem Creation units only at the NAV calculated in accordance with the Constitutive Documents.
18. AMC shall ensure that the issuance and redemption of Creation units with AP are priced on the basis of NAV of the ETF. However, the unit of the ETF shall trade on the stock exchange on the basis of the market price.
19. AMC shall ensure that the INAV per unit and the end of day NAV per unit are calculated on the basis of a process and criteria which is consistently applied by the AMC or the third-party to whom this function is delegated to ensure that the valuations are objective and independently verifiable.
20. AMC shall carry out determination of the INAV per unit on a current (with regular interval) basis, within a business day as deemed necessary by the AMC and as specified in the Constitutive Documents. The AMC shall ensure that INAV is disseminated to the stock exchange on which the ETF is listed on a current basis (with regular interval) and as per the disclosures made in the Constitutive Documents.
21. AMC may delegate calculation of INAV to an independent third-party subsequent to ensuring that the said party possesses requisite financial, human and technological resources available to perform the delegated function satisfactorily. Notwithstanding delegation of this function to an independent party, an AMC shall be fully responsible for proper calculation and timely dissemination of INAV on the basis disclosed in the Constitutive Documents.
22. The Trustee of an ETF shall ensure that issuance and redemption of Creation units is done on historic pricing basis and any transfer of underlying securities into and out of the ETF is also based on the valuation used in determining the ETF's NAV.

VII. AUTHORIZED PARTICIPANTS

23. AMC shall ensure that the AP has sufficient resources and capabilities to satisfactorily fulfill its role and obligations and comply with the requirements on an ongoing basis.
24. AMC shall ensure that the ETF has at least one AP at all times who shall be appointed by the AMC for the purpose of In-kind issuance and In-kind redemption of Creation units with ETF under the APA and for active market making in ETF units.

VIII. DEALING OF ETF UNITS ON THE STOCK EXCHANGE

25. AMC shall ensure that an ETF complies with the listing requirements and any other regulations of the stock exchange on which it is listed on an ongoing basis.



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26. In the event trading in ETF units is suspended, AMC shall ensure that before resumption of trading of such ETF units, it notifies the Commission in writing of the effective date of the proposed resumption.
27. The trustee of an ETF shall not process or facilitate any request for issuance or redemption of Creation Units during the period of suspension of trading in ETF units on the stock exchange.
28. Trading in ETF units on the exchange may continue during the period of suspension of issuance and redemption of ETF units.
29. AMC shall ensure that in the event it requests for de-listing of an ETF, it shall immediately inform the Commission in writing stating its reasons, rationale and circumstances for such delisting.

IX. DISSEMINATION OF INFORMATION

30. AMC shall ensure that information as stated below is disseminated to the public on regular and timely basis:
- a) AMC or third party on behalf of an AMC shall disclose the following information regarding ETF:

Components	Frequency	Measured
ETF Market Price	Real Time	Per unit
INAV	Current with regular interval	Per unit
Net Asset Value	Last day	Per unit
Units Outstanding	Last day	No of units
Accumulated Dividend	Last day	Per unit
Total Cash Component	Last day	Per creation unit
Benchmark Index	Real time	-

- b) AMC shall disclose in respect of an ETF the details including portfolio deposit, cash component and the number of units outstanding, on a daily basis to the Exchange on which the ETF is listed.
31. AMC may use other acceptable channels or modes of communication for dissemination of information relating to the ETF and the said modes may include:
- a) hyperlink to the website of the exchange or the AMC's own website;
- b) pages made available by information vendors to disseminate trading information of the ETF units in their ordinary course of business and which are easy accessible by retail investors/ general public;



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- c) electronic medium for information dissemination as provided by the exchange from time to time; or
 - d) any other channel considered acceptable by the Commission.
32. The Commission may from time to time require additional information to be disclosed on a real-time or any other basis, as it may deem necessary.

X. FEES AND EXPENSES OF ETF

33. AMC may charge to the ETF only those expenses that are directly related to and necessary for managing the operations of the ETF including Index license fee, maintenance or independent verification fee of an Index by a third party.
34. AMC shall ensure that all expenses chargeable to the ETF are properly and clearly disclosed in the Constitutive Documents.

XI. NON-APPLICABILITY OF REGULATION 41(K), 57 AND 58(1)(1) OF THE NBFC REGULATIONS

35. The following requirements of the NBFC Regulations shall not apply in the case of an ETF:
- a) The requirement under paragraph 41(k) of the NBFC Regulations, whereby trustee shall ensure issuance of units after realization of subscription money provided that the trustee has received the underlying securities and cash component;
 - b) The requirements and procedures for open-end schemes as specified under Regulation 57, except for sub-regulation (1) of the said Regulation; and
 - c) The prohibition under Regulation 58(1)(l), from issuance of units for consideration other than cash, in case of in-kind issuance of Creation units of an ETF.
36. The Commission may, from time to time, specify additional requirements or such other conditions as it may deem fit.


Muhammad Ali
Commissioner (SCD)

Distribution

- I. Chief Executives of all Asset Management Companies
- II. Mutual Funds Association of Pakistan
- III. Trustees of Collective Investment Schemes
- IV. All the Stock Exchanges



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Annexure A

MINIMUM CONTENTS TO BE COVERED IN AUTHORIZED PARTICIPANT (AP) AGREEMENT

AP agrees to act as a market maker of the Fund (the ETF) and the Asset Management Company (AMC) authorizes AP to create and redeem units of the fund in Creation Unit size or multiple thereof.

Both parties mutually agree to clauses relating to the following areas:

- (i) Adherence to Constitutive Documents, applicable Rules, Regulations, Laws and other procedures devised by AMC from time to time;
- (ii) Relationship and Role of each party to the agreement;
- (iii) Procedure for Creation and Redemption of units;
- (iv) Procedure for settlement of Cash Component;
- (v) Conditions where Bids and Offers can be withdrawn by AP (such as at upper & lower caps);
- (vi) Fees (if any), and disclosure on charging of fee;
- (vii) Notification to AP by AMC for changes in index weights and composition;
- (viii) Indemnification from AP to AMC (to cover AMC for areas where AMC cannot regulate the AP);
- (ix) Availability of Information;
- (x) Standard format of notices and procedure to be exchanged between the parties;
- (xi) Procedure for making amendments to the Agreement;
- (xii) Effectiveness, Termination of Agreement and Dispute Resolution;
- (xiii) Governing Laws;
- (xiv) Definitions (other than those covered in the NBFC Regulations and this Circular); and
- (xv) Signatories to the Agreement and Witnesses.



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Annexure B

MINIMUM ADDITIONAL INFORMATION TO BE DISCLOSED IN OFFERING DOCUMENT OF ETF

AMCs shall ensure that the following disclosures are made in the offering document of an ETF in addition to the areas specified in Schedule VIII of the Regulations.

INTRODUCTION TO ETF

- (i) Description of ETF highlighting the basic features;
- (ii) Advantages and disadvantages of ETF;
- (iii) Difference between ETF and other Open ended Funds;
- (iv) Parties to an ETF; and
- (v) Description of how an ETF works through a flow chart.

AUTHORIZED PARTICIPANT

- (vi) Role, Duties and Responsibilities of Authorized Participants;
- (vii) Names and Contact information of Authorized Participants; and
- (viii) Salient features of Authorized Participant Agreement.

BENCHMARK INDEX

- (ix) Profile of Benchmark Index;
- (x) Constituent of Benchmark Index;
- (xi) Circumstances under which Benchmark Index of ETF may change;
- (xii) Disclosure of Risk Factors related to Benchmark Index;
- (xiii) Constituents of Benchmark Index and weightings of the top 10 largest constituent securities (where applicable) of the benchmark index as of a date within a month of the date of the offering document;
- (xiv) Frequency with which benchmark index composition is reviewed;
- (xv) Means by which investors may obtain the latest benchmark index information and other important news of the index; and
- (xvi) Target tracking error.

OFFER/ REDEMPTION OF UNITS

- (xvii) Offer of units during Pre-Listing phase (Initial Offer);
- (xviii) Offer of units in Post-Listing phase;
- (xix) Procedure of In Kind Creation;
- (xx) Procedure of In-Kind Redemption; including monetary and time cost to the investor, and policy for partial shares;



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- (xxi) Procedure of Trading of ETF units on exchange;
- (xxii) Timeline for issuance and redemption of Creation Units; and
- (xxiii) Frequency and Notification of change in Portfolio Deposit.

INAV

- (xxiv) Calculation Methodology of INAV;
- (xxv) Mode and frequency of dissemination of INAV; and
- (xxvi) Entity responsible for transmitting INAV.

WARNINGS/RISKS

- (xxvii) Where necessary, a statement to the effect that the investment of the scheme may be concentrated in the securities of a single issuer or several issuers;
- (xxviii) A statement to the effect that there is no guarantee or assurance of exact or identical replication at any time of the performance of the benchmark index;
- (xxix) Circumstances that may lead to tracking errors and the related risks, and strategies employed in minimizing such errors;
- (xxx) A warning that benchmark index composition may change and underlying securities may be delisted;
- (xxxi) A warning in relation to any licensing conditions (including indemnity given to the index provider, if any) for using the benchmark index, and the contingency plan in the event of cessation of the availability of the benchmark index;
- (xxxii) A warning of lack of discretion to adapt to market changes due to the inherent investment nature of index funds and that falls in the benchmark index are expected to result in corresponding falls in the value of the ETF;
- (xxxiii) A statement on whether the index provider and the AMC of the scheme (or its connected persons) are independent of each other. If not, the means by which possible conflicts of interests may be addressed; and
- (xvi) any other information which is relevant and material for investors to make an informed investment decision.