

## **GUIDELINES FOR ISSUANCE OF DOMESTIC EXCHANGE TRADED FUNDS (ETFs) IN UGANDA**

### **A. INTRODUCTION**

- i. Exchange Traded Funds (ETFs) are open-ended passive investment products that track the performance of an index, a commodity or a basket of assets like an index fund, but trades like a stock on an Exchange, much like shares. Most ETFs are passively managed index funds which normally track an index, with their main objective being to participate in the economic growth of an industry, sector or commodity.
- ii. The index or unit may be composed of equity or debt, commodities, futures or a combination of real assets with the objective of allowing for exposure to a portfolio of securities, assets or indices whose price movement is in tandem with the price movement of the constituent underlying securities or commodities.
- iii. ETFs generally provide the attraction of the returns of a traditional tracker fund (like unit trusts) with the liquidity of a listed security. ETFs are traded at prevailing market prices, which are approximately the same price as the net asset value (NAV) of their underlying assets over the course of the trading day.
- iv. An ETF can be a domestic or offshore product. This guidance note applies to domestic ETFs. Off-Shore ETFs issuances are guided by the ETF Guidelines 2016
- v. In case of any doubt, it is advised that direction be sought from the Capital Markets Authority (CMA).
- vi. As is the case with any other listed security, investors shall buy and sell their ETFs through a securities exchange and clear or settle through existing Clearing and Settlement Infrastructure.
- vii. Investors should view ETFs as long-term investments designed to not only diversify investment horizons but also reduce exposure to significant price fluctuations that sometimes characterize buying and selling of securities and thus minimize their risk exposure.

### **B. ADVANTAGES OF EXCHANGE TRADED FUNDS**

- ETFs provide a diversified exposure through the purchase of a single ETF share.
- They offer a market related performance or return.
- Straightforward access to the performance of key indices and sectors.
- A cost effective way of trading a basket of securities through a single transaction.
- Automatic portfolio rebalancing of the constituent holdings of the respective index.
- The flexibility to buy and sell the ETF securities during SEM trading hours.
- A convenient method to invest and realise returns on investment.
- The convenience of calculating the value of the ETF investment at any time.
- Provide an opportunity for individuals and smaller institutions to track a market.

### **C. PURPOSE**

- i. These Guidelines aim to provide a guide to listing ETFs from domestically issued securities in Uganda, whilst identifying and mitigating the likely regulatory risks arising from ETF transactions in Uganda, to promote market confidence and integrity, key planks of fair and efficient capital markets in Uganda.
- ii. The introduction of an ETFs market in Uganda is aimed at offering investors another option of investing in capital markets through pooled securities or indirectly in commodities in a formal securities exchange environment.

### **D. CAUTION**

Just as is the case with trading in other securities, the value of an investment in an ETF may go up or down as the market conditions change. Also, ETFs are not capital protected; there is therefore no guarantee that on selling after purchase, investors would get back the whole amount invested.

### **E. KEY CONSIDERATIONS FOR ISSUANCE OF ETFs IN UGANDA**

- i. ETFs shall have their own market sub-segment – to be created by a relevant listing exchange.
- ii. ETFs shall have their own International Security Identification Numbers (ISINs) and codes.
- iii. Domestic ETFs shall be subject to intra-day price fluctuation limits on trading like shares. Domestic ETFs shall at the minimum, comply with internationally accepted principles of issuance and trading of ETFs.
- iv. Units in an ETF shall be listed and traded in Uganda Shillings.
- v. The maximum ETFs' fees charged shall be established by the rules of the Exchange on which they are traded. All fees shall be fully disclosed in the issuance or introduction documentation.
- vi. The methodology of computation of the ETF Net Asset Value (NAV) shall be clearly spelt out and be easily understandable as shall be outlined in the ETF's constitutive documents and any relevant information memorandum and marketing materials.
- vii. Calculation of an ETFs per unit value shall be done by a competent institution that shall either be an approved exchange or an outsourced organization that shall also provide error tracking services
- viii. Exchange traded funds in Uganda shall have one or more Market Makers (MMs), licensed by CMA and admitted by listing exchanges. MMs, shall at all times give a binding two-way (bid and offer) quote for the ETF units for which they are MMs.
- ix. ETFs listed in Uganda shall be open-ended unless an exemption is granted.
- x. The constituent assets or securities shall be housed in a trust arrangement with a trustee being appointed, subject to approval by CMA.
- xi. ETFs listed in Uganda shall be fully backed by an underlying asset of an equivalent value at all times.

- xii. Trading in ETFs shall be open to all investors and shall be subject to these CMA Guidelines and any other rules as issued by listing exchanges or CMA.

#### **F. APPROVAL OF ETF**

1. A person who intends to issue an ETF shall make an application to **CMA for approval** to issue in accordance with these guidelines and the ETF Issuer shall be notified of the decision of the Authority in writing. If the application is rejected, the reason for rejection shall be stated in the notification, as well as the procedure and time limit for resolution.
2. The offer documents for the ETF issue shall comply with the Capital Markets (Prospectus Requirements) Regulations, the Collective Investment Schemes Act, 2003 and the Collective Investment Schemes (Open-Ended Investment Companies) Regulations, 2003.
3. An ETF Issuer shall be a legal person
4. On approval of the ETF by CMA, the ETF shall be listed on a securities exchange subject to:
  - a. The ETF being in compliance with the approved exchange Listing and Trading Rules. The ETF Listing and Trading rules shall clearly and comprehensively outline procedures, processes, frequency and content of reporting, clearly highlighting the disclosures to be made daily, weekly, monthly, quarterly or annually;
  - b. The ETF units being freely transferable;
  - c. Have proper price formation;
  - d. Have a net asset value (NAV) that is calculated in a transparent manner and clearly published;
  - e. Be fully covered at all times.

#### **G. THE INFORMATION MEMORANDUM / PROSPECTUS**

A potential issuer of ETFs shall submit to the Authority, for approval an Information Memorandum/ Prospectus complying with the disclosures under “Requirements on the specific details of the ETF” of these Guidelines, together with the information, documents or Annexes highlighted below:

- i. Full name and profile of promoter/issuer, manager (where applicable) and trustee;
- ii. Place and date of incorporation of promoter/issuer, manager (where applicable) and trustee;
- iii. The full names, details and addresses of directors of the issuer, manager (where applicable) and trustee;
- iv. Fit and proper forms for each of the Directors and Senior Management of the promoter/ issuer
- v. Details of the financials, corporate governance structures and key personnel of the promoter/ issuer;
- vi. the audited annual financial statements of the Issuer for the three financial years prior to the date of such issue,

- vii. Copies of all necessary authorizations, licenses and agreements; e.g. agreements with sponsors, depositors or authorized participants. Specifically, the submission should include the following:
  - a) Evidence of appointment of an Authorized Participant/Dealer
  - b) Authorized Participant / Dealer Agreement
  - c) Market making agreement concluded between the Issuer, the Manager and the Market Maker, in terms of which, inter alia, the Market Maker is appointed by the Manager as a market maker with a view to such Market Marker, in normal market circumstances, endeavoring to provide and maintain a reasonable bid and offer
  - d) Trust Agreement and Declaration of Trust
  - e) Custody Agreement between the Fund and the Custodian
  - f) Evidence of approval/license of the Fund Manager
  - g) Evidence of appointment of professional managers /investment adviser to the Fund / Management Agreement between the Fund and the Fund Manager, where outsourced.
  - h) Index licensing Agreement (where applicable)
  - i) Service level Agreements (where applicable)
- viii. Constitutive documents including the Certificate of incorporation, or Memorandum and Articles of Association as applicable;
- ix. A certified copy of the Minutes of the board meeting or meeting of the promoter(s)/Issuer at which the resolution to establish an ETF was passed; a copy of registered resolution should be attached.
- x. A resolution to apply for admission to a securities exchange listing that shall have been passed by the board of directors, and the CMA approval application shall be signed by the board of directors or by a party duly authorized by the board of directors. If the application is signed pursuant to a power of attorney, a copy of the signed power of attorney shall be attached.
- xi. the board resolutions of the Issuer authorising the establishment of the Prospectus / Offer Document and the creation and issue of ETF shares thereunder.

#### **H. REQUIREMENTS ON THE SPECIFIC DETAILS OF THE ETF**

The following specific details shall be outlined in the Information Memorandum submitted to CMA:

- i. The type of ETF(s) to be issued;
- ii. A description of the ETF, including the name of the promoter of the ETF, its date of establishment and how it shall be compiled or constituted;
- iii. Information on the computation(s) behind the number of block or portfolio securities to make up ETF units and the targeted unit holder category;
- iv. A justification (reasons for establishment, reasons for selection of assets or portfolio of assets, reasons for choice of jurisdiction, benefits to investors and the issuer etc.) for issuance of the stated type of ETF(s);
- v. A description of the constituent assets and the ratio of their combination;

- vi. A detailed ETF unit's creation and redemption process; an essential feature of ETFs (it is the key to what makes an ETF an ETF). Further guidance on this is provided in the section below.
- vii. A detailed explanation of the anticipated institutional, human resource and infrastructural arrangements to be used in the ETF units' creation, trading and cancellation process;
- viii. The identity and competence of the party or parties that shall be involved in sponsoring or calculating the ETF;
- ix. The frequency with which the ETF shall be updated or reconstituted and circumstances instigating reconstitution;
- x. The names and addresses of the advisors to the issue amongst whom can be fund manager, market maker, trustee, custodian or administrator, index provider and external auditor;
- xi. Net Asset Value (NAV) of the said fund as at the date of application, in cases where a mutual fund for an underlying portfolio of securities is already in existence and is seeking to convert to an ETF,
- xii. Pricing, dividend distribution and tracking approach. Specifically:
  - a. The dividend or interest distribution policy in terms of timeliness, retention, distribution costs, re-investment and preferred mode (bank, phone, cheque etc.);
  - b. The issues anticipated to affect the ETF's ability to fully replicate its target index, the level of tracking error that may be reasonably expected and a policy to minimize tracking error.
  - c. The fund or portfolio's constituent assets/securities on which the ETF shall be structured (where applicable);
  - d. The course of action that shall be taken by the issuer where an underlying security is suspended or delisted and the repercussions on the computation of NAV;
- xiii. The Issuer/Promoter shall
  - a. prove to have relevant expertise and experience to issue ETFs or prove to have access to such expertise.
  - b. Satisfy CMA that a secondary market for the ETF shall be established and maintained;
  - c. Undertake to compute the Net Asset Value (NAV) of the ETF on a daily basis and make the NAV public to all market participants at the same time through a listing exchange.
  - d. Commit to computing NAV, while taking into account any corporate actions for instance better than anticipated performance of the underlying asset(s).
  - e. Commit to providing linkage with CMA's surveillance infrastructure; and
  - f. Highlight the anticipated fees to be charged by service providers and their justification.
- xiv. A licensed dealing member must undertake to quote buy and sell prices in respect of the exchange traded funds on a daily basis;

## **I. THE CREATION AND REDEMPTION PROCESS**

Each ETF application must clearly specify the creation and redemption process of the ETF under consideration.

### **i. Creation of ETFs:**

The method of creating an ETF starts when an institutional investor provides a basket of specified securities for deposit into the ETF's portfolio. In exchange, the institutional investor receives the equivalent value of the ETF's shares in large lot sizes called "creation units." Thereafter, the institutional investor (known as the "authorized participant, (AP) or Authorised Dealer) may hold the shares in creation units, or sell some or all of the individual shares into the secondary market, where they are bought, sold and priced throughout the day on an approved securities exchange.

When an AP wants to create shares of an ETF, it will buy the requisite number of securities in the ETF's underlying portfolio on the secondary market.

### **ii. Redemption of ETFs:**

The AP can also redeem its shares directly to the ETF: If it has enough ETF shares on hand, it can tender a creation unit in exchange for the equivalent value of the ETF's portfolio securities (at net asset value, or NAV). Just as it tenders actual shares of individual companies to the ETF "in kind" when creating ETF shares, it receives the actual shares of the underlying ETF portfolio back-again in kind-when redeeming ETF shares.

### **iii. Why Is The Creation/Redemption Process Important?**

- a) The "creation/redemption process," is the key to what makes an ETF an ETF.
- b) It is the key to the efficiency that keeps the pricing of ETF shares close to the actual value of their underlying portfolios. It is what keeps ETF share prices trading in line with the fund's underlying NAV.

### **iv. Who participates in the creation/ redemption process?**

Only APs can create or redeem ETF shares directly with the ETF Issuer. Retail investors do not participate in the creation/redemption process; rather they buy, hold and sell ETF shares just the way they invest in and trade any other listed stock. Many institutions can also trade in shares on the secondary market and do not participate in the creation/redemption process.

As indicated above, many institutional and all retail investors do not acquire or redeem their shares directly at the NAV from the ETF provider, but instead buy and sell them at their market prices on the secondary market, similar to the way in which shares of closed-end funds are bought and sold

Minimum securities or asset blocks in the case of creation, redemption or cancellation shall be agreed upon with CMA and clearly indicated in the information memorandum, while minimum trading lots shall be equivalent to those in the listing exchange.

#### **J. SETTING UP AN ETF – ROLE PLAYERS AND STAKEHOLDERS TO LIST AN ETF**

ETFs must:

- a. be open ended in nature;
- b. be issued over an asset or group of assets, which include, but are not limited to, indices, commodities, currencies or any other asset acceptable to CMA and the Securities Exchange; and
- c. be fully covered at all times.

The applicant must:

- a) prove to the CMA that it has the relevant expertise to issue ETFs or has access to such expertise; and
- b) confirm that it will always in normal market circumstances endeavour to provide and maintain a reasonable bid and offer.

#### **K. LICENSING THE ETF**

Technically, an ETF is an investment Fund that needs to be licensed by the Authority, because it holds a portfolio of securities and continuously issues and redeems its shares at daily NAV, just like an open-end fund (commonly known as a "mutual fund").

#### **L. REQUIREMENTS ON RISK AND RISK MITIGATION**

1. Before ETF issuance, CMA shall satisfy itself that the issuer has addressed most of the potential risks associated with early-stage ETF markets, in line with established international standards. In this respect the issuer shall be required to:
  - a. Detail within the Information Memorandum, a comprehensive report on the likely risks, including;
    - Continuing (financial, computational, risk management and/or reporting) obligations of key stakeholders (e.g. the promoter/ Issuer, market maker(s), listing exchange, trustee, custodian, brokers/investment banks, investors etc.)
    - Disclose potential conflict of interest, for instance, in situations where a custom index is created by an affiliate of the issuer, CMA may:
      - i. Require the issuer to make publicly available, all the rules that would govern the composition, and weighting of assets or securities in each commodity or index;
      - ii. Limit the ability to change the rules for asset or index compilation and require public notice before any changes are made; and
      - iii. Where appropriate, require the establishment of firewalls between the staff responsible for the portfolio and management staff.

2. Sufficiently address Counterparty credit risk either in an OTC (primary market) transaction or in a formal securities trading arrangement. This shall involve putting in place:
  - a. Appropriate risk management procedures;
  - b. Limits with respect to an ETF's net exposure to counterparty risk posed by a specific issuer;
  - c. Appropriate procedures for management of tracking error.
  - d. Other safeguards to mitigate potential operational and legal risks arising from ETF units trading (e.g. conditions governing pledging).
  - e. Appropriate actions to be taken by the issuer to shield investors particularly if an ETF issuer fails for whatever reason (e.g. fraud, loss of liquidity) as investors 'rush for the exits', a bad business model or poor risk management).
  - f. A comprehensive and exhaustive complaints handling procedure and recourse (penalty, transaction recall etc.) process.
  - g. Fully outline embedded risks which include general market risks, interest rate risks, exchange rate risks, inflationary risks, liquidity risks and legal and regulatory risks and clearly link them to transactions in ETFs.
  - h. Detail the risk mitigation measures to minimize risk exposure to the identified potential risks in ETFs trading.
  - i. Intermediaries shall be required to use existing compliance function infrastructure and internal control policies and procedures for ETFs trading.

**M. APPOINTMENT OF MARKET MAKERS**

A market maker in Uganda's ETF market shall play the role of creating liquidity through two-way price quotes in order to eradicate substantial price gaps and ensure a liquid market for all.

- a. An issuer shall, prior to the listing of the ETF, be required to appoint a market maker and such duly appointed market maker shall undertake to quote buy and sell price(s) in respect of units in the ETF on a daily basis.
- b. The issuer and market maker shall sign a written agreement on clear terms of market making for an ETF. The market maker shall submit to CMA and the listing exchange a copy of the market making agreement concluded with the issuer prior to commencement of market making.
- c. A listing exchange may establish an incentive mechanism for the most active Market Makers in the market, on the basis of a clear formula that may be independently verified.

**N. APPOINTMENT AND RESPONSIBILITIES OF THE MANAGER**

**There must be a Fund Manager.**

1. The issuer may appoint a Fund Manager to act on its behalf for the purpose of managing the ETF or undertake to manage the ETF by itself if it has capacity to do so. Regulatory requirements with respect to Fund Management shall apply.



2. Subject to the Listing Rules and ETF rules, the manager may in its absolute discretion:
  - Act and enter into all arrangements as necessary for the administration of the fund so as to achieve the investment objective(s) of the ETF;
  - On receiving the necessary approvals, select, purchase, sell, exchange or change any of the assets of the underlying securities in the ETF;
  - Appoint persons to exercise powers and perform duties on its behalf;
  - Act on the advice or information obtained from professional advisers and others considered by it to be experts;
3. The manager may, with the written approval of the trustee and the listing exchange, appoint any company qualified to act on its behalf, and may assign to such appointee all its rights and duties as manager.
4. Where it is imminent that the manager will be liquidated, the trustee shall take immediate steps to ensure the appointment of a new manager before the commencement of the liquidation process of the exiting manager.

#### **O. APPOINTMENT AND RESPONSIBILITIES OF THE TRUSTEE**

1. Prior to ETF issuance, the Issuer shall appoint a trustee licensed by CMA, who shall have the primary responsibility of protecting the interests of investors.
2. The powers, authority, obligations and responsibilities of the trustee shall be detailed in the trust deed and shall include the following among others:
  - The trustee's powers necessary to protect the interests of investors and to perform its functions.
  - The trustee's liability in making distributions to unit holders only out of funds held by or paid to it for the purpose under the ETF rules.
  - The trustee's obligation to take delivery of and retain in safe custody and under its supervision and control, the documents of title to the underlying assets.
  - The trustee's duty to prepare a detailed delisting or winding-up process that shall be underpinned by a distribution of redemption funds mechanism guided by the ETF's NAV on an average price in the last trading month of the ETF.
  - A trustee shall be deemed to have resigned if its certificate of registration is revoked or suspended and the issuer shall in that event immediately appoint another legal person qualified to act as trustee.

#### **P. CORPORATE ACTIONS**

1. Continuous creation or cancellation of ETF units shall be allowed, subject to the relevant institution (issuer or Market Maker) effecting the process through an account that shall be readily accessible in real time by both the listing exchange and CMA
2. Where corporate actions, including but not limited to mergers, takeovers, ETF creation, ETF cancellation, rights issues, capital reductions etc. occur in a constituent security of the ETF, the issuer of the ETF shall immediately publicly disclose the corporate event and

take steps to rebalance its portfolio while complying with the rules pertaining to the ETF's reconstitution.

#### **Q. INFORMATION AND INFORMATION DISSEMINATION**

1. There shall be a clear set of policies and procedures on ETF market data disclosure and circulation by relevant information and data stakeholders (a listing Exchange, intermediaries, trustees, data vendors etc.)
2. CMA shall require that further information is included in the Information Memorandum if it considers this necessary in view of the interests of investors or for the purpose of evaluating whether an ETF is suitable for a securities exchange listing.
3. Intra-day ETF value information dissemination by a listing exchange shall be real-time.
4. The CMA may in special circumstances grant exemptions from the requirements of this guidance note where it deems it necessary or appropriate for the listing of ETFs to be done.

#### **R. CONTINUING OBLIGATIONS**

1. All ETF issuers shall be required to always comply with the continuous listing requirements established by the Exchanges on which their ETFs are listed from to time.

#### **S. THE ROLE OF A LISTING EXCHANGE**

1. A listing exchange shall provide the first-line supervision and surveillance.
2. A listing exchange shall have the right to require the issuer, its Trustee, its officers or its employees to provide it with all the information necessary for it to carry out its legal duties.
3. Any supervisory request or action by a listing exchange shall be in writing. In special circumstances, a listing exchange may make a demand orally. However, such oral demand shall be confirmed in writing as soon as possible.
4. A listing exchange shall submit to CMA, for approval, listing and trading rules for ETFs.

#### **T. THE ROLE OF THE TRUSTEE**

1. The ETF issuer shall appoint a trustee who shall have the primary responsibility of protecting the interests of investors. The powers, authority, obligations and responsibilities of the trustee shall be detailed in the trust deed and shall include the following among others:
  - (a) hold the underlying assets of an ETF on behalf of the Exchange Traded Fund.
  - (b) the trustee's powers necessary to protect the interests of investors and to perform its functions
  - (c) that the trustee shall be liable to make distributions to unit holders only out of funds held by or paid to it for the purpose under the ETF Rules

- (d) the trustee shall take delivery of and retain in safe custody and under its supervision and control the documents of title to the assets.

#### **U. WINDING UP / DELISTING OF ETFs**

If circumstances are such that the ETF has to be delisted or wound up, this shall be done based on the ETFs' NAV on the basis of the average price of the last traded month. This process shall be clearly provided for and outlined in the ETF's constitutive documents and any relevant information memorandum and marketing materials.

#### **V. THE ROLE OF CMA**

1. CMA shall from time to time issue revisions to these guidelines as and when necessary.
2. The ETF issuer and other key stakeholders may be subjected to either existing or reasonable financial requirements by the Authority.
3. CMA may at any time require that the issuer/ Promoter, its trustees/managers, its officers and/or its employees provide it with information.
4. CMA shall require to be satisfied that end-to-end ETF data transmission and sharing between the various players (Issuer/Market Maker, listing exchange, CSD, Vendors, CMA, etc.) is seamless, before giving approval for the listing of the ETF.
5. CMA may at any time take enforcement action on any party where it finds that such party has not complied with the provisions of this guidance note.
6. The CMA and relevant listing exchange shall establish mechanisms for cooperation and coordination of the oversight of ETF products with other ETF exchanges and regulatory entities in order to cater for sharing of information relating to material events, market data and transaction records in addition to the effective oversight of cross-market events.