(FIN CR 3/7/2201/00)

LEGISLATIVE COUNCIL BRIEF

REVENUE (NO.3) BILL 2001

INTRODUCTION

Annex

At the meeting of the Executive Council on 27 March 2001, the Council **ADVISED** and the Chief Executive **ORDERED** that the Revenue (No.3) Bill 2001 at **Annex** should be introduced into the Legislative Council to implement the proposals relating to transaction costs of securities trading in the 2001-02 Budget.

BACKGROUND AND ARGUMENT

The 2001-02 Budget

2. In the 2001-02 Budget, the Financial Secretary proposed to reduce the stamp duty on stock transactions from the existing *ad valorem* rate of 0.225% to 0.2%, **and** increase the rate of levy on securities transactions by 0.002 percentage point for the purpose of setting up a new Investor Compensation Fund.

Stamp Duty on Stock Transactions

3. We **propose** to reduce stamp duty on stock transactions by 11% from the existing 0.225% to 0.2% per round transaction in 2001-02, following a 10% reduction in the duty rate in 2000-01. This is in line with the worldwide trend of reducing or entirely abolishing stamp duty on stock transactions in

order to lower transaction costs of stock trading. The proposal also seeks to complement the efforts made by the Hong Kong Exchanges and Clearing Ltd (HKEx) to abolish minimum brokerage commission rate and to open up the brokerage trading rights from 1 April 2002.

4. We do not consider this reduction purely as a revenue concession proposal. Rather, this is a positive move to promote the further development of our financial market and should bring about additional revenues for Government over time.

Levy on Stock Transactions

(A) Removing the Levy Income for Stock Exchange of Hong Kong

5. Section 52(1) of the Securities and Futures Commission Ordinance stipulates that the purchaser and the seller of a securities transaction recorded on or notified to the Stock Exchange of Hong Kong (SEHK) shall each of them be liable to pay to the Securities and Futures Commission (SFC) a levy at such rate as may be specified by order of the Chief Executive in Council. At present, the transaction levy is charged at the rate of 0.01% per side of the consideration of transaction and the levy income collected is equally shared between the SFC and the SEHK.

6. Since the SEHK has become a subsidiary of the HKEx which is a commercial entity, we consider it no longer justifiable for SEHK to rely on the statutory levy as a source of income. The share of the levy by the SEHK should be phased out and replaced by an alternative revenue source which may take the form of a user transaction fee or any other fees and charges.

7. Following discussions with the SEHK, it is now agreed to remove the portion of the levy going to the SEHK. This would allow the levy to be lowered from 0.01% to 0.005%. At the same time, the SEHK has proposed to introduce a trading fee, which will initially be set at the same rate of the levy reduction, i.e. 0.005% per side of the consideration of transaction. The fee level would be subject to review by the SFC and the SEHK after a year of its coming into effect.

(B) Setting Up a New Investor Compensation Fund

8. The Securities Ordinance provides for the establishment of a compensation fund, namely the Unified Exchange Compensation Fund (UECF), to provide compensation to investors who suffer from pecuniary loss as a result of default by a stockbroker, who is an exchange participant of the SEHK.

9. The Commodities Trading Ordinance also provides for the establishment of the Commodity Exchange Compensation Fund (CECF) to provide compensation to investors who suffer from pecuniary loss as a result of default by a commodity futures contract dealer, who is an exchange participant of the Hong Kong Futures Exchange.

10. In pursuit of the objective of enhancing investors' protection, the SFC conducted a review on the existing compensation arrangements in consultation with the market in 1998 and conducted a further study in 2000 with a view to devising a new scheme. The intention is to set up a new Investor Compensation Fund to cover not only the defaults of exchange participants, but also those of other licensed persons or exempt dealers authorized to provide intermediary services in securities and commodity futures contracts relating to products traded on the two exchanges in Hong Kong. The new Fund would

limit the compensation amount payable to $150,000 per investor. Money for the new Fund would come from the balance[1] of the existing UECF and CECF (excluding the necessary reserves for payment of outstanding compensation claims and refund of deposits to exchange participants) and from an *ad valorem* levy on securities transactions. The SFC is now consulting the industry on the implementation details of the new Fund.

11. The setting up of a new compensation scheme is envisaged in the Securities and Futures Bill (SF Bill), which is currently being examined by the Legislative Council. The SF Bill provides for a flexible framework for implementing new compensation schemes and empowers the Chief Executive in Council to make rules to provide for the funding of compensation schemes in future.

12. Accordingly, we plan to set up the new Investor Compensation Fund after the enactment of the SF Bill. Prior to this, we consider it prudent to start building up the balance under the UECF so that a bigger amount may be transferred to the new Fund when established. As announced in the 2001-02 Budget Speech, we **propose** to increase the existing levy on securities transactions by 0.002 percentage point for a limited period of time. Our current thinking is that the proposed levy increase would last until the new Investor Compensation Fund has accumulated $1 billion.

13. Pending the setting up of the new Investor Compensation Fund, the income from the proposed 0.002% levy would be received by the SFC, which would pay the monies in full to the UECF. As noted in para 10 above, the balance of the UECF will be transferred to the Investor Compensation Fund when established.

[1] The balance for transfer to the new compensation fund is estimated to be $655 million as at the end of the year 2000.

(C) Net Reduction of the Levy

14. Taking into account the removal of the portion of the levy going to the SEHK (i.e. 0.005%) and the proposed levy to build up the new Investor Compensation Fund (i.e. 0.002%), the existing levy rate will be revised from 0.01% to 0.007% per side of the consideration of transaction.

Implementation

15. We **propose** to implement the stamp duty reduction and the levy adjustment at the same time, hence their inclusion in the same Bill. Together they will have the effect of bringing down the transaction cost to investors considerably.

16. Subject to the passage of the Bill by the Legislative Council, we intend to implement the changes in July 2001 taking into account the need for the HKEx and the industry to make the necessary adjustments to their operation systems before the new rates come into force.

THE BILL

17. The Bill amends the Stamp Duty Ordinance and the Securities and Futures Commission (Levy) (Securities) Order as follows -

(a) **clauses 2 and 3** amend the Securities and Futures Commission (Levy)(Securities) Order to -

(i) revise the rate of levy payable under section 52(1) of the Securities and Futures Commission Ordinance in respect of every securities transaction recorded on the Unified Exchange or notified to it under its rules; and

(ii) decrease the proportion of levy which is to be retained by the Stock Exchange Company under section 52(3)(b) of that Ordinance to 0%; and

(b) **clause 4** amends the Stamp Duty Ordinance to reduce the rate of stamp duty payable on contract notes for sale or purchase of Hong Kong stock and on certain transfers of such stock.

HUMAN RIGHTS IMPLICATIONS

18. The proposed legislation has no human rights implications.

BINDING EFFECT OF THE LEGISLATION

19. The Bill will not affect the binding effect of the existing provisions of the Securities and Futures Ordinance and Stamp Duty Ordinance and their subsidiary legislation.

ECONOMIC IMPLICATIONS

20. The proposal to reduce Stamp Duty on stock transactions is in line with world trend, and should help strengthen the competitiveness of Hong Kong's stock market by lowering the transaction costs of stock trading. This should help Hong Kong sustain its position as an international financial centre. The related proposal to increase the levy on securities transactions for building

up a new Investor Compensation Fund, which seeks to strengthen protection of investors' interests, should also be conducive to achieving this objective.

FINANCIAL AND STAFFING IMPLICATIONS

21. We estimate that the proposal to reduce stamp duty in the Bill would cost the Government $680 million in 2001-02 and $4.17 billion over the Medium Range Forecast period up to 2004-05. There are no staffing implications.

LEGISLATIVE TIMETABLE

22. The legislative timetable is -

Publication in the Gazette	6 April 2001
First Reading and commencement of Second Reading debate	25 April 2001
Resumption of Second Reading debate, committee stage and Third Reading	To be notified

PUBLICITY

23. We will issue a press release on 4 April 2001.

ENQUIRIES

24. In case of enquiries about this brief, please contact Ms. Esther Leung, Principal Assistant Secretary for the Treasury (Revenue), at 2810 2370.

Finance Bureau
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