

**LEGISLATIVE COUNCIL BRIEF**

Securities and Futures Commission Ordinance  
(Chapter 24)

**SECURITIES AND FUTURES COMMISSION  
(LEVY) (SECURITIES) (AMENDMENT) ORDER 2001**

**SECURITIES AND FUTURES COMMISSION  
(LEVY) (FUTURES CONTRACTS)  
(AMENDMENT) (NO. 2) ORDER 2001**

**INTRODUCTION**

At the meeting of the Executive Council on 18 September 2001, the Council ADVISED and the Chief Executive ORDERED that -

- (a) the Securities and Futures Commission (Levy) (Securities) (Amendment) Order 2001 (Securities Levy Amendment Order), at Annex A, be made under section 52(1) of the Securities and Futures Commission Ordinance (SFCO), so as to practically exempt ETF Market Makers from payment of the levy under that section for their market making trades; and
- (b) the Securities and Futures Commission (Levy) (Futures Contracts) (Amendment) (No. 2) Order 2001 (Futures Levy Amendment Order), at Annex B, be made under section 52(2) of the SFCO to specify the levy per leviabale transaction in relation to stock futures contracts to be \$0.20.

## **BACKGROUND AND ARGUMENT**

### **(A) Exemption for ETF market makers**

#### **(a) General background**

2. Under section 52(1)(a) of the SFCO, a person who engages in the purchase or sale of securities recorded on the Stock Exchange of Hong Kong (SEHK) is liable to pay to the SFC a levy at a rate specified by order of the Chief Executive in Council. The current rate of the levy is 0.007% of the relevant consideration as specified in paragraph 2 of the Securities and Futures Commission (Levy) (Securities) Order (Securities Levy Order). A practical exemption has been granted to market makers of SEHK's Nasdaq-Amex Pilot Programme to the effect that the rate of levy for their market making trades shall be 0% of the consideration.

3. ETFs are open-ended mutual funds or unit trusts that are listed and traded on recognised exchanges. Investors can buy and sell them in exactly the same way they would buy and sell stocks of an individual company. An ETF represents a portfolio of securities and generally reflects the price and yield performance of the underlying portfolio of securities.

4. The Tracker Fund of Hong Kong is the first locally created ETF to list and trade on the SEHK. The SEHK has also introduced trading (but not listing) of regional ETFs, known as iShares, under its Nasdaq-Amex Pilot Programme. As a further step to develop the ETF market, SEHK plans to launch locally created ETFs later this year. These locally created ETFs will be listed and traded on the main board.

#### **(b) The Proposal**

5. Unlike most equities, ETFs are normally set up without an initial public offering and are listed as almost empty vehicles with limited seed shares. This unique structure of ETFs means that the growth of the number of shareholders and hence the trading at the initial period would be very slow, unless market making is in place to improve liquidity of the ETFs. Nearly all overseas ETF markets, such as Nasdaq, have put in place a market making system.

6. As market makers perform an important market function by providing liquidity and they take on additional financial risks in the process, the SFC proposes to exempt ETF market makers from the payment of

transaction levy in their sale or purchase of ETF shares in such capacity. This will encourage stock exchange participants to perform the market making function and help increase the liquidity of the ETF market.

## **(B) Rationalisation of levy for stock futures contracts**

### **(a) General Background**

7. Since the merger of the two exchanges and their three associated clearing houses in March 2000, the Hong Kong Exchanges and Clearing Limited (HKEx) has been rationalising various aspects of its business so as to achieve the synergy which the merger intended to create. As part of its efforts, HKEx harmonised the stock futures and stock options markets on 27 August 2001 by standardising the contract multiplier\* for stock futures contracts and bringing it in line with the standard adopted for stock options contracts.

8. Before the rationalisation, the size of the contract multipliers for most stock futures contracts was equivalent to five board lots of the underlying stock, whereas that for all stock options contracts have been standardised as one board lot. Following the rationalisation, contract multipliers for all stock futures contracts have been adjusted to one board lot of the underlying stock. Adopting the board lot size as the contract multiplier makes the stock futures contracts more user friendly, as it is easier for investors to calculate the contract size. A smaller contract size also makes the contracts more affordable to investors. Furthermore, synchronising the contract multipliers for products in the stock derivatives market facilitates trading, back-to-back hedging and arbitrage activities.

### **(b) The Proposal**

9. The levy currently specified in paragraph 2 of the Securities and Futures Commission (Levy) (Futures Contracts) Order (Futures Levy Order) is \$1 per leviabale transaction in each market of the Hong Kong Futures Exchange, save in relation to Mini-Hang Seng Index Futures Contracts, where the levy is \$0.20 for each leviabale transaction. Following rationalisation of the contract multipliers, the size of most stock futures contracts was reduced to one-fifth of their original size. To rationalise the transaction cost correspondingly, the SFC proposes to reduce the levy in relation to all stock futures contracts from \$1 to \$0.20 per leviabale transaction.

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\* **Note** The contract multiplier is the fixed number of underlying shares for one futures contract.

## **THE ORDERS**

10. The Securities and Futures Commission (Levy) (Securities) Amendment Order 2001 amends paragraph 2 of the Securities Levy Order. Where an ETF Market Maker purchases or sells an ETF, the Amendment Order specifies the rate of levy for the purpose of section 52(1) of SFCO at 0% of the relevant consideration.

11. The Securities and Futures Commission (Levy) (Futures Contracts) (Amendment) (No. 2) Order 2001 amends paragraph 2 of the Futures Levy Order to the effect that the levy for stock futures contracts shall be \$0.20 for each leviable transaction. The levy for other contracts shall remain unchanged.

## **PUBLIC CONSULTATION**

12. HKEx has consulted exchange participants who have indicated an interest in the ETF market. They welcome the practical exemption on the payment of levy for market making trades. The public is not expected to have any concern on the rationalisation of levy for stock futures contracts and no public consultation is considered necessary for the technical amendment.

## **BASIC LAW IMPLICATIONS**

13. The Department of Justice advises that the Orders do not conflict with those provisions of the Basic Law carrying no human rights implications.

## **HUMAN RIGHTS IMPLICATIONS**

14. The Department of Justice advises that the Orders are consistent with the human rights provisions of the Basic Law.

## **BINDING EFFECT OF THE ORDERS**

15. The Orders will not affect the current binding effect of the Securities Levy Order and the Futures Levy Order.

## **FINANCIAL AND STAFFING IMPLICATIONS**

16. The levy exemption proposal will result in a small revenue loss to the SFC but this should be more than offset by the increase in trading volumes of ETF shares. The levy rationalisation proposal for stock futures contracts will only have a neutral effect on the SFC revenue. An increase in the trading volume will have positive impact on stamp duty revenue for Government. However, it is difficult to ascertain the quantum of duty so increased at this moment. There are no staffing implications for Government.

## **ECONOMIC IMPLICATIONS**

17. The proposals will be conducive to the development of the Hong Kong securities market.

## **LEGISLATIVE TIMETABLE**

18. The legislative timetable for Orders is as follows—

Publication in the Gazette	28 September 2001
Table before Legislative Council	10 October 2001

## **PUBLICITY**

19. A press release will be issued on the day the Orders are published in the Gazette. A spokesman will be available for answering media enquiries.

## **ENQUIRIES**

20. For any enquiries on this brief, please contact Ms Salina Yan, Principal Assistant Secretary for Financial Services at 2528 9161.

Financial Services Bureau  
28 September 2001