For discussion
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Legislative Council Panel on Financial Affairs

Legislative proposal to implement the stamp duty waiver in respect of exchange traded funds

Purpose

This paper briefs Members on the legislative proposal to amend the Stamp Duty Ordinance ("SDO") (Cap. 117) to implement the stamp duty waiver for the transfer of shares or units of all exchange traded funds ("ETFs") as proposed in the 2014-15 Budget.

Background

<u>ETFs</u>

2. The ETF sector is one of the key components of the asset management industry worldwide. It has been growing rapidly. In Hong Kong, ETFs are open-ended collective investment schemes that are listed or traded on the Stock Exchange of Hong Kong ("SEHK"). These ETFs seek to track, replicate or correspond to the performance of an underlying index on, for instance, a group of stock markets in a region, or an underlying benchmark such as gold and silver fixing prices. A major benefit of ETFs is that they allow investors to diversify their investments by giving investors an exposure to assets represented by their underlying index or benchmark without actually owning the constituents that comprise the index or benchmark.

<u>Current Stamp Duty Arrangement</u>

3. A supportive tax environment is an important factor that an ETF issuer would take into account in its decision to domicile or list an ETF in a particular place. Since 2010, Hong Kong has extended the stamp duty

remission to ETFs which track indices comprising no more than 40% in Hong Kong stocks as a 2010-11 Budget initiative[1]. The number of ETFs listed in Hong Kong has increased substantially from 69 at end-2010 to 124 as of 13 June 2014, and the daily average turnover has increased from $2.4 billion in 2010 to $3.7 billion in 2013. This makes Hong Kong one of the largest ETF markets in the Asia-Pacific region with strong potential for further growth. The Hong Kong ETF market ranked second in Asia in terms of market capitalization as of April 2014 and third in Asia in terms of total turnover for the first four months in 2014.

Challenges

4. At present, Hong Kong is the only place among major international financial markets to impose a stamp duty on the transactions of ETF shares or units. For those ETFs that do not enjoy the current stamp duty waiver, the buyer and the seller each needs to pay a stamp duty at 0.1% of the value of the transaction. Other jurisdictions including Australia, Japan, Korea, Mainland China, Singapore, the United Kingdom and the United States do not impose a stamp duty on the transactions of ETF shares or units. Amid increasing competition from major financial markets in the region, the additional transaction cost of ETF shares or units owing to stamp duty is adversely affecting Hong Kong's competitiveness as an international financial centre. Albeit the increase in the number of ETFs and turnover on the SEHK over the past few years, Hong Kong's position as a regional ETF hub faces serious challenges by other markets.

5. The stamp duty on ETFs would also put ETFs tracking Hong Kong stocks on the SEHK with registers of holders maintained in Hong Kong at a competitive disadvantage. For example, trading of units of an ETF which tracks Hong Kong stocks and is listed on the New York Stock Exchange with no register of holders maintained in Hong Kong is free from stamp duty[2]. However, without any exemption or remission provided, trading of units of an ETF which tracks Hong Kong stocks and is listed on the SEHK with a register of holders maintained in Hong Kong

[1] Since 2010, the Government has been relying on section 52 of the SDO to grant stamp duty remission to qualified ETFs on a case-by-case basis.

[2] Stamp duty is generally payable on the transfers of Hong Kong stocks. Under the SDO, "Hong Kong stock" is defined to mean "stock of which the transfer is required to be registered in Hong Kong".

is subject to stamp duty. There is a need to further develop and support Hong Kong stock-based ETFs listed or traded on the SEHK to anchor liquidity in Hong Kong.

6. Extension of the stamp duty waiver to all ETFs will also level the playing field for ETFs, irrespective of their portfolios, as ETFs that track indices comprising not more than 40% of Hong Kong stocks are not subject to stamp duty.

Proposed Stamp Duty Waiver

7. Against this background, the Government has proposed in the 2014-15 Budget to waive the stamp duty for the transfer of all ETF shares or units, so that the trading cost of ETFs with a higher percentage of Hong Kong stocks in their portfolios can be reduced as well to help promote the development, management and trading of ETFs in Hong Kong. This will be conducive to fostering Hong Kong's position as an asset management centre and the development of our financial services sector as a whole, and bring about increased businesses for market practitioners and a greater range of products for investors.

8. The stamp duty for the transfer of ETF shares or units is currently provided under head 2 in the First Schedule to the SDO. We propose to amend the SDO to implement the stamp duty waiver for the transfer of all ETF shares or units.

Way Forward

9. We are preparing the amendment bill and aim to introduce it into the Legislative Council in the first half of the 2014-15 legislative session.

Financial Services and the Treasury Bureau
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