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For information

Legislative Council Panel on Financial Affairs

Legislative Proposal to Extend Stamp Duty Waiver to Market Makers in the Course of Creation and Redemption of Exchange Traded Funds

PURPOSE

This paper briefs Members on the legislative proposal to give effect to a new initiative as announced in the 2020-21 Budget to waive the stamp duty on stock transfers paid by exchange traded fund ("ETF") market makers in the course of creating and redeeming ETF units listed in Hong Kong.

BACKGROUND

ETFs

2. ETF is a type of investment product that tracks a certain class of underlying assets, including stocks, fixed income and currency, commodity, and their respective indices. As at end-2019, there were 104 ETFs listed in Hong Kong. Among these 104 ETFs listed in Hong Kong, 20 of them are with portfolio covering Hong Kong stocks.

3. As at end-2019, the asset under management (AUM) by all ETFs listed in Hong Kong was over $330 billion. The average daily turnover of these ETFs listed in Hong Kong was about $4.4 billion, representing a 9% year-on-year increase.

4. According to the Hong Kong Exchanges and Clearing Limited ("HKEX"), the adoption of passive funds (such as ETFs) as investment by investors in the Asia-Pacific region is expected to experience a rapid growth over the next five years, with AUM growing from USD 1.5 trillion today to over USD 5 trillion. In light of the growth of the ETF market, major jurisdictions around the world, including Hong Kong, have been competing for the position as an ETF listing platform.

Current Stamp Duty Waiver in respect of ETFs

5. The Government has been providing stamp duty waiver to certain transactions relating to ETFs since 2015. The policy consideration back then was to drive the development of the ETF market, in particular the secondary market in Hong Kong.

6. Since the introduction of the stamp duty waiver, the AUM and the average daily turnover of some flagship ETFs listed on the HKEX increased by nearly 50% and more than doubled respectively. Nevertheless, ETF market makers are still required to pay stamp duty for the acquisition and disposal of underlying stocks in the course of creating and redeeming ETF units listed in Hong Kong. This adds to the cost of ETF market-making activities and translates into the cost (including the spread) of trading ETFs in Hong Kong, which undermines the competitiveness of Hong Kong *vis-à-vis* other major jurisdictions as an ETF listing platform.

PROPOSED STAMP DUTY WAIVER

7. In order to foster the development of the ETF market in Hong Kong and to drive more ETFs to list in Hong Kong, the Financial Secretary announced in the 2020-21 Budget to waive the stamp duty paid by ETF market makers in the course of creating and redeeming ETF units listed in Hong Kong. This initiative will further reduce the cost of creating ETF units with Hong Kong stock as underlyings if such ETFs are to be listed in Hong Kong. Coupled with other market microstructure improvements (such as amending the tick size table of ETFs) to be implemented by the HKEX, this will consequentially reduce the transaction cost, and hence promoting the liquidity and depth of the ETF market and stock market in Hong Kong. This will also bring benefits to the wider investing public, including making available a broader range of ETFs for passive investment and at a more competitive transaction cost.

8. Based on the estimated ETF creation and redemption activities in 2019, it is projected that the proposed Stamp Duty waiver would reduce the annual Government revenue by approximately $400 million.

LEGISLATIVE PROPOSAL

9. The scope of the stamp duty waiver relating to ETFs is currently provided in Schedule 8 to the Stamp Duty Ordinance (SDO). We propose to take forward the above initiative by amending the Schedule to cover the purchase and sale of Hong Kong stocks by ETF market makers in the course of creating and redeeming ETF units listed in Hong Kong. Such amendments to the Schedule will be effected through a regulation made by the Financial Secretary (i.e. a piece of subsidiary legislation). The Financial Secretary is vested with such power of amending the Schedule under section 63 of the SDO.

WAY FORWARD

10. We are preparing the regulation to give effect to the proposal. We aim to table the regulation before the Legislative Council for negative vetting in the first half of 2020.

ADVICE SOUGHT

11. Members are invited to note the content of this paper.

Financial Services and the Treasury Bureau
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