

**LEGISLATIVE COUNCIL BRIEF**

**STAMP DUTY ORDINANCE  
(Chapter 117)**

**Stamp Duty Ordinance (Amendment of Schedule 8) Regulation 2020**

**INTRODUCTION**

A The Financial Secretary (“FS”) has, pursuant to section 63(c) of the Stamp Duty Ordinance (Cap. 117) (“SDO”), made the Stamp Duty Ordinance (Amendment of Schedule 8) Regulation 2020 (“Regulation”) at **Annex A**. The Regulation seeks to give effect to a new initiative as announced in the 2020-21 Budget to waive the stamp duty on stock transfers involving the activities of exchange traded fund (“ETF”) market makers in the course of allotting and redeeming ETF units listed in Hong Kong.

**JUSTIFICATIONS**

*Overview of the ETFs market*

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 in 2019 was about \$4.4 billion, representing a 9% year-on-year increase.

4. Investing in ETFs is increasingly popular in recent years and it allows investors to diversify their portfolios by investing in a basket of assets

(such as assets represented by a certain index) without actually owning the wide range of constituents that comprise the basket. 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 a preferred ETF listing platform.

### ***Current stamp duty waiver in respect of ETFs***

5. A supportive tax environment is an important factor that ETF issuers would take into account in their decision to list an ETF in a particular place. With this in mind, 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, showing that our initiative in the secondary market to promote the growth of ETFs in Hong Kong has been successful.

### ***Further stamp duty waiver for primary market activities of ETFs***

7. Market makers play an important role in the overall development of the ETF market by providing liquidity and facilitating the price-discovery process of ETFs. Market makers will initiate the allotment of more ETF units when the demand for such units from the market surges, and likewise initiate the redemption of ETF units when their demand drops. These primary market activities are essential parts of the operation of the ETF market.

8. In performing their market-making or liquidity-providing activities in the ETF market, market makers need to allot and redeem units of the ETFs

with the ETF issuers (where applicable, through the participating dealer<sup>1</sup> authorized by the respective ETF issuers). During the allotment process, market makers will purchase the underlying stocks of the ETF from the market to form a basket of stocks (“ETF underlyings”). Market makers will then pass the ETF underlyings to the ETF issuers (where applicable, through a participating dealer) and receive the ETF units in return. The whole process essentially increases the supply of ETF units in circulation. During the redemption process, market makers will pass the ETF units to the ETF issuers (where applicable, through a participating dealer) and receive the ETF underlyings in return. The market maker would then sell the basket of stocks in the market. The whole process essentially decreases the overall supply of ETF units in circulation. Please see **Annex B** for the illustration of the above primary market activities of ETFs.

B

B

9. As shown in **Annex B**, ETF market makers are required to pay stamp duty for the purchase and sale of ETF underlyings in the course of allotting and redeeming ETF units listed in Hong Kong. Where a participating dealer is involved in the process, the transactions between the participating dealer and market makers that involve the ETF underlyings are also subject to stamp duty. 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.

### ***Benefits of the ETF stamp duty waiver***

10. Against this background, the Financial Secretary announced in the 2020-21 Budget to waive the stamp duty involving the activities of ETF market makers in the course of allotting and redeeming ETF units listed in Hong Kong. This initiative will further reduce the cost of allotting and redeeming ETF units with Hong Kong stocks 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

---

<sup>1</sup> In some cases, the market makers will also be the participating dealer and hence the market makers will transact with the ETF issuers direct.

stock market in Hong Kong. The reduced transaction cost of primary market activities of ETFs listed in Hong Kong will enhance the competitiveness of Hong Kong as an ETF listing venue. 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.

## **DETAILS OF STAMP DUTY WAIVER**

### *The approach*

11. Under section 19(1) of the SDO, a person who effects any sale or purchase of Hong Kong stock is required to make and execute a contract note and cause the note to be stamped under head 2(1) or (2) in the First Schedule to the SDO. In order to waive the stamp duty involving the activities of ETF market makers in the course of allotting and redeeming ETF units listed in Hong Kong, the relevant transactions are excluded from the application of section 19(1), and hence head 2(1) or (2) in the First Schedule. At present, Schedule 8 to the SDO sets out the types of transactions that are excluded from the requirements of making and executing a contract note under section 19(1) of the SDO (including those secondary market activities of ETFs mentioned in paragraph 5 above)<sup>2</sup>. The Regulation seeks to amend the Schedule to expand its coverage to include those transactions relating to primary market activities as highlighted at **Annex B**.

B

### *Eligibility of the waiver*

12. The market-making and liquidity-providing activities are undertaken by securities market makers (and their affiliates) and designated specialists of individual ETFs. The HKEX maintains the lists of securities market makers (and the eligibility of their affiliates) and designated specialists who are approved or registered market makers of individual ETFs. These entities are collectively known as the “market makers” of individual ETFs.

---

<sup>2</sup> Separately, Schedule 10 to the SDO waives the stamp duty payable for the in-kind allotment and redemption undertaken by all authorized open-ended collective investment schemes including ETFs (i.e. the transfers of ETF underlyings between participating dealer and ETF issuer during the ETF allotment or redemption process as shown in **Annex B**).

13. The stamp duty waiver applies to both the allotment and redemption of ETF units. As far as the allotment of ETF units is concerned, the waiver covers:

- (a) the purchase of Hong Kong stocks by the market maker from the market; and
- (b) where a participant dealer authorized by the ETF issuer is involved in the process (see paragraph 8 and Footnote 1 above), the sale of constituent Hong Kong stocks by the market maker and the corresponding purchase of constituent Hong Kong stocks by the participating dealer. This is essentially the process of passing the stocks from the market maker to the ETF issuer through the participating dealer in exchange for ETF units.

14. For the redemption of the ETF units, the stamp duty waiver covers:

- (a) where a participant dealer authorized by the ETF issuer is involved in the process (see paragraph 8 and Footnote 1 above), the sale of constituent Hong Kong stocks by the participating dealer and the corresponding purchase of constituent Hong Kong stocks by the market maker. This is essentially the process of passing the stocks from the ETF issuer through the participating dealer to the market maker in exchange for ETF units; and
- (b) the sale of constituent Hong Kong stocks by the market maker to the market.

***Requirements on the timing of the transactions***

15. In order to ensure that the transactions eligible for the stamp duty waiver are genuinely related to the allotment and redemption activities of individual ETFs, we need to impose restrictions on the timing of the transactions. For instance, if a market maker's purchase of constituent Hong Kong stocks from the market is too remote (either being too early or too late) from the actual placement of an allotment order, it would not be reasonable to consider such purchase as being genuinely related to ETF

allotment. The same applies to redemption.

16. As far as the allotment of the ETF units is concerned, the guiding principle is that the purchase of ETF underlyings should not be settled too early (i.e. the purchase should not have been settled before the day on which the allotment order of ETF units is placed by the market maker), nor too late (i.e. the purchase of stocks should not have been settled after the day on which the allotment is settled). The same restriction applies to the transactions (if any) between market makers and participating dealers. Transactions falling outside the specified period are not considered as ones relating to the corresponding ETF allotment activity.

17. Similarly, for the redemption of the ETF units, the guiding principle is that the sale of ETF underlyings should not be made too early (i.e. the stocks should not have been sold before the day that the redemption order is placed by the market maker), nor too late (i.e. the stocks should not have been sold later than the trading day immediately following the effect of the redemption order). The same restriction applies to the transactions (if any) between market makers and participating dealers. Transactions falling outside the specified period are not considered as being related to the corresponding ETF redemption activity.

## **SUBSIDIARY LEGISLATION**

### ***Stamp Duty Ordinance (Amendment of Schedule 8) Regulation 2020***

18. The Regulation amends Schedule 8 to the SDO in the following manner –

- (a) The existing Part 1 is amended to add certain definitions, including “market makers” (see paragraphs 12 to 14 above), “allotment”, “redemption”, “allotment period”, “redemption period” (see paragraphs 15 to 17 above), etc.;
- (b) The existing Part 2 is amended to disapply section 19(1) of the SDO for the following transactions that take place within the allotment period or redemption period (as appropriate) –

- (i) a purchase of Hong Kong stocks made by a market maker of an ETF for the allotment of a share or unit of the ETF;
- (ii) a sale of Hong Kong stocks made by a marker maker of an ETF for the redemption of a share or unit of the ETF; and
- (iii) the sale and purchase of Hong Kong stocks between a market maker of an ETF and a participating dealer of the ETF for the allotment or redemption of a share or unit of the ETF.

## **LEGISLATIVE TIMETABLE**

19. The Regulation will be published in the Gazette on 15 May 2020 and tabled before the Legislative Council at its sitting of 20 May 2020. The Regulation will come into operation on 1 August 2020.

## **IMPLICATIONS OF THE REGULATION**

20. The waiver will reduce the transaction cost of ETFs listed in Hong Kong. This will be conducive to fostering Hong Kong's position as an ETF listing hub and the development of our financial services sector as a whole. Based on the estimated ETF allotment and redemption activities in 2019, it is estimated that the waiver would reduce the Government revenue by \$400 million annually.

21. The Regulation is in conformity with the Basic Law, including the provisions concerning human rights. It does not affect the binding effect of the existing provisions of the SDO.

## **PUBLIC CONSULTATION**

22. In formulating the proposal, we have taken into account the views received from stakeholders during the Budget consultation process. Following the announcement of the initiative in the 2020-21 Budget, we issued an information paper to the Legislative Council Panel on Financial Affairs in April 2020 and no comment has been received.

## **PUBLICITY**

23. We will issue a press release upon the gazettal of the Regulation. A spokesperson will be made available to answer media and public enquiries.

## **ENQUIRIES**

24. Enquiries should be directed to Mr George Tsoi, Principal Assistant Secretary for Financial Services and the Treasury (Financial Services), at 2810 2056.

**Financial Services and the Treasury Bureau  
Inland Revenue Department  
13 May 2020**



## Stamp Duty Ordinance (Amendment of Schedule 8) Regulation 2020

(Made by the Financial Secretary under section 63(c) of the Stamp Duty Ordinance (Cap. 117))

### 1. Commencement

This Regulation comes into operation on 1 August 2020.

### 2. Stamp Duty Ordinance amended

The Stamp Duty Ordinance (Cap. 117) is amended as set out in section 3.

### 3. Schedule 8 amended (transactions and transfers relating to exchange traded funds)

- (1) Schedule 8, Part 1, section 1, definition of *purchase, sale* and *sale or purchase*—

#### Repeal

“19(16).”

#### Substitute

“19(16);”.

- (2) Schedule 8, Part 1, section 1—

#### Add in alphabetical order

“*allotment* (分配), in relation to a share or unit of an exchange traded fund, means an issue of the share or unit, where—

- (a) the issue arises from market making or liquidity providing activities in respect of the shares or units of the fund; and

- (b) those activities are conducted through, or recorded on, the trading system of the Stock Exchange Company;

*allotment period* (分配時段), in relation to the allotment of a share or unit of an exchange traded fund, means the period between the following 2 days (both days inclusive)—

- (a) the day on which the order for the allotment is placed by a market maker of the fund;
- (b) the day on which the allotment is settled;

*market maker* (莊家), in relation to an exchange traded fund, means a person approved by or registered with the Stock Exchange Company for performing, in accordance with rules made by the Stock Exchange Company, market making or liquidity providing activities in respect of the shares or units of the fund;

*participating dealer* (參與證券商), in relation to an exchange traded fund, means a person who is authorized by the trustee or manager of the fund to accept orders for the allotment and redemption of shares or units of the fund;

*redemption* (贖回), in relation to a share or unit of an exchange traded fund, means a cancellation of the share or an extinguishment of the unit, after the share or unit is eventually transferred to the fund, where—

- (a) the cancellation or extinguishment arises from market making or liquidity providing activities in respect of the shares or units of the fund; and
- (b) those activities are conducted through, or recorded on, the trading system of the Stock Exchange Company;

*redemption period* (贖回時段), in relation to the redemption of a share or unit of an exchange traded fund, means the

period between the following 2 days (both days inclusive)—

- (a) the day on which the order for the redemption is placed by a market maker of the fund;
- (b) the trading day immediately after the day on which the relevant Hong Kong stock is delivered to the market maker for the redemption;

**Stock Exchange Company** (聯交所) has the meaning given by section 1 of Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571).”.

(3) Schedule 8, Part 2, after item 2—

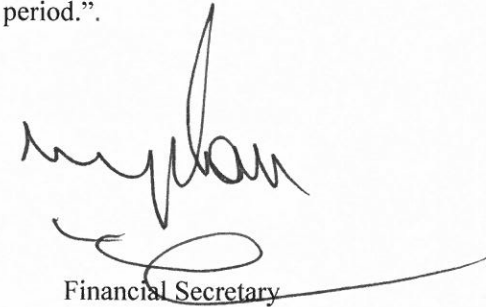
**Add**

“3. Each of the following transactions that is made for the allotment of a share or unit of an exchange traded fund—

- (a) a purchase of Hong Kong stock, made by a market maker of the fund, that is settled within the allotment period;
- (b) both the sale and purchase of a transaction of Hong Kong stock (if any) that satisfies both of the following conditions—
  - (i) the sale is made by a market maker of the fund and the purchase is made by a participating dealer of the fund;
  - (ii) the transaction is settled within the allotment period.

4. Each of the following transactions that is made for the redemption of a share or unit of an exchange traded fund—

- (a) both the sale and purchase of a transaction of Hong Kong stock (if any) that satisfies both of the following conditions—
  - (i) the sale is made by a participating dealer of the fund and the purchase is made by a market maker of the fund;
  - (ii) the transaction is effected within the redemption period;
- (b) a sale of Hong Kong stock, made by a market maker of the fund, that is effected within the redemption period.”.



Financial Secretary

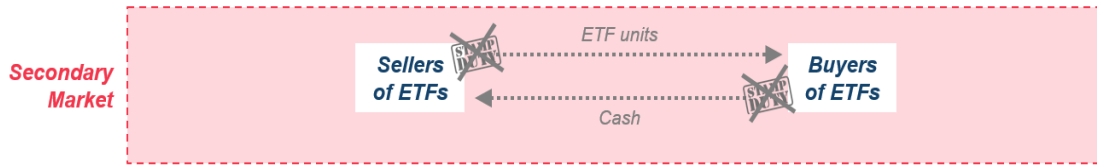
11 May 2020

### Explanatory Note

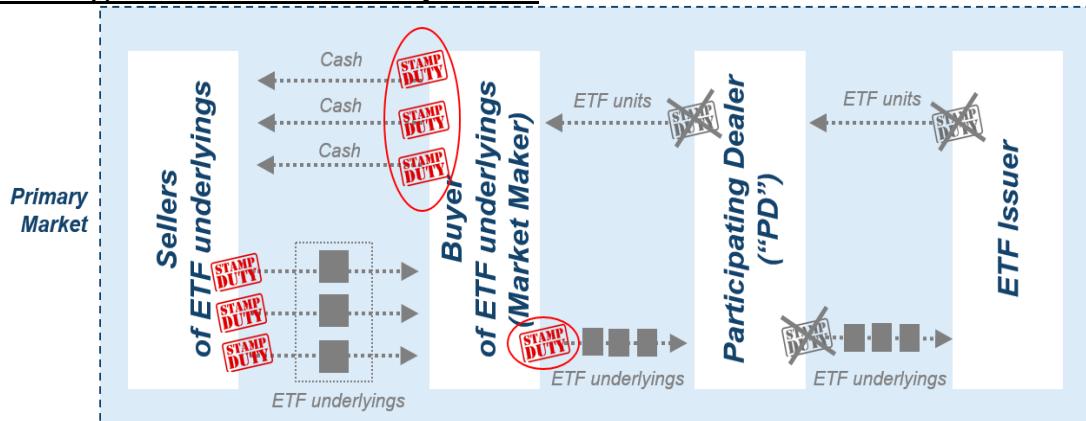
This Regulation amends the Stamp Duty Ordinance (Cap. 117) (*SDO*) to implement an initiative in the 2020–21 Budget of the Government.

2. The objective of the Regulation is to reduce the transaction costs relating to exchange traded funds, which in turn may narrow bid-ask spreads of the shares or units of exchange traded funds.
3. Section 19(1) of the SDO requires the making, execution and stamping of contract notes for the sale and purchase of Hong Kong stock. The Regulation amends Schedule 8 to the SDO to disapply that section 19(1) to the following transactions settled or effected within a specified period—
  - (a) the following transactions made by a market maker of an exchange traded fund—
    - (i) a purchase of Hong Kong stock made for the allotment of a share or unit of the fund;
    - (ii) a sale of Hong Kong stock made for the redemption of a share or unit of the fund;
  - (b) the sale and purchase of Hong Kong stock between a market maker of an exchange traded fund and a participating dealer of the fund for the allotment or redemption of a share or unit of the fund.

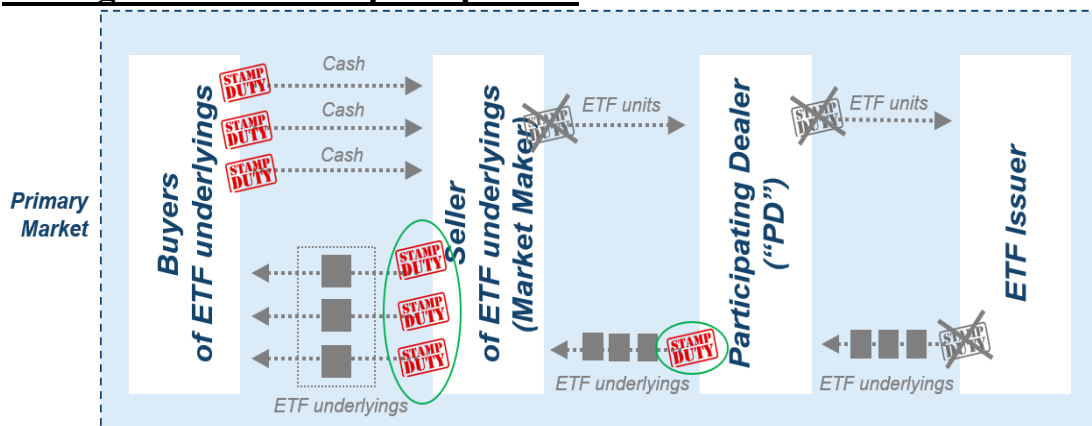
**Current Position and New Stamp Duty Waiver**



**During the ETF allotment process**



**During the ETF redemption process**



Stamp Duty waiver relating to allotment of ETFs



Stamp Duty waiver relating to redemption of ETFs



Stamp Duty currently waived



Stamp Duty that remains chargeable (i.e. not covered by the Regulation)