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26 March 2010

Securities and Futures Commission
Supervision of Markets Division
8th Floor, Chater House
8 Connaught Road Central
Hong Kong

By Hand

Dear Sirs

Joint consultation paper on a proposed operational model for implementing a scripless securities market in Hong Kong (the "Consultation")

We are grateful for the opportunity to submit written comments in respect of the Consultation.

Please accept this submission from Simmons & Simmons on behalf of Deutsche Bank AG, Hong Kong Branch as a response to question 6 in the Consultation, in respect of which we have particular views. Deutsche Bank AG, Hong Kong Branch is the Hong Kong listing agent of db x-tracker ETFs, of which there are presently 24 listed in Hong Kong.

Question 6

6. Do you agree with the proposal that the formal register comprise two parts (the "Proposal") as discussed in paragraphs 49 to 53? If not, why not?

Simmons & Simmons and Deutsche Bank AG, Hong Kong Branch generally welcome the Proposal. In principle, we believe that enhanced shareholder transparency and corporate communication would benefit investors in equity securities as well as exchange traded funds ("ETFs") which are listed on The Stock Exchange of Hong Kong Limited (the "SEHK").

However we are concerned that the existence of a CCASS record for those ETFs which maintain their respective registers of members outside Hong Kong (the "Cross-Listed ETFs") may cause shares in such Cross-Listed ETFs to constitute Hong Kong stock. If so, this will result in investors who invest in Cross-Listed ETFs being subject to stamp duty on transfers of shares in such Cross-Listed ETFs, which is not the case at present. As explained below, we believe this is an unintended side-effect of the Proposal which warrants further consideration before the Proposal is implemented.

A. Background

Currently, the interests of all Cross-Listed ETFs which are listed on the SEHK are uncertificated. These interests are held within CCASS with HKSCC Nominees Limited as the registered owner (i.e. the sole holder of record) of all outstanding interests of all the Cross-Listed ETFs whose shares are deposited within CCASS. Investors owning shares of such Cross-Listed ETFs in CCASS are beneficial owners as shown on the records of the participating brokers or the relevant participating dealers.

Most importantly, Cross-Listed ETFs currently are not required to maintain a sub-register in Hong Kong. As a result, the interests of these Cross-Listed ETFs do not constitute "Hong Kong stock" as defined under the Stamp Duty Ordinance (Cap.117 of Laws of Hong Kong) (the "SDO"). Accordingly an investor who purchases or sells shares of a Cross-Listed ETFs on the SEHK will not be required to pay any stamp duty.

However, under the Proposal, all uncertificated securities will be held within CCASS and all certificated securities will be held outside CCASS. The formal register of holders of a listed entity will thus consist of two parts:

- (i) an uncertificated sub-register, which will record details of all holdings within CCASS, and
- (ii) a certificated sub-register, which will record details of all holdings outside CCASS.

Accordingly, if the Proposal as presently drawn is implemented and applied to Cross-Listed ETFs, then the shares of the Cross-Listed ETFs listed and traded on the SEHK will constitute "Hong Kong Stock" under the SDO. Consequently stamp duty will be levied on any sale or purchase of the shares of a Cross-Listed ETF on the SEHK by an investor, unless a stamp duty remission or exemption order applies.

We believe this is not the intended purpose of the Proposal because it seems inconsistent with the government's intention of exempting ETFs from stamp duty as illustrated by the government's budget for 2010/2011 which extends the stamp duty concession in respect of the trading of ETFs by investors in the secondary market on the SEHK (please refer to Sub-section B3 below) to cover ETFs that track indices comprising not more than 40 per cent of Hong Kong stock.

B. Stamp Duty Remission

As the SFC is aware, the Inland Revenue Department has issued 3 explanatory notes in respect of:

- (i) Remission of Stamp Duty on Delivery of Hong Kong Stocks as Consideration for allotment or redemption of Collective Investment Products (the "Creation and Redemption Remission Order");
- (ii) Remission or Refund of Stamp Duty – (a) Transactions in Fixed-Income ETFs (b) Market Making Trades of ETFs (the "Market Maker Remission Order"); and
- (iii) Remission or Refund of Stamp Duty ETFs (the "Secondary Market Remission Order").

The Creation and Redemption Remission Order relates to creation and redemption *in specie* in respect of Hong Kong stock. If the basket of stocks required to be delivered by a participating dealer to an ETF pursuant to an *in specie* creation (or the basket of stocks required to be delivered by an ETF to a participating dealer pursuant to an *in specie* redemption) consists of any Hong Kong stock, then this remission order will be particularly important to the ETF.

The Market Maker Remission Order deals with stamp duty payable by ETF market makers. We understand that so long as an exchange participant is registered with the SEHK to act as a market maker of a particular ETF, it can rely on this remission order.

The Secondary Market Remission Order concerns the trading of shares or units in an ETF by investors in the secondary market on the SEHK. We understand that, for policy reasons, only ETFs that do not invest in any Hong Kong stock and/or that track an index without Hong Kong

stocks (please refer to Sub-section C3 below) will generally be eligible as a "Specified ETF" and granted remission under this order. As explained in Section A above, under the government's budget for 2010/2011, the government intends to extend such stamp duty concession to cover ETFs that track indices comprising not more than 40 per cent of Hong Kong stock.

C. Impact of the Proposal on ETFs

Unless an appropriate carve out or exemption is applied, the Proposal may have the following undesirable impact on the development of the ETF market on the SEHK:

1. The growth of the Hong Kong ETF market may be impaired

As explained above, the implementation of the Proposal will result in stamp duty being levied on transfers by investors in ETFs, when such transfers are currently exempt from stamp duty. The increased trading costs may deter investors from investing in ETFs listed on the SEHK. This may impair the further growth of ETF market in Hong Kong and jeopardise Hong Kong's current position as the leading Asian hub for ETFs. We do not believe this to be the intention of the government, the SEHK or the SFC.

2. Existing investors of Cross-Listed ETFs may be unfairly prejudiced

The existing investors of Cross-Listed ETFs might have chosen to invest in the Cross-Listed ETFs, rather than other ETFs, because of the absence of stamp duty on secondary market trading for such investments. It would be unfair to impose stamp duty on these investors when they sell their shares of the Cross-Listed ETFs (which were acquired before the Proposal is implemented). This will be detrimental to the ETF market in Hong Kong as a whole.

3. Additional costs may be incurred by the Cross-Listed ETFs

Although we believe that the Cross-Listed ETFs should be able to benefit from the existing stamp duty remissions under the Creation and Redemption Remission Order and the Market Maker Remission Order as explained in Section B above, the applications for remissions will result in delay and additional costs being incurred by the Cross-Listed ETFs.

Regarding the Secondary Market Remission Order, it is unclear which test (i.e. whether the Financial Services and Treasury Bureau would look at the underlying constituents of the relevant index, or the composition of the investments that were held by the ETFs) will apply in considering whether remission should be granted under this Order as the SFC's and the Stamp Office's respective approaches, we understand, may be different. This creates uncertainty on the success of such stamp duty remission application.

D. Suggestions on ways to eliminate the unintended side effects

We believe the following suggestions will eliminate the unintended side effects described in Section C above:

1. The definition of "stock" or "Hong Kong stock" under the SDO could be revised to exclude any interests issued by Cross-Listed ETFs.
2. Alternatively, the Stamp Office of the Inland Revenue Department could grant a blanket exemption to all Cross-Listed ETFs with regard to all secondary trading.

E. Conclusions

Deutsche Bank AG, Hong Kong Branch agrees with the SFC that a scripless market is a natural progression of the global securities market. In fact, the majority of the ETFs (including db x-trackers) have already adopted a scripless operational model.

Hong Kong is presently the second largest ETF market in Asia in terms of market capitalisation and the largest in terms of average daily turnover (excluding the Mainland exchanges) as at January 2010. 6 ETFs from Hong Kong are amongst the largest top 10 ETFs in Asia ex-Japan (in terms of assets under management).

We recognise the need for Hong Kong to review the existing operational model and to address the issues which have been highlighted in the Proposal. However, as pointed out above, the implementation of the Proposal in its current form may have an unintended negative impact on the development of the ETF market. We therefore hope that the suggestions in Section D above will be taken into consideration by the relevant parties before the Proposal is implemented.

Please let _____ or _____ know should the SFC wish to discuss any of the above in more detail.

Yours faithfully;


Simmons & Simmons

Copy to:

Deutsche Bank AG, Hong Kong Branch