HONG KONG SECURITIES MARKET

Brief history

Records of securities trading in Hong Kong date back to 1866. In 1891 when the Association of Stockbrokers in Hong Kong was established, Hong Kong had its first formal stock market. It was renamed The Hong Kong Stock Exchange in 1914. By 1972, Hong Kong had four stock exchanges in operation. There were subsequently calls for the formation of a unified stock exchange. The Stock Exchange of Hong Kong Limited (the Exchange) was incorporated in 1980 and trading on the Exchange finally commenced on 2 April 1986.

Since 1986, a number of major developments have taken place. The 1987 market crash revealed flaws in the market and led to calls for a complete reform of the Hong Kong securities industry. This led to significant regulatory changes and infrastructural developments. As a result, the Securities and Futures Commission (SFC) was set up in 1989 as the single statutory securities market regulator. The market infrastructure was much improved with the introduction by the Exchange of the Central Clearing and Settlement System (CCASS) in June 1992 and the Automatic Order Matching and Execution System (AMS) in November 1993.

Since then, the framework of market rules and regulations, both Exchange-administered or otherwise, have been undergoing continuing review and revision to meet changing market needs while ensuring effective market regulation. The Exchange Listing Rules have been made more comprehensive, and other existing regulations have been improved or new regulations introduced to enhance market development and investor protection. Enhancements were also made to the system infrastructure, including the launch of off-floor trading terminals in brokers' offices in January 1996. The third generation of the trading system, AMS/3, will be launched in 2000. It will provide enhanced functionality and a platform for a straight-through transaction process.

In respect of market and product development, there are the listing of the first derivative warrant in February 1988, the listing of the first China-incorporated enterprise (H share) in July 1993; and the introduction of regulated short selling in January 1994 and stock options in September 1995. Furthermore, the Exchange introduced the Growth Enterprise Market (GEM) in November 1999 to provide fund raising opportunities for growth companies of all sizes from all industries, and to promote the development of technology industries in the region.

However, in order to meet the challenge from technological advances, globalisation of the international financial markets and the needs of the increasingly sophisticated investors both locally and overseas, fundamental reform of the existing market structure is needed. According to the reform plan announced in March 1999, the Exchange, the Hong Kong Futures Exchange and their clearing houses will merge into a new holding company, the Hong Kong Exchanges and Clearing Limited. The new holding company will ultimately seek a listing on the Exchange.

Regulatory framework

The securities market in Hong Kong is under the oversight of the SFC whose chairman and directors are appointed by Hong Kong's Chief Executive. The SFC supervises the self-regulatory market bodies, including the Stock Exchange of Hong Kong, the Hong Kong Futures Exchange, securities clearing houses, and financial intermediaries.

The SFC was established under the Securities and Futures Commission Ordinance as an autonomous statutory body outside the civil service. The SFC Ordinance, together with the Securities Ordinance and the Stock Exchange Unification Ordinance, provide the fundamental framework within which dealings in securities are conducted and regulated. Apart from these and other statutory instruments, the operation of the securities market is also governed by the regulations, administrative procedures and guidelines developed by the SFC, as well as by the rules and regulations introduced and administered by the exchanges (see Appendix 1). The two exchanges have the front-line responsibility for maintaining the integrity, efficiency and fairness of their markets, as well as for ensuring the financial soundness and correct business conduct of their members.

The SFC is required to seek approval of its budget from the Legislative Council, report its policy to the Financial Secretary and to submit its annual report including audited financial report to the Financial Secretary and the Legislative Council. The Exchange's budget is also required to be approved by the Financial Secretary.

Securities products on the Exchange

Listed securities on the Main Board of the Exchange include equities, warrants, debt, unit trusts and mutual funds. As at the end of 1999, there were 701 listed companies on the Main Board (of which 44 were China-incorporated enterprises) with a total market capitalisation of HK$4,727,527 million, 1,205 listed securities with 181 stocks designated for short selling, and 17 classes of stock options.

The first two companies were listed on GEM on 25 November 1999. By the end of 1999, there were 7 companies listed on GEM with a total market capitalisation of HK$7,237 million.

Restriction of ownership

Companies engaged in television and sound broadcasting (with the exception of satellite broadcasting) are subject to a limit of 49% on voting control by non-residents. Otherwise, there are no restrictions regarding the ownership of securities, either for residents or non-residents.

Looking ahead

To proactively pursue and secure the Hong Kong's status as the international financial centre and the leading exchange in Asia, the Financial Secretary announced on 3 March 1999 comprehensive reforms for the securities and futures markets. These involve the demutualisation and merger of the Stock Exchange of Hong Kong, the Hong Kong Futures Exchange and their clearing houses under a new holding company, Hong Kong Exchanges and Clearing Limited ("HKEx").

HKEx's competitiveness will be sought by:

- creating a performance-, client- and profit-driven commercial organisation;
- putting in place an efficient and balanced framework for the operation of HKEx;
- separating trading rights from ownership of the Exchanges and opening up market access;
- developing the investor base and issuer base as well as diversifying and customising access to its markets;
- upgrading and diversifying its products and services;
- developing state-of-the-art technology and systems for markets under HKEx; and
- preserving a strong regulatory framework to promote market integrity and protect public interests.

HKEx will become a business organisation which focuses on shareholder value creation and long term business growth, and will be a public listed company. The merger has been approved by the shareholders of the two Exchanges and sanctioned by the Court, and became effective in the first quarter of 2000.

Apart from the demutualisation and merger of the Exchanges and clearing houses, the reform also involves: (1) an upgrading of the market infrastructure to achieve a single clearing arrangement for securities, stock options and futures transactions, the financial technology architecture to facilitate straight through processing, and a scripless securities market; (2) some rationalisation of the regulatory functions administered by the Exchange and the SFC; and (3) regulatory reform to provide regulation to protect investors while allowing for market development, healthy competition, market innovation and responsiveness to the changing market environment. The regulatory reforms will be incorporated in a Composite Securities and Futures Bill which consolidates the existing securities legislation.

THE YEAR 1999 IN REVIEW

The Hong Kong economy bottomed out in the second quarter of 1999 and gradually recovered from its historic downturn triggered by the Asian financial crisis in 1997-1998. The latest economic forecast expected a GDP growth of 1.8% in real terms for 1999, up from – 4.3% in 1998. However, the unemployment rate remained at a high level of 6% in December 1999 . Deflation only slightly improved with Composite Consumer Price Index registering a year-on-year decrease of 4% in December 1999.

Relatively, the Hong Kong stock market performed more energetically during 1999. Hang Seng Index rose above the 16,000 level in December, the highest since 15 August 1997. The market boom was contributed by many positive factors including the signing of the Sino-US trade agreement on WTO, the successful offering of the Hong Kong Tracker Fund and the plan for building Disneyland in Hong Kong. The Hang Seng Index ended the year at 16,962, 68.8% higher than the 1998 closing. The average daily turnover also climbed to HK$7.8 billion. With a total market capitalisation of HK$4,735 billion (Main Board and GEM) as at end of 1999, Hong Kong regained its position as the 10th largest territorial market in the world.

To respond to global market challenges, the SAR government introduced a three-pronged strategy in 1999 to upgrade the securities and futures market in Hong Kong.

1. Fundamental change in the market structure to be accomplished through the demutualisation and merger of the stock and futures exchanges and their associated clearing houses.
2. Enhancement of the financial infrastructure to improve risk management, increase efficiency and reduce costs.
3. Regulatory and legislative reform to improve the supervisory framework and protection of market participants.

The demutualisation of the stock and futures exchanges proceeded smoothly during the year and Hong Kong saw the formation of the merged Hong Kong Exchanges and Clearing Limited in March 2000.

Stock market

Main board – primary market

During the year, 31 companies were newly listed on the Exchange, raising $15.6 billion in new capital. Comparatively, new equity issuers raised only $6 billion in 1998. Most of the new listings were local Hong Kong companies with only three H-share and three red-chip companies.

The Exchange’s rules were amended in April and July 1999 to strengthen investor protection and streamline listing procedures. Major amendments include requiring disclosure by controlling shareholders of the pledging or charging of any of their beneficially owned securities within 12 months after listing; reduction of the retention period of the sponsors to PRC-incorporated issuers from 3 years to one year; termination of recognition of the Cook Islands as an approved and acceptable jurisdiction; and some codification to facilitate efficient review of new listing applications. The Exchange also consulted the market on other proposed changes to deal with competing business, notifiable transactions and share schemes.

The Exchange introduced a Primary Market Database on its website which holds summaries of information submitted under Securities (Disclosure of Interests) Ordinance and selected listed company announcements.

Hong Kong Securities Clearing Company (Hongkong Clearing) launched the Electronic Initial Public Offering (EIPO) service in May 1999. The service allowed broker, custodian and investor participants of the Central Clearing and Settlement System (CCASS) to apply for new IPO shares through CCASS terminals and the phone system. The facility was first used for T S Telecom Technologies Limited's flotation on the Growth Enterprise Market (GEM) on 23 Novermber 1999.

Main board – secondary market

The beginning of 1999 was over shadowed by worries on the possible depreciation of the Renminbi. The Hang Seng Index fell to its year-lowest at 9076.33 on 10 February. As this concern reduced, the market began to rally in response to favorable news. The Hang Seng Index and All Ordinaries Index closed the year at 16,962 and 7,135 respectively, representing an increase of 69 percent and 65 percent from 1998. The Hang Seng China Enterprises Index and Hang Seng China-Affiliated Corporations Index, which track H-share and red-chip companies respectively, rose 14.1% and 40.7% during the year. The Hang Seng MidCap 50 Index rose 29.5%. All sectors of the All Ordinaries Index recorded increases in 1999, with Utilities up 100.8%, Consolidated Enterprises up 95.1%, Industrials 53.9%, Finance 51.1%, Properties 31.6% and Hotels up 15.1%.

Trading activity in equities improved slightly in 1999, recording a year total of HK$1,773 billion which represented 93% of the total trading turnover.

Facing increasing threats from overseas exchanges and alternative trading systems, the Hong Kong stock market recognised the need to upgrade its existing secondary market infrastructure. A steering committee led by the Chairman of the Securities and Futures Commission was set up during 1999 to study and recommend necessary improvements to the financial infrastructure in Hong Kong. The Committee released a proposal in September 1999, outlining its vision of an integrated, scripless, straight-through electronic infrastructure for Hong Kong and recommending core actions to be accomplished within a two-year timeframe.

The Exchange released a consultation paper in September 1999 on electronic share applications (which covers non-CCASS participants).

During the year, the Exchange continued its efforts to develop a new trading system AMS/3, which will support multiple market models and an open interface for wider market access and more flexible trading strategies. The new system is expected to be launched in 2000.

The Exchange also explored the establishment of a dual-listing and trading arrangement with the Nasdaq-Amex Market Group, resulting in the signing of a regulatory agreement on information sharing by the two parties in December 1999. To support the initiative, Hongkong Clearing has become a participant of the US National Clearing Corporation in order to provide clearing and settlement services for Nasdaq stocks to be listed in Hong Kong.

The Exchange and the Securities and Futures Commission acquired a new automated surveillance and trading analysis system SMARTS in 1999. This integrated data management system will strengthen daily surveillance and regulation work.

Growth Enterprise Market (GEM)

In November 1999, a separate and alternative stock market was established by the Exchange to support capital raising by growth enterprises from all industries and of all sizes. The Growth Enterprise Market aims to become a successful stock market in its own right to satisfy the level and quality of transparency and regulation sought by informed investors wishing to participate in the growth of Hong Kong, Mainland China and the region. GEM has its own dedicated team of front-line management and operates independently from the Main Board. As of the end of 1999, there were 7 companies listed on GEM. A total of HK$1.6 billion new capital was raised from the market and the total market capitalisation as at end of 1999 was HK$7.2 billion. The daily trading turnover for 1999 was HK$144 million.

Warrant market

There were 51 equity warrants and 162 derivative warrants newly listed on the Exchange in 1999. The total number of warrants listed on the Exchange declined to 192 as at end of 1999, compared to 271 in 1998. Turnover of warrants for 1999 increased slightly to HK$130.2 billion, representing an increase of 25% compared with 1998's HK$104.1 billion.

Stock options market

In line with the recovery of the cash market, trading turnover in the stock options market picked up in 1999, with total contract value increasing from 1998's HK$4,037 million to HK$5,315 million. In terms of contract number, the daily average turnover for 1999 increased to 8,899 (compared to 6,629 contracts in 1998). The total number of option classes remained 17.

Educational programmes were organised to promote the stock options market, including a new investment game which was launched on the Exchange's website.

Debt securities market

Eighty-seven new debt securities listed in Hong Kong in 1998, compared with 11 in 1997. The total number of debt securities expanded to 280 at end of December 1998. Over half of the debt securities (65%) are issued by foreign issuers, mostly corporations. Debt securities issuance programmes were established by the Hong Kong Mortgage Corporation and the Hong Kong Monetary Authority (HKMA) to list their notes on the Exchange. To promote retail investors' interest in these products, 20 investor educational seminars were organized by the Exchange. Trading remained inactive with a year total of HK$137 million.

Unit trusts and mutual funds

As at the end of December 1999, there were 23 unit trusts listed on the Exchange, compared to 27 and 52 in 1998 and 1997 respectively. This year saw the introduction of an index depository receipt product, the Tracker Fund of Hong Kong (TraHK), which is an investment fund tracking the performance of Hang Seng Index. A total of 2,588 million units (or HK$33.3 billion) was offered to the market on 12 November 1999; the fund was received warmly by both retail and institutional investors. As a result of this successful product, the total trading turnover of unit trusts listed on the Exchange increased substantially to HK$12.4 billion in 1999 compared to HK$8.8 million in 1998.

MAJOR EVENTS 1999

March	On 3 March, the Financial Secretary announced in his budget speech for 1999/2000 a plan to reform the structure of the Hong Kong securities and futures market. The plan involves the demutualisation, merger and subsequent listing of the stock and futures exchanges and their associated clearing houses under a new holding company.
	On 31 March, the SFC published a Guidance Note on Internet Regulation to clarify its regulatory approach on various Internet activities under the existing legislation. The principles of regulation apply regardless of the medium of communication, whether paper-based or electronic. The SFC would not seek to regulate Internet activities that originate outside Hong Kong, provided that such activities are not detrimental to the interests of the Hong Kong investing public.
April	On 28 April, amendments to the Exchange Listing Rules became effective. Major amendments include requiring disclosure by a controlling shareholder in pledging or charging any of his beneficially owned securities within 12 months after listing, and relaxing the period for retaining the services of a sponsor following the listing of PRC-incorporated issuers from three years to one year.
May	On 17 May, Hongkong Clearing launched an Electronic Initial Public Offering (EIPO) service for CCASS participants. New shares of EIPOs may be applied for through the CCASS terminals and CCASS phone system. The first company to use the EIPO service on 23 November 1999 was a company listed on the newly established Growth Enterprise Market (GEM).
July	On 22 July, the Exchange issued the GEM Listing Rules. GEM adopts a regulatory regime emphasising disclosure with quarterly financial reporting. There is no profit requirement but applicants need to have active business pursuit for the two years prior to listing. The minimum public float is the higher of HK$30 million or 20% to 25% of the issued share capital.
August	On 16 August, Exchange Fund Notes (EFN) started listing on the Exchange. EFNs are traded via the existing order-matching system and settled on a T+2 basis. The minimum transaction size is HK$50,000. No stamp duty is payable, the minimum brokerage commission is 0.1% (lower than the minimum 0.25% for equity trades), and the spread is HK$0.05.
September	On 1 September, the Exchange introduced the category Options Broker Member, being a member who does not have direct access to the stock options trading system but executes his or his client's options trades via an Options Trading Member.
	On 28 September, both the Exchange and the Hong Kong Futures Exchange (HKFE) shareholders approved a merger scheme which was expected to be effective on or before 31 March 2000. Under the new scheme, the Exchange, HKFE and their respective clearing houses would become wholly owned subsidiaries of a new entity, Hong Kong Exchanges and Clearing Ltd (HKEx).
October	On 22 October, after the amendments to the Rules of the Exchange in relation to the trading arrangements for Hong Kong Mortgage Corporation (HKMC) Notes had become effective, the minimum brokerage commission of HKMC notes would not be less than 0.1% of transaction value and HK$50, and their spread size would be HK$0.05.

November

On 12 November, the Tracker Fund of Hong Kong (TraHK) was listed on the Exchange. TraHK is a collective investment fund launched by the Hong Kong SAR Government to dispose of part of the stock portfolio it acquired in 1998. TraHK is designed to closely follow the movement of the benchmark Hang Seng Index, and is eligible for short selling.

On 15 November, the Growth Enterprise Market (GEM) was formally launched.

On 17 November, the Exchange amended the GEM Listing Rules governing the public float requirements and accounting standards. The required level of public float was lowered. The preparation and reporting of financial statements in accordance with Generally Accepted Accounting Principles in the US are allowed for issuers listed on both GEM and either the New York Stock Exchange or the NASDAQ National Market.

On 25 November, the first two companies started trading on GEM.

December

On 13 December, the Exchange and the National Association of Securities Dealers, Inc. (NASD) signed regulatory agreements to transfer mutually useful and necessary regulatory information as part of a pilot program to provide for listings on the Exchange by companies listed on NASDAQ.

On 30 December, amendments to the Exchange Listing Rules regarding the prescribed minimum percentage of securities in public hands became effective. An additional provision was introduced to relax the requirement in cases of a shortfall in the prescribed percentage resulting from an increased holding by a connected person who is a substantial shareholder of the issuer.

TRADING MECHANISM

The trading system of the Exchange is an order-driven system that accepts only limit orders.

Trading is conducted on weekdays (excluding Saturdays and public holidays) at the following times :

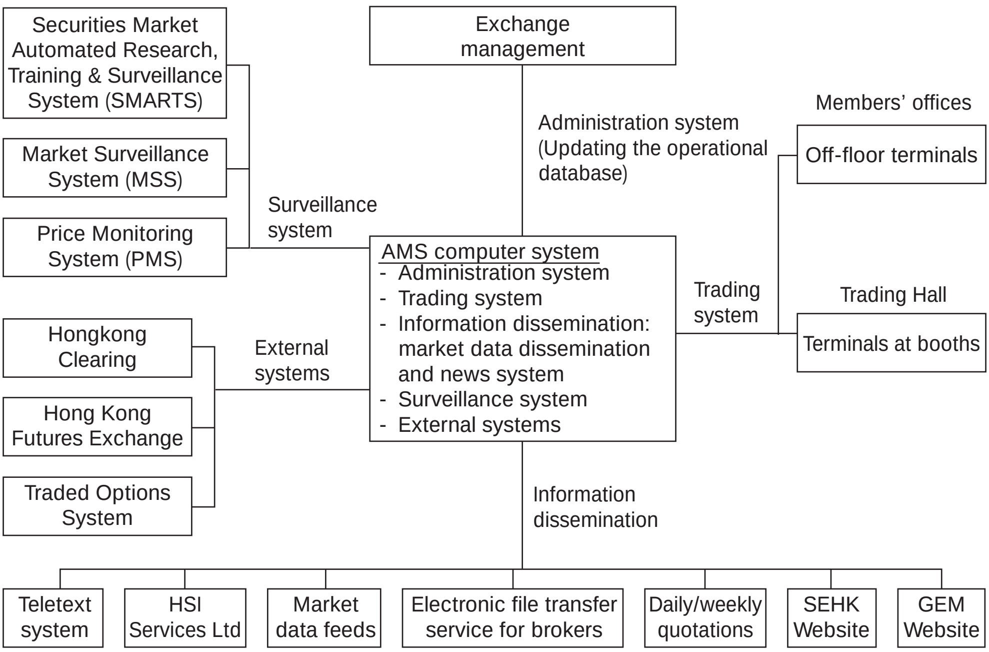
Morning session	10:00 a.m.	—	12:30 p.m.
Afternoon session	2:30 p.m.	—	4:00 p.m.

There is no afternoon trading session on the eves of Christmas, New Year and Lunar New Year.

Trading is conducted through terminals in the Trading Hall of the Exchange or through the off-floor trading terminals at members' offices.

Orders are executed through the Automatic Order Matching and Execution System (AMS).

Electronic trading and support systems



Automatic Order Matching and Execution System ("AMS")

Effective from 3 March 1997, all securities listed on the Exchange are traded by automatching through AMS.

AMS supports only limit orders (orders with a limit price) for automatching. Orders are executed in *strict price and time priority*. The maximum order size for automatch stocks is now 400 board lots. The maximum number of outstanding orders per trading terminal in the system is 400 while the number of orders in each order queue is limited to 1,000.

An order entered into the system at an earlier time must be executed in full before an order at the same price entered at a later time is executed. Ask orders priced lower than the current best bid price will receive a warning message and are not allowed to enter the system; the same applies for bid orders priced higher than the current best ask price. An input order having a price equal to the best opposite orders will match with opposite orders at the best price queue residing in the system, one by one according to time priority. Executed trades will be reported to the two counterparties' trading terminals and disseminated to the market.

Order and trade information is disseminated to the market and investors through the Teletext System, market data feed, the Exchange's Internet website and other information systems. There is also a news system to display compliance and Exchange news and news on listed companies in both English and Chinese to enhance information dissemination to members and the public.

Transactions must be concluded by automatic order matching except the following:

- special lot and odd lot transactions;
- transactions concluded outside AMS;
- direct business transactions;
- Isolated Trades entered into for purposes of effecting a buy-in; and
- orders exceeding the size limit of 400 board lots.

AMS off-floor terminals

Off-floor terminals are trading terminals installed in Exchange members' offices. Members are permitted to install two off-floor terminals (one Second and one Third Terminal) per Exchange seat held.

The off-floor terminals have the same trading functions as the trading terminals located at the Exchange's trading floor. With the installation of the off-floor terminals, members' trading capacity has been raised. Trading efficiency is also enhanced with the off-floor terminals since telephone communication between dealers in the office and floor traders is reduced.

Quotation rules

The first bid or ask order entered into the trading system on each trading day is governed by the opening quotation rule. The first order if it is a bid must be higher than or equal to the previous closing price minus four spreads. The first order if it is an ask must be lower than or equal to the previous closing price plus four spreads. The first order, whether it is a bid or ask, shall not in any case deviate by 9 times or more from the previous closing price. Quotations for buy and sell orders other than the opening quotations are governed by another set of quotation rules and a scale of spreads. In particular, a buy order or a sell order shall not be made at a price that deviates by 9 times or more from the nominal price.

Spread table

Price range (HK$)			Spread (HK$)
For all securities other than debt:			
0.01	—	0.25	0.001
> 0.25	—	0.50	0.005
> 0.50	—	2.00	0.010
> 2.00	—	5.00	0.025
> 5.00	—	30.00	0.050
> 30.00	—	50.00	0.100
> 50.00	—	100.00	0.250
> 100.00	—	200.00	0.500
> 200.00	—	1,000.00	1.000
> 1,000.00	—	9,995.00	2.500
Exchange Fund Notes and Hong Kong Mortgage Corporation Notes:			
0.50	—	9,999.95	0.050
Other debt securities:			
0.50	—	9,999.875	0.125

AMS/3 trading system

The Exchange will introduce the AMS/3 trading system in 2000. The AMS/3 trading system will incorporate an open interface with members' in-house computer systems, and order routing facilities, e.g. order placing by investors through the Internet and mobile phones. This will improve access to the Exchange's marketplace and form the platform for a straight-through transaction process in securities trading, clearing and settlement. The straight-through transaction process will in turn help reduce the risk and costs of securities trading.

BROKERAGE AND FEES

The following brokerage and fees are applied to each securities transaction (*):

1. Brokerage

Both the buyer and seller of a transaction will pay a brokerage to their brokers:

- for Exchange Fund Notes (EFN) and Hong Kong Mortgage Corporation (HKMC) Notes, not less than 0.1% of the transaction value; and
- for other securities transactions, not less than 0.25% of the transaction value.

All transactions are subject to a minimum brokerage of HK$50.

Remark: For the tendering of EFN, the brokerage commission will be calculated based on the tender (bid) price submitted by the applicants and NOT the principal amount of the EFN. For the tendering of HKMC Notes, the brokerage will be calculated based on the principal amount of the HKMC Notes.

2. Transaction levy

The Exchange charges a transaction levy of 0.011% of the amount of the consideration for each purchase or sale of securities, payable by both the buyer and the seller. The levy is shared in the proportion of 7:4 between the Exchange and the Securities and Futures Commission.

3. Trading tariff

A trading tariff of HK$0.5 is payable to the Exchange on each and every purchase or sale transaction.

4. Ad valorem stamp duty

An ad valorem stamp duty is levied on each transaction at the ratio of HK$1.125 for every HK$1,000[#] or part thereof on the value of the transaction, on both the buyer and the seller.

5. Transfer deed stamp duty

Independent of the quantity of shares traded, the Government levies a transfer deed stamp duty of HK$5, payable by the registered holder of the pertaining share certificate(s), i.e. the seller, on each new transfer deed.

6. Transfer fee

Independent of the quantity of shares traded, the registrar of each listed company levies a transfer fee of HK$2.5 per share certificate from the registered holder, i.e. the buyer, for each new certificate issued.

(*) There are no charges levied by Hongkong Clearing ("HKSCC") on investors if investors settle with brokers or custodians outside the Central Clearing and Settlement System (CCASS). However, brokers or custodians have to pay HKSCC fees for use of the clearing, settlement, custody and nominee services offered by CCASS. The decision on whether to pass these fees on to investors will be totally at the discretion of the brokers or custodians.

According to the 2000/01 Budget, the stamp duty will be reduced from HK$1.25 to HK$1.125 for every HK$1,000, payable by both the buyer and seller, effective from 7 April 2000.

TAXATION

The following applies equally to residents and non-residents.

1. Stamp duty

Stamp duty is levied on each transaction in registered securities at the rate of HK$1.125 for every HK$1,000[#] or part thereof of the transaction value, payable by both the buyer and seller. For bearer securities, the stamp duty rate is HK$3 per HK$100 or part thereof of the market value on issue, payable only upon issue by the receiver.

Stamp duty is not payable on transactions in straight bonds, but is payable on transactions in Hong Kong registered equity-linked bonds.

A transfer deed stamp duty of HK$5 is payable by the registered shareholder on each new transfer deed.

2. Withholding tax

There is no withholding tax on interest or dividends.

3. Capital gains tax

There is no capital gains tax.

4. Profits tax

Profits tax is only payable on profits arising from transactions in securities which constitute a business carried on in Hong Kong, at the rate of 16% for corporations and 15% for individuals and partnerships. Normally, this will apply only to transactions carried out by a financial institution (including brokerage firms) for its own account. Authorised unit trusts and mutual fund companies are exempt.

Profits tax is also payable on interest income from a Hong Kong source in the hands of a corporate recipient (interest income from deposits placed in a Hong Kong authorised financial institution is exempt). However, interest income on Exchange Fund debt instruments[*] and multilateral agency debt instruments is exempt. In addition, interest income and trading profits derived from debt instruments lodged with and cleared through the Hong Kong Monetary Authority and meeting certain conditions are subject to a concessionary tax rate equivalent to 50% of the normal profits tax rate.

Dividends are deemed paid out of taxed profits, therefore they are not subject to Hong Kong tax in the hands of the recipient.

Stock brokers are excluded from potential profits tax liability in respect of share trading profits derived by non-resident investors for whom they act as agents.

5. Capital fees

On incorporation and registration of an increase in nominal share capital and a return of allotments in respect of a Hong Kong-incorporated company limited by shares, capital duty is payable at the rate of HK$1 for every or part of HK$1,000 of authorized share capital and of the share premium subject to the amount of the fee so calculated not exceeding HK$30,000 per case.

According to the 2000/01 Budget, the stamp duty will be reduced from HK$1.25 to HK$1.125 for every HK$1,000, payable by both the buyer and seller, effective from 7 April 2000.

* Exchange Fund debt instruments are those issued by the Hong Kong Monetary Authority for the account of the Exchange Fund.

CLEARING AND SETTLEMENT

Clearing and settlement of securities transactions on the Exchange are carried out through the Central Clearing And Settlement System (CCASS) which is operated by the Hong Kong Securities Clearing Company Limited (Hongkong Clearing).

Hongkong Clearing

Hongkong Clearing was incorporated in Hong Kong in May 1989. It is a non-profit distributing company limited by guarantee, of which the Exchange provides 50 per cent while the rest is provided by five major banks in equal shares. By a scheme of arrangement taking effect in March 2000, Hongkong Clearing became a wholly-owned subsidiary of Hong Kong Exchanges and Clearing Limited.

In addition to securities clearing and settlement services, Hongkong Clearing also provides depository services, common nominee services, share registration services, Stock Borrowing and Lending (SBL) service, Electronic Initial Public Offering service, and tendering and settlement services for Exchange Fund Notes and Hong Kong Mortgage Corporation Notes.

CCASS

CCASS was introduced in June 1992. It is a computerized book-entry clearing and settlement system for transactions in listed securities in Hong Kong. It reduces scrip circulation in the market by the immobilization of share certificates delivered by participants to Hongkong Clearing's central securities depository. Settlement is electronically recorded as increases or decreases in participants' stock account balances, without the physical movement of share certificates. Ordinary shares, preference shares, registered warrants, rights issues, unit trusts and debts listed on the Exchange have been admitted into CCASS. Hongkong Clearing has the infrastructure ready to admit more debt securities into CCASS, starting with Hong Kong dollar denominated issues. At the end of 1999, a total of 969 securities had been admitted into CCASS, of which 703 were ordinary shares. Securities in CCASS custody represented 55% of the number in issue and 31% of their market value.

There are six categories of participant in CCASS: brokers, custodians, stock lenders, stock pledgees, clearing agency and investors. Each participant holds a stock account and a money ledger in CCASS. At the end of 1999, there were 3,049 CCASS participants, of which 495 were brokers, 60 custodians, 7 stock pledgees, 1 clearing agency (i.e. the SEHK Options Clearing House Limited) and 2,486 investors.

Investor participation

Hongkong Clearing's Investor Account Service was launched in May 1998; it allows individual and corporate investors to open direct stock accounts in CCASS and become investor participants. An Investor Account is in fact a depository account for share custody that allows an investor to have legal and physical control over his shares. Purchases and sales of stocks by investor participants and related settlements are handled through CCASS broker and/or custodian participants. Each investor participant will receive activity statements and monthly statements from Hongkong Clearing, and may inquire his account balance via the CCASS Phone System using a touch-tone or screen phone.

Transactions in eligible securities accepted for clearing and settlement in CCASS are either Exchange trades between two broker participants or Settlement Instruction Transactions between any two participants.

Exchange trades (trades in admitted securities effected on the Exchange) between two broker participants are settled in CCASS under Continuous Net Settlement (CNS), where Hongkong Clearing acts as the settlement counterparty to both the buying and selling broker; or under the Isolated Trade system on a trade-for-trade basis. Under CNS, trades are settled on a continuous netting basis where an overdue settlement position of a broker on one day is carried forward to the next settlement day and offset against any opposite net position due for settlement on that day. During 1999, 99.98% of Exchange trades were settled in CCASS, with 98.62% being settled through CNS.

Settlement Instruction (SI) Transactions are used to effect broker-custodian/clearing agency transactions, stock borrowing and lending, stock pledging and portfolio movements. They require the input of Settlement Instructions by both participants. Clearing is effected by matching the instructions. For investor participants, a special type of SI – *Investor Settlement Instruction (ISI)* – is input by a broker or custodian participant to transfer shares into and out of the Investor Account. The ISI must be affirmed by the investor participant via the CCASS Phone System or in person by submitting a completed form. Without the affirmation, the ISI will not be executed. Upon execution, the investor participant will receive an activity statement from Hongkong Clearing which records the details of the ISI.

Procedures

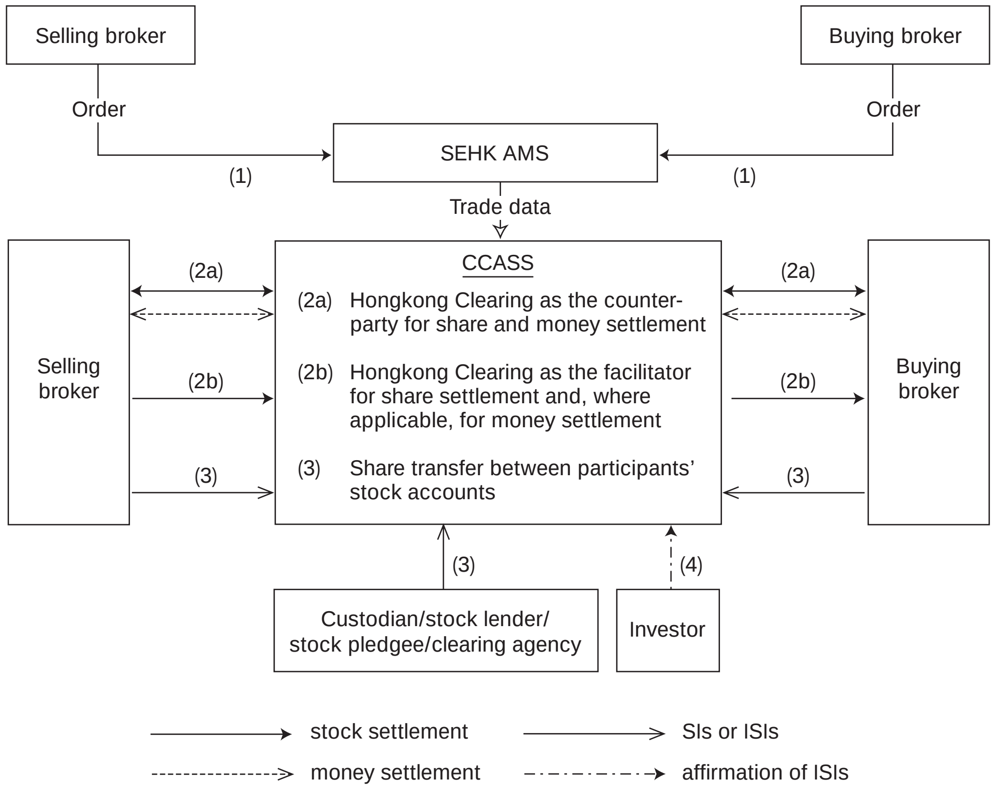
Trade data and trade amendment data is automatically transferred from the Exchange's trading system to CCASS. Broker participants receive Provisional Clearing Statements of their stock and money positions through their CCASS terminals shortly after 6:00pm on each trade day (T). Final Clearing Statements are transmitted shortly after 2:00pm on T+1 for confirmation and reconciliation purposes.

All Exchange trades are settled on T+2 through electronic debit and credit entries to broker participants' stock accounts either by daily batch settlement runs at stated times, or by the input of a Delivery Instruction by the delivering broker which is effected immediately. After the introduction of phase I of SBL service, Hongkong Clearing will act as the borrower on behalf of the defaulting broker to borrow from stock lenders in CCASS to close out any outstanding long positions at the day end of T+2. For failed settlements, Hongkong Clearing will execute a compulsory buy-in on T+3 to purchase the shares needed to close out a broker participant's outstanding position, unless an exemption is granted in certain specified circumstances. The defaulting broker will be responsible for the cost of the shares purchased and subject to penalties.

For money settlement under CNS, participants are required to establish a designated bank account and authorise Hongkong Clearing to make electronic debits and credits to this account. Money obligations between a participant and Hongkong Clearing are recorded in the participant's money ledger on a daily net basis. Settlement is effected with Hongkong Clearing issuing debit and credit instructions to raise debits and credits to participants' designated accounts, which are executed through the banking industry's clearing system.

Stock and money settlement between a broker and an investor participant as his client is subject to the arrangement between the broker and the investor, as in the case between a broker and his client who is not a CCASS participant. But an investor participant may choose to settle with his broker through his Investor Account and designated bank account by indicating so to his broker and affirmation of ISIs.

The Realtime Delivery versus Payment (RDP) service is offered for the settlement of SIs and ISIs to eliminate credit risk. Participants may choose to effect their SIs and ISIs on RDP basis under which the transfer of stocks to the paying participant's stock account is effected upon receipt of payment confirmation from Hong Kong Interbank Clearing Limited. During 1999, 0.7% of SIs and 37.7% of ISIs in value were effected by RDP.



Notes

(1) Orders are executed and confirmed through floor traders at the Exchange or through the off-floor trading terminals in brokers' offices.

(2a) The majority of Exchange trades are cleared and settled by Continuous Net Settlement (CNS) with Hongkong Clearing acting as the counterparty to both brokers. Stock settlement is by electronic book-entry. Money settlement is through CCASS.

(2b) Alternatively, brokers can settle between themselves on a trade-for-trade basis. Stock settlement is by electronic book-entry. Money obligations may be settled through CCASS or outside CCASS according to brokers' own arrangements.

(3) Share transfer may also be effected by Settlement Instructions (SIs) entered by both participants involved in transactions which are either broker-custodian/clearing agency transactions, or the result of stock borrowing and lending, stock pledging and portfolio movements. Investor settlement instructions (ISIs) are input by a broker or custodian participant to transfer shares into and out of the Investor Account.

(4) ISIs must be affirmed with CCASS by investor participants over the phone or in person.

CCASS tariff

The following are the typical fees charged by Hongkong Clearing to its intermediary participants like brokers and custodians for settling an Exchange trade and for other services.

Fee nature	Fee amount
Stock clearing fee	Nil
Stock settlement fee	0.002% of gross value Min. HK$2, max. HK$100 per side per trade
Money settlement fee	HK$0.8 per instruction
Stock deposit fee	Nil
Stock withdrawal fee	HK$3.5 per board lot (registration and transfer fee inclusive)
Stock custody fee	HK$0.012 per board lot per month Max. HK$100,000 per month per participant
Dividend and debt securities interest collection service fee	0.12% of cash dividend and interest Max. HK$10,000 per stock per collection
Registration and transfer fee	HK$1.5 per board lot

In general, Hongkong Clearing charges investor participants the same fees as it charges its intermediary participants. In addition, the following fees will be charged to investor participants for Investor Account Service.

Fee nature	Fee amount
Stock settlement fee for ISIs	0.002% of gross value Min. HK$2, max. HK$100 per transaction
Money settlement fee for ISIs	HK$0.8 per instruction
Dormant account fee	HK$200 annually in arrears for accounts that have not generated CCASS service fees over the preceding 12 months.

Note: CCASS tariffs are subject to revision from time to time.