

Legislative Council
Panel on Financial Affairs

Securities and Futures Commission Budget
for the Financial Year 2003/04

INTRODUCTION

The budget of the Securities and Futures Commission (SFC) for 2003/04 is at Annex for Member's information. This note highlights the main features of SFC's budget for 2003/04 and compares the approved budget for 2002/03 with the revised estimates. Members may wish to note that, for the eleventh consecutive year, the SFC has not requested the Government to make an appropriation to fund its operation.

BACKGROUND

2. On 12 April 1989, Members noted the following procedures for the approval of the SFC budget (FCR (89-90)12) -

- (a) the SFC will submit its budget to the Administration for the next financial year before 31 December;
- (b) the Administration will examine the SFC budget and present it to the Finance Committee for information;
- (c) the Administration will then submit the SFC budget to the Chief Executive for approval; and

- (d) the Administration will table the approved SFC budget in the Legislative Council and will, at the same time, submit the request for recurrent Government grant in the context of the draft Estimates.

In 1995, the authority for approval for SFC budget was delegated to the Financial Secretary.

3. The SFC submitted on 13 December 2002 its budget for 2003/04 to the Financial Secretary.

FUNDING OF THE SFC

4. Part VII of the Securities and Futures Commission Ordinance (“SFCO”) (Cap.24) provides that the SFC may be financed by transaction levies, fees and charges on services rendered to market operators and participants, and government appropriation. Since 1993/94, the SFC has not requested for government appropriation, and as a result, the funding of the SFC today has practically come largely from the market in the form of levies, fees and charges.

5. SFC’s levy income comes from the securities and futures markets. The current rate of levy on securities transactions is 0.005% for the SFC. For futures contracts trading, the current levy is \$1 or \$0.2 per leviable transaction for different categories of contracts.

6. As regards fees and charges, the SFC adopts, to the extent possible, the principle of full cost recovery when setting the level of its fees

and charges. The rates of SFC fees and charges have not been revised since 1994. Two attempts were made in 1997 and 1998 to adjust the rates of fees and charges to achieve full cost recovery but were rejected by the then Provisional Legislative Council.

7. As foreshadowed in the budget last year, the SFC will implement a new licensing regime for financial intermediaries upon the commencement of the Securities and Futures Ordinance (“SFO”) on 1 April 2003. The licensing fee structure has been reviewed in light of the streamlined procedures and the benefits to be brought about by early migration of intermediaries to the new regime. First, all existing licensing fees for intermediaries will be reduced by 3%. In addition, a 5% discount is offered to existing licensees who apply to migrate to the new regime during the first year of the two-year transitional period.

8. As regards funding by the Government, an annual grant can be given to the SFC as a stable source of income to offset the more volatile income from levies, fees and charges. In accordance with FCR (89-90)12, such a grant should be equivalent to the cost to the Government in 1988 of funding the former Office of the Commissioner for Securities and Commodities Trading, less income. The Government will provide the provisional grant at the beginning of each financial year, with a reconciliation and, if necessary, adjustment made for the previous financial year. The grant in 1992/93 was \$60 million¹. There is also an emergency fall-back whereby the SFC can seek loans with the approval of the Finance Committee to enable the Commission to survive any exceptionally prolonged period of low market activities.

¹ Should a grant be requested for in 2003-04, the grant is estimated to be \$91million at current price.

9. With the levels of securities transactions turnover since 1993 and a reasonable size of reserves, the SFC has for the eleventh consecutive year not requested for any government grant. As a result, the total grant so far foregone by the SFC amounts to about \$876 million.

BUDGET FOR 2003/04

10. The main features of the 2003/04 budget are as follows –

(a) **Estimated revenue** for 2003/04 is \$339.9 million, which represents about 3.5% or \$11.6 million higher than the revised estimates for 2002/03 (\$328.3 million). The slight increase is attributable mainly to –

- an increase in securities levy income by \$5.1 million as a result of a higher estimated average daily stock market turnover, from \$6.8 billion assumed in the revised estimates of 2002/03 to \$7 billion for 2003/04²;
- an increase in fees and charges income because a fee of \$20 million is expected from HKEx to cover expenses incurred in performing the new “dual filing” functions upon the commencement of the SFO, according to a Memorandum of Understanding (MOU) signed between the SFC and the Hong Kong Exchanges and Clearing Limited (HKEx) on 28 January 2003;

² The market turnover figure includes both secondary market trading volume and IPO issues. The average daily turnover was about \$7 billion for the first 10 months of 2002/03. It is assumed that the trading pattern for 2003/04 would remain unchanged.

- a reduction of levy income from futures/options contracts by 3.6% (\$0.5 million) as a result of a lower estimated daily turnover, from 25,300 contracts per day projected in the revised estimates for 2002/03 to 25,000 contracts per day in 2003/04³; and
 - a reduction in investment income because of the use of SFC reserves to finance the deficits and the continuous softening of the interest rate.
- (b) **Estimated operating expenditure** is \$407.9 million, which represents about 6.5% or \$25 million above the revised estimates for 2002/03.

Items of major increase compared with the revised estimates include -

- personnel costs increase by \$19.7 million (+6.4%) even with freezing of salary. 15 additional staff will be hired to perform the new duty of “dual filing” while another four will be deployed to meet urgent operational needs of the Commission;
 - general office and insurance expenses increase by \$2 million (+40.2%) due to the steep rise in professional indemnity and general insurance premium; and
 - information and systems services increase by \$0.9 million (+5.6%) mainly due to the need of maintenance for computer application systems of the Commission;
- (c) An **estimated deficit** of \$93.3 million is expected, as compared with the revised deficit of \$78.7 million by end 2002/03.

³ It is assumed that the trading volume for 2003/04 will resemble that of 2002/03. The projection of

(d) As a result, the Commission's **estimated reserves** are expected to fall to \$451.9 million by end 2003/04 from \$545.3 million as at end 2002/03. The estimated reserves (\$451.9 million) is equivalent to about 13 months of the proposed operating expenditure (including depreciation) for 2003/04.

(e) **Estimated capital expenditure** is \$23.1 million. The only capital expenditure will be furniture and fixtures and office equipment for the new office, since office relocation is expected towards mid 2003. All development projects for computer systems will be shelved.

A projected income and expenditure statement and a projected balance sheet for the year 2003/04 are on pages 4.1 and 4.2 of the Annex.

COMPARISON OF THE APPROVED BUDGET WITH THE REVISED ESTIMATES FOR 2002/03

11. The agreement between the Government and the SFC is that the actual total expenditure of the SFC should not exceed the approved budget by more than 10% without the prior approval of the Financial Secretary. The table on page 2.4 of the Annex provides a comparison of the approved budget and the revised estimates for 2002/03. The salient features are -

25,000 contracts is a rounding of the figure in the revised estimate for 2002/03.

(a) Revenue

The SFC projects that the total revenue will decrease by \$4.4 million, which is a moderate difference from the approved estimates. The increase in income from futures / options contracts (\$0.4 million) and investment (\$4.3 million) is leveled off by the decrease in income from the securities market (\$5.1 million) and fees and charges (\$3.8 million). It is common for people to engage in more hedging activities under a bearish market condition, leading to money flowing from the securities market to the futures market.

(b) Operating Expenditure

The total operating expenditure has been projected downward from \$421.6 million to \$382.9 million as a result of reduction in all the expenses, significant ones as follows –

- personnel expenses (by \$21.7 million) due to freezing of employees' salaries;
- professional and other fees (by \$4 million) mainly due to the Commission's effort to cut costs; and
- premises (by \$3.6 million) due to the assumption that the renewed office rent would be the same as the current rent paid, instead of the higher rent price assumed in the original budget with effect from

January 2003.

(c) Capital Expenditure

The estimated capital expenditure is revised significantly downward by \$15.4 million because SFC has proceeded only with indispensable projects. For example, the expenditure for computer systems development is revised downward by about \$9 million while that for office equipment is reduced by \$3.2 million.

ADMINISTRATION'S VIEWS

12. The Administration has examined the SFC budget for 2003/04 and is satisfied that the SFC has made efforts to reduce expenditure without undermining the delivery of its services or performance of its regulatory functions.

13. Notwithstanding the \$93.3 million deficit in the estimate, the SFC has for the eleventh consecutive year decided not to request an appropriation of annual grant from the Government. The budgeted deficit will be absorbed by the SFC's reserves, which are expected to decrease to \$451.9 million by end 2003/04, or to about 13 months of the proposed operating expenditure (including depreciation) for the same year.

14. We are watching closely the financial position of the Commission, particularly its budgetary deficit. We note that the

Commission has frozen its staff salaries in 2002/03 and will continue to exercise strict control measures in monitoring the number of total staff and expenses in the coming year. The Commission will also continue its various measures in reducing the expenditure.

15. Commencement of the SFO will bring about amongst others, a new licensing regime for the intermediaries and the “dual filing” functions. These will necessarily have resource implications on the proposed budget of SFC for 2003/04 as noted above.

16. Under the SFCO, the SFC levies may be reduced if the SFC has accumulated reserves equivalent to twice its annual operating expenses. As the SFC reserves are below the threshold, there is no plan to review the levies for funding SFC operation in 2003/04.

Financial Services Branch

Financial Services and the Treasury Bureau

March 2003

SECURITIES & FUTURES COMMISSION
PROPOSED ESTIMATES OF INCOME & EXPENDITURE
FOR THE FINANCIAL YEAR 2003/2004

CONTENT

<u>Section</u>	<u>Description</u>	<u>Page</u>
1	Executive Summary	1.1 - 1.3
2	Bases of Proposed Estimates and Highlights	2.1 - 2.10
3	Proposed Estimates of Income & Expenditure	
	- Income	3.1
	- Operating Expenditure	3.2
	- Capital Expenditure	3.3
4	Projected Financial Statements	
	- Income & Expenditure Statement	4.1
	- Balance Sheet	4.2

EXECUTIVE SUMMARY**Extract of Proposed Estimates for the Year 2003/2004**

	Proposed Estimates <u>2003/2004</u> HK\$'M	Revised Estimates <u>2002/2003</u> HK\$'M	(Note 1) Budgetary Target <u>2002/2003</u> HK\$'M	Approved Estimates <u>2002/2003</u> HK\$'M
Revenue	339.94	328.32	332.70	332.70
Operating Expenditure	407.88	382.86	400.51	421.61
Depreciation	25.40	24.20	28.70	28.70
Deficit	93.34	78.74	96.51	117.61
Projected reserves at beginning of the year	545.25		590.34	590.34
Actual reserves at beginning of the year		623.99		
Reserves at end of the year	451.91	545.25	493.83	472.73
Capital Expenditure	23.10	10.42	25.85	25.85
Establishment (Note 2)	392	385	373	373

Note 1 The Budgetary Target represents 95% of the approved operating expenditure estimate within which we undertook to the Government to contain our actual expenditure for 2002/2003 subsequent to the Financial Affairs Panel's discussion of the Approved Budget in March 2002.

Note 2 Including 6 Special Advisers on term contract for legislative and market reforms, regulatory policies, China-related projects, new products and market development, and 6 Manager Trainees.

Budgetary Strategy

1. On the expenditure side, for the year 2003/2004 the Commission will freeze salary and continue strict cost control measures. Except for personnel expenses which will be increased mainly to meet our commitment for dual filing functions and expenses which are subject to external market constraint, all expenses are either capped at 2002/2003 level or scaled down in order to keep the total expenditure for 2003/2004 at the level of the 2002/2003 revised estimate for its core functions.
2. On the revenue side, the sharp decline in revenue is outside the control of the Commission due to adverse market condition. However, the Commission decided not to request for the annual grant from the Government for 2003/2004. The Commission also decided for the time being not to revise its fees and charges level which largely remains at 1993/94 level, but will launch a new licensing fee structure in 2003/2004 when the new licensing regime is introduced under the Securities & Futures Ordinance.

Revenue

3. The estimated revenue for 2003/2004 is \$339.94 million, 3.54% (\$11.62 million) above the revised estimates. In comparison with the revised estimates in 2002/2003, securities levy income will increase by \$5.14 million as the average daily SEHK turnover for 2003/2004 is assumed to be \$7 billion versus \$6.8 billion assumed in 2002/2003 revised estimate; levy income from futures/options contracts will decrease by 3.63% (\$0.47 million) as the projected turnover is expected to decrease marginally from about 25,300 contracts per day as projected in the revised estimates for 2002/2003 to 25,000 contracts per day in 2003/2004.
4. Fees and charges income is expected to be higher than the revised estimates of 2002/2003 mainly because a fee of \$20 million is expected from HKEx to cover dual filing expenses. The reduction of investment fund for funding the deficits projected for 2002/2003 and 2003/2004, together with the continuous softening of interest rate will result in a projected \$9.14 million drop in investment income when compared with the revised estimates.
5. Furthermore, for the eleventh year in a row, the Commission will invite the Government not to request any appropriation from the Legislative Council. This decision is made without prejudice to the funding principles established when the Commission was formed, and has no implication for requests for appropriation in future years. It is estimated that the annual government grant foregone by the Commission for 2003/2004 would be c.\$91 million, and that the total annual grant foregone since 1993/94 amounted to \$876 million.

Operating Expenditure

6. The total estimated operating expenditure for 2003/2004 before depreciation is \$407.88 million, about \$25.02 million (6.54%) above the revised estimates for 2002/2003. The general price increase for the year 2003/2004 is assumed to be at 0%. Except for personnel expenses which will be increased to meet our commitment for dual filing functions and the premium for professional indemnity insurance which will be greatly increased in light of external market conditions, all expenses are either capped at 2002/2003 level or scaled down in order to keep the aggregate non-personnel expenditure for 2003/2004 at the level of the 2002/2003 revised estimate. The major changes are noted as follows :
 - (i) increase in personnel costs (\$19.65 million) despite the freezing of salary. The increase is mainly due to the full year effect of staff recruited for dual filing functions;
 - (ii) increase in information and systems services expenses (\$0.9 million) mainly because of the need of maintenance for computer application systems which are expected to move from development stage into production stage;
 - (iii) increase in general office and insurance expenses (\$2.04 million) due to the projected increase in professional indemnity and general insurance premium;

All other expenditure estimates are comparable to the revised 2002/2003 level.

Capital Expenditure

7. The total capital expenditure budget proposed for 2003/2004 is \$23.1 million. All computer systems development projects will be shelved. The only capital expenditure will be furniture and fixtures and office equipment for the new office if office relocation is required towards late 2003. The projected fitting out cost of \$21 million which allows for a moderate fitting out standard is based on the assumption that all existing loose furniture and office equipment will be reused. A contingency equal to 10% of the estimated capital expenditure (\$2.1 million) is also included.

Operating Result

8. The projections result in a deficit of \$93.34 million, which will reduce the reserves from \$545.25 million (31st March 2003) to \$451.91 million (31st March 2004). On this basis, the reserves at 31st March 2004 will be equivalent to about 13 months of the proposed annual operating expenditure (including depreciation) for 2003/2004. Should the Commission request an annual grant from the Government, which is provisionally assessed to be about \$91 million for 2003/2004, the projected deficit will be diminished.
9. As always, the projected financial position of the Commission is largely dependent on the level of turnover on the SEHK. It is worth noting that at the prevailing levy rate of 0.005%, any change of \$1 billion in the average daily turnover will result in a fluctuation of about \$24.8 million in the total levy received by the Commission for the year 2003/2004, i.e. \$8 billion or \$6 billion turnover would result in a variation of \pm \$24.8 million in levy income from the budget and reduce the projected deficit to \$68.54 million or increase it to \$118.14 million.
10. The estimates of revenue are subject to considerable market uncertainty, as they depend on the recovery of the major markets and the Hong Kong economy. We shall continue our cost control measures with a view to containing our operating expenditure within our financial means, in particular, the personnel costs notwithstanding the anticipated increasing workload arising from new regulatory initiatives.

BASES OF PROPOSED ESTIMATES AND HIGHLIGHTS

The proposed estimates for the year 2003/2004 are prepared on the following bases :-

Strategy

11. Given the grim economic outlook and the financial constraints faced by the Commission, we decided to continue tight cost control measures, including salary freezing, in 2003/2004. Except for personnel expenses which will be increased to meet our commitment for dual filing functions and expenses which are subject to external market constraints (such as insurance premium in General Office & Insurance), all expenses are either capped at 2002/2003 level or scaled down in order to keep the total expenditure for 2003/2004 at the level of the 2002/2003 revised estimate.
12. On the revenue side, the major income source of the Commission is still investor levies which are dependent on market turnovers. The Commission's share of levy rates will remain at 0.005% on each stock exchange transaction and \$1 per futures contract. Despite the projected heavy deficit for 2002/2003 (\$78.74 million) and 2003/2004 (\$93.34 million), the Commission proposes not to request for the annual grant from the Government for 2003/2004. We shall launch a new licensing fee structure in 2003/2004 when the new licensing regime is introduced under the Securities & Futures Ordinance. The fee level of the new structure has incorporated 3% discount from the old fee level and also a further 5% discount to encourage early registration. The fee levels of other areas, such as investment products and corporate finance remain unchanged though they have not been revised since 1993/1994.

Assumptions

13. Price Increase

The general price increase for the year 2003/2004 is assumed to be at zero %.

14. Remuneration Adjustment

No salary adjustment is provided for in the proposed 2003/2004 budget.

15. Interest Rate

The average return of dated securities on hand is 5%-5.5% p.a. and the yield on deposit/dated securities is assumed to be 1.5% to 2% p.a. for the year 2003/2004.

16. Capital Expenditure

It is assumed that the approved estimates of capital expenditure for different capital projects will, as previously, be carried forward until the completion of the projects.

17. Manpower Plan

The manpower plan for 2003/2004 which is based on the assessment of staff strength required to discharge duties efficiently and effectively is outlined below :

Division	Function	Establishment per Approved 2002/2003 Budget	Proposed Establishment for 2003/2004 (Note 3)	Changes
Chairman's Office	Division Management & Commission Secretariat	8	9	+1
	Research (Note 1)	4	0	-4
	Information Technology (Note 2)	17	0	-17
Corporate Finance	Corporate Finance	36	44	+8
Intermediaries & Investment Products	Division Management	4	5	+1
	Licensing	37	32	-5
	Intermediaries Supervision	64	65	+1
	Investment Products	25	27	+2
Enforcement	Enforcement	79	89	+10
Supervision of Markets	Supervision of Markets	18	18	-
	Research (Note 1)	0	4	+4
Legal Services	Legal Services	16	16	-
Corporate Affairs (formerly called Corporate Resources)	Corporate Communications	13	13	-
	Investor Education & Communications	12	13	+1
	Information Technology (Note 2)	0	17	+17
	Finance & Administration	17	17	-
	Human Resources & Training & Development	11	11	-
Total		361	380	+19
Special Advisers		6	6	-
Manager Trainees		6	6	-

Note 1 : The Research function was transferred from Chairman's Office to Supervision of Markets Division on 1 January 2002.

Note 2 : The Information Technology function was transferred from Chairman's Office to Corporate Resources which was renamed as Corporate Affairs on 1 January 2002.

Note 3 : Staff complement is 380 regular staff plus 6 Special Advisers and 6 Manager Trainees. In addition, provision has been included for hiring 18 temporary staff as and when required. Separately, 14 executive trainees are included in and funded out of the SFC Internship Programme under Training and Development expenditure.

Chairman's Office

It is proposed to add one executive post to assist the Commission Secretary in performing tasks of the Secretariat and coordinating cross-divisional work within the Commission.

Corporate Finance

It is proposed to add seven additional posts for new “dual filing” and “dual key” functions. In addition, it is also proposed to add one director post to deal with takeover transactions. This new post will mainly participate in and supervise vetting important draft announcements and offer documents.

Intermediaries and Investment Products – Division Management

One executive post will be transferred from Enforcement to deal with policy and disciplinary work.

Intermediaries and Investment Products – Licensing

The Discipline Team, including 5 posts, was transferred from Licensing Department to Enforcement Division on 1 March 2002.

Intermediaries and Investment Products – Intermediaries Supervision

One additional post is proposed to monitor high-risk brokers and inspect hedge fund managers and promoters.

Intermediaries and Investment Products – Investment Products

Two additional posts will be added mainly due to a continued increase in the number of investment products seeking SFC authorization, such as Investment Linked Assurance Schemes (ILAS), Exchange-traded Funds (ETFs) and Real Estate Investment Trusts (REITs) etc..

Enforcement

The Discipline Team, including five posts, was transferred to Enforcement Division from Licensing Department on 1 March 2002. In respect of the “dual filing” function, 6 new posts are to be added. One executive post will be transferred to Intermediaries & Investment Products to deal with policy and disciplinary work.

Legal Services

It is proposed to add one Counsel post to alleviate the additional workload arising from the implementation of the Securities and Futures Ordinance and the new dual filing role. On the other hand, one secretary post will be deleted.

Corporate Affairs – Investor Education & Communications

It is proposed to increase one post to cope with an increase in investors’ complaints as a result of dual filing.

18. Following is a summary of major estimate items :-

	(A)	(B)	(C)		(A)-(B) (B)	(B)-(C) (C)
	Proposed Estimates for Year <u>2003/2004</u> HK\$'000	Revised Estimates For Year <u>2002/2003</u> HK\$'000	Budgetary Target For Year <u>2002/2003</u> HK\$'000	Approved Estimates for Year <u>2002/2003</u> HK\$'000	Proposed Estimates Over/(Under) Revised <u>Estimates</u> %	Revised Estimates Over/(Under) Budgetary <u>Target</u> %
REVENUE						
Investor Levy						
Securities	173,600	168,458	173,600	173,600	3.05	(2.96)
Futures/Options Contracts	12,400	12,867	12,400	12,400	(3.63)	3.77
Fees & Charges	127,984	111,900	115,700	115,700	14.37	(3.28)
Investment Income	24,152	33,290	29,000	29,000	(27.45)	14.79
Other Income	<u>1,800</u>	<u>1,800</u>	<u>2,000</u>	<u>2,000</u>	--	(10.00)
Total	<u>339,936</u>	<u>328,315</u>	<u>332,700</u>	<u>332,700</u>	3.54	(1.32)
OPERATING EXPENDITURE						
Premises	31,549	31,444	35,057	35,057	0.33	(10.31)
Personnel Expenses	327,000	307,354	312,560	329,011	6.39	(1.67)
Info. & Sys. Services	16,929	16,033	16,510	17,010	5.59	(2.89)
General Office & Insurance	7,100	5,063	6,448	6,448	40.23	(21.48)
Training & Development	2,800	2,785	3,868	4,068	0.54	(28.00)
Professional & Others	12,005	11,368	12,436	15,436	5.60	(8.59)
Corporate Communications	2,100	2,100	2,990	2,990	--	(29.77)
External Relations	1,800	1,924	2,694	2,994	(6.44)	(28.58)
SCEFI	<u>3,600</u>	<u>3,600</u>	<u>5,100</u>	<u>5,600</u>	--	(29.41)
Sub-total	404,883	381,671	397,663	418,614	6.08	(4.02)
Contingency	<u>3,000</u>	<u>1,188</u>	<u>2,850</u>	<u>3,000</u>	152.53	(58.32)
Total	<u>407,883</u>	<u>382,859</u>	<u>400,513</u>	<u>421,614</u>	6.54	(4.41)
DEPRECIATION	25,400	24,200	28,700	28,700	4.96	(15.68)
DEFICIT	(93,347)	(78,744)	(96,513)	(117,614)	18.54	(18.41)
CAPITAL EXPENDITURE						
Furniture & Fixtures	18,000	-	1,000	1,000	N/A	(100.00)
Office Equipment	3,000	350	3,500	3,500	757.14	(90.00)
Computer Sys. Development	<u>-</u>	<u>10,032</u>	<u>19,000</u>	<u>19,000</u>	(100.00)	(47.20)
Sub-total	21,000	10,382	23,500	23,500	102.27	(55.82)
Contingency	<u>2,100</u>	<u>35</u>	<u>2,350</u>	<u>2,350</u>	5,900	(98.51)
Total	<u>23,100</u>	<u>10,417</u>	<u>25,850</u>	<u>25,850</u>	121.75	(59.70)

* The revised estimates for the year 2002/2003 were derived from a review undertaken in November 2002 of the Budgetary Target for the year 2002/2003.

The Budgetary Target represents 95% of the approved operating expenditure estimate within which we undertook to the Government to contain our actual expenditure for 2002/2003 subsequent to the Financial Affairs Panel's discussion of the Approved Budget in March 2002.

REVENUE

Annual Grant from Government

19. S.53 of the Securities and Futures Commission Ordinance provides that : “In each financial year there shall be paid to the Commission out of general revenue such moneys as shall be appropriated for that purpose by the Legislative Council.” The Commission will ask the Government not to request an appropriation from the Legislative Council for the financial year 2003/2004. The Commission’s decision is made without prejudice to the funding principles established when the SFC was formed, and has no implications for requests for appropriations in future years.
20. Should a request for an appropriation be made, it would be provisionally assessed at about \$91 million. The assessment is based on the principle that the annual grant would be equivalent to the net cost to Government for funding the former Office of the Commissioner of Securities, adjusted annually from 1988/89 prices by reference to adjustments in levels of Government civil service salaries, rent and the general rate of inflation in Hong Kong. Since 1993/94, the Commission had foregone annual grant amounting to \$876 million.

Investor Levy - Securities

21. The revised estimate of Investor Levy-Securities is expected to be lower than the budgetary target for 2002/2003 by about 2.96% (\$5.14 million). In view of the decline of the average daily turnover in the SEHK from about \$8 billion in the first quarter of 2002 to about \$6.5 billion in the second quarter, the average daily turnover for the rest of the year is assumed to be \$6 billion. This brings the annual average daily turnover for 2002/2003 to \$6.8 billion, slightly lower than the \$7 billion average daily turnover assumed in the budgetary target.
22. The average daily turnover for projecting Investor Levy - Securities for 2003/2004 is assumed to be \$7 billion, which is slightly higher than the average daily turnover of \$6.8 billion of the revised estimates for 2002/2003. The Commission’s transaction levy rate remains at 0.005% throughout the year. Levy income from SEHK is projected to be \$173.6 million, about 3% higher than the 2002/2003 revised estimate. 248 trading days are assumed in the proposed estimates for 2003/2004.

Investor Levy - Futures / Options Contracts

23. The revised estimate of Investor Levy - Futures / Options Contracts is higher than the budgetary target by about 3.77% (\$0.47 million). The increase reflects the higher than expected average daily turnover on the Futures Exchange (Average 25,585 contracts cf. 25,000 contracts in the budgetary target) during the first seven months of the year 2002/2003. Daily turnover for the period November 2002 to March 2003 (102 trading days) is assumed at 25,000 contracts.

24. The average daily turnover for 2003/2004 is assumed at the level of 25,000 contracts. The contract levy rate is assumed to remain at \$1 per contract.

Fees and Charges

25. The revised estimates of overall fees and charges for the year 2002/2003 are lower than the budgetary target of \$115.7 million by 3.28% (\$3.8 million). The decrease in corporate finance fee income is expected to more than offset the projected increase in licensing and investment products fees having regard to the first seven months receipt and the fact that the new licensing fees structure which will offer discount incentive to registrants will not be introduced till next year.
26. For 2003/2004, the fees and charges income is projected to be about \$127.98 million, higher than the revised 2002/2003 estimate by 14.37% (\$16.08 million). The new licensing fees structure, which will offer discount incentive to registrants, will be introduced in 2003/2004. The estimate of licensing fees for the year is thus expected to be \$1.3 million lower than its revised estimate for 2002/2003. The investment product fees structure will be rationalized to apply equally to underlying funds of all collective investment schemes (including sponsors of investment-linked assurance schemes which are not required to pay any fees for their underlying funds under existing fees rules) regardless of their structure. This will bring about \$3.2 million increase in fee income of investment products. The inclusion of \$20 million fee from HKEx for dual filing also contributes to the increase.

Investment Income

27. Investment income includes the return on the investment portfolio operated under the advice of an external advisor after taking into account the amortization of premium or discount on purchases of dated securities. It also includes interest earned on deposits placed out of in-house funds.
28. The revised estimate for 2002/2003 is higher than the budgetary target by about 14.79% (\$4.29 million) because more fund than expected was available for investment as the actual deficit in the first seven months at \$26 million was much lower than the deficit of about \$68.6 million originally budgeted.
29. Having taken into account the deteriorating operating results projected for 2002/2003 and 2003/2004, the average amount of fund available for investment for 2003/2004 will be reduced. The average rate of return of dated securities on hand is 5% to 5.5% and the yield on deposit/new dated securities is assumed to be 1.5% to 2%. The continuous softening of interest rate dilutes the average return on investment. On this basis, the investment income for 2003/2004 is projected to further decrease by \$9.14 million (27.45%).

Other Income

30. Based on historical data after adjustment for extraordinary items, other income for 2002/2003 and 2003/2004 is expected to be \$1.8 million respectively comprising mainly costs awarded to the Commission by the Court and sale proceeds of SFC publications.

OPERATING EXPENDITURE

Premises

31. The revised estimate of premises expenses is expected to be about \$31.44 million, about 10.31% (\$3.61 million) lower than the budgetary target. The decrease is due to the assumption that the renewed office rent would be the same as the current rent paid, instead of \$40/sq. ft. assumed in the original budget with effect from January 2003.
32. Premises estimate for 2003/2004 is comparable with the revised estimate because the rent assumed is the same as the current rent paid for the existing office.

Personnel Expenses

33. Since dual filing staff will be hired later in the second half of the year giving rise to a cost of about \$1.4 million, despite the inclusion of dual filing personnel costs which is not included in the budgetary target, the total personnel expenses estimate for the year is revised downward to \$307.35 million, about 1.67% (\$5.21 million) lower than the budgetary target. The decrease is mainly due to the decision to freeze salary for the rest of the year in view of the projected financial position of the Commission.
34. For 2003/2004, we shall continue to freeze our salary. We shall recruit staff for dual filing functions and urgent operational needs. Replacement will be recruited only upon the Chairman and executive directors' approval having regard to merits of each case of replacement. On this basis, personnel expenses for 2003/2004 will be higher than the revised 2002/2003 expenses by about 6.39% (\$19.65 million). The increase is mainly due to the full year effect of personnel already on board and additional posts for dual filing. No salary adjustment is provided for in the estimate.

Information and Systems Services

35. The revised 2002/2003 estimate is lower than the budgetary target by 2.89% (\$0.48 million). The downward revision is mainly due to the rationalisation of the usage of information services such as Reuters and Bloomberg services.
36. The proposed 2003/2004 information and systems services expenses are 5.59% (\$0.9 million) higher than the revised estimate. The increase is mainly attributable to the growing demand for systems maintenance service which is kept to a minimum to cope with the gradual migration of application systems developed in past years into maintenance mode. EDP hardware and software maintenance costs are also expected to be higher in 2003/2004 as a result of the increase in software and computer equipment.

General Office and Insurance

37. The revised general office & insurance expenses are lower than the approved estimate by about 21.48% (\$1.39 million) mainly because of underspending in printing, stationery & supplies and repairs and maintenance expenses. Printing expenses are revised downward mainly because part of the expenses relating to the printing of new Licensing forms will be deferred to the following year. Stationery and supplies expense are revised downward to reflect the low consumption level during the first seven months. As no office reconfiguration work is expected for the rest of the year, the estimate for repairs and maintenance expense is reduced.
38. The estimates of general office and insurance expenses for 2003/2004 are expected to be higher than its revised estimate of 2002/2003 by 40.23% (\$2.04 million). The increase is mainly due to the premium increase for professional indemnity and general insurance that is projected to be very substantial consequential to the recent corporate failure and the terrorist attack.

Training and Development

39. The revised 2002/2003 estimate is adjusted downward by about 28% (\$1.08 million) made possible mainly by scaling down training programmes for the year.
40. The proposed 2003/2004 estimate is comparable to that of the revised estimate.

Professional & Others

41. Professional & Others expenses are revised downward by about 8.59% (\$1.07 million). The main reduction is in external professional service and appeals panel expenses. These estimates are revised downward to reflect the low usage of external consultancy services and appeal panel hearings.
42. Professional and Others expenses for 2003/2004 are higher than the revised estimate by about 5.6% (\$0.64 million). Legal fees and external professional services are provided for largely at their revised estimate level. Other expenses are provided for to meet actual needs anticipated including recruitment expenses to cover executive search fees in 2003/2004.

Corporate Communications

43. The revised 2002/2003 estimate is adjusted downward by 29.77% (\$0.89 million) as less activities are envisaged in public relations publications, public relations programmes, community education and eIRC maintenance.
44. The proposed 2003/2004 estimate is retained at the revised 2002/2003 estimate level.

External Relations

45. The revised 2002/2003 expenses are adjusted downward by 28.58% (\$0.77 million) to reflect mainly the cut back in overseas travelling activities which is partially offset by the expenses for the provision of educational programmes to publicize the implementation of the Securities and Futures Ordinance.
46. External Relations expenses for 2003/2004 are comparable to the revised 2002/2003 level.

SCEFI

47. The 2002/2003 estimate of SCEFI is revised downward from \$5.1 million to \$3.6 million to reflect the reduction of spending on internet mail relay, email rental, anti-virus protection and LAN interface installation.
48. The estimate of 2003/2004 is \$3.6 million, same as the revised estimate for 2002/2003. The estimates cover the operating cost of the FinNet and also costs for further developing the services range of FinNet and promoting the use of FinNet to market participants.

CONTINGENCY

49. A contingency of \$3 million is provided for the year 2003/2004 to cover unforeseen expenses arising from abrupt changes of environment or unforeseen special requirements.

CAPITAL EXPENDITURE

Revised Estimates

50. As one of the cost control measures, only indispensable capital expenditure projects that are essential for keeping the operation going will be retained. The total capital expenditure estimate is reduced by 59.7% (\$15.4 million) with major movements in various sub-heads :
- (i) No provision for Furniture and Fixtures is made for the rest of the year;
 - (ii) Office Equipment is revised downward by 90% (\$3.15 million) to cover sundry purchase of PCs and peripherals;
 - (iii) Computer Systems Development is revised downward by 47.2% (\$8.97 million) to cover those system development projects that have been committed with vendors or considered indispensable for keeping the operation going. Contingency is also reduced to \$0.035 million, equivalent to 10% of the estimate of capital expenditure for the next five months.

Proposed Estimates

51. Tight control on capital expenditure will be continued in 2003/2004. The total proposed capital expenditure budget for 2003/2004 is expected to be \$23.1 million. The 2003/2004 capital expenditure comprises the following :
- (i) \$18 million is provided for the renovation of the new office premises if relocation is required in late 2003/2004. The provision is made on the presumption that all existing loose furniture will be reused;
 - (ii) \$3 million is budgeted for the wiring and relocation costs of the telephone system, security system, audio/video and simultaneous interpretation system and other office equipment to be installed in the new office premises due to office relocation;
 - (iii) a contingency equals to 10% of the projected total capital expenditure.

SECURITIES & FUTURES COMMISSION
ESTIMATES OF INCOME FOR THE YEAR 2003/2004

	Proposed Estimates Year 2003/2004 HK\$	Revised Estimates Year 2002/2003 HK\$	Budgetary Target Year 2002/2003 HK\$	Approved Estimates Year 2002/2003 HK\$
Annual Grant from Government	-	-	-	-
Investor Levy - Securities	173,600,000	168,458,000	173,600,000	173,600,000
Investor Levy - Futures / Options Contracts	12,400,000	12,867,000	12,400,000	12,400,000
Fees and Charges	127,984,000	111,900,000	115,700,000	115,700,000
Investment Income	24,152,000	33,290,000	29,000,000	29,000,000
Other Income	<u>1,800,000</u>	<u>1,800,000</u>	<u>2,000,000</u>	<u>2,000,000</u>
Total	<u><u>339,936,000</u></u>	<u><u>328,315,000</u></u>	<u><u>332,700,000</u></u>	<u><u>332,700,000</u></u>

**SECURITIES & FUTURES COMMISSION
ESTIMATES OF EXPENDITURE FOR THE YEAR 2003/2004**

OPERATING EXPENDITURE

	Proposed Estimates Year 2003/2004 HK\$	Revised Estimates Year 2002/2003 HK\$	Budgetary Target Year 2002/2003 HK\$	Approved Estimates Year 2002/2003 HK\$
Premises	31,549,000	31,444,000	35,057,000	35,057,000
Personnel Expenses	327,000,000	307,354,000	312,560,000	329,011,000
Information & Systems Services	16,929,000	16,033,000	16,510,000	17,010,000
General Office & Insurance	7,100,000	5,063,000	6,448,000	6,448,000
Training & Development	2,800,000	2,785,000	3,868,000	4,068,000
Professional & Others	12,005,000	11,368,000	12,436,000	15,436,000
Corporate Communications	2,100,000	2,100,000	2,990,000	2,990,000
External Relations	1,800,000	1,924,000	2,694,000	2,994,000
SCEFI	3,600,000	3,600,000	5,100,000	5,600,000
Sub-total	404,883,000	381,671,000	397,663,000	418,614,000
Contingency	3,000,000	1,188,000	2,850,000	3,000,000
Total Operating Expenditure	407,883,000	382,859,000	400,513,000	421,614,000

**SECURITIES & FUTURES COMMISSION
ESTIMATES OF EXPENDITURE FOR THE YEAR 2003/2004**

CAPITAL EXPENDITURE

	Proposed Estimates Year 2003/2004 HK\$	Revised Estimates Year 2002/2003 HK\$	Budgetary Target Year 2002/2003 HK\$	Approved Estimates Year 2002/2003 HK\$
Furniture & Fixtures	18,000,000	-	1,000,000	1,000,000
Office Equipment	3,000,000	350,000	3,500,000	3,500,000
Computer Systems Development	-	10,031,903	19,000,000	19,000,000
Sub-total	21,000,000	10,381,903	23,500,000	23,500,000
Contingency (Note 1)	2,100,000	35,000	2,350,000	2,350,000
Total Capital Expenditure	23,100,000	10,416,903	25,850,000	25,850,000

Note 1 : Contingency is provided for at 10% of the total 2003/2004 capital expenditure (2002/2003 : 10%)

**SECURITIES & FUTURES COMMISSION
PROJECTED INCOME & EXPENDITURE STATEMENT
FOR THE YEAR 2003/2004**

	Proposed Estimates 2003/2004	Revised Estimates 2002/2003
	HK\$	HK\$
INCOME		
Investor Levy - Securities	173,600,000	168,458,000
Investor Levy - Futures/Options Contracts	12,400,000	12,867,000
Fees & Charges	127,984,000	111,900,000
Investment Income	24,152,000	33,290,000
Other Income	1,800,000	1,800,000
Total Income	<u>339,936,000</u>	<u>328,315,000</u>
EXPENDITURE		
Operating Expenditure	407,883,000	382,859,000
Depreciation	25,400,000	24,200,000
Total Expenditure	<u>433,283,000</u>	<u>407,059,000</u>
RESULT FOR THE YEAR	<u>(93,347,000)</u>	<u>(78,744,000)</u>

**SECURITIES & FUTURES COMMISSION
PROJECTED BALANCE SHEET
FOR THE YEAR 2003/2004**

	Proposed Estimates 2003/2004	Revised Estimates 2002/2003
	HK\$	HK\$
Fixed Assets	<u>29,400,000</u>	<u>31,800,000</u>
Net Current Assets	<u>422,501,744</u>	<u>513,448,744</u>
Net Assets	<u><u>451,901,744</u></u>	<u><u>545,248,744</u></u>
Representing :		
Reserves		
Government Start-up Grant	<u>42,840,429</u>	<u>42,840,429</u>
Income & Expenditure Account		
Beginning Balance	502,408,315	581,152,315
Result for the Year	<u>(93,347,000)</u>	<u>(78,744,000)</u>
	<u>409,061,315</u>	<u>502,408,315</u>
	<u><u>451,901,744</u></u>	<u><u>545,248,744</u></u>