

**Legislative Council
Panel on Financial Affairs**

**Securities and Futures Commission Budget
for the Financial Year 2004/05**

INTRODUCTION

The budget of the Securities and Futures Commission (SFC) for 2004/05 is at Annex for Member's information. This note highlights the main features of SFC's budget for 2004/05 and compares the approved budget for 2003/04 with the revised estimates. Members may wish to note that, for the twelfth consecutive year, the SFC has not requested the Government to make an appropriation to fund its operation.

BACKGROUND

2. This paper is prepared in accordance with the consultation procedures as agreed with LegCo when the SFC was first established¹. The SFC submitted on 15 December 2003 its budget for 2004/05 to the Financial Secretary² (Annex).

FUNDING OF THE SFC

3. Part XVI of the Securities and Futures Ordinance (Cap. 571) ("SFO") provides that the SFC may be financed by transaction levies, fees and charges on services rendered to market operators and participants. Section 14 of the SFO further provides that the Government may provide funding to the SFC as appropriated by the Legislative Council. In practice, the SFC has not requested for government appropriation since 1993/94, and the funding of the SFC today has practically come largely from the market in the form of levies and fees and charges.

4. SFC's levy income comes from the securities and futures markets. The current rate of levy on securities transactions is 0.005%. For

¹ Members may wish to refer to FCR(89-90)12 considered by LegCo on 12 April 1989 for details.

² The Chief Executive has delegated the authority to approve the SFC budget under the Securities and Futures Ordinance (Cap. 571) to the Financial Secretary.

futures contracts trading, the current levy is \$1.0 or \$0.2 per leviabie transaction, for different categories of contracts.

5. As regards fees and charges, the SFC adopts, to the extent possible, the principle of full cost recovery. 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.

BUDGET FOR 2004/05

6. The robust market activities in the second half of 2003 has turned the SFC budget from an estimated deficit (-\$93.34 million) to a surplus (+ \$49.95 million) in 2003/04. Taking a cautiously optimistic view of the stock market in 2004/05, the SFC proposed a surplus budget in 2004/05 (+ \$3.93 million).

7. With the surplus budget and a reasonable size of reserves, for the twelfth year in a row the SFC did not request any appropriation from the Legislative Council as provided under section 14 of the SFO. The SFC estimated that its reserves would amount to \$615.56 million (as at 31 March 2004) and increase to \$619.49 million (as at 31 March 2005). The estimated reserves as at 31 March 2005 will be equivalent to about 17 months of the proposed annual operating expenses for 2004/05. With the reserves, the SFC anticipated that it would be able to withstand financial pressure in the event of any lower than assumed average daily turnover of the Stock Exchange of Hong Kong, thereby not requesting for appropriation.

8. The main features of the 2004/05 budget are set out in paragraphs 9 to 17 below.

(a) Estimated Revenue

9. The estimated revenue for 2004/05 is \$447.30 million, 8.3% or \$40.42 million below the revised estimated revenue for 2003/04, mainly for the following reasons –

- (a) the average daily turnover of the Stock Exchange of Hong Kong (SEHK) is projected to be \$11 billion for 2004/05,

compared to the revised estimate of \$12.4 billion in 2003/04³; and

- (b) fees and charges income is expected to decrease by \$4.85 million, as licensing fee income is projected to drop as a result of existing licensees' consolidation of businesses.

(b) Estimated Operating Expenditure

10. Estimated operating expenditure for 2004/05 is \$416.37 million, which represents about 2% or \$8.40 million above the revised expenditure estimates of 2003/04 (\$407.97 million). The increase is attributable to –

- (a) an increase in professional fees of \$6.21 million due to increase in legal fees in anticipation of more market manipulation and corporate misconduct cases;
- (b) an increase in corporate communications and external relations expenses at \$1.48 million, due to an increase in public relations programmes and in overseas travelling expenses relating to the Commissions' liaison with overseas regulators;
- (c) an increase in general office and insurance expenses of \$1.09 million mainly due to the expected increase in professional indemnity insurance;
- (d) an increase in information system and services of \$0.96 million mainly due to growing demand for system maintenance service; and
- (e) an increase in training and development expenses (\$0.70 million) and an increase in contingency (\$0.30 million).

11. The above increases are partly offset by a decrease of premises expenses (\$2.34 million) given the lower rent of the new office, and that the one-off expenses incurred for the office relocation in July 2003 would not be repeated.

(c) Staff establishment

12. The SFC proposed to increase 10 posts in its establishment in 2004/05 from the approved establishment in 2003/04 (an increase of 14

³ The estimated reduction in levy income (securities) in 2004/05 as a result of a more moderate estimated daily turnover is \$34.79 million.

permanent established posts partly offset by a deletion of 4 temporary established posts). The total establishment will become 402 (comprising 394 permanent established posts and 8 temporary established posts).

13. The main reasons for the proposed increase in staff establishment are as follows –

- (a) to cope with on-going and increasing needs related to international regulatory policies and China-related work (turning 3 temporary posts permanent in the Chairman's Office);
- (b) to cope with increasing workload from dual filing, which is a new responsibility under the SFO (+ 3 posts);
- (c) to cope with new market and product development (+ 4 posts); and
- (d) to handle administration and IT support (+ 4 posts).

The detailed justifications are described at paragraph 17 of the budget at Annex.

14. The SFC considers that it is important to have the staff increase in order to perform the new responsibilities and keep up with market developments. The SFC also advises that redeployment of internal resources from other divisions to cope with this on-going work is not feasible due to the limited availability of qualified experts and their tight manpower situation.

(d) Staff salary

15. The SFC did not propose any adjustment to staff salary. Since April 2001, SFC has frozen staff salary. The SFC advised that their staff have not received any variable pay award for 2001/02 and 2002/03 which represents an average of 8% reduction in overall take home pay of the SFC staff compared to the 2000/01 level. When compared to the recommended remuneration figures of the top three tiers (namely Chairman, Executive Directors and Senior Directors) in the Hay Report, the remuneration of the SFC senior executives is also below the recommended figures for all three levels. The SFC will continue to benchmark its pay levels with the prevailing market rates of comparable organisations and review its salary level annually with reference to the findings of the pay level survey.

(e) Estimated capital expenditure

16. The total capital expenditure budget proposed for 2004/05 is \$13.08 million. The proposed budget includes (a) a provision of \$7.26 million for the development of web-based application systems and further enhancement of system infrastructure and knowledge-based management; (b) a provision of \$3.63 million for office equipment including PCs and other PC peripherals and software; and (c) a provision of \$1 million for the replacement of furniture due to wear and tear. A contingency equal to 10% of the estimated capital expenditure (\$1.19 million) is also included.

17. A projected income and expenditure statement and a projected balance sheet for the year 2004/05 are on pages 4.1 and 4.2 of the budget at Annex.

COMPARISON OF THE APPROVED BUDGET WITH THE REVISED ESTIMATES FOR 2003/04

18. The table on page 2.4 of the budget at Annex provides a comparison of the approved budget and the revised estimates for 2003/04. The salient features are set out in paragraphs 19 to 21 below.

(a) Revenue

19. The SFC's revenue in 2003/04 has grown significantly, mainly a result of an increase in levy income due to the revised estimated average daily SEHK turnover of \$12.4 billion for 2003/04, 77% higher than the \$7 billion average daily turnover assumed in the approved 2003/04 budget⁴. The revised estimated revenue for 2003/04 is \$487.72 million, which represents 43.47% or \$147.78 million higher than the approved estimated revenue of \$339.94 million for 2003/04.

(b) Operating expenditure

20. The total operating expenditure has been projected at \$407.97 million, which is comparable with the approved one of \$407.88 million (marginal increase of \$0.084 million). The major changes are –

⁴ The increase in levy income (securities) in 2003/04 as a result of the increase in daily turnover is \$133.99 million.

- (a) premises expenses increase by about \$1.62 million (+5.13%) due to the unbudgeted office relocation expenses of \$2.59 million, partially offset by the rental savings achieved on relocation to the new office since July 2003;
- (b) professional and other expenses increase by about \$0.88 million (+7.3%) due to increases in legal fees and recruitment in anticipation of more litigation in respect of unfair prejudice to interests of members of listed corporations and more executive search fees respectively; and
- (c) external relations, corporation communication and training and development increase of about \$0.84 million.

The above increases are partially offset by a reduction of expenditure on information and system services (\$0.67 million), general office and insurance (\$0.79 million) and contingency (\$1.8 million).

(c) Capital expenditure

21. The total capital expenditure estimate is reduced slightly from \$23.1 million to \$22.8 million.

ADMINISTRATION'S VIEWS

22. The Administration is pleased to note that the SFC has prepared a surplus budget, the first time since 1994/1995⁵, and that the SFC has not requested for Government appropriation as a result.

23. The Administration has examined the SFC budget for 2004/05, and is generally satisfied that the SFC has made efforts to control expenditure without undermining the delivery of its services or performance of its regulatory functions.

24. We note that the SFC has taken on more responsibilities as a result of the commencement of the SFO on 1 April 2003 (e.g. dual filing, new licensing regime), as well as increasing international and China-related work. At the same time, we have expressed concern to SFC about the proposed staff increase despite the general trend of downsizing in the public

⁵ The SFC has proposed a deficit budget since financial year 1994/1995, although in reality the SFC ran into deficits in 1998/99, 2001/02 and 2002/03 only.

and private sectors. In response, the SFC considers that it is important to have the staff increase in order to perform the new responsibilities and keep up with market developments. In considering the budget, we have urged the SFC to be vigilant in managing its staff resources.

25. Under the SFO, 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 this threshold, there is no plan to review the levies for funding the SFC operation for the moment. Nonetheless, the Administration will keep in view the reserves level of the SFC and review the level of levies once the threshold has been reached.

Financial Services Branch
Financial Services and the Treasury Bureau
February 2004

SECURITIES & FUTURES COMMISSION
PROPOSED ESTIMATES OF INCOME & EXPENDITURE
FOR THE FINANCIAL YEAR 2004/2005

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EXECUTIVE SUMMARY**Extract of Proposed Estimates for the Year 2004/2005**

| | Proposed Estimates <u>2004/2005</u> HK\$'M | Revised Estimates <u>2003/2004</u> HK\$'M | Approved Estimates <u>2003/2004</u> HK\$'M |
|--|---|--|---|
| Revenue | 447.30 | 487.72 | 339.94 |
| Operating Expenditure | 416.37 | 407.97 | 407.88 |
| Depreciation | 27.00 | 29.80 | 25.40 |
| Surplus / (Deficit) | 3.93 | 49.95 | (93.34) |
| Projected reserves at beginning of the year | 615.56 | | 545.25 |
| Actual reserves at beginning of the year | | 565.61 | |
| Reserves at end of the year | 619.49 | 615.56 | 451.91 |
| Capital Expenditure | 13.08 | 22.77 | 23.10 |
| Headcount | | | |
| Permanent established post | 394 | 392 | 380 |
| Temporary established post-Special Advisers | 2 | 2 | 6 |
| Temporary established post-Manager Trainees | 6 | 6 | 6 |

Budgetary Strategy

- As a result of our continuous cost control effort in three consecutive years since 2000/2001 despite the growing market complexity that had strained the Commission's capacity, we managed to keep our operating expenditure (before depreciation) for 2001/2002 (\$392 million) and 2002/2003 (\$372 million) below 2000/2001 level of \$400 million. In 2003/2004, we envisage that our revised budget, including the additional capacity needed for the newly added dual filing functions, will be \$407.97 million, only 2% over 2000/2001 level. In 2004/2005, we shall continue this strategy to tightly control all expenditure having regard to 2003/2004 expenditure level as a benchmark except for areas where additional resources are considered necessary to improve market quality through further strengthening the Commission's existing teams of staff and focusing on certain regulatory functions.
- On the revenue side, we assume that our share of the securities levy rate will remain at 0.005% for 2004/2005. Fees and charges will remain at the 2003/2004 level. Same as prior years, we propose not to request for the annual grant from the Government for 2004/2005.

Revenue

3. The estimated revenue for 2004/2005 is \$447.30 million, 8.3% (\$40.43 million) below the revised estimates. In comparison with the revised estimates in 2003/2004, securities levy income will decrease by \$34.79 million as the average daily SEHK turnover for 2004/2005 is assumed to be \$11 billion versus \$12.4 billion assumed in 2003/2004 revised estimate; levy income from futures/options contracts will decrease by 3% (\$0.58 million) as the projected turnover is expected to decrease marginally from about 39,100 contracts per day as projected in the revised estimates for 2003/2004 to 38,000 contracts per day in 2004/2005.
4. Fees and charges income is expected to be lower than the revised estimates of 2003/2004 by \$4.85 million. Fee income from Licensing is projected to be lower as it is envisaged that the number of licensed corporations and individuals will be reduced gradually owing to consolidation of businesses and departure of some existing registrants from the industry. Investment income is expected to remain at the 2003/2004 revised estimate level as it is expected that interest rates will remain low in 2004/2005, despite the increase in investment funds resulting from the projected surplus for the years 2003/2004 and 2004/2005.
5. Furthermore, for the twelfth 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 2004/2005 would be c.\$86 million, and that the total annual grant foregone since 1993/94 amounted to \$968 million.

Operating Expenditure

6. The total estimated operating expenditure for 2004/2005 before depreciation is \$416.37 million, about \$8.4 million (2.06%) above the revised estimates for 2003/2004. The general price increase for the year 2004/2005 is assumed to be at 0%. The major changes are noted as follows :
 - (i) increase in professional & others expenses (\$6.21 million) in anticipation of higher legal fees and higher demand for external professional consultancy services;
 - (ii) increase in general office and insurance expenses (\$1.09 million) mainly due to the projected increase in professional indemnity premium; and
 - (iii) increase in external relations expenses (\$0.85 million) mainly due to the anticipated increase in overseas business travel in connection with the Commission's international work and liaison with overseas regulatory bodies;
 - (iv) increase in training and development expenses (\$0.7 million) due to the slightly more intensive training activities planned for 2004/2005.

Capital Expenditure

7. The total capital expenditure budget proposed for 2004/2005 is \$13.08 million. The proposed budget includes (i) a provision of \$7.26 million for the development of web-based application systems and further enhancement of system infrastructure and knowledge-based management; (ii) a provision of \$3.63 million for office equipment including PCs and other PC peripherals and software; and (iii) a provision of \$1 million for the replacement of furniture due to wear and tear. A contingency equal to 10% of the estimated capital expenditure (\$1.19 million) is also included.

Operating Result

8. The projections result in a surplus of \$3.93 million, which will increase the projected reserves from \$615.56 million (31st March 2004) to \$619.49 million (31st March 2005). On this basis, the projected reserves at 31st March 2005 will be equivalent to about 17 months of the proposed annual operating expenditure (including depreciation) for 2004/2005.
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 2004/2005, i.e. \$12 billion or \$10 billion turnover would result in a variation of \pm \$24.8 million in levy income from the budget and increase the projected surplus to \$28.73 million or reduce it to a deficit of \$20.87 million.
10. The estimates of revenue are subject to considerable market uncertainty, as they depend on the performance 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 and implementation of the Securities & Futures Ordinance.

BASES OF PROPOSED ESTIMATES AND HIGHLIGHTS

The proposed estimates for the year 2004/2005 are prepared on the following bases :-

Strategy

11. Although market sentiment has improved and the financial position of the Commission has reversed from a projected deficit to a surplus in the first seven months of 2003/2004, we will continue to exercise stringent controls on our expenditure in 2004/2005. Except for areas where additional resources are considered necessary to improve market quality through further strengthening the Commission's teams of staff and focusing on certain regulatory functions, all expenses are restrained having regard to 2003/2004 revised estimates as a benchmark.
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. The Commission proposes not to request for the annual grant from the Government for 2004/2005. The fee levels will remain unchanged though they have not been revised since 1993/1994.

Assumptions

13. Price Increase

The general price increase for the year 2004/2005 is assumed to be at zero %.

14. Remuneration Adjustment

No salary adjustment is provided for in the proposed 2004/2005 budget.

15. Interest Rate

The average return of dated securities on hand is 3%-3.5% p.a. and the yield on deposit/dated securities is assumed to be 0.5% to 1% p.a. for the year 2004/2005.

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 2004/2005 which is based on the assessment of staff strength required to discharge duties efficiently and effectively is outlined below :

| Division | Function | Establishment per Approved 2003/2004 Budget | Proposed Establishment for 2004/2005 (Note) | Changes |
|---|--|---|---|---------|
| Chairman's Office | Division Management & Commission Secretariat | 9 | 12 | +3 |
| Corporate Finance | Corporate Finance | 44 | 47 | +3 |
| Intermediaries & Investment Products | Division Management | 5 | 6 | +1 |
| | Licensing | 32 | 33 | +1 |
| | Intermediaries Supervision | 65 | 65 | - |
| | Investment Products | 27 | 28 | +1 |
| Enforcement | Enforcement | 89 | 89 | - |
| Supervision of Markets | Supervision of Markets | 18 | 19 | +1 |
| | Research | 4 | 4 | - |
| Legal Services | Legal Services | 16 | 16 | - |
| Corporate Affairs | Corporate Communications | 13 | 13 | - |
| | Investor Education & Communications | 13 | 13 | - |
| | Information Technology | 17 | 18 | +1 |
| | Finance & Administration | 17 | 19 | +2 |
| | Human Resources & Training & Development | 11 | 12 | +1 |
| Permanent Established Posts | | 380 | 394 | +14 |
| Temporary Established Posts: Special Advisers | | 6 | 2 | -4 |
| Manager Trainees | | 6 | 6 | - |
| TOTAL | | 392 | 402 | +10 |

Note : The staff complement is 394 Permanent Established Posts plus 8 Temporary Established Posts (2 Special Advisers and 6 Manager Trainees) and 19 temporary staff.

Separately, 14 executive trainees are included in and funded out of the SFC Internship Programme under Training and Development expenditure.

Chairman's Office

Three Temporary Established Posts of Special Adviser will be converted to Permanent Established Posts to deal with on-going regulatory policies and China-related work.

Corporate Finance

It is proposed to add three additional posts to deal with the increasing workload arising from dual filing, which is important for improving the quality of disclosure by listing applicants, and listed companies.

Intermediaries and Investment Products – Division Management

Two additional posts are proposed to deal with policy work related to new SFO and IOSCO projects and to assist the Division in terms of projects, research and day-to-day coordination work. One post was transferred back from this area to Licensing on 1 September 2003. Hence, the net increase for this area is one additional post.

Intermediaries and Investment Products –Investment Products

One additional post is proposed to deal with an increased operational workload in the light of the launching of the REITs Code and the increasing complexity of structured investment products seeking SFC authorization.

Supervision of Markets

One Temporary Established Post of Special Adviser will be converted to Permanent Established Post to formulate market related policies and facilitate the implementation of market and product development initiatives and the enhancement of market infrastructure.

Corporate Affairs – Information Technology

One temporary staff for handling day-to-day network operation will be converted to Permanent Established Post.

Corporate Affairs – Finance & Administration

It is proposed to add one post to directly manage the team of Office Assistants and to perform other administrative functions in the Administration Department. One temporary staff for on-going imaging work will be converted to Permanent Established Post.

Corporate Affairs – Human Resources and Training & Development

One post was created on 1 April 2003 to cope with the additional workload arising from the implementation of the recommendations of the Audit Committee Report.

Special Advisers

Following the conversion of four Temporary Established Posts of Special Adviser (three in Chairman's Office and one in Supervision of Markets) to Permanent Established Posts, a provision of two Special Advisers on term contract will be retained for China-related projects, new initiatives, new products and market development, and listing regulation.

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

| | (A) | (B) | (C) | (A)-(B) (B) | (B)-(C) (C) |
|------------------------------|---|--|---|--|--|
| | Proposed Estimates For Year <u>2004/2005</u> HK\$'000 | Revised Estimates For Year <u>2003/2004 *</u> HK\$'000 | Approved Estimates For Year <u>2003/2004</u> HK\$'000 | Proposed Estimates Over/(Under) Revised Estimates % | Revised Estimates Over/(Under) Approved Estimates % |
| REVENUE | | | | | |
| Investor Levy | | | | | |
| Securities | 272,800 | 307,587 | 173,600 | (11.31) | 77.18 |
| Futures/Options Contracts | 18,848 | 19,430 | 12,400 | (3.00) | 56.69 |
| Fees & Charges | 132,350 | 137,200 | 127,984 | (3.53) | 7.20 |
| Investment Income | 21,500 | 21,500 | 24,152 | -- | (10.98) |
| Other Income | <u>1,800</u> | <u>2,000</u> | <u>1,800</u> | (10.00) | 11.11 |
| Total | <u>447,298</u> | <u>487,717</u> | <u>339,936</u> | (8.29) | 43.47 |
| OPERATING EXPENDITURE | | | | | |
| Premises | 30,823 | 33,166 | 31,549 | (7.07) | 5.13 |
| Personnel Expenses | 327,000 | 327,000 | 327,000 | -- | -- |
| Info. & Sys. Services | 17,223 | 16,260 | 16,929 | 5.92 | (3.95) |
| General Office & Insurance | 7,405 | 6,315 | 7,100 | 17.26 | (11.06) |
| Training & Development | 3,550 | 2,850 | 2,800 | 24.56 | 1.79 |
| Professional & Others | 19,088 | 12,881 | 12,005 | 48.19 | 7.30 |
| Corporate Communications | 3,036 | 2,405 | 2,100 | 26.24 | 14.52 |
| External Relations | 3,140 | 2,290 | 1,800 | 37.12 | 27.22 |
| SCEFI | <u>3,600</u> | <u>3,600</u> | <u>3,600</u> | -- | -- |
| Sub-total | 414,865 | 406,767 | 404,883 | 1.99 | 0.47 |
| Contingency | <u>1,500</u> | <u>1,200</u> | <u>3,000</u> | 25.00 | (60.00) |
| Total | <u>416,365</u> | <u>407,967</u> | <u>407,883</u> | 2.06 | 0.02 |
| DEPRECIATION | 27,000 | 29,800 | 25,400 | (9.40) | 17.32 |
| SURPLUS / (DEFICIT) | 3,933 | 49,950 | (93,347) | (92.13) | 153.51 |
| CAPITAL EXPENDITURE | | | | | |
| Furniture & Fixtures | 1,000 | 17,518 | 18,000 | (94.29) | (2.68) |
| Office Equipment | 3,630 | 4,453 | 3,000 | (18.48) | 48.43 |
| Computer Sys. Development | <u>7,260</u> | <u>300</u> | <u>-</u> | 2,320 | N/A |
| Sub-total | 11,890 | 22,271 | 21,000 | (46.61) | 6.05 |
| Contingency | <u>1,189</u> | <u>500</u> | <u>2,100</u> | 137.80 | (76.19) |
| Total | <u>13,079</u> | <u>22,771</u> | <u>23,100</u> | (42.56) | (1.42) |

* The revised estimates for the year 2003/2004 were derived from a review undertaken in November 2003 of the approved estimates for the year 2003/2004.

REVENUE

Annual Grant from Government

19. S.14 of the Securities and Futures Ordinance provides that : “For each financial year of the Commission, the Government shall pay to the Commission out of general revenue the moneys appropriated by the Legislative Council for that purpose.” The Commission will ask the Government not to request an appropriation from the Legislative Council for the financial year 2004/2005. 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 \$86 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 \$968 million.

Investor Levy - Securities

21. The revised estimate of Investor Levy-Securities is expected to be higher than the approved estimates for 2003/2004 by about 77.18% (\$133.99 million). The robust market activities for the past few months and the optimistic market sentiment pushed the securities market average daily turnover in the first seven months of 2003/2004 to about \$11.6 billion, 66% higher than the \$7 billion / day assumed in the approved estimate. The average daily turnover for the rest of the year is assumed to be \$13.5 billion. This brings the annual average daily turnover for 2003/2004 to \$12.4 billion.
22. The average daily turnover for projecting Investor Levy - Securities for 2004/2005 is assumed to be \$11 billion, which is 11% lower than the average daily turnover of \$12.4 billion of the revised estimates for 2003/2004. The Commission’s transaction levy rate will remain at 0.005%. Levy income from SEHK is projected to be \$272.8 million, about 11% lower than the 2003/2004 revised estimate. 248 trading days are assumed in the proposed estimates for 2004/2005.

Investor Levy - Futures / Options Contracts

23. The revised estimate of Investor Levy - Futures / Options Contracts is higher than the approved estimate by about 56.69% (\$7.03 million). The increase reflects the higher than expected average daily turnover on the Futures Exchange (Average 40,000 contracts cf. 25,000 contracts in the approved estimates) during the first seven months of the year 2003/2004. Daily turnover for the period November 2003 to March 2004 (103 trading days) is assumed at 38,000 contracts.

24. The average daily turnover for 2004/2005 is assumed at the level of 38,000 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 2003/2004 are higher than the approved estimate of \$127.98 million by 7.2% (\$9.22 million). The increase in corporate finance fee income is expected to more than offset the projected decrease in licensing fees having regard to the first seven months receipt.
26. For 2004/2005, the fees and charges income is projected to be about \$132.35 million, lower than the revised 2003/2004 estimate by 3.53% (\$4.85 million). The projected fee income from Licensing for 2004/2005 is lower than the 2003/2004 revised estimate by \$5.3 million as it is envisaged that the number of licensed corporations and individuals will be reduced gradually owing to consolidation of businesses and departure of some existing registrants from the industry under the new Licensing regime. The projected income from Investment Products for 2004/2005 is higher than the 2003/2004 revised estimate by \$0.6 million. Fee income from Corporate Finance for 2004/2005 is comparable to the level assumed in the 2003/2004 revised estimate.

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 2003/2004 is lower than the approved estimate by about 10.98% (\$2.65 million) because interest rates remained low in the first seven months of the year and the trend is expected to persist for the rest of the year.
29. Having taken into account the operating results projected for 2003/2004 and 2004/2005, and the continuous softening of interest rates, we expect that the projected investment income for 2004/2005 will remain at the 2003/2004 level.

Other Income

30. Based on historical data after adjustment for extraordinary items, other income for 2003/2004 and 2004/2005 is expected to be \$2 million and \$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 \$33.17 million, about 5.13% (\$1.62 million) higher than the approved estimate. We moved from Edinburgh Tower to Chater House in July 2003. The net effective rental for the new lease was concluded at \$20.23/sq. ft., slightly lower than the \$23/sq. ft. in the old lease. The net increase in premises expenses is mainly due to unbudgeted office relocation expenses of \$2.59 million incurred in June and July 2003, which was partially offset by the rental savings achieved on relocation to the new office since July 2003.
32. Premises estimate for 2004/2005 is revised downward from the revised estimate by 7.07% (\$2.34 million) mainly because the office relocation expenses of \$2.59 million incurred in 2003/2004 will not be repeated in 2004/2005.

Personnel Expenses

33. Personnel expenses will remain the same as the approved budget. Salary level was frozen at 2001/2002 level. In comparison with the approved 2003/2004 establishment, 12 permanent posts are established including 3 posts for dual filing and the conversion of 4 temporary established posts of special advisers into permanent posts. The revised establishment at the end of 2003/2004 will be 400 (including 8 temporary established posts).
34. For 2004/2005, we have not provided for salary adjustment. The proposed establishment for 2004/2005 is 402 (including 8 temporary established posts). Comparing with the revised establishment of 400 for 2003/2004, the 2 additional permanent posts are converted from existing temporary staff to reflect the actual operational needs of the Commission. Nevertheless, personnel expenses for 2004/2005 will be kept at the 2003/2004 level.

Information and Systems Services

35. The revised 2003/2004 estimate is lower than the approved estimate by 3.95% (\$0.67 million). The downward revision is mainly due to the under-spending in software and hardware maintenance and the rationalisation of the usage of information services, such as Reuters, Bloomberg etc.
36. The proposed 2004/2005 information and systems services expenses are 5.92% (\$0.96 million) higher than the revised estimate. The increase is mainly attributable to the growing demand for systems maintenance service to cope with the gradual migration of application systems developed in past years into production mode. Higher library related expenses is also expected to facilitate internal research work.

General Office and Insurance

37. The revised general office & insurance expenses are lower than the approved estimate by about 11.06% (\$0.79 million). The saving is mainly derived from lower than expected professional indemnity insurance premium concluded with the insurer.
38. The estimates of general office and insurance expenses for 2004/2005 are expected to be higher than its revised estimate of 2003/2004 by 17.26% (\$1.09 million). The increase is mainly due to the expected premium increase for professional indemnity. Repairs and maintenance expense is projected to be higher in 2004/2005 as provision is made for minor office reconfiguration work.

Training and Development

39. The revised 2003/2004 estimate is comparable to that of the approved estimate.
40. The proposed 2004/2005 estimate is higher than the revised estimate by 24.56% (\$0.7 million). The full year effect for the internship programme covering 14 executive trainees and the slightly more intensive training activities expected in 2004/2005 largely explain the increase.

Professional & Others

41. Professional & Others expenses are revised upward by about 7.3% (\$0.88 million). The main increases are in legal fees and recruitment in anticipation of more litigation in respect of unfair prejudice to interests of members of listed corporations (S.214 of the Securities & Futures Ordinance) and more executive search fees respectively.
42. Professional and Others expenses for 2004/2005 are higher than the revised estimate by 48.19% (\$6.21 million). Legal fees will be increased by \$5 million in anticipation of more market manipulation and corporate misconduct cases that will be put to the court. More external professional services are anticipated to help divisions discharge their operational duties and advise on policy issues, particularly in the areas of intermediaries supervision and enforcement.

Corporate Communications

43. The revised 2003/2004 estimate is adjusted upward by 14.52% (\$0.31 million) mainly due to the increase in public relations publications.
44. The proposed 2004/2005 estimate is higher than the 2003/2004 revised estimate by 26.24% (\$0.63 million). The increase is mainly noted in public relations programme and community education to enhance investors' knowledge about the Commission's functions and securities/futures market operations.

External Relations

45. The revised 2003/2004 expenses are adjusted upward by 27.22% (\$0.49 million) to reflect mainly the projected increase in overseas travelling activities and the unbudgeted preparation cost for hosting the 2006 IOSCO Annual Conference.
46. External Relations expenses for 2004/2005 are higher than the revised estimate by 37.12% (\$0.85 million). Major increase is in overseas travelling expenses relating to anticipated increase in the Commission's international work and liaison with overseas regulators.

SCEFI

47. The 2003/2004 estimate of SCEFI is retained to cover the recurring network operation and support expenses plus the launching of new services (such as e-cert) in the next 5 months.
48. The estimate of 2004/2005 is \$3.6 million, same as the revised estimate for 2003/2004. 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 \$1.5 million is provided for the year 2004/2005 to cover unforeseen expenses arising from abrupt changes of environment or unforeseen special requirements.

CAPITAL EXPENDITURE

Revised Estimates

50. The total capital expenditure estimate is reduced slightly from \$23.1 million to \$22.8 million, with major movements in various sub-heads : (i) Office Equipment is revised upward by 48.43% (\$1.45 million) mainly to cover the 1st phase of the PC renewal programme; (ii) \$0.3 million is provided for the Placee Information project to be carried out in the second half of the year. As a result, contingency is reduced to \$0.5 million, about 10% of the estimate of capital expenditure for the next five months.

Proposed Estimates

51. The total proposed capital expenditure budget for 2004/2005 is expected to be \$13.08 million, \$9.69 million lower than the revised 2003/2004 estimates. The 2004/2005 capital expenditure comprises the following :
- i. \$1 million is provided for replacement of existing loose furniture due to normal wear and tear;
 - ii. \$3.63 million for office equipment mainly for (i) the 2nd phase of the PC renewal programme; (ii) acquisition of office software, network management software and operating systems; and (iii) replacement of existing equipment due to obsolescence;
 - iii. \$7.26 million for costs relating to the systems development of internal and external workflow, knowledge base management and further enhancement of system infrastructure; and
 - iv. a contingency equal to 10% of the projected total capital expenditure.

SECURITIES & FUTURES COMMISSION
ESTIMATES OF INCOME FOR THE YEAR 2004/2005

| | Proposed Estimates Year 2004/2005 HK\$ | Revised Estimates Year 2003/2004 HK\$ | Approved Estimates Year 2003/2004 HK\$ |
|--|---|--|---|
| Annual Grant from Government | - | - | - |
| Investor Levy - Securities | 272,800,000 | 307,587,000 | 173,600,000 |
| Investor Levy - Futures / Options Contracts | 18,848,000 | 19,430,000 | 12,400,000 |
| Fees and Charges | 132,350,000 | 137,200,000 | 127,984,000 |
| Investment Income | 21,500,000 | 21,500,000 | 24,152,000 |
| Other Income | 1,800,000 | 2,000,000 | 1,800,000 |
| Total | <u>447,298,000</u> | <u>487,717,000</u> | <u>339,936,000</u> |

**SECURITIES & FUTURES COMMISSION
ESTIMATES OF EXPENDITURE FOR THE YEAR 2004/2005**

OPERATING EXPENDITURE

| | Proposed Estimates Year 2004/2005 | Revised Estimates Year 2003/2004 | Approved Estimates Year 2003/2004 |
|------------------------------------|--|---|--|
| | HK\$ | HK\$ | HK\$ |
| Premises | 30,822,760 | 33,166,000 | 31,549,000 |
| Personnel Expenses | 327,000,000 | 327,000,000 | 327,000,000 |
| Information & Systems Services | 17,223,000 | 16,260,000 | 16,929,000 |
| General Office & Insurance | 7,405,000 | 6,315,000 | 7,100,000 |
| Training & Development | 3,550,000 | 2,850,000 | 2,800,000 |
| Professional & Others | 19,088,000 | 12,881,000 | 12,005,000 |
| Corporate Communications | 3,036,000 | 2,405,000 | 2,100,000 |
| External Relations | 3,140,000 | 2,290,000 | 1,800,000 |
| SCEFI | <u>3,600,000</u> | <u>3,600,000</u> | <u>3,600,000</u> |
| Sub-total | 414,864,760 | 406,767,000 | 404,883,000 |
| Contingency | <u>1,500,000</u> | <u>1,200,000</u> | <u>3,000,000</u> |
| Total Operating Expenditure | <u>416,364,760</u> | <u>407,967,000</u> | <u>407,883,000</u> |

**SECURITIES & FUTURES COMMISSION
ESTIMATES OF EXPENDITURE FOR THE YEAR 2004/2005**

CAPITAL EXPENDITURE

| | Proposed Estimates Year 2004/2005 | Revised Estimates Year 2003/2004 | Approved Estimates Year 2003/2004 |
|-------------------------------------|--|---|--|
| | HK\$ | HK\$ | HK\$ |
| Furniture & Fixtures | 1,000,000 | 17,518,000 | 18,000,000 |
| Office Equipment | 3,630,000 | 4,453,000 | 3,000,000 |
| Computer Systems Development | 7,260,000 | 300,000 | - |
| Sub-total | 11,890,000 | 22,271,000 | 21,000,000 |
| Contingency (Note 1) | 1,189,000 | 500,000 | 2,100,000 |
| Total Capital Expenditure | 13,079,000 | 22,771,000 | 23,100,000 |

Note 1 : Contingency is provided for at 10% of the total 2004/2005 capital expenditure (2003/2004 : 10%)

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SECURITIES & FUTURES COMMISSION
PROJECTED INCOME & EXPENDITURE STATEMENT
FOR THE YEAR 2004/2005

| | Proposed Estimates 2004/2005 | Revised Estimates 2003/2004 |
|---|---|--|
| | HK\$ | HK\$ |
| INCOME | | |
| Investor Levy - Securities | 272,800,000 | 307,587,000 |
| Investor Levy - Futures/Options Contracts | 18,848,000 | 19,430,000 |
| Fees & Charges | 132,350,000 | 137,200,000 |
| Investment Income | 21,500,000 | 21,500,000 |
| Other Income | 1,800,000 | 2,000,000 |
| Total Income | <u>447,298,000</u> | <u>487,717,000</u> |
| EXPENDITURE | | |
| Operating Expenditure | 416,364,760 | 407,967,000 |
| Depreciation | 27,000,000 | 29,800,000 |
| Total Expenditure | <u>443,364,760</u> | <u>437,767,000</u> |
| RESULT FOR THE YEAR | <u>3,933,240</u> | <u>49,950,000</u> |