立法會
Legislative Council

LC Paper No. CB(1)117/2025(04)

Ref: CB1/PL/FA

Panel on Financial Affairs
Meeting on 3 February 2025

Background brief
on annual budgets of the Securities and Futures Commission

Purpose

This paper sets out background information on the arrangements for funding the Securities and Futures Commission ("SFC") and the scrutiny of SFC's annual estimates. The paper also summarizes the major concerns and views expressed by Members when the Panel on Financial Affairs ("FA Panel") discussed SFC's proposed budgets for the financial years from 2020-2021 to 2024-2025.

Background

Establishment, regulatory objectives and organizational structure

2. SFC was established under the then Securities and Futures Commission Ordinance in 1989 as the statutory regulator of the securities and futures market in Hong Kong. In 2002, the Legislative Council ("LegCo") enacted the Securities and Futures Ordinance (Cap. 571) ("SFO") which consolidated and modernized 10 ordinances including the Securities and Futures Commission Ordinance regulating the securities and futures market. SFO came into operation on 1 April 2003.

3. The regulatory objectives of SFC as prescribed in section 4 of SFO are to:

(a) maintain and promote the fairness, efficiency, competitiveness, transparency and orderliness of the securities and futures industry;

(b) promote understanding by the public of financial services including the operation and functioning of the securities and futures industry;

(c) provide protection for members of the public investing in or holding financial products;

(d) minimize crime and misconduct in the securities and futures industry;

(e) reduce systemic risks in the securities and futures industry; and

(f) assist the Financial Secretary ("FS") in maintaining the financial stability of Hong Kong by taking appropriate steps in relation to the securities and futures industry.

4. Under SFO, the Board of Directors of SFC shall make up of no fewer than eight members and the majority of them must be non-executive directors.[1] All directors of the Board are appointed by the Chief Executive ("CE") or FS with the delegated authority of CE. The Executive Committee performs administrative, financial and management functions as delegated by the Board of Directors. As at 31 March 2024, the actual staff strength of SFC was 958,[2] consisting of 763 professional staff and 195 support staff. The organizational structure of SFC as at January 2025 is shown in **Appendix 1**.

Financial arrangements

5. Section 14 of SFO provides that the Government shall provide funding to SFC as appropriated by LegCo. In practice, SFC has been self-funded since 1993-1994 through collecting transaction levies from investors and fees and charges from market intermediaries, and thus has not requested for appropriation from LegCo since then.

6. Under section 13(2) of SFO, SFC is required to submit, not later than 31 December of each year, the estimates of its income and expenditure (i.e. budget) for the next financial year to CE for approval.[3] The approval authority was delegated to FS in 1995. Under section 13(3) of SFO, FS shall cause the budget as approved pursuant to section 13(2) to be laid on the table of LegCo. In addition, under section 15(3) of SFO, SFC shall send a report on its activities conducted during the previous financial year (i.e. the annual report) to

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1 Section 1 of Part 1 of Schedule 2 to SFO provides for the composition of the Board of Directors.

2 The budgeted headcount in the 2023-2024 budget of SFC was 1 022.

3 Section 13(1) of SFO specifies that the financial year of SFC commences on 1 April in each year.

FS, who shall cause a copy to be laid on the table of LegCo. The approved budget and annual report of SFC are usually tabled at a Council meeting in May and June respectively each year.[4] It is a practice for SFC and the Administration to brief FA Panel in February or March each year on SFC's proposed budget and major initiatives proposed for the next financial year.

7. According to section 396 of SFO, if SFC's reserves, after deducting depreciation and all provisions, are more than twice its estimated operating expenses for a financial year and SFC has no outstanding borrowings, SFC may consult FS with a view to recommending to CE in Council that the rate of a levy be reduced under section 394 of SFO.[5]

Major views and concerns expressed by Members

8. The major views and concerns expressed by Members when FA Panel discussed the proposed budgets of SFC for the financial years from 2020-2021 to 2024-2025 at the meetings on 17 March 2020, 1 February 2021, 7 February 2022, 6 February 2023 and 5 February 2024 are summarized in the ensuing paragraphs.

<u>Annual licensing fee</u>

9. When FA Panel discussed SFC's proposed budget for 2020-2021, Members noted that SFC had announced in December 2019 that after considering the challenging market environment, it would waive the annual licensing fees for one year in 2020-2021 in order to relieve the regulatory cost burden on the securities and futures industry. Members urged SFC to consider **extending the fee waiver** when preparing the budget for 2021-2022 given the significant economic downturn caused by the coronavirus disease-2019 pandemic.

10. SFC advised that it had offered an annual licensing fee waiver in 2009-2010 and from 2012-2013 to end March 2019. Following the resumption of annual licensing fees from 2019-2020 in a phased approach with a 50% discount, SFC had expected to fully reinstate the fees from 2021-2022 onwards. However, after reviewing its fees and charges level and the market conditions,

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[4] In the past five years, SFC's approved budgets were tabled at the Council meetings on 20 May 2020, 26 May 2021, 25 May 2022, 24 May 2023 and 29 May 2024. SFC's annual reports were tabled at the Council meetings on 24 June 2020, 7 July 2021, 22 June 2022, 21 June 2023 and 19 June 2024.

[5] Under section 394(1) of SFO, a levy at the rate specified by CE in Council by order published in the Gazette shall be payable to SFC by the person so specified by CE in Council for the sale and purchase of securities or futures contracts. The order is subject to the negative vetting procedure of the Council.

SFC announced in December 2019 to fully waive the annual licensing fees for one year in 2020-2021 as a relief measure for brokerage firms.[6] SFC would carefully review the market conditions when considering whether and when to reinstate the collection of annual licensing fees.

11. When FA Panel discussed SFC's proposed budget for 2024-2025, Members supported SFC's decision to maintain **the annual licensing fee waiver** for one more year in 2024-2025. Noting that SFC would review whether the annual licensing fee should be reinstated in the following year, Members enquired about the factors to be considered in the review process.

12. SFC advised that with budget deficit recorded in 2023 and expected to continue in 2024, SFC would need to seriously examine various measures to generate revenue and manage costs in case of persistent budget deficits. There were three main sources of income for SFC, the first being transaction levies which would depend on market turnover. The second and third sources of income were annual licensing fee and investment income respectively. SFC's overall investment return, similar to that of last year, was at a stable level. If necessary, it would **consider whether the annual licensing fee should be reinstated in full or in phases**. SFC would carefully review the market situation when considering whether and when the annual licensing fee should be reinstated.

<u>Estimated income and expenditure</u>

13. When FA Panel discussed SFC's proposed budget for 2023-2024, Members noted that in projecting the estimated income for 2023-2024, SFC had adopted the assumption that the average securities market turnover would be $107 billion per day, which was lower than the actual turnover for the first six months of the previous year averaged at $112 billion per day. Members enquired whether SFC would **project the estimated income for 2023-2024 again** with reference to the recent rebound in the trading volume of the securities market. SFC was also asked to explain why the budgeted investment income for 2023-2024 (i.e. around $230 million) was well above the projected investment loss of $64.63 million for 2022-2023.

14. SFC advised that in preparing the annual budget, the assumed securities market turnover level was derived from an internal statistical analysis model in order to maintain consistency in its estimates. Based on the statistical analysis model, the securities market turnover for 2023-2024 would be approximately $107 billion per day. As it was impossible to predict precisely the market

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6 According to SFC's annual report 2022-2023, full annual licensing fee waivers were granted in 2020-2023 and would be extended for another year beginning 1 April 2023.

turnover, there were bound to be discrepancies between the estimates and actual figures. An increase in market turnover would help SFC increase its income and reduce its deficit. On investment income, SFC expected that investment valuations in the stock market would rebound in 2023-2024, and as a lot of its reserves were invested in fixed income products and bank deposits, return would increase following a hike in interest rate. The 2023-2024 investment income was therefore budgeted to be around $230 million.

15. Members noted that SFC had projected a budget deficit of some $570 million in 2023-2024, leaving its total non-ring-fenced reserves at $3.3 billion as at 31 March 2024, which was approximately 1.34 times its estimated expenditure for 2023-2024. Members enquired whether SFC had put in place **measures to reduce its expenditure** and when a balanced budget was expected to be achieved.

16. SFC replied that on an average of five years, SFC had achieved broadly-balanced budgets. SFC would keep a close watch on the situation and might consider ceasing the annual licensing fee waiver when necessary. SFC would continue to deploy its resources and control its expenditures in a prudent manner.

<u>Staff costs and establishment</u>

17. When FA Panel discussed SFC's proposed budget for 2022-2023 and 2023-2024, Members enquired about the reasons for the Corporate Finance Division ("CFD") having the highest number of positions upgraded. Members also expressed concern on **the cost effectiveness of proposing new headcount** in various divisions in the budgets of recent years, in particular the five new headcount proposed for CFD in the 2022-2023 budget.

18. SFC explained that **CFD** would need to implement the new listing regime for special purpose acquisition companies ("SPAC"), and to prepare for the perspective "homecoming listing" of a number of US-listed Chinese companies, as well as the potential further reform of the listing rules. As regards the cost effectiveness of proposing the five new headcount in CFD, SFC advised that while only a small number of SPACs had been listed in Hong Kong given the volatile global financial market conditions in 2023, the establishment of such a listing regime would help strengthen Hong Kong's position as an international financial centre. SFC added that in addition to increasing its manpower, it was also actively using advanced technology and digitalizing its services (including allowing e-submission of documents to SFC) to enhance its work efficiency and strengthen its market surveillance capabilities.

19. Pointing out that SFC had proposed 10 and 4 new headcount in the Intermediaries Division ("INT") in the budgets of 2022-2023 and 2023-2024 respectively to strengthen its supervisory regime in respect of virtual assets ("VA"), Members enquired whether SFC would, apart from increasing manpower, consider **re-structuring various divisions** and redeploying staff with a view to making more effective use of existing resources to cope with the increasing workload of INT. Given the time needed for recruiting additional staff, Members were concerned whether the work of INT had thus been affected.

20. SFC advised that in addition to creating new posts, INT had also **deployed staff with experience in licensing and supervision** to cope with the VA-related regulatory work. Besides, due to the high turnover of junior professionals, SFC could only conduct on-site inspections of some 200 licensed corporations in 2023, which fell short of the target of 300. SFC stressed that digitalized licensing process had been adopted to enhance efficiency and hence the relevant work had not been affected by recruitment difficulties.

21. When FA Panel discussed SFC's proposed budget for 2023-2024, Members urged SFC to consider reforming Hong Kong's securities market, in particular to review the positioning and functions of GEM, so as to **attract enterprises** (including small and medium enterprises ("SMEs")) **of the Association of Southeast Asian Nations** ("ASEAN") **to list in Hong Kong**, with a view to increasing market turnover. Members enquired whether SFC would, in recruiting staff, consider absorbing talents with experience in handling the listing and financing of ASEAN enterprises, so as to attract such enterprises to list in Hong Kong.

22. SFC noted Members' comments on staff recruitment. SFC advised that there had been a decline in initial public offerings and fund raising activities in Hong Kong, as well as a drop in securities market turnover last year. SFC and the Hong Kong Exchanges and Clearing Limited ("HKEX") would continue to enhance the competitiveness of Hong Kong's listing platform, including **enhancing the listing mechanism** to **attract overseas enterprises** (including those from ASEAN and Middle East countries) to list in Hong Kong. In addition, the China Securities Regulatory Commission announced last year to support a series of new initiatives to further expanding **mutual access between the Mainland and Hong Kong financial markets**, including promoting the inclusion of eligible securities of overseas enterprises that were primary listed in Hong Kong and fulfilled certain conditions in the eligible scope of Southbound Trading under Stock Connect. This would facilitate Mainland investors to engage in diverse global asset allocation, while encouraging quality overseas enterprises that wished to attract trading by Mainland investors to list in Hong Kong.

23. When FA Panel discussed SFC's proposed budget for 2024-2025, Members expressed concern about the 13.8% year-on-year increase in its staff costs, and urged SFC to spend only on essentials and **achieve staff cost savings** as far as possible. In addition, Members enquired (a) whether SFC had adjusted its **manpower in the regulation of virtual assets ("VA")**, particularly in the aftermath of two incidents which had aroused wide public concern; (b) whether more investors had opted for trading on licensed VA trading platforms after those incidents; and (c) how SFC would step up the relevant **investor education**.

24. SFC advised that in light of its budget deficit, one of the work priorities of SFC for 2024 was to continue with efforts to enhance the efficiency of different divisions, while actively **adopting advanced technologies** and other means to **control costs**. SFC further advised that following a number of suspected scams on VA trading platforms, it had conducted a comprehensive review on the relevant staffing deployment and workflow and strengthened cooperation with the Police in **handling complaints and investigations**, including exchanging intelligence with the Police twice a week, issuing press releases on investigation results, untrue reports or suspected scams as soon as possible, and blocking websites suspected of fraudulent activities with the Police's assistance. Currently, about 45 staff were responsible for VA-related regulatory work. SFC would conduct more anti-deception publicity work, while urging investors to ensure that the VA trading platforms concerned were licensed before investing or opening an account.

<u>Regulatory and enforcement work</u>

Listing requirements

25. During the discussion of SFC's proposed budget for 2021-2022, Members enquired about SFC's efforts in introducing **requirements and regulatory measures** on **environmental, social and governance ("ESG")** aspects of listed companies and companies seeking listing.

26. SFC advised that in mid-2020, SFC and the Hong Kong Monetary Authority jointly initiated the establishment of **the Green and Sustainable Finance Cross-Agency Steering Group** ("Steering Group") with other members including HKEX and the Insurance Authority which was tasked to coordinate regulatory policy making and market development initiatives on green and sustainable finance in Hong Kong. In late 2020, the Steering Group published a strategic plan which set out a framework to strengthen the Hong Kong financial ecosystem and leverage international collaboration to promote the development of green finance. SFC would focus on developing the criteria for corporate disclosure of climate risks and measures to combat greenwashing around funds labelled ESG.

Investment frauds

27. When FA Panel discussed SFC's proposed budget for 2023-2024, Members expressed concern about **the significant increase in online investment frauds**, and enquired about the statistics on investment frauds received and handled by SFC, how investors were educated to recognize the authenticity of information, and the measures to combat investment frauds and protect investors from financial losses.

28. SFC advised that it had been in close liaison and taken joint action with the Hong Kong Police Force and other regulators to **combat online financial frauds and investment scams** (e.g. "ramp and dump"). In addition, SFC had stepped up publicity and education to alert the public about the common fraudulent schemes (e.g. scammers posing as investment intermediaries and enticing the public to make investment) and to stay vigilant against deception. Through its website and online social platforms, SFC also reminded the public to check the Public Register of Licensed Persons and Registered Institutions and the Alert List available on SFC's website to verify the identity of investment intermediaries.

Development and regulation of the virtual asset market

29. When FA Panel discussed SFC's proposed budget for 2023-2024, Members enquired how SFC would, in complement with the Government's policy statement on the development of VA in Hong Kong, strike a proper balance between promoting the development of and regulating the VA market. Members were concerned whether SFC had sufficient manpower to cope with the future work relating to **the licensing regime for VA trading platform ("VATP") operators**, in particular the large number of licence applications that might need to be processed after the implementation of the regime.

30. SFC responded that it was proactively working on the regulatory requirements in respect of the licensing regime for VATP operators. In comparison with the VA supervisory regimes in other regions which only focused on anti-money laundering, the licensing regime in Hong Kong adopted **a more comprehensive and rigorous regulatory approach** covering **investor protection** aspects, including the requirement of holding client assets in segregated accounts from those on the platform, and more stringent requirements on depositaries and network security, etc. Upon implementation of the licensing regime, SFC would closely monitor the situation of licence applications and deploy staff in a timely manner to process the applications. SFC would also draw reference from the experience of other countries and enhance the application of technology (e.g. regulatory technology and blockchain, etc.) to enhance its future regulatory and enforcement work.

Measures to boost the stock market

31. When FA Panel discussed SFC's proposed budget for 2024-2025, Members enquired about SFC's proposals to boost the stock market (such as by reducing the rate of stamp duty on stock transfers), and how SFC, as an important market regulator and stakeholder, would work with the Government and HKEX to consolidate and enhance Hong Kong's status as an international financial centre. Members considered that SFC should increase its revenue from transaction levies by enhancing stock market liquidity and attracting more enterprises to list in Hong Kong by initial public offering, and urged SFC to expedite the implementation of various recommendations on **enhancing the competitiveness of the stock market** put forward by the Task Force on Enhancing Stock Market Liquidity ("the Task Force") and to keep the public informed of the progress of implementation.

32. In addition, Members made the following suggestions: (a) extending the geographical coverage of remote onboarding services to **include more emerging markets such as the Middle East and ASEAN**, and enhancing the knowledge of officers involved in the listing vetting and approving process on the emerging markets, with a view to proactively attracting and assisting issuers and capital from these emerging markets to come to Hong Kong; (b) **optimizing the delisting regime**, including allowing delisted companies more time and flexibility in the delisting process, and setting up an over-the-counter ("OTC") trading platform for stocks of delisted companies; and (c) in addition to the Main Board and the Growth Enterprise Market, providing **small and medium-sized enterprises** ("SMEs") with an additional **listing channel** similar to the OTC trading market in the United States, the alternative investment market in the United Kingdom, as well as the "New Third Board" in the Mainland, so as to allow listing by such enterprises on a voluntary disclosure basis.

33. SFC advised that the Task Force had put forward a number of short-term measures, including reducing the rate of stamp duty on stock transfers, maintaining the operation of the securities market under severe weather, and attracting more overseas enterprises to list in Hong Kong. SFC and HKEX would implement or further study the detailed proposals. To further enhance market efficiency and liquidity, SFC and HKEX were also exploring a series of measures, including **expanding the mutual market access mechanism**, attracting more capital from outside the traditional markets of the Mainland, Europe and the United States (including **Southeast Asia** and **the Middle East**) to Hong Kong, **enhancing the trading mechanism** to boost the trading volume of different investment products in the market, and exploring the establishment of different boards to facilitate smaller SMEs to raise funds through the stock market.

34. SFC further advised that over the past few years, the Administration had introduced different fund structures, including open-ended fund companies and limited partnership funds. The number of new applications from **asset management companies** for Type 9 regulated activity licences had also increased in the past year. In terms of mutual access, the "**Cross-boundary Wealth Management Connect**" had been expanding continuously. Apart from allowing securities companies which met the relevant requirements to be participating institutions, the scope of products eligible for "Southbound Trading" had also been expanded to allow Mainland investors to purchase a wider range of investment products, including more funds registered and established in Hong Kong. SFC hoped that through the coordination of these initiatives, the asset management and wealth management platforms in Hong Kong would be optimized and enhanced to create more development opportunities for the local wealth management industry. Regarding **share buy-back** by issuers, SFC had implemented a facilitation measure to allow those companies to repurchase their own shares and release them to the market in a timely manner.

35. On developing new markets, SFC advised that SFC and HKEX had been actively taking forward related work, including external publicity and promotion. SFC had recently approved the listing of the first **exchange-traded fund ("ETF") in the Asia-Pacific region to track Saudi Arabian equities**, which was also the largest ETF tracking this emerging market in the world. HKEX had also confirmed that listed companies from Indonesia and some new markets could apply for a secondary listing in Hong Kong. While the responsible officers might tend to be more cautious in the vetting and approval of listing applications from these fund origins, it was not because they were unfamiliar with the markets. Regarding **remote onboarding**, SFC advised that a mechanism was in place to draw up a list of jurisdictions eligible for the remote onboarding process. SFC would review the mechanism and update the list from time to time.

<u>Expenditure on acquisition of office premises</u>

36. When FA Panel discussed SFC's proposed budget for 2024-2025, Members queried whether it was a wise decision for SFC to acquire office premises amidst the uncertainties in the property market and asked whether it had consulted the Government before such acquisition. In addition, Members requested SFC to provide detailed information about **the acquisition and financial arrangements**, as well as the mechanism for selecting the lending bank.

37. SFC advised that the Government had been informed about the acquisition of office premises, and the loan formalities could only proceed with the approval of FS. The transaction for the nine floors currently occupied by SFC was completed in December 2023. For future development, a total of 12 floors would be acquired, with the transactions of the remaining three floors to be

completed in 2026, 2027 and 2028 respectively. This was the best financial arrangement. SFC had also sought professional advice in calculating the total expenses. On the financial arrangements, SFC pointed out that in the past, the total amount of rental was over $150 million, while the loan interest incurred for such property acquisition was less than $100 million. The annual cashflow position would improve by more than $40 million due to the cessation of rental payments that were partially offset by loan interest payments.

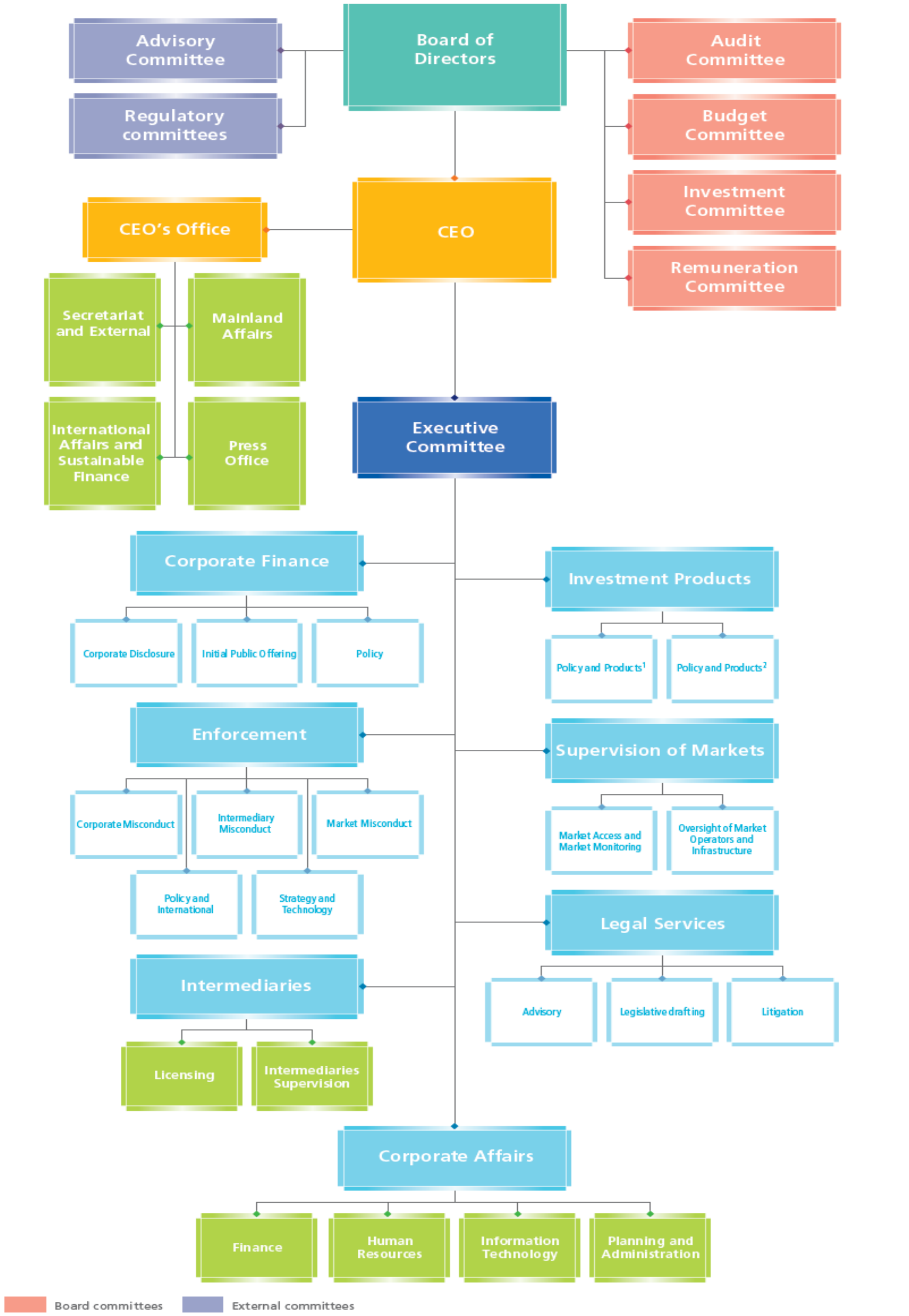
38. SFC pointed out that in the process of identifying and selecting the office premises, SFC had, in addition to the involvement of its in-house team, engaged various professional advisers including lawyers, independent valuers, surveyors and property consultants. All along, it had maintained close communication and reporting with the Government and its Board of Directors, with comprehensive assessment made and approval obtained before making the decision. On the financing arrangements, half of the $5.4 billion purchase cost was funded by SFC's ring-fenced reserves for property acquisition, and the remaining 50% by bank loan. After evaluating the loan terms offered by a number of banks in their proposals during the tendering process, SFC selected a bank to provide financing for 50% of the purchase cost, with the amount of repayment set at a level commensurate with current rental expenses. **The interest paid** by SFC **was still about one-third lower than current rental expenses**. As regards property valuation, according to an independent valuation conducted at that time, the premises were sold at some 15% discount as compared with the market price of comparable floors. SFC considered it an appropriate decision to acquire the office premises at that time.

Relevant papers

39. A list of relevant papers is in **Appendix 2**.

Council Business Divisions
Legislative Council Secretariat
27 January 2025

Organization structure of the Securities and Futures Commission



¹ Relating to the International Organization of Securities Commissions, environmental, social and governance, mandatory provident funds, pooled retirement funds, structured products, unit trusts and mutual funds.

² Relating to the Mainland, exchange-traded funds, investment-linked assurance schemes, real estate investment trusts, unit trusts and mutual funds.

SFC's website [Accessed in January 2025]

Appendix 2

Annual budgets of the Securities and Futures Commission
List of relevant papers

Committee	Date of Meeting	Paper
Panel on Financial Affairs	17 March 2020	Agenda Item III: Budget of the Securities and Futures Commission for the financial year 2020-2021 Minutes
	1 February 2021	Agenda Item IV: Budget of the Securities and Futures Commission for the financial year 2021-2022 Minutes Follow-up paper
	7 February 2022	Agenda Item VI: Budget of the Securities and Futures Commission for the financial year 2022-2023 Minutes Follow-up paper
	6 February 2023	Agenda Item IV: Budget of Securities and Futures Commission for the financial year 2023-2024 Minutes
	5 February 2024	Agenda Item IV: Budget of the Securities and Futures Commission for the financial year of 2024-2025 Minutes