

SECURITIES & FUTURES COMMISSION
PROPOSED ESTIMATES OF INCOME & EXPENDITURE
FOR THE FINANCIAL YEAR 2001/2002

28th February 2001

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EXECUTIVE SUMMARY**Extract of Proposed Estimates for the Year 2001/2002**

	Proposed Estimates <u>2001/2002</u> HK\$'M	Latest Estimates <u>2000/2001</u> HK\$'M	Revised Estimates <u>2000/2001</u> HK\$'M	Approved Estimates <u>2000/2001</u> HK\$'M
Revenue	447.79	485.08	494.88	433.49
Operating Expenditure	472.67	414.38	446.73	452.02
Depreciation	28.00	20.89	23.50	22.50
Surplus / (Deficits)	(52.88)	49.81	24.65	(41.03)
Projected reserves at beginning of the year	684.61	-	-	783.80
Actual reserves at beginning of the year	-	634.80	634.80	-
Reserves at end of the year	631.73	684.61	659.45	742.77
Capital Expenditure	38.34	36.73	36.73	36.73
Headcount	373 ***	340 *	362 **	359 **

* Including 4 Special Advisers on temporary contract for the market and legislative reform

** Including 6 Special Advisers on temporary contract for the market and legislative reform.

*** Including 6 Special Advisors on temporary contract for the market and legislative reform and 6 Manager Trainees.

Budgetary Strategy

- On the expenditure side, for the year 2001/2002 the Commission will particularly focus on (i) the promotion of international cooperation with overseas regulators in order to maintain Hong Kong's image as an international financial centre; and (ii) the development of necessary skill and technical know-how within the Commission to meet the challenges of the technological development of the market. As a reflection of this strategy, External Relations and SDNet are created as two new expenditure categories in the 2001/2002 proposed budget. External Relations is to cover activities dealing with overseas (including Mainland China) institutions and SDNet is to provide for the setting up of an industry wide network platform that will facilitate electronic communication and order routing among market operators, their participants and the regulators.
- On the revenue side, the Commission decided not to request for the annual grant from the Government for 2001/2002 since its reserves was at \$717 million at the end of September. The Commission also decided not to revise its current fees and charges level for the time being, but will re-examine the subject later in 2001/2002 in connection with the new licensing regime which will be introduced under the Securities and Futures Bill.

General

3. The approved estimates for 2000/2001 were reviewed in October to produce the revised estimates. Latest estimates for 2000/2001 were also worked out to provide a close to actual picture of the Commission's performance. They are also a reference for comparison with the proposed estimates for 2001/2002. In a two year span from 2000/2001 to 2001/2002, the Commission is somehow expected to achieve an almost breakeven operation as the surplus of \$50 million in 2000/2001 will almost make up the deficit of \$53 million projected in 2001/2002.

Revenue

4. The estimated revenue for 2001/2002 is \$447.79 million, 7.69% (\$37.29 million) below the latest estimates. In comparison with the latest estimates in 2000/2001, securities levy income will increase by \$10.4 million as the average daily SEHK turnover for 2001/2002 is assumed to be \$11 billion, representing the full year effect of the new SFC's share of levy rate at 0.005%, which came into effect from 12th June 2000; levy income from futures/options contracts will drop by 25.69% (\$2.7 million) as the projected turnover is expected to drop from 21,445 contracts per day as registered in the latest estimates for 2000/2001 to 16,000 contracts per day in 2001/2002.
5. Fees and charges income is expected to be lower than the latest estimates of 2000/2001 because the fee level will be frozen for another year and the several high document fee transactions in 2000/2001 are not expected to repeat in 2001/2002. The reduction of fund available for investment stemming from the deficits projected for 2001/2002, together with the contribution to the Unified Exchange Compensation Fund (\$150 million already paid during the first six months of 2000/2001 and the balance of \$50 million will become payable towards the end of the financial year), will result in a projected \$8.89 million drop in investment income when compared with the latest estimates. Other income also registers substantial decrease because the \$30 million legal costs recovered in 2000/2001 in relation to a single case is an one-off occurrence.
6. Furthermore, for the ninth 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 would be c.\$93.3 million, and that the total annual grant foregone since 1993/94 amounted to \$688 million.

Operating Expenditure

7. The total estimated operating expenditure for 2001/2002 before depreciation is \$472.67 million, about \$58.28 million (14.07%) over the latest estimates for 2000/2001. The general price increase for the year 2001/2002 is assumed to be at 0%. With the exception of the general office and insurance which are expected to be lower in 2001/2002 because no sizable office reconfiguration programme is anticipated, all other expenditure categories are expected to be higher than the latest estimates for 2000/2001. The major increases are noted as follows :

- (i) increase in personnel costs (\$30.46 million), mainly resulting from (i) the continuous build up of staff capacity to the full complement of 373, comprising an increase of 5 headcounts to cope with the increasing workload in the areas of investigation, unit trusts/MPF related matters and investor education during the year 2001/2002; (ii) the establishment of the manager trainee programme as a new initiative to groom future securities regulators in the Commission; and (iii) the inclusion of a provisional salary adjustment rate of 4.5%, which comprises both variable pay and adjustment of basic salary;
- (ii) increase in information and systems services expenses (\$2.29 million) mainly because of the full year effect of out-sourcing the “IT help-desk and computer centre operation support” services which started in October 2000;
- (iii) increase in training and development expenses (\$2.51 million) due to higher projected expenses in internship programme, and training expenses stemming from the emphasis on continuous professional training;
- (iv) increase in professional and others (\$12.16 million) due to the provision for increasing demand for external experts /consultants to assist divisions to discharge their functions and that the Commission incurred relatively low legal fees during the current year;
- (v) increase in corporate communication expenses (\$1.19 million), mainly due to expenses for the upkeep and enhancement of the eIRC, which was launched in 2000/2001 and more publications planned in 2001/2002 than those done in the current year; and
- (vi) increase in SDNet (\$5.72 million) to provide for the continuous development of the network.

Capital Expenditure

8. The total capital expenditure budget proposed for 2001/2002 is \$38.34 million. The proposed budget includes (i) a provision of \$25 million for the development of web-based application systems (e-workflow and STP) and further enhancement of system infrastructure and knowledge-based management; (ii) a provision of \$4 million for the replacement of furniture due to wear and tear, and work booth partitions for the second phase of the proposed office renewal programme; and (iii) a provision of \$5.8 million for office equipment including server PCs for applications and network, PCs and software for additional headcounts, PC notebooks for travelling, other PC peripherals such as printers, scanners and tape drives, network management software and Chinese operating system (\$5 million). A contingency equal to 10% of the estimated capital expenditure (\$3.49 million) is also included.

Operating Result

9. The projections result in a deficit of \$52.88 million, which will reduce the reserves from \$684.61 million (31st March 2001) to \$631.73 million (31st March 2002). On this basis, the reserves at 31st March 2002 will be equivalent to about 15 months of the proposed annual operating expenditure (including depreciation) for 2001/2002. Should the Commission request an annual grant from the Government, which is provisionally assessed to be about \$93.3 million for 2001/2002, the projected deficit will be eliminated.
10. 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 \$24.4 million in the total levy received by the Commission for the year 2001/2002, i.e. \$12 billion or \$10 billion turnover would result in a variation of \pm \$24.4 million in levy income from the budget and reduce the projected deficit to \$28.48 million or increase it to \$77.28 million.

BASES OF PROPOSED ESTIMATES AND HIGHLIGHTS

The proposed estimates for the year 2001/2002 are prepared on the following bases :-

Strategy

11. While continuing to impose strict control on expenditure, the 2001/2002 budgetary strategy for expenditure is to devote resources to further promote international cooperation with overseas regulators in order to maintain Hong Kong's image internationally, and to equip the Commission with the necessary skills and technical know-how to meet the challenges of the technological development of the market.
12. To facilitate the implementation of this strategy, two new expenditure categories, namely External Relations and SDNet, are introduced. External Relations mainly covers activities in dealing with overseas (including Mainland China) market institutions and regulatory bodies. These activities are essential if Hong Kong wants to maintain its image as an international financial centre. It is expected that such activities would grow substantially in the coming year.
13. In 1999/2000 the Commission embarked on the Securities and Derivatives Network (SDNet), as an initiative of the report of the Steering Committee on the Enhancement of Financial Infrastructure (SCEFI). The purpose of this project is to provide for the setting up of an industry wide network platform that will facilitate electronic communication and order routing among market operators, their participants and the regulators. For the past two years, the Commission has expensed about \$5.8 million on this project. It is expected that more resources will be needed to bring this project to fruition, thus the SDNet related expenses are identified as an independent expenditure category for budgetary control purpose.
14. 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. In the light of its reserves standing at \$717 million (about 1.6 times its annual operating expenditure) at the end of September 2000, the Commission proposes not to request for the annual grant from the Government for 2001/2002. After a review in October 2000 the Commission decides not to increase its fees and charges level but will re-examine the subject in 2001/2002 when the new licensing regime is introduced under the Securities and Futures Bill.

Assumptions

15. Manpower Plan

The total projected headcount for 2001/2002 is 373 (including 6 Special Advisers and 6 Manager Trainees), versus the 2000/2001 approved staff complement of 359 (including 6 Special Advisers). Changes from 2000/2001 are highlighted in the following table which summarizes the headcount by divisions and functions:-

Division	Function	Headcount per 2000/2001 Approved Estimates	Forecast Headcount for 2001/2002	Changes
Chairman's Office	Division Management & Commission Secretariat	7	7	-
	Research	4	4	-
	Information Technology	14	17	+3
Corporate Finance	Corporate Finance	36	36	-
Intermediaries & Investment Products	Division Management	4	4	-
	Licensing	37	37	-
	Intermediaries Supervision	64	64	-
	Investment Products	23	25	+2
Enforcement	Enforcement	77	79	+2
Supervision of Markets	Supervision of Markets	19	19	-
Legal Services	Legal Services	16	16	-
Corporate Resources	Corporate Communications	14	13	-1
	Investor Education & Communications	10	12	+2
	Finance & Administration	17	17	-
	Human Resources & Training & Development	11	11	-
Total		353	361	+8
Special Advisers		6	6	-
Manager Trainees		-	6	+6

Information Technology

It is proposed to increase three professional staff posts in order to maintain an adequate pool of IT skills to further improve the Commission's technology infrastructure and business systems.

Investment Products

It is proposed to increase two professional staff posts to cope with increasing workload in unit trusts and MPF related matters.

Enforcement

It is proposed to increase two professional staff posts to cope with increasing workload in investigation.

Corporate Communications

It is proposed to reduce one professional staff post in the Translation Section.

Investor Education & Communications

It is proposed to increase two professional staff posts to cope with the increasing workload in maintaining the eIRC websites and outreach activities.

Manager Trainees

The Manager Trainee Programme will be implemented in 2001/2002 to groom future regulators in the Commission. Six Manager Trainee posts are proposed during the year.

16. Price Increase

The general price increase for the year 2001/2002 is assumed to be at zero %.

17. Remuneration Adjustment

The provisional salary adjustment proposed for 2001/2002 is 4.5%. This comprises both variable pay and adjustment of basic salary.

18. Interest Rate

The average return on dated securities and deposits is assumed to be 7% p.a. on average for the year 2001/2002.

19. 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.

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

	(A)	(B)	(C)	(D)	<u>(A)-(B)</u> (B) Proposed Estimates Over/(Under) Latest Estimates %	<u>(B)-(C)</u> (C) Latest Estimates Over/(Under) Revised Estimates %	<u>(C)-(D)</u> (D) Revised Estimates Over/(Under) Approved Estimates %
	Proposed Estimates for Year <u>2001/2002</u> HK\$'000	Latest Estimates for Year <u>2000/2001</u> HK\$'000	Revised Estimates For Year <u>2000/2001</u> HK\$'000	Approved Estimates for Year <u>2000/2001</u> HK\$'000			
REVENUE							
Investor Levy							
Securities	268,400	257,988	275,390	269,500	4.04	(6.32)	2.19
Futures/Options Contracts	7,808	10,508	9,675	12,250	(25.69)	8.61	(21.02)
Fees & Charges	120,578	126,259	122,179	93,736	(4.50)	3.34	30.34
Investment Income	49,000	57,895	55,241	56,000	(15.36)	4.80	(1.36)
Other Income	<u>2,000</u>	<u>32,428</u>	<u>32,400</u>	<u>2,000</u>	(93.83)	0.09	1,520.00
Total	<u>447,786</u>	<u>485,078</u>	<u>494,885</u>	<u>433,486</u>	(7.69)	(1.98)	14.16
OPERATING EXPENDITURE							
Premises	31,424	30,825	30,030	35,093	1.94	2.65	(14.43)
Personnel Expenses	356,429	325,967	334,519	330,510	9.35	(2.56)	1.21
Info. & Sys. Services	12,951	10,660	11,925	9,817	21.49	(10.61)	21.47
General Office & Insurance	7,018	8,571	9,190	7,970	(18.12)	(6.74)	15.31
Training & Development	7,635	5,128	6,783	11,944	48.89	(24.40)	(43.21)
Professional & Others	35,859	23,700	38,718	47,487	51.30	(38.79)	(18.47)
Corporate Communications	5,350	4,159	4,663	4,720	28.64	(10.81)	(1.21)
External Relations	5,000	3,097	3,600	0	61.45	(13.97)	N/A
SDNet	<u>8,000</u>	<u>2,276</u>	<u>4,600</u>	<u>0</u>	251.49	(50.52)	N/A
Sub-total	469,666	414,383	444,028	447,541	13.34	(6.68)	(0.78)
Contingency	<u>3,000</u>	<u>0</u>	<u>2,700</u>	<u>4,475</u>	N/A	(100.00)	(39.66)
Total	<u>472,666</u>	<u>414,383</u>	<u>446,728</u>	<u>452,016</u>	14.07	(7.24)	(1.17)
DEPRECIATION	28,000	20,892	23,500	22,500	34.02	(11.10)	4.44
(DEFICITS)/SURPLUS	(52,880)	49,803	24,657	(41,030)	(206.18)	101.98	(160.10)
CAPITAL EXPENDITURE							
Furniture & Fixtures	4,000	3,750	3,750	2,750	6.67	--	36.36
Office Equipment	5,850	6,490	6,490	5,390	(9.86)	--	20.41
Computer Sys. Development	<u>25,000</u>	<u>25,250</u>	<u>25,250</u>	<u>25,250</u>	(0.99)	--	--
Sub-total	34,850	35,490	35,490	33,390	(1.80)	--	6.29
Contingency	<u>3,485</u>	<u>1,239</u>	<u>1,239</u>	<u>3,339</u>	181.27	--	(62.89)
Total	<u>38,335</u>	<u>36,729</u>	<u>36,729</u>	<u>36,729</u>	4.37	--	--

* The revised estimates for the year 2000/2001 were derived from a review undertaken in October 2000 of the approved estimates for the year 2000/2001.

REVENUE

Annual Grant from Government

21. 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 2001/2002. 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.
22. Should a request for an appropriation be made, it would be provisionally assessed at about \$93.3 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 \$688 million.

Investor Levy - Securities

23. The revised estimate of Investor Levy-Securities is expected to be higher than the approved estimate for 2000/2001 by about 2.19% (\$5.89 million). This is because the average daily turnover in the SEHK reached about \$12 billion during the first six months of 2000/2001, higher than the \$11 billion average daily turnover assumed in the approved estimates. The effect of such higher average daily turnover on income was partially washed out by the delay of the increase of the Commission’s share of levy rate from 0.004% to 0.005% to 12th June 2000 instead of 1st April 2000 as assumed in the approved budget. For the second half of 2000/2001, the original turnover assumption (i.e. \$11 billion per day) is retained.
24. However, the latest estimates show a levy income of \$257.99 million, lower than the revised estimates by 6.32% (\$17.41 million) because the actual average daily turnover for the year is expected to be about \$11 billion, lower than the average of \$11.7 billion assumed in the revised estimate.
25. The average daily turnover for projecting Investor Levy - Securities for 2001/2002 is assumed to be \$11 billion, which is in line with the average daily turnover of \$11 billion of the latest estimates for 2000/2001. The Commission’s 50% share of the transaction levy rate remains at 0.005% throughout the year. Levy income from SEHK is projected to be \$268.4 million, about 4% higher than the 2000/2001 latest estimate. 244 working days are assumed in the proposed estimates for 2001/2002 against 245 working days for 2000/2001.

Investor Levy - Futures / Options Contracts

26. The revised estimate of Investor Levy - Futures / Options Contracts is lower than the approved estimate by about 21% (\$2.58 million). The reduction reflects the lower than expected average daily turnover on the Futures Exchange (Average 19,000 contracts cf. 25,000 contracts in the approved estimate) during the first six months of the year 2000/2001, and the downward revision of the daily turnover to 20,000 contracts for the period October 2000 to March 2001 (122 trading days).
27. Since the average daily turnover for the second half year of 2000/2001 turned out to be 23,412 contracts, which is better than expected, the latest estimate of futures levy income is better than the revised estimate by about 8.6% (\$0.83 million).
28. The average daily turnover for 2001/2002 is assumed at the level of 16,000 contracts. The contract levy rate is assumed to remain at \$1 per contract. These assumptions result in a projected revenue of about 25.69% (\$2.7 million) lower than the 2000/2001 latest estimate.

Fees and Charges

29. The revised estimates of overall fees and charges for the year 2000/2001 are revised upward by 30.34% (\$28.44 million). The upward revision is the result of the higher than projected number of registrants in the area of Licensing and Investment Products, and the exceptionally high document fees received during the first six months of 2000/2001, arising from a few takeover/whitewash waiver transactions. The latest estimates show a further improvement of 3.3% (\$4.08 million) upon the revised estimates.
30. The projected income from fees and charges for 2001/2002 is lower than the latest estimate of 2000/2001 by 4.5% (\$5.68 million). The expected increase in the number of registrants in Licensing and Investment Products is more than counter balanced by the expected decrease in corporate finance activities in 2001/2002.
31. Based on the estimates for 2001/2002, the projected cost recovery rate for the functional areas of Licensing and Investment Products will be around 75% and Corporate Finance 40%. Despite the less than full cost recovery position of our fees and charges areas, the Commission decided to freeze its current fee level for the financial year 2001/2002. However, the Commission will re-examine the adequacy of the fees and charges level and structure when the new licensing regime is introduced under the Securities and Futures Bill.

Investment Income

32. 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.
33. The revised estimate for 2000/2001 is lower than the approved estimate by about 1.36% (\$0.76 million) because the total fund available for investment has been reduced by the

payment of \$150 million to the Unified Exchange Compensation Fund (UECF). Investment income is expected to be further depleted by the payment of the remaining contribution balance of \$50 million to the UECF later this year. The latest estimates expect a better operating result than that projected in the revised estimates. This results in a better investment income than the revised estimates.

34. For 2001/2002, the average return on dated securities and deposit is assumed to be 7% p.a.. The 15.36% (\$8.9 million) decrease from the latest 2000/2001 estimate results from the expected reduction in investment funds caused by deficits projected for 2001/2002, and the full year effect of the payment of \$200 million to the UECF in 2000/2001.

Other Income

35. Other income for 2000/2001 is revised upward by \$30.4 million due to the recovery of \$30 million legal costs from Mr. Chim in the Mandarin Resources Corp. case. As such exceptional income is not expected to repeat in 2001/2002, other income estimate is expected to be at the notional level of \$2 million.

OPERATING EXPENDITURE

Premises

36. The revised estimate of premises expenses is expected to be about \$30.03 million. This is lower than the approved estimate of \$35.09 million by about \$5.06 million, as the net effective rental concluded at the last rent review was lower than the rental assumed in the approved estimate. The latest estimate is close to the revised estimate.
37. Premises expenses for 2001/2002 will be increased by 1.94% (\$0.6 million) over the latest estimate to cover price increase in electricity and management fees.

Personnel Expenses

38. The recruitment process lagged behind schedule for the first six months of 2000/2001. The revised estimate not only reflects the under-spending, but also includes (i) the phased-in salary adjustment for mid-year special pay adjustments and variable pay awards; and (ii) the expenses for new recruits, including the three additional headcount and one off expenses such as temporary staff and leave pay.
39. The latest estimate is lower than the revised estimate by 2.56% (\$8.55 million) largely because the recruitment progress is not fast enough to fill up all vacancies resulting from the planned expansion in capacity and the surge of staff turnover stemming from the improvement of local employment market.
40. The proposed estimate is expected to be about 9.35% (\$30.46 million) above the latest estimate but if the impact of the surge of staff turnover is discounted, the proposed estimate is only 6.5% above the revised estimate. The increase is intended to cater for (i) a projected merit-based salary increase of 4.5% (comprising variable pay and basic salary adjustment); (ii) a projected salary adjustment of 2% for staff progression; (iii) five additional headcounts; (iv) staff upgrades; and (v) a new manager trainee programme.

Information and Systems Services

41. The revised 2000/2001 estimate is higher than the approved estimate by 21.47% (\$2.11 million). The upward revision is due to the additional services which were not included in the approved estimate and the cost of outsourcing the "IT help desk and computer centre operation support" services from October 2000. The latest estimate was lower than the revised estimate by about 10.6% (\$1.27 million) mainly because of underspending in fax supplies, information services and library research facilities.
42. The proposed 2001/2002 estimate is higher than the latest 2000/2001 estimate by 21.49% (\$2.29 million). The increase is mainly due to the full year effect of outsourcing the "IT help desk and computer centre operation support" services. The annual cost of this is around \$2.16 million. EDP hardware and software maintenance costs are also higher in 2001/2002 due to the increased number of software and computer equipment.

General Office and Insurance

43. The revised 2000/2001 estimate is higher than the approved estimate by about 15.31% (\$1.22 million) mainly because of additional expenses for office renovation and the construction cost for the first phase of the proposed office renewal programme. The latest estimate is lower than the revised estimate by 6.74% (\$0.62 million) indicating that the expenditure is under control.
44. The proposed 2001/2002 estimate is lower than the latest 2000/2001 estimate by about 18.12% (\$1.55 million). The decrease is mainly in repairs and maintenance as no sizable office reconfiguration programme is anticipated.

Training and Development

45. The revised 2000/2001 estimate is adjusted downward by 43.21% (\$5.16 million) to reflect (i) under-spending in various training categories; and (ii) the re-allocation of overseas travelling expenses (\$3 million) and part of entertainment expenses (\$0.6 million) to a new budget category "External Relations" (see para. 51 & 52). The latest estimate is lower than the revised estimate by about 24.4% (\$1.66 million). This reflects the fact that training activities and internship programme lag behind schedule.
46. The proposed 2001/2002 estimate is about 48.89% (\$2.51 million) higher than the latest 2000/2001 estimate. Major increases are due to (i) more training programmes planned for executives; and (ii) the full year charge for 14 interns.

Professional & Others

47. The revised estimate for 2000/2001 is revised downward by 18.47% (\$8.77 million). The downward revision is the combined effect of (i) the lower than budget expenditure in legal fees and recruitment expenses; and (ii) the re-allocation of expenses related to the Securities and Derivatives Network project (SDNet) (\$4.6 million) to a new budget category "SDNet" (see para. 53-57). SDNet expenses of \$5 million were originally included in the approved estimate under external professional services. The latest estimate is below the revised estimate by about 38.79% (\$15.02 million). The main underspending is noted in legal fees because less than expected number of cases needs external legal counsel services.
48. The proposed 2001/2002 estimate is higher than the latest 2000/2001 estimate by 51.3% (\$12.16 million). The main increase is due to the projected increase in the demand for external professional services to assist divisions to discharge their functions, and the inclusion of a reasonable provision for legal fees to cater for the needs for external legal services during next year.

Corporate Communications

49. The revised 2000/2001 estimate is adjusted downward by 1.21% (\$0.06 million) due to the slight cost adjustment in other publications and public relations programmes. The latest estimate is lower than the revised estimate by about 10.81% (\$0.5 million). The underspending is due to that the production of publications lags behind schedule.

50. The proposed 2001/2002 estimate is 28.64% (\$1.19 million) over the latest 2000/2001 estimate, largely as a result of the increase in expenses for public relations programme, publications and a new provision of \$0.5 million for minor programme enhancement, as well as hosting expenses for equipment of the eIRC.

External Relations

51. In view of the growing effort in promoting international (including Mainland China) co-operation with overseas regulators, a new budget category "External Relations" is created to keep management focus on these activities. Overseas travelling expenses which were originally included under "Training and Development" are now grouped under this category. The approved 2000/2001 estimate for overseas travelling was \$3.3 million and the revised 2000/2001 estimate is adjusted downward to \$3 million. Entertainment expenses which are related specifically to hosting seminars for market participants and the reception of delegates from overseas institutions are also grouped under this new category bringing the revised estimate to \$3.6 million. The latest estimate is lower than the revised estimate by 13.97% (\$0.5 million) mainly reflecting the lower expenditure in overseas travelling.
52. The proposed 2001/2002 estimate is higher than the latest 2000/2001 estimate by 61.45% (\$1.9 million) as a result of the projected increase in activities in these areas.

SDNet

53. The Commission took the lead to embark on the SDNet (Securities and Derivatives Network) as an initiative of the Steering Committee on the Enhancement of Financial Infrastructure (SCEFI). The SDNet is to provide for the setting up of an industry wide network that will facilitate electronic communication and order routing among market operators, their participants and the regulators. In 1999/2000, about \$3.5 million was spent on the development of the project.
54. There are currently over 70 licensed entities of the Commission, two share registrars and a custodian bank connected to the SDNet. Three applications, namely, electronic submissions of financial returns (e-FRRR), electronic IPO services (e-IPO) and the submission of consolidated accounts report (CAR), have been launched over the network.
55. The estimate of \$5 million for SDNet project expenses was included in the budget category "Professional & Others" in the approved 2000/2001 estimate. In view of the substantial amount involved, it is considered more appropriate to group expenses related to this project under a separate budget category to enhance budgetary control. Based on the latest progress of the project, the projected estimates are revised downward to \$4.6 million to cover the costs for network circuit and expansion, and the hiring of additional professional experts to oversee the project. The latest estimate is lower than the revised estimate by 50.52% (\$2.32 million) mainly because the implementation of some scheduled projects is deferred into the following year.

56. The proposed 2001/2002 estimate is higher than the latest 2000/2001 estimate by 251.49% (\$5.72 million). The activities envisaged to be carried out in 2001/2002 will include :
- (i) investment in new equipment and circuits in order to accommodate the anticipated growing demand by licensed entities and service providers for connection onto the SDNet;
 - (ii) enhancement of the current FinNet web-site to provide for new applications and services over the network;
 - (iii) to become a Registered Authority of the Hong Kong Post for issuing e-certificates to licensed entities; and
 - (iv) the outsourcing of FinNet to an experienced and reputable network operator. It is intended that the project will eventually be spun off as a self-contained independent entity.
57. It is expected that the Commission will form part of the independent entity sharing the initial start up investment which will comprise the development costs incurred for the establishment of the SDNet. In long run, the investment will be paid off by revenue generated by the operation of the SDNet.

CONTINGENCY

58. A contingency of \$3 million is provided for the year 2001/2002 to cover unforeseen expenses arising from abrupt changes of environment or unforeseen special requirements.

CAPITAL EXPENDITURE

Revised Estimates & Latest Estimates

59. There is no change to the total capital expenditure estimate. However, adjustments are made in various sub-heads : (i) furniture and fixtures are revised upward by 36.36% (\$1 million) to cater for the fitting out cost arising from the first phase of the office renewal programme; and (ii) office equipment is revised upward by 20.41% (\$1.1 million) to cover the replacement of LCD monitors for space saving. Contingency is thus reduced by 62.89% (\$2.1 million) to reflect the reallocation of resources to fund (i) and (ii) above.

Proposed Estimates

60. The total proposed capital expenditure budget for 2001/2002 is expected to be \$38.33 million, 4.37% (\$1.61 million) higher than the revised 2000/2001 estimates. The 2001/2002 capital expenditure comprises the following :

- (i) \$4 million for the replacement of furniture due to wear and tear, and work booth partitions for the second phase of the office renewal programme;
- (ii) \$5.85 million for office equipment mainly including (i) personal computers for the PCs renewal programme and additional headcounts; (ii) server PCs for applications and network; and (iii) acquisition of office software, network management software and Chinese operating systems;
- (iii) \$25 million for costs relating to the development of web-based application systems (with e-workflow and STP) for licence applications under Securities Ordinance, Commodities Trading Ordinance and Leveraged Foreign Exchange Trading Ordinance and further enhancement of system infrastructure and knowledge base management; and
- (iv) a contingency equals to 10% of the projected total capital expenditure.

SECURITIES & FUTURES COMMISSION
ESTIMATES OF INCOME FOR THE YEAR 2001/2002

	Proposed Estimates Year 2001/2002 HK\$	Latest Estimates Year 2000/2001 HK\$	Revised Estimates Year 2000/2001 HK\$	Approved Estimates Year 2000/2001 HK\$
Annual Grant from Government	-	-	-	-
Investor Levy - Securities	268,400,000	257,988,000	275,390,000	269,500,000
Investor Levy - Futures / Options Contracts	7,808,000	10,508,000	9,675,000	12,250,000
Fees and Charges	120,578,000	126,259,000	122,179,000	93,736,000
Investment Income	49,000,000	57,895,000	55,240,830	56,000,000
Other Income	<u>2,000,000</u>	<u>32,428,000</u>	<u>32,400,000</u>	<u>2,000,000</u>
Total	<u><u>447,786,000</u></u>	<u><u>485,078,000</u></u>	<u><u>494,884,830</u></u>	<u><u>433,486,000</u></u>

**SECURITIES & FUTURES COMMISSION
ESTIMATES OF EXPENDITURE FOR THE YEAR 2001/2002**

OPERATING EXPENDITURE

	Proposed Estimates Year 2001/2002 HK\$	Latest Estimates Year 2000/2001 HK\$	Revised Estimates Year 2000/2001 HK\$	Approved Estimates Year 2000/2001 HK\$
Premises	31,424,000	30,825,000	30,030,000	35,092,880
Personnel Expenses	356,429,000	325,967,000	334,519,000	330,510,000
Information & Systems Services	12,951,000	10,660,000	11,925,000	9,817,000
General Office & Insurance	7,018,000	8,571,000	9,190,000	7,970,000
Training & Development	7,635,000	5,128,000	6,783,000	11,944,000
Professional & Others	35,859,000	23,700,000	38,718,000	47,487,000
Corporate Communications	5,350,000	4,159,000	4,663,000	4,720,000
External Relations	5,000,000	3,097,000	3,600,000	-
SDNet	8,000,000	2,276,000	4,600,000	-
Sub-total	469,666,000	414,383,000	444,028,000	447,540,880
Contingency	3,000,000	-	2,700,000	4,475,000
Total Operating Expenditure	472,666,000	414,383,000	446,728,000	452,015,880

**SECURITIES & FUTURES COMMISSION
ESTIMATES OF EXPENDITURE FOR THE YEAR 2001/2002**

CAPITAL EXPENDITURE

	Proposed Estimates Year 2001/2002 HK\$	Latest Estimates Year 2000/2001 HK\$	Revised Estimates Year 2000/2001 HK\$	Approved Estimates Year 2000/2001 HK\$
Furniture & Fixtures	4,000,000	3,750,000	3,750,000	2,750,000
Office Equipment	5,850,000	6,490,000	6,490,000	5,390,000
Computer Systems Development	25,000,000	25,250,000	25,250,000	25,250,000
Sub-total	34,850,000	35,490,000	35,490,000	33,390,000
Contingency (Note 1)	3,485,000	1,239,000	1,239,000	3,339,000
Total Capital Expenditure	38,335,000	36,729,000	36,729,000	36,729,000

Note 1 : Contingency is provided for at 10% of the total 2001/2002 capital expenditure (2000/2001 : 10%)

**SECURITIES & FUTURES COMMISSION
PROJECTED INCOME & EXPENDITURE STATEMENT
FOR THE YEAR 2001/2002**

	Proposed Estimates 2001/2002	Latest Estimates 2000/2001
	HK\$	HK\$
INCOME		
Investor Levy - Securities	268,400,000	257,988,000
Investor Levy - Futures/Options Contracts	7,808,000	10,508,000
Fees & Charges	120,578,000	126,259,000
Investment Income	49,000,000	57,895,000
Other Income	2,000,000	32,428,000
Total Income	<u>447,786,000</u>	<u>485,078,000</u>
EXPENDITURE		
Operating Expenditure	472,666,000	414,383,000
Depreciation	28,000,000	20,892,000
Total Expenditure	<u>500,666,000</u>	<u>435,275,000</u>
RESULT FOR THE YEAR	<u>(52,880,000)</u>	<u>49,803,000</u>

**SECURITIES & FUTURES COMMISSION
PROJECTED BALANCE SHEET
FOR THE YEAR 2001/2002**

	Proposed Estimates 2001/2002	Latest Estimates 2000/2001
	HK\$	HK\$
Fixed Assets	<u>45,234,000</u>	<u>34,213,000</u>
Net Current Assets	<u>586,488,797</u>	<u>650,389,797</u>
Net Assets	<u><u>631,722,797</u></u>	<u><u>684,602,797</u></u>
Representing :		
Reserves		
Government Start-up Grant	<u>42,840,429</u>	<u>42,840,429</u>
Income & Expenditure Account		
Beginning Balance	641,762,368	591,959,368
Result for the Year	<u>(52,880,000)</u>	<u>49,803,000</u>
	<u>588,882,368</u>	<u>641,762,368</u>
	<u><u>631,722,797</u></u>	<u><u>684,602,797</u></u>