

## NOTE FOR FINANCE COMMITTEE

### Securities and Futures Commission Budget for the Financial Year 2002-03

#### PURPOSE

Encl. This note highlights the main features of the budget of the Securities and Futures Commission (SFC) for 2002-03 and compares the approved budget for 2001-02 with the latest revised estimates. A copy of the budget is at the Enclosure for Members' reference. Members may wish to note that, for the tenth consecutive year, the SFC has not requested the Government to make an appropriation to fund its operation.

#### BACKGROUND

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

- (a) the SFC will submit its budget to the Administration for the next financial year before 31 December;
- (b) the Administration will examine the SFC budget in January and present it to the Finance Committee for information in January/February;
- (c) the Administration will then submit the SFC budget to the Chief Executive for approval; and
- (d) the Administration will table the approved SFC budget in the Legislative Council and will, at the same time, submit the request for recurrent Government grant in the context of the draft Estimates of Expenditure.

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

3. The SFC submitted in December 2001 its budget for 2002-03 to the Financial Secretary. The budget was subsequently updated and discussed at the meeting of the Financial Affairs Panel of the Council on 4 March 2002. Thus we were unable to present the SFC budget to Members in strict accordance with the time schedule set out in paragraph 2 above. Nonetheless, as the SFC requires no Government appropriation for 2002-03, it will cause no operational problem to the SFC.

#### **FUNDING OF THE SFC**

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

5. SFC's levy income comes from the securities and futures markets. The current rate of levy is 0.005% on securities transactions ("securities levy"), and \$1.0 per leviable transaction for futures contracts (or \$0.2 for mini-futures and stock futures contracts).

6. As regards fees and charges, the SFC principally adopts the principle of full cost recovery when setting the level of its fees and charges. The rates of SFC fees and charges have not been revised since 1994. Attempts were made in 1997 and 1998 to adjust the fees and charges to recover the full cost against inflation but were rejected by the then Provisional Legislative Council.

7. As regards funding by the Government, an annual grant can be given to the SFC as a stable source of income to offset the more volatile income from the levy and from fees and charges. In accordance with FCR (89-90)12, such a grant should be equivalent to the cost to the Government in 1988 of funding the former Office of the Commissioner for Securities and Commodities Trading, less income. The Government will provide the provisional grant at the beginning of each financial year. Such grant will include a reconciliation and, if necessary, adjustment made for the previous financial year. The grant in 1992-93 amounted to \$60 million<sup>1</sup>. There is also an emergency fall-back whereby the SFC can seek loans with the approval of the Finance Committee to enable the SFC to survive any exceptionally prolonged period of low market activities.

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<sup>1</sup> Should a grant be requested for in 2002-03, the grant is estimated to be about \$95 million at current price.

8. With sustainable securities transactions turnover since 1993 and a reasonable level of reserves, the SFC has for the tenth consecutive year not requested any Government grant. As a result, the total grant so far foregone by the SFC amounts to about \$783 million.

### BUDGET FOR 2002-03

9. The main features of the 2002-03 budget are as follows -

- (a) **Estimated revenue** for 2002-03 is \$332.7 million, which represents about 7.8% or \$28.3 million below the revised estimated revenue of \$361 million for 2001-02. The reduction is attributable mainly to -
- a reduction in securities levy income by \$10.8 million as a result of an estimated drop in the average daily stock market turnover, from \$7.6 billion assumed for 2001-02 to \$7 billion for 2002-03;
  - a reduction in fees and charges income by \$4.3 million because of a projected reduction in takeover and other corporate finance activities and reduction in licensing fees. On reduction of licensing fees, as a concerted effort to lower the operating costs of the trade, the SFC proposes to lower the licensing fees when the single licensing regime under the Securities and Futures Ordinance comes into effect. The details have been set out in a consultation paper on the relevant subsidiary legislation published on 8 March 2002. Broadly speaking, the SFC seeks to lower licensing fees by 3% and offer an additional one-off discount of 5% to encourage intermediaries to apply early during the first year of the transitional period provided for by the Ordinance; and
  - a reduction in investment income by \$13.5 million because of the use of SFC reserves to finance deficit and SFC's contribution of \$30 million to the Unified Exchange Compensation Fund<sup>2</sup> which reduced the investment principal.

**Estimated operating expenditure** for 2002-03 is \$421.6 million, which represents about 0.3% or \$1.5 million below the revised

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<sup>2</sup> The Fund was established under Part X of the Securities Ordinance to provide compensation to investors who suffer from losses due to defaults of exchange participants of The Stock Exchange of Hong Kong Limited.

estimated operating expenditure of \$423.1 million for 2001-02. In an effort to contain expenditure, the SFC has frozen its headcount and staff salary. For other expenditures, except for some inevitable increase in expenses resulting from external market conditions or structural changes, the SFC strives to maintain all expenses at previous year's level or scale them down.

Major increases include -

- information and systems services (increase by \$3.9 million) mainly due to the inclusion of \$3.1 million for maintaining the computer application systems which the SFC has developed for its internal use over the past years;
- premises expenses (increase by \$3.7 million) as the rental of office premises is due for review in December 2002. This is a rough projection only as the SFC has yet to start negotiation with the landlord. The SFC will try its best to negotiate a new lease at the lowest possible rent; and
- personnel expenses (increase by \$1.3 million) because of expected increase in medical and life insurance premium for policies due for renewal this year.

The above increases will be partly offset by the reduced requirement for the following items -

- professional and others (decrease by \$4.6 million) due to the trimming down of external professional services in anticipation of fewer external consultancy work required and the headcount freeze;
- FinNet<sup>3</sup> (decrease by \$2.5 million) due to the completion of the developing work in 2001-02 while implementation details of other Steering Committee for the Enhancement of Financial Infrastructure projects are being drawn up; and
- external relations expenses (decrease by \$1.3 million) since expenses for overseas travelling commitments and organisation of seminars are scaled down.

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<sup>3</sup> The Financial Services Net (FinNet) is a high performance community network built to interconnect all financial institutions including securities, derivatives, banking, insurance and all other licensed financial entities in Hong Kong, to effect straight through processing and ultimately real-time financial transactions such as delivery versus payment.

- (b) Taking into account (a) above and the depreciation expense, an **estimated deficit** of \$117.6 million is expected for 2002-03, as compared with the revised deficit of \$87.9 million for 2001-02.
- (c) As a result, the SFC's **estimated reserves** are expected to fall to \$472.7 million by the end of the 2002-03 financial year from \$590.3 million as at the end of the 2001-02 financial year. The 2002-03 year-end estimated reserves is equivalent to about 13 months of the proposed operating expenditure (including depreciation) for the year.
- (d) **Estimated capital expenditure** is expected to be \$25.9 million of which \$19 million is for the development and upgrading of the SFC's licensing application and other systems to support the newly enacted Securities and Futures Ordinance and other internal e-workflow. These new systems will provide web-based access to the SFC's licensees and straight-through processing of licence applications and other business processes. The remaining balance is largely for the replacement of furniture and office equipment.

A projected income and expenditure statement and a projected balance sheet for 2002-03 are on pages 4.1 and 4.2 of the Enclosure.

#### **COMPARISON OF THE APPROVED BUDGET WITH THE REVISED ESTIMATES FOR 2001-02**

10. The agreement between the Government and the SFC is that the actual total expenditure of the SFC should not exceed the approved budget by more than 10% without the prior approval of the Financial Secretary. The table on page 2.3 of the Enclosure provides a comparison of the approved budget and the revised estimates for 2001-02. The salient features are -

**(a) Revenue**

The SFC projects that the total revenue would decrease by \$86.8 million, mainly due to a substantial decrease in the revenue from levy income on securities transaction (\$84 million) as a result of the low market turnover and economic downturn. This decline is slightly offset by an increase of \$4.2 million in the income from futures levy due to increased activity in the futures market. It is common to see more hedging activities in a bearish market, leading to money flowing from the securities market to the futures market.

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**(b) Operating Expenditure**

The total operating expenditure has been projected downward from \$472.7 million to \$423.1 million mainly as a result of the reduction in the expenses on –

- personnel expenses (decrease by \$28.8 million) due to the freeze of headcount and employees' salaries to control its expenditure; and
- professional and other fees (decrease by \$15.8 million) and training and development (decrease by \$1.9 million) mainly due to effort to cut costs.

The above reduction is partly offset by a slight increase in the expenses on information and system services (increase by \$0.2 million).

**(c) Capital Expenditure**

The estimated expenditure on “office equipment” is revised slightly upward by \$0.6 million to cater for the installation of a new office security system. This increase was more than offset by a decrease of \$2 million in the expenditure on “furniture and fixtures” following the completion of the office renewal program.

**ADMINISTRATION'S VIEWS**

11. The Administration has examined the SFC budget for 2002-03 and is satisfied that the SFC has made efforts to reduce expenditure without undermining the delivery of its services or performance of its regulatory functions. The SFC is also considering other measures to reduce its expenditure further.

12. The Administration noted that the SFC has reviewed the structure and level of its fees and charges to reflect the principle of full cost recovery as far as possible. However, in view of the present economic situation and as a concerted effort to lower the operating costs of the trade, the SFC proposes, as an interim measure, to lower the licensing fees when the single licensing regime under the Securities and Futures Ordinance comes into effect. In parallel, the SFC will conduct a review during 2002 to assess whether the downturn in its revenue is cyclical or structural.

13. Under the Securities and Futures Commission Ordinance (Cap. 24), the SFC levies may be reduced if the SFC has accumulated reserves equivalent to twice its annual operating expenses. As the SFC reserves are below the threshold, there is no plan to review the levies for funding SFC operation in 2002-03.

14. We will continue to monitor the situation, and watch closely the financial position of the SFC, particularly its budget deficit.

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Financial Services Bureau  
April 2002

**Enclosure to FCRI (2002-03)2**

**SECURITIES & FUTURES COMMISSION**  
**PROPOSED ESTIMATES OF INCOME & EXPENDITURE**  
**FOR THE FINANCIAL YEAR 2002/2003**

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**EXECUTIVE SUMMARY****Extract of Proposed Estimates for the Year 2002/2003**

	Proposed Estimates <u>2002/2003</u> HK\$'M	Revised Estimates <u>2001/2002</u> HK\$'M	Approved Estimates <u>2001/2002</u> HK\$'M
<b>Revenue</b>	332.70	361.01	447.79
<b>Operating Expenditure</b>	421.61	423.07	472.67
<b>Depreciation</b>	28.70	25.80	28.00
<b>Deficits</b>	(117.61)	(87.86)	(52.88)
<b>Projected reserves at beginning of the year</b>	590.34	-	684.61
<b>Actual reserves at beginning of the year</b>	-	678.20	-
<b>Reserves at end of the year</b>	472.73	590.34	631.73
<b>Capital Expenditure</b>	25.85	34.24	38.34
<b>Establishment</b>	<b>373 *</b>	<b>373 *</b>	<b>373 *</b>

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

**Budgetary Strategy**

1. On the expenditure side, for the year 2002/2003 the Commission will freeze headcount and salary and to continue to impose strict control on all expenditure in order to keep the total expenditure for 2002/2003 at the level of the 2001/2002 revised estimate. The Commission is committed to completing major market reforms in the Securities Law and market infrastructure, as well as internal reforms that will enhance Hong Kong's competitiveness as an international financial center and regulatory efficiency.
2. On the revenue side, the sharp decline in revenue is outside the control of the Commission due to adverse market condition. However, the Commission decided not to request for the annual grant from the Government for 2002/2003. The Commission also decided for the time being not to revise its fees and charges level which largely remains at 1993/94 level, but will launch a new licensing fee structure in mid 2002/2003 when the new licensing regime is introduced under the Securities & Futures Bill. The new licensing fee structure will incorporate some reduction from the present fee level in view of the current local economic downturn.

## **Revenue**

3. The estimated revenue for 2002/2003 is \$332.7 million, 7.84% (\$28.31 million) below the revised estimates. In comparison with the revised estimates in 2001/2002, securities levy income will decrease by \$10.84 million as the average daily SEHK turnover for 2002/2003 is assumed to be \$7 billion versus \$7.6 billion assumed in 2001/2002 revised estimate; levy income from futures/options contracts will increase by 3.04% (\$0.37 million) as the projected turnover is expected to increase marginally from 24,600 contracts per day as projected in the revised estimates for 2001/2002 to 25,000 contracts per day in 2002/2003.
4. Fees and charges income is expected to be lower than the revised estimates of 2001/2002 because the several high document fee transactions in 2001/2002 are not expected to repeat in 2002/2003. The reduction of fund available for investment stemming from the deficits projected for 2001/2002 and 2002/2003, together with the payment of the \$30 million contribution to the Unified Exchange Compensation Fund will result in a projected \$13.5 million drop in investment income when compared with the revised estimates.
5. Furthermore, for the tenth 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 2002/2003 would be c.\$95 million, and that the total annual grant foregone since 1993/94 amounted to \$783 million.

## **Operating Expenditure**

6. The total estimated operating expenditure for 2002/2003 before depreciation is \$421.61 million, about \$1.46 million (0.34%) below the revised estimates for 2001/2002. The general price increase for the year 2002/2003 is assumed to be at 0%. Except for some inevitable increases in expenses resulting from external market conditions or structural change, all expenses are either capped at 2001/2002 level or scaled down in order to keep the total expenditure for 2002/2003 at the level of the 2001/2002 revised estimate. The major changes are noted as follows :
  - (i) increase in premises expenses (\$3.7 million) as the rental of office premises is due for review in December 2002. The rental estimate is thus revised upward from January 2003 at the latest market indicative rent;
  - (ii) increase in personnel costs (\$1.3 million) despite the freezing of headcount and salary. The increase is mainly due to the full year effect of staff already on board and the expected increase in life insurance premium, inflicted by the 11<sup>th</sup> September disaster in the USA;
  - (iii) increase in information and systems services expenses (\$3.9 million) mainly because of the need of maintenance for computer application systems which are expected to move from development stage into production stage;

- (iv) increase in general office and insurance expenses (\$0.65 million) due to the projected increase in professional indemnity and general insurance premium and the costs of printing new licensing forms and stationery to match the enactment of the Securities & Futures Bill;
- (v) decrease in training and development expenses (\$1.66 million) because training activities are to be kept at a minimal level;
- (vi) decrease in professional and others (\$4.6 million) due to the trimming down of external professional services in anticipation of fewer external consultancy work required and the decrease in recruitment expenses stemming from headcount freeze;
- (vii) decrease in corporate communication expenses (\$0.9 million) since less activities are planned for community education and publications and minimum operating cost is provided for the maintenance of eIRC;
- (viii) decrease in external relations expenses (\$1.3 million) mainly because expenses relating to overseas travelling and hosting seminars are scaled down in the light of the tight budget constraint; and
- (ix) decrease in SCEFI (\$2.45 million) because no further consultancy work is anticipated.

### **Capital Expenditure**

7. The total capital expenditure budget proposed for 2002/2003 is \$25.85 million. The proposed budget includes (i) a provision of \$19 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 \$1 million for the replacement of furniture due to wear and tear; and (iii) a provision of \$3.5 million for office equipment including server PCs for applications and network, PC notebooks for travelling, other PC peripherals such as printers, scanners and tape drives, network management software and Chinese operating system. A contingency equal to 10% of the estimated capital expenditure (\$2.35 million) is also included.

### **Operating Result**

8. The projections result in a deficit of \$117.61 million, which will reduce the reserves from \$590.34 million (31<sup>st</sup> March 2002) to \$472.73 million (31<sup>st</sup> March 2003). On this basis, the reserves at 31<sup>st</sup> March 2003 will be equivalent to about 13 months of the proposed annual operating expenditure (including depreciation) for 2002/2003. Should the Commission request an annual grant from the Government, which is provisionally assessed to be about \$95 million for 2002/2003, the projected deficit will be reduced substantially.

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 2002/2003, i.e. \$8 billion or \$6 billion turnover would result in a variation of  $\pm$  \$24.8 million in levy income from the budget and reduce the projected deficit to \$92.81 million or increase it to \$142.41 million.
10. The estimates of revenue are subject to considerable market uncertainty, as they depend on the recovery of the major markets and the Hong Kong economy. A major review will be undertaken in early 2002 to assess whether the downturn in revenue is cyclical or structural.

## **BASES OF PROPOSED ESTIMATES AND HIGHLIGHTS**

The proposed estimates for the year 2002/2003 are prepared on the following bases :-

### **Strategy**

11. Given the grim economic outlook and the deteriorating financial position of the Commission, we decided to freeze headcount and salary in October 2001. Except for expenses which are subject to external market constraints (such as rental in Premises and insurance premium in General Office & Insurance) or structural changes (such as maintenance of computer systems in Information & Systems Services), all expenses are either capped at 2001/2002 level or scaled down in order to keep the total expenditure for 2002/2003 at the level of the 2001/2002 revised estimate.
12. On the revenue side, the major income source of the Commission is still investor levies which are dependent on market turnovers. The Commission's share of levy rates will remain at 0.005% on each stock exchange transaction and \$1 per futures contract. Despite the projected heavy deficits for 2001/2002 (\$87.86 million) and 2002/2003 (\$117.61 million), the Commission proposes not to request for the annual grant from the Government for 2002/2003. We also decided not to increase our fees and charges level which has not been revised since 1993/1994 but will launch a new licensing fee structure in mid 2002/2003 when the new licensing regime is introduced under the Securities & Futures Bill. The new licensing fee structure will incorporate some reduction from the present fee level in view of the current local economic downturn.

### **Assumptions**

#### 13. Price Increase

The general price increase for the year 2002/2003 is assumed to be at zero %.

#### 14. Remuneration Adjustment

No salary adjustment is provided for in the proposed 2002/2003 budget.

#### 15. Interest Rate

The average return of dated securities on hand is 7.23% p.a. and the yield on deposit/dated securities is assumed to be 2% to 3.5% p.a. for the year 2002/2003.

#### 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 total projected establishment for 2002/2003 is 373 (including 6 Special Advisers and 6 Manager Trainees), same as the 2001/2002 approved staff complement, with the re-deployment of one Director from Supervision of Markets to Chairman's Office to cope with policy and planning work. Changes from 2001/2002 are highlighted in the following table which summarizes the establishment by divisions and functions:-

<b>Division</b>	<b>Function</b>	<b>Establishment per 2001/2002 Approved Estimates</b>	<b>Forecast Establishment for 2002/2003</b>	<b>Changes</b>
Chairman's Office	Division Management & Commission Secretariat	7	<b>8</b>	+1
	Research	4	<b>4</b>	-
	Information Technology	17	<b>17</b>	-
Corporate Finance	Corporate Finance	36	<b>36</b>	-
Intermediaries & Investment Products	Division Management	4	<b>4</b>	-
	Licensing	37	<b>37</b>	-
	Intermediaries Supervision	64	<b>64</b>	-
	Investment Products	25	<b>25</b>	-
Enforcement	Enforcement	79	<b>79</b>	-
Supervision of Markets	Supervision of Markets	19	<b>18</b>	-1
Legal Services	Legal Services	16	<b>16</b>	-
Corporate Resources	Corporate Communications	13	<b>13</b>	-
	Investor Education & Communications	12	<b>12</b>	-
	Finance & Administration	17	<b>17</b>	-
	Human Resources & Training & Development	11	<b>11</b>	-
<b>Total</b>		<b>361</b>	<b>361</b>	-
Special Advisers		6	<b>6</b>	-
Manager Trainees		6	<b>6</b>	-

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

	(A)	(B)	(C)	(A)-(B) (B)	(B)-(C) (C)
	Proposed Estimates for Year <u>2002/2003</u> HK\$'000	Revised Estimates For Year <u>2001/2002</u> HK\$'000	Approved Estimates for Year <u>2001/2002</u> HK\$'000	Proposed Estimates Over/(Under) Revised Estimates %	Revised Estimates Over/(Under) Approved Estimates %
<b><u>REVENUE</u></b>					
Investor Levy					
Securities	173,600	184,436	268,400	(5.88)	(31.28)
Futures/Options Contracts	12,400	12,034	7,808	3.04	54.12
Fees & Charges	115,700	120,040	120,578	(3.62)	(0.45)
Investment Income	29,000	42,500	49,000	(31.76)	(13.27)
Other Income	<u>2,000</u>	<u>2,000</u>	<u>2,000</u>	--	--
Total	<u>332,700</u>	<u>361,010</u>	<u>447,786</u>	(7.84)	(19.38)
<b><u>OPERATING EXPENDITURE</u></b>					
Premises	35,057	31,340	31,424	11.86	(0.27)
Personnel Expenses	329,011	327,753	356,429	0.38	(8.05)
Info. & Sys. Services	17,010	13,118	12,951	29.67	1.29
General Office & Insurance	6,448	5,798	7,018	11.21	(17.38)
Training & Development	4,068	5,728	7,635	(28.98)	(24.98)
Professional & Others	15,436	20,054	35,859	(23.03)	(44.08)
Corporate Communications	2,990	3,931	5,350	(23.94)	(26.52)
External Relations	2,994	4,300	5,000	(30.37)	(14.00)
SCEFI	<u>5,600</u>	<u>8,050</u>	<u>8,000</u>	(30.43)	0.63
Sub-total	418,614	420,072	469,666	(0.35)	(10.56)
Contingency	<u>3,000</u>	<u>3,000</u>	<u>3,000</u>	--	--
Total	<u>421,614</u>	<u>423,072</u>	<u>472,666</u>	(0.34)	(10.49)
<b>DEPRECIATION</b>	28,700	25,800	28,000	11.24	(7.86)
<b>DEFICITS</b>	(117,614)	(87,862)	(52,880)	33.86	66.15
<b><u>CAPITAL EXPENDITURE</u></b>					
Furniture & Fixtures	1,000	2,000	4,000	(50.00)	(50.00)
Office Equipment	3,500	6,451	5,850	(45.74)	10.27
Computer Sys. Development	<u>19,000</u>	<u>25,000</u>	<u>25,000</u>	(24.00)	--
Sub-total	23,500	33,451	34,850	(29.75)	(4.01)
Contingency	<u>2,350</u>	<u>786</u>	<u>3,485</u>	198.98	(77.45)
Total	<u>25,850</u>	<u>34,237</u>	<u>38,335</u>	(24.50)	(10.69)

\* The revised estimates for the year 2001/2002 were derived from a review undertaken in November 2001 of the approved estimates for the year 2001/2002.

## REVENUE

### Annual Grant from Government

19. S.53 of the Securities and Futures Commission Ordinance provides that : “In each financial year there shall be paid to the Commission out of general revenue such moneys as shall be appropriated for that purpose by the Legislative Council.” The Commission will ask the Government not to request an appropriation from the Legislative Council for the financial year 2002/2003. 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 \$95 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 \$783 million.

### Investor Levy - Securities

21. The revised estimate of Investor Levy-Securities is expected to be lower than the approved estimate for 2001/2002 by about 31.28% (\$84 million). In view of the decline of the average daily turnover in the SEHK from about \$10 billion in the first quarter of 2001/2002 to about \$6.8 billion in the second quarter, the average daily turnover for the rest of the year is assumed to be \$6.8 billion. This brings the annual average daily turnover for 2001/2002 to \$7.6 billion, 31% lower than the \$11 billion average daily turnover assumed in the approved estimates.
22. The average daily turnover for projecting Investor Levy - Securities for 2002/2003 is assumed to be \$7 billion, which is slightly lower than the average daily turnover of \$7.6 billion of the revised estimates for 2001/2002. The Commission’s transaction levy rate remains at 0.005% throughout the year. Levy income from SEHK is projected to be \$173.6 million, about 6% lower than the 2001/2002 revised estimate. 248 trading days are assumed in the proposed estimates for 2002/2003 against 241 trading days for 2001/2002.

### Investor Levy - Futures / Options Contracts

23. The revised estimate of Investor Levy - Futures / Options Contracts is higher than the approved estimate by about 54.12% (\$4.2 million). The increase reflects the higher than expected average daily turnover on the Futures Exchange (Average 24,300 contracts cf. 16,000 contracts in the approved estimate) during the first seven months of the year 2001/2002, and the upward revision of the daily turnover to 25,000 contracts for the period November 2001 to March 2002 (100 trading days).

24. The average daily turnover for 2002/2003 is assumed at the level of 25,000 contracts. The contract levy rate is assumed to remain at \$1 per contract.

### **Fees and Charges**

25. The revised estimates of overall fees and charges for the year 2001/2002 are comparable with the approved estimate of \$120.58 million.
26. For 2002/2003, the fees and charges income is projected to be about \$115.7 million, lower than the revised 2001/2002 estimate by 3.6% (\$4.34 million). The decrease is mainly due to the lower income projected in the area of Corporate Finance in anticipation of very low takeovers/other deal activity under recessionary economic conditions.

### **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 2001/2002 is lower than the approved estimate by about 13.27% (\$6.5 million) because the total fund available for investment has been reduced by the heavy deficit projected for the rest of the year.
29. Having taken into account the deteriorating operating results projected for 2001/2002 and 2002/2003 and the payment of contribution of \$30 million to the Unified Exchange Compensation Fund assumed to take place at the end of 2001/2002, the average amount of fund available for investment for 2002/2003 will be reduced by 18% from that of 2001/2002. The average rate of return of dated securities on hand is 7.23% and the yield on deposit/new dated securities is assumed to be 2 to 3.5%. On this basis, the investment income for 2002/2003 is projected to further decrease by \$13.5 million (31.76%).

### **Other Income**

30. Based on historical data after adjustment for extraordinary items, other income for 2001/2002 and 2002/2003 is expected to be \$2 million respectively comprising mainly costs awarded to the Commission by the Court and sale proceeds of SFC publications.

## **OPERATING EXPENDITURE**

### **Premises**

31. The revised estimate of premises expenses is expected to be about \$31.3 million, close to the approved estimate of \$31.4 million.
32. The current office rental will be subject to rental review by December 2002. The projected rental increase in the last quarter of 2002/2003 as a result of the rental review largely accounts for the increase of about \$3.7 million in premises expenses when compared with the revised 2001/2002 estimate.

### **Personnel Expenses**

33. The total personnel expense estimate for the year is revised downward to \$327.8 million, about 8% (\$28.7 million) lower than the approved estimate. The decrease is mainly due to recruitment progress lagging behind schedule and the decision to freeze headcount and salary for the rest of the year in view of the projected financial position of the Commission.
34. For 2002/2003, we plan to freeze our manpower at the 2001/2002 level. Personnel expenses for 2002/2003 will be higher than the revised 2001/2002 expenses by about 0.4% (\$1.26 million). The increase is mainly due to the full year effect of staff already on board and the expected increase in life insurance premium, inflicted by the 11<sup>th</sup> September disaster in the USA. No salary adjustment is provided for in the estimate.

### **Information and Systems Services**

35. The revised 2001/2002 estimate is higher than the approved estimate by 1.3% (\$0.17 million). The upward revision is due to the provision for the additional information services subscribed and the cost of extended services of the "IT help desk and computer centre operation support" which has been outsourced.
36. The proposed 2002/2003 information and systems services expenses are 29.7% (\$3.9 million) higher than the revised estimate. The increase is mainly due to the inclusion of \$3.1 million system maintenance costs as most application systems developed in past years are expected to move into maintenance mode. EDP hardware and software maintenance costs are also expected to be higher in 2002/2003 as a result of the increase in software and computer equipment. Expenditure on subscription for market information services is also expected to increase to meet the demand arising from operational needs.

### **General Office and Insurance**

37. The revised general office & insurance expenses are lower than the approved estimate by about 17% (\$1.22 million) mainly because of underspending in printing and repairs and maintenance expenses. Printing expenses are revised downward mainly because the printing of new Licensing forms will be deferred to the following year. As the office reconfiguration programme has been completed and no major office reconfiguration work is expected in the rest of the year, the estimate is reduced.
38. The estimates of general office and insurance expenses for 2002/2003 are expected to be higher than its revised estimate of 2001/2002 by 11.2% (\$0.65 million). The increase is mainly due to the projected drastic increase in professional indemnity and general insurance premium consequential to the 11<sup>th</sup> September disaster in the USA. Printing expenses will also be increased to cover the printing of new licensing form and stationery when the new Licensing regime become operative in mid 2002/2003. The aggregate increase is partially offset by the decrease in repairs and maintenance expenses as no major office renovation projected is envisaged in 2002/2003.

### **Training and Development**

39. The revised 2001/2002 estimate is adjusted downward by about 25% (\$1.9 million) to reflect (i) the reallocation of part of overseas training and secondment programmes to “relations” vote that involves working with Mainland and other regulators; (ii) the lower than budget expenses in training and internship programmes during the first seven months; and (iii) the scale down of training activities in general for the rest of the year.
40. The proposed 2002/2003 estimate is about 29% (\$1.66 million) lower than the revised estimate. The decrease is essentially due to the reduction in the total training budget (including External Training- Overseas, Local Training- External and In-house) for 2002/2003 as a result of the deferment of training programmes which will be reinstated when our financial position permits.

### **Professional & Others**

41. Professional & Others expenses are revised downward by about 44% (\$15.8 million). The main reduction is in legal fees estimate and recruitment expenses. Legal fees estimate is revised downward to reflect the low usage of external legal counsel services. Recruitment expenses are projected lower in view of the headcount freezing.
42. Professional and Others expenses for 2002/2003 are lower than the revised estimate by about 23% (\$4.62 million). The decrease is essentially caused by the reduction in external professional services and recruitment expenses. External professional services are projected lower in anticipation of reduced consultancy work needed and decrease in recruitment expenses are expected to result from the continuation of headcount freezing policy.

### **Corporate Communications**

43. The revised 2001/2002 estimate is adjusted downward by about 27% (\$1.4 million) as less activities are envisaged in public relation programmes and community education though some increase in eIRC maintenance is expected for carrying out a major revamp and switching to a more powerful server to accommodate the growth of website visits by public. Statistics show that the monthly website hit total has increased by 69% for the past six months from about 569,000 hits in April 2001 to 962,000 hits in October 2001.
44. The proposed 2002/2003 estimate is about 24% (\$0.94 million) lower than the revised 2001/2002 estimate. The decrease is mainly accounted for by the continuation of scaling down activities in community education and other publications in view of the prevailing grim financial outlook, and reduction in eIRC maintenance expenditure as no major revamp is envisaged next year.

### **External Relations**

45. The revised 2001/2002 expenses are adjusted downward by 14% (\$0.7 million) to reflect the cut back in overseas travelling activities and relations promotion programmes.
46. External Relations expenses for 2002/2003 are lower than the revised estimate by about 30% (\$1.3 million). The decrease is mainly due to (i) the decrease in the provision for hosting seminars as major promotional events are cut back next year and (ii) the reduction in overseas travelling as staff are encouraged to travel on economy class and to attend via conference calls as far as possible.

### **SCEFI**(formerly called “SDNet”)

47. The Steering Committee on the Enhancement of Financial Infrastructure (SCEFI) is to set up an industry wide network that will facilitate electronic communication and order routing among market operators, their participants and regulators. This project is planned to be ultimately operated by a governance on a self contained basis. To help this project to take off, the SFC has been providing staff and financial resources to do feasibility study and network construction.
48. The Securities and Derivatives Network (SDNet), as the core of this project, has been constructed and lately integrated with the HKMA’s STET network to form the FinNet. There are currently 256 licensed entities of the Commission, three organisations, four share registrars and three banks connected to the FinNet. Four applications, namely, electronic submissions of financial returns (e-FRRR), electronic IPO services (e-IPO), submission of consolidated accounts report (CAR) and STET Info by HKMA, have been launched over the network.
49. To pursue its recognition as an industry wide platform by the market, it is necessary to bring more services on the network and further enhance its functionalities.

50. The 2001/2002 estimate of SCEFI is slightly revised upward from \$8 million to \$8.05 million to accommodate a consultancy study on market development besides the FinNet operating costs already provided for.
51. The estimate of 2002/2003 is \$5.6 million, lower than the revised estimate by about 30% (\$2.5 million). 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**

52. A contingency of \$3 million is provided for the year 2002/2003 to cover unforeseen expenses arising from abrupt changes of environment or unforeseen special requirements.

## **CAPITAL EXPENDITURE**

### **Revised Estimates**

53. The total capital expenditure estimate is reduced by about 11% (\$4.1 million) with major movements in various sub-heads : (i) Furniture and Fixtures are revised downward by 50% (\$2 million) as no major office renovation is envisaged in the next five months; and (ii) Office Equipment is revised upward by 10% (\$0.6 million) to cover the purchase of PC peripherals in relation to the installation of high speed scanning device for e-filing and the enhancement of the office security system. Contingency is also reduced to \$0.79 million, equivalent to 10% of the estimate of capital expenditure for the next five months.

### **Proposed Estimates**

54. The total proposed capital expenditure budget for 2002/2003 is expected to be \$25.85 million. The 2002/2003 capital expenditure comprises the following :
- a. \$1 million for the replacement of loose furniture due to normal wear and tear;
  - b. \$3.5 million for office equipment mainly including (i) server PCs for applications and network; (ii) acquisition of office software, network management software and Chinese operating systems; and (iii) replacement of existing office equipment due to obsolescence;
  - c. \$19 million for costs relating to the development of internal and external workflow to enhance process and work productivity, knowledge base management and further enhancement of system infrastructure; and
  - d. a contingency equal to 10% of the projected total capital expenditure.

**SECURITIES & FUTURES COMMISSION  
ESTIMATES OF INCOME FOR THE YEAR 2002/2003**

	<b>Proposed Estimates Year 2002/2003 HK\$</b>	<b>Revised Estimates Year 2001/2002 HK\$</b>	<b>Approved Estimates Year 2001/2002 HK\$</b>
<b>Annual Grant from Government</b>	-	-	-
<b>Investor Levy - Securities</b>	<b>173,600,000</b>	<b>184,436,000</b>	<b>268,400,000</b>
<b>Investor Levy - Futures / Options Contracts</b>	<b>12,400,000</b>	<b>12,034,000</b>	<b>7,808,000</b>
<b>Fees and Charges</b>	<b>115,700,000</b>	<b>120,040,000</b>	<b>120,578,000</b>
<b>Investment Income</b>	<b>29,000,000</b>	<b>42,500,000</b>	<b>49,000,000</b>
<b>Other Income</b>	<b>2,000,000</b>	<b>2,000,000</b>	<b>2,000,000</b>
<b>Total</b>	<b>332,700,000</b>	<b>361,010,000</b>	<b>447,786,000</b>

**SECURITIES & FUTURES COMMISSION  
ESTIMATES OF EXPENDITURE FOR THE YEAR 2002/2003**

**OPERATING EXPENDITURE**

	<b>Proposed Estimates Year 2002/2003 HK\$</b>	<b>Revised Estimates Year 2001/2002 HK\$</b>	<b>Approved Estimates Year 2001/2002 HK\$</b>
Premises	35,057,000	31,340,000	31,424,000
Personnel Expenses	329,011,000	327,752,773	356,429,000
Information & Systems Services	17,010,000	13,118,000	12,951,000
General Office & Insurance	6,448,000	5,798,000	7,018,000
Training & Development	4,068,000	5,728,000	7,635,000
Professional & Others	15,436,000	20,054,000	35,859,000
Corporate Communications	2,990,000	3,931,000	5,350,000
External Relations	2,994,000	4,300,000	5,000,000
SCEFI	<u>5,600,000</u>	<u>8,050,000</u>	<u>8,000,000</u>
Sub-total	418,614,000	420,071,773	469,666,000
Contingency	<u>3,000,000</u>	<u>3,000,000</u>	<u>3,000,000</u>
<b>Total Operating Expenditure</b>	<b><u>421,614,000</u></b>	<b><u>423,071,773</u></b>	<b><u>472,666,000</u></b>

**SECURITIES & FUTURES COMMISSION  
PROJECTED INCOME & EXPENDITURE STATEMENT  
FOR THE YEAR 2002/2003**

	<b>Proposed Estimates 2002/2003</b>	<b>Revised Estimates 2001/2002</b>
	<b>HK\$</b>	<b>HK\$</b>
<b>INCOME</b>		
Investor Levy - Securities	173,600,000	184,436,000
Investor Levy - Futures/Options Contracts	12,400,000	12,034,000
Fees & Charges	115,700,000	120,040,000
Investment Income	29,000,000	42,500,000
Other Income	2,000,000	2,000,000
	<hr/>	<hr/>
Total Income	332,700,000	361,010,000
	<hr/>	<hr/>
<b>EXPENDITURE</b>		
Operating Expenditure	421,614,000	423,071,773
Depreciation	28,700,000	25,800,000
	<hr/>	<hr/>
Total Expenditure	450,314,000	448,871,773
	<hr/>	<hr/>
<b>RESULT FOR THE YEAR</b>	<b><u>(117,614,000)</u></b>	<b><u>(87,861,773)</u></b>

**SECURITIES & FUTURES COMMISSION  
PROJECTED BALANCE SHEET  
FOR THE YEAR 2002/2003**

	<b>Proposed Estimates 2002/2003</b>	<b>Revised Estimates 2001/2002</b>
	<b>HK\$</b>	<b>HK\$</b>
Fixed Assets	<u>43,300,000</u>	<u>43,000,000</u>
Net Current Assets	<u>429,424,031</u>	<u>547,338,031</u>
Net Assets	<u><u>472,724,031</u></u>	<u><u>590,338,031</u></u>
Representing :		
Reserves		
Government Start-up Grant	<u>42,840,429</u>	<u>42,840,429</u>
Income & Expenditure Account		
Beginning Balance	547,497,602	635,359,375
Result for the Year	<u>(117,614,000)</u>	<u>(87,861,773)</u>
	<u>429,883,602</u>	<u>547,497,602</u>
	<u><u>472,724,031</u></u>	<u><u>590,338,031</u></u>