Opening Statement by Andrew Sheng
Chairman of the Securities and Futures Commission

LegCo Financial Affairs Panel Meeting

20 March 2003

Honourable Chairman Ambrose Lau

Honorable Members of the Financial Affairs Panel

1. I am pleased to have this opportunity to highlight the main features of the Commission's budget for the coming financial year to Members of the Financial Affairs Panel. I shall first brief Members on the revised estimates for the current financial year and then outline our proposed budget for the next financial year.

<u>Revised Estimates for 2002/2003</u>

2. When we tabled our estimates for 2002/2003 to this Panel last March, we projected a deficit of $117.6 million (after depreciation of $28.7 million). Soon after our budget was approved, we realised that, given the unfavourable economic climate and the uncertainty surrounding the market, we needed to continue to exercise stringent cost control over our expenditure to contain any worsening of the deficit. As a result of the various cost control measures which we have been taking since the beginning of the financial year such as salary freeze, strict control on hiring, we were able to revise downward our estimated deficit for this financial year to $78.7 million, representing a 33% or $38.9 million reduction from the approved level.

3. On the revenue side, we expect the overall revenue for this financial year to decrease by 1.3% or $4.4 million from the approved budget. Levy income from securities, which accounts for about 51% of our total revenue, was revised downward by 3% or $5.1 million because of the lower than expected market turnover. In revising the estimate, we have assumed an average daily market turnover of $6.8 billion which is lower than the average daily turnover of $7 billion assumed in the approved budget.

4. For income from fees and charges, we also expect a 3.3% or $3.8 million decrease which is mainly due to lower than expected income from corporate finance fees. On the other hand, we expect the investment income to be 14.8% or $4.3 million higher than the approved budget because more fund is available for investment as a result of the improvement in our deficit position.

5. On the expenditure side, the revised estimate on total expenditure after depreciation was below the approved budget by 10% or $43.3 million with personnel expenses accounting for $21.6 million or half of the total reduction.

6. As at 28 February 2003, the Commission recorded a deficit of $48.6 million for the first 11 months of the financial year. With one more month to financial year-end on 31 March 2003, and with the stringent cost control measures in place, we believe the deficit for the current financial year can be contained at around $59 million which would be 25% or $19.6 million better than the revised deficit. This is half of the forecast deficit of $117.6 million estimated last March.

7. Furthermore, when comparing the latest forecast of this financial year with the actual figures of the last financial year, we note that although our income has dropped by about 7.5% or $27.3 million from last year's level, we have managed to reduce our total operating expenditure after depreciation by 5.4% or $22.4 million, with 48% of the reduction or $10.7 million coming from personnel expenses. In addition, our capital expenditure has come down by 43.6% from last year's $26.8 million to this year's $15.1 million.

8. In sum, our projected deficit of $59.1 million this year is roughly comparable with last year's actual deficit of $54.2 million even though revenue is 7.5% lower.

Proposed Estimates for 2003/2004

9. Our financial position is largely dependent on market turnover and external market conditions. Given the uncertain market conditions, we have decided not only to continue the stringent cost control measures introduced in the past two years but also take steps to cut back capital expenditure including mainly computer systems development. We expect the proposed operating expenditure to be at a similar level of the revised budget for 2002/03 except for personnel expenses and general office and insurance expenses. We estimate that the total expenditure before depreciation for 2003/2004 will be 6.5% above this year's revised level, whilst revenue will be 3.5% above the revised estimate. On these bases, we expect to have a deficit of about $93.3 million after depreciation of $25.4 million in the coming financial year.

10. Despite the estimated deficit, the Commission has, for the 11th consecutive year, decided not to request from the Government and the Legislative Council for an appropriation which is estimated to be about $91 million. With the projected deficit, our reserves will decrease by 17% from the revised level of $545.3 million at the end of this financial year to $451.9 million by the end of the next financial year.

11. In preparing the budget for the coming financial year, the Commission has assumed an average daily turnover of $7 billion, which is in line with the HKEx assumption. We expect to receive $186 million in levy income, which is about 2.6% or $4.8 million higher than the revised estimate.

12. Income from fees and charges in the coming financial year is estimated at $128 million, about 14.4% or $16.1 million higher than the revised estimate mainly because a fee of $20 million is expected from HKEx to cover dual filing expenses. While we face a deficit budget and uncertain market conditions, we will still lower the licensing fees to be paid by market intermediaries under the single licensing regime when the Securities and Futures Ordinance is implemented next month. The new licensing structure has incorporated a 3% discount from the old fee level and an additional 5% discount to encourage early registration. Such discounts mean our income from licensing fees in 2003/2004 will be $1.3 million lower than that of this year. Furthermore, the Commission has decided not to revise fee levels of other areas, such as investment products and corporate finance, even though they have remained at their 1993/1994 levels.

13. We shall have less money for investment as we draw down our reserves to fund the projected deficit for 2003/2004. In addition, the continuous low interest rate environment will dilute the average return on investment. We expect the investment income to shrink by 27.5% or $9.1 million to $24.2 million.

14. On the whole, the total revenue for 2003/2004 is estimated to be $339.9 million, 3.5% or $11.6 million above the revised level for this financial year.

15. On the expenditure side, we expect the estimated expenditure for 2003/2004 to be $407.9 million before depreciation of $25.4 million. This is about 6.5% or $25 million above the revised estimate. In the coming financial year, except for personnel expenses and the premium for professional indemnity insurance, we shall cap most expenses at about the 2002/2003 levels or scale them down even further. I would like to elaborate on the following aspects:

    (i) Personnel expenses account for about 80% of the total operating expenditure before depreciation of the Commission. Despite our effort to continue to freeze our salary and to tightly control recruitment and replacement, we expect personnel expenses for 2003/2004 to increase from the revised level by about 6.4% or $19.7 million mainly due to the full year effect of staff recruited and additional posts to fulfil our dual filing commitments.

    (ii) Information and services expenses will be about 5.6% or $0.9 million higher than the revised estimate due to an increase in system maintenance cost as most application systems developed in past years will move into maintenance mode.

(iii) There will be an increase in general office and insurance expenses of 40% or $2 million due primarily to projected increase in professional indemnity and general insurance premium. The large increases are consequential to the professional insurance claims worldwide and the terrorist attack.

(iv) In proposing a capital expenditure budget of $23.1 million, we shall cut back most of our computer system development projects except those that are indispensable for our operation. However, we shall have to spend money on furniture and fixtures for fitting out our new offices since we were asked by our existing landlord to move out our current premises by the end of this June. We have provided $21 million to cover the cost relating to office relocation. The fitting out standard will be modest. To achieve this, we will exercise strict discipline of following prescribed fitting out standard and the presumption that all existing loose furniture and office equipment will be reused.

Conclusion

16. To sum up, I would like to emphasize that, the Commission will not ask for any Government grant for the 11th consecutive year despite the budgetary deficit. We have foregone a total of $876 million in government annual grant since 1993/94.

17. This year is a year of implementation for the Commission as the new Securities and Futures Ordinance ("SFO") will come into operation next month. Our top priority is to ensure a smooth transition to the new regulatory framework with particular focus on the implementation of the dual filing system and to exercise our new powers under the SFO to tackle corporate crime and misconduct in the securities and futures market.

18. In the coming year, we anticipate that our workload will increase. However, we shall continue to try our best to contain expenditure, while fulfilling our duties by enhancing our operational efficiency and cost effectiveness without compromising regulatory quality.

19. I shall be happy to explain further details and answer your questions. Thank you.