

**Opening Statement by Peter Au-Yang
Chief Operating Officer of the Securities and Futures Commission**

LegCo Financial Affairs Panel Meeting

1 March 2004

Honourable Chairman Henry Wu

Honorable Members of the Financial Affairs Panel

1. I am pleased to have this opportunity to brief Members of the Financial Affairs Panel on the main features of the Commission's budget. I shall first talk about the revised estimates for the current financial year before introducing our proposed budget for the next financial year.

Revised Estimates for 2003/2004

2. When we tabled our budget for 2003/2004 to this Panel last March, the economic climate and market condition were unfavourable and we projected a deficit of \$93 million. However, since April last year, we have witnessed gradual improvement in the activity of the stock market with the Hang Seng Index rising from 8,717 at the end of April 2003 to 13,907 at the end of February 2004, an increase of about 60%. This year's strong market turnover has helped turn around our budget position from a projected deficit to a surplus. This shows that our financial position is highly dependent on the level of market activities. In the revised estimates which were prepared in October 2003, we project that by the end of the current financial year, we will have a surplus of around \$50 million.

3. On the revenue side, we expect the overall revenue for this financial year to increase by more than 43% or \$148 million from the approved budget. 90% of the increase in revenue will come from the increase in our securities levy income, which has been revised upward by 77% as a result of active market activities. In the approved budget, we assumed an average daily market turnover of \$7.0 billion. We increased that figure to \$12.4 billion when we prepared our revised estimates in last October.
4. For income from fees and charges, we expect a 7% or \$9 million increase from the approved level with the increase in corporate finance fee more than offsetting the projected decrease in licensing fees. At the same time, we expect to have less income from investment as interest rates have remained low during the year.
5. Although our financial situation has improved, we are conscious not to relax our tight control over expenditure. During the year, we have continued to implement stringent cost control measures including salary freeze to contain our expenditure at the level of the approved budget. The revised estimate of total expenditure before depreciation was kept at \$408 million, roughly the same as the approved budget.
6. It is worth noting that in the revised estimates, we have not made any revision to personnel expenses, which stay at the approved level of \$327 million despite an increase in headcounts to cope with dual filing functions and other product and market initiatives during the year.
7. On capital expenditure, the revised estimate has been slightly reduced by \$0.3 million from the approved level of \$23 million.

8. At this juncture, I would like to give an update of our latest financial position. As at 31 January 2004, the Commission recorded a surplus of \$97 million for the first 10 months of the current financial year. This was a combined result of our stringent cost control measures and, more importantly, the better than expected income from securities levy. Owing to the increase in the level of stock market activities in the last few months, the average daily market turnover for the period from April 2003 to January 2004 was actually \$13.7 billion, which is even higher than the \$12.4 billion figure used in our revised estimates. The average daily market turnover of the February just passed was \$19.5 billion. This, together with our continuous effort to contain expenditure, means that we can expect our surplus for the current financial year to go up further. The expected surplus of the current financial year will allow the Commission to replenish its reserves which has decreased by a total of \$113 million over the last two years.

Proposed Estimates for 2004/2005

9. I will now move on to talk about the proposed estimates for 2004/2005. As mentioned before, our financial position is largely dependent on market turnover and external market conditions. Given the unpredictability of the securities markets, both in terms of directions and volume of trading, we have to remain cautious on our financial planning and we will continue our strategy of exercising tight control over all our expenditure. We aim to contain our operating expenditure after depreciation at roughly the 2003/2004 level with very moderate increase to put additional resources to areas that are considered necessary.

10. While government grant is one of our sources of income, for the 12th year in a row, the Commission will invite the Government not to request any appropriation from the Legislative Council. It is estimated that the annual government grant foregone by the Commission for 2004/2005 would be about \$86 million, and that the total annual grant foregone since 1993/1994 would amount to \$968 million.
11. The estimated revenue for 2004/2005 is \$447 million or 8% below the 2003/2004 revised estimate. In making the estimate, we have assumed the average daily market turnover for 2004/2005 to be \$11 billion which is lower than the \$12.4 billion assumed in the revised estimates. As a result, our securities levy income for the coming year is estimated to decrease by 11% from that of 2003/2004.
12. Fees income from Licensing is projected to be lower than the 2003/2004 revised estimates by \$5 million since we expect the number of licensed corporations and individuals will go down slightly as a result of business consolidation. On the whole, income from fees and charges for 2004/2005 is projected to be 4% or \$5 million lower than the 2003/2004 revised estimates. Despite this, the Commission has decided not to revise its fees and charges, which remain at their 1993/1994 levels.
13. Although we will have more fund available for investment as a result of the projected surplus in the current financial year, we expect our investment income for the coming year to stay at the same level as the 2003/2004 revised estimates as interest rates are expected to continue to remain low.

14. On the expenditure side, we budget our estimated expenditure for 2004/2005 at \$416 million before depreciation. This is about 2% or \$8 million above the 2003/2004 revised estimate.
15. We will maintain personnel expenses at the 2003/2004 level of \$327 million. As part of our cost control measures, we do not propose any salary increase for 2004/2005. In fact, salary level has been frozen since the 2001/2002 financial year, which was almost three years ago.
16. Premises expenses will be 7% or more than \$2 million lower than the 2003/2004 revised estimate as office relocation expenses will not be repeated in 2004/2005.
17. We have provided a larger budget for professional and other expenses in 2004/2005 as we expect more market manipulation and corporate misconduct cases to be put to the court. In addition, more external professional services will be required by the Commission on policy and operational issues, particularly in the areas of intermediaries supervision and enforcement.
18. Information and systems services expenses will be 6% or \$1 million higher than the 2003/2004 revised estimate owing to a projected increase in system maintenance cost as most application systems developed in the past years have moved into maintenance mode.
19. General office and insurance expenses are expected to be 17% or \$1 million higher than the 2003/2004 revised level and this is mainly due to the expected increase in premium for professional indemnity insurance.

20. On the bases of the proposed expenditure and revenue, we expect to have a small surplus of \$4 million in the coming financial year.
21. On capital expenditure, the proposed amount is \$13 million, which is 43% or \$10 million lower than the 2003/2004 revised estimate as we continue to make capital investment only in areas which are essential to our operation.

Conclusion

22. To conclude, I would like to stress that, despite the unexpected significant improvement in our revenue during the current financial year, the Commission has been keeping its expenditure including personnel expenses within budget while we cope with the increased workload and various challenges brought about by the implementation of the Securities and Futures Ordinance. During the year, we have successfully implemented the new regulatory framework and established the dual filing regime which has been welcomed by the market, and had a smooth transition to the single licensing regime.
23. In the coming year, we anticipate that our workload will increase further as we continue to put our effort in enhancing the quality of the Hong Kong market through upkeeping market standards, facilitating market development and enforcing the law.
24. I shall be happy to explain further details and answer your questions.
Thank you.