

**Legislative Council Panel on Financial Affairs**

**Securities and Futures Commission  
Budget for the Financial Year 2010-11**

**PURPOSE**

The purpose of this paper is to highlight the main features of the budget of the Securities and Futures Commission (“SFC”) for 2010-11.

**BACKGROUND**

2. Section 13(2) of the Securities and Futures Ordinance (Cap. 571) (“SFO”) requires the SFC to submit the estimates of its income and expenditure (“the budget”) for each financial year to the Chief Executive for approval. The Chief Executive has delegated the authority to the Financial Secretary. In accordance with section 13(3) of the SFO, the Financial Secretary shall cause the budget to be laid on the table of the Legislative Council. In line with past practice, the Administration has prepared this paper to brief Members on the main features of the SFC’s budget for 2010-11, a copy of which is attached at the Annex.

**FUNDING OF THE SFC**

3. Section 14 of the SFO provides that the Government shall provide funding to the SFC as appropriated by the Legislative Council. In practice, the SFC has not requested for appropriation from the Legislative Council since 1993-94. Its funding basically comes from the market in the form of levies, fees and charges.

4. Over the years, levies on securities transactions and futures and options contracts have been the main source of income for the SFC. The current rate of levy on securities transactions is 0.004% while that on futures and options contracts is \$0.8 or \$0.16 per leviable transaction, depending on the type of contracts.

## **BUDGET FOR 2010-11**

5. The SFC has projected a surplus budget of \$767.43 million for 2010-11. With the projected budget surplus and sizable reserves, for the eighteenth year in a row, the SFC does not request for any appropriation from the Legislative Council for the 2010-11 budget. The main features of the 2010-11 budget are set out in paragraphs 6 to 11 below.

### **Estimated Revenue**

6. The estimated revenue for 2010-11 is \$1,662.77 million, which is 7% below the revised estimates for 2009-10, assuming that –

- (a) levy income from securities transactions and futures and options contracts will decrease by \$129.57 million (8.8%), on the basis that the levies will be reduced by 25% with effect tentatively from 1 October 2010 for budget purpose, and assuming the average daily turnover is \$74 billion for securities transactions and 187 000 contracts for futures and options; and
- (b) income from fees and charges will be \$26.7 million (16.2%) higher than the 2009-10 revised estimates, arising from the resumption of collection of annual licence fees from intermediaries after the one-off fee waiver granted for one year from 1 April 2009.

### **Estimated Expenditure**

7. The estimated expenditure for 2010-11 is \$895.34 million, which is \$102.33 million (12.9%) above the 2009-10 revised estimates (\$793.01 million). The increase is mainly attributable to –

- (a) increase in Personnel Expenses by \$74.88 million (13.4%) arising mainly from –

- (i) a net increase of 51 new posts (4 already created in 2009 to meet unexpected urgent need) to meet the demand in the areas of regulatory reform, enhanced enforcement and supervisory capabilities and organisational improvements (\$45.5 million);
  - (ii) a provision of \$18.9 million for annual pay review, i.e. an amount equivalent to 3% of staff payroll for salary adjustment and 0.5% for promotions ; and
  - (iii) a provision of \$2.5 million for strategic adjustment to deal with the structural problem within the current pay band structure, and align salary level of individuals with the market norm;
- (b) increase in Premises Expenses by \$7.54 million (9.1%) mainly attributable to the leasing of additional office space (\$7 million);
  - (c) increase in Professional and Other Expenses by \$5.54 million (13.1%) due to the increase in legal fees and external professional services arising from more complex cases and increasing number of civil actions and external expert services required;
  - (d) increase in expenses for Information and Systems Services by \$2.01 million (6.8%) for additional software maintenance costs relating to the new Licensing Business Re-engineering Project and Document Management System, and new market data subscription to facilitate enforcement and supervision; and
  - (e) increase in expenses under the Internship Programme by \$2.58 million (124.6%) for extending the duration of the programme to two years and increasing the number of interns from 14 to 30.

## **Staff Establishment**

8. The SFC has an establishment of 536 posts under the approved estimates for 2009-10. The SFC proposes a net increase of 51 new posts in the budget of 2010-11 (paragraph 7(a)(i) above refers). The new posts are required mainly to cope with the increase in workload in the following areas –

- (a) **Intermediaries Supervision Division** (12 posts) – meeting new challenges for the regulation and supervision of licensed corporations by stepping up inspection work;
- (b) **Enforcement Division** (10 posts) – developing further the market surveillance capabilities and dealing with increased mis-selling cases;
- (c) **Policy, China & Investment Products Division** (8 posts) – implementing new initiatives relating to authorisation of investment products and the Mainland market;
- (d) **Corporate Affairs Division** (5 posts) – strengthening support in the areas of IT, complaint handling, human resources, office administration, etc.;
- (e) **Licensing Division** and **Legal Services Division** (8 posts) – improving the licensing process and strengthening the in-house legal advisory services; and
- (f) **Corporate Finance Division, Supervision of Markets Division** and the **Commission Secretariat** (8 posts) – handling of increase in new IPO applications, supervising and monitoring development of alternative trading venues, enhancement of research capacity, etc.

Altogether the headcounts for the SFC will increase to 587 under the proposed budget for 2010-11.

## **Surplus and Reserves**

9. As at end December 2009, the reserves of the SFC reached \$5,795.54 million which is 7.3 times of its revised expenditure for the current financial year (\$793.01 million). The SFC estimates that by 31 March 2010, the reserves will reach \$5,948.12 million, which is 7.5 times of the expenditure of the 2009-10 revised estimates.

10. According to section 396 of the SFO, the SFC may consult the Financial Secretary with a view to recommending to the Chief Executive in Council that the rate or amount of levy be reduced if the reserves of the SFC are more than twice its operating expenses for that financial year. Having regard to the size of the reserves, the SFC now proposes a 25% reduction in levy rates, from 0.004% to 0.003% for securities transactions and from \$0.8 or \$0.16 per contract (depending on the type of contracts) to \$0.6 or \$0.12 per contract respectively for futures and options. The reduction is planned to be effective tentatively from 1 October 2010 for budget purpose. Taking into account the proposed levy reduction, the reserves of the SFC are expected to reach \$6,715.55 million by the end of 2010-11.

## **Estimated Capital Expenditure**

11. The total capital expenditure budget proposed for 2010-11 is \$44.18 million, representing a decrease of \$18.89 million (30.0%) above the revised estimates for 2009-10. Provisions for major capital items include the following and a 10% contingency -

- (a) technological improvement to the systems for market surveillance, investigation management and investment product monitoring, etc. (\$15.89 million); and
- (b) replacement of obsolete office furniture and fixtures and computer and office equipment, office renovation and furniture for the additional office, and investment in storage technology and data base capacity (\$24.27 million).

## **COMPARISON OF THE APPROVED ESTIMATES WITH THE REVISED ESTIMATES FOR 2009-10**

### **Revenue**

12. The revised estimated revenue for 2009-10 is \$1,787.65 million, representing an 18.1% increase over the approved estimates. Income from levies on securities transactions and futures and options contracts is estimated to increase by \$177.63 million (13.6%) due to increased market activities<sup>1</sup>, whereas the fees and charges are also expected to increase by \$80.9 million (96.3%) due mainly to higher licensing fees received<sup>2</sup>. The surplus for the year is estimated to be \$994.64 million, which is 42.7% above the original estimates of \$697.06 million.

### **Expenditure**

13. The revised estimated expenditure is \$793.01 million, which is \$23.76 million (2.9%) below the approved estimates (\$816.77 million). The decrease is mainly attributable to the lower personnel expenses (by \$8.04 million) arising from deferred filling of vacancies and below budget professional services and legal fees (by \$10.23 million).

### **Capital Expenditure**

14. The total capital expenditure estimate is expected to decrease from \$65.51 million to \$63.07 million (3.7%) mainly arising from a reduction in contingency provision.

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<sup>1</sup> The revised estimates for 2009-10 assumed the average daily turnover of securities transactions and futures and options contracts to be \$69 billion for the second half of the year (actual turnover of \$73 billion for the first half) and 180 000 respectively.

<sup>2</sup> The licence fee income includes fees received from new applicants which were not included in the waiver programme, and apportionment of annual licence fees received in 2008-09 over the 12-month validity period which spilled over to 2009-10 in accordance with the SFC's established accounting practice.

## **ADMINISTRATION'S VIEWS**

15. The Administration has examined the SFC's proposed budget for 2010-11. We note that the SFC has projected a surplus in its budget; and as in the past years, it has not requested for appropriation from the Legislative Council.

16. Having regard to the sizable reserves accumulated by the SFC over the years, we concur with the SFC that the levy rates should be reduced by 25%. This would reduce the transaction costs borne by investors and be conducive to the further development of our securities and futures markets.

17. On the increase in personnel expenses, we note that the increasing complexity of our regulatory activities and the global financial crisis could put pressure on the SFC and additional manpower would be required to meet new challenges.

## **ADVICE SOUGHT**

18. Members are invited to note the proposed budget of the SFC for 2010-11.

Financial Services Branch  
Financial Services and the Treasury Bureau  
February 2010



**SECURITIES AND FUTURES COMMISSION**  
證券及期貨事務監察委員會

Annex

**SECURITIES & FUTURES COMMISSION**  
**BUDGET OF INCOME & EXPENDITURE**  
**FOR THE FINANCIAL YEAR 2010/2011**



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## 1. Approach and overview of 2010/11 budget

- 1.1 Each year the budget is prepared based on a policy of tightly controlling all expenditure, as befits a publicly funded organization. Prior year expenditure levels are utilized as a benchmark except in areas where additional resources have clearly been identified as necessary to meet our regulatory obligations or to support initiatives to modify and strengthen the regulatory environment. During the year strict controls are exercised to ensure that costs stay within budget commitments.
- 1.2 The budget this year follows a period of intense activity for the Commission and reflects our view of the challenges that the organisation will face in the next financial year. Notwithstanding the welcome reduction in volatility in the financial markets we are still in a highly volatile period from a regulatory perspective as both local and global responses to the financial crisis are debated and implemented. This budget represents our best estimate of the resource implications for the organisation in the immediate future, based on information available at the time of preparation.
- 1.3 However, in this period of regulatory volatility, the increased possibility of unanticipated resource requirements must be recognised. Should any such matters arise they will be dealt with either through the existing latitude for budget variances or through a separate interim budget request depending on their significance. In this connection we specifically note the ongoing discussions regarding the introduction of legislation governing the disclosure of Price Sensitive Information, which for the purposes of this budget has been assumed to have no significant resource implications in the coming financial year.
- 1.4 As with every year's budget the determination of our required level of personnel resources is the most significant issue. The challenging economic environment, the environment of regulatory change and the increased expectations placed on the organisation by stakeholder groups, all serve to increase the significance of the decisions that need to be taken in this area. Retaining, recruiting and managing our personnel resources will be critical to the delivery of our regulatory objectives over what is expected to be a challenging financial year.
- 1.5 The determination of the appropriate HR budget provisions requires a consideration of both 'volume' and 'price' – the number of staff we have, at what grade and at what cost. Our budget includes proposals to recruit a significant number of additional headcount for reasons that are explained in more detail in section 3. However, these proposals should not be considered simply in terms of absolute numbers of staff. It must also be recognised that we are continuing a long-term strategy of trying to reshape the staffing structure of the organisation and increase the relative percentage of junior staff. This strategy is necessary for several reasons including to develop an in-house pipeline of staff to fill senior vacancies as they arise, to provide a structured career path for our staff and also to develop process efficiencies enabling senior personnel, where appropriate, to delegate more tasks to junior personnel.
- 1.6 Our budget proposals again include provisions to deal with a long-term structural problem within our pay band structure. It has been recognised for some years that certain middle ranking grades are underpaid relative to the market. This has made recruitment difficult, it has increased turnover within those grades and it has resulted in an artificial distortion of the staffing structure of the organisation. This also implies that the relative quality standard at these grades will decline since, all other things being

equal, we will only be able to attract and retain those prepared to accept below market remuneration. Resolution of this issue is viewed as strategically important and in past years the Remuneration Committee has instructed that we should address this by having a small 'top up' provision in each year's budget so this distortion can be gradually resolved.

- 1.7 The roots of the current distortion in our pay bands can be traced to the period 2002-2004 when salaries were frozen and subsequent increases lagged behind the market. Given the strict controls imposed on subsequent year's pay rises we were never able to 'catch up' and correct this distortion. The current economic downturn presents similar risks. Not only do we have an existing distortion in our pay band structure but we risk increasing the problem for these, and other grades, unless we correctly anticipate the forthcoming market conditions.
- 1.8 In our 2009/10 budget process we were advised by the Government that we could not include the 'strategic adjustment' we believed was appropriate in our budget given the economic downturn. As the economy picks up and the financial sector start to recruit again, which we believe has already started, then we will be exposed to the loss of experienced middle management staff. These staff will be the most sought after by an industry that has an increased focus on regulatory compliance and regulatory change. A failure to proactively mitigate this risk could have a significant impact on the delivery capacity of the organisation. We have therefore included a provision of 0.5% of payroll costs within this budget, as a strategic adjustment, which has the full support of our Executive Committee.
- 1.9 In 2007 we proposed the formation of a separate subsidiary to significantly expand the delivery of investor education to the public. This was not taken forward at that time but was revived earlier in 2009 and in July 2009 we submitted a revised proposal to the Government, which has also been presented to the Commission. This proposal envisaged the SFC funding the entire costs of the new body, which would be tasked with providing a broad financial literacy programme and not be limited to our specific responsibilities for investor education as set out in the SFO. The Government are taking this initiative forward as recommended in the report prepared by the Commission and submitted to the Financial Secretary in December 2008. We note that a consultation paper has been published in early February 2010. However, at the time of preparing this budget the proposals have not been finalised and so no provision has been made for any costs that may be borne by the Commission in support of this project. This may require a budget adjustment at a later stage, which will require a separate approval process.
- 1.10 The Government is also formulating proposals for a dispute resolution body, as recommended in the report prepared by both the SFC and HKMA<sup>1</sup> and submitted to the Financial Secretary in December 2008. It is likely that the SFC will be asked to provide some funding support for this body but since these proposals are not yet finalised no provision has been made within this budget. Again a separate budget provision may need to be considered for this at a later stage.

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<sup>1</sup> "Issues raised by the Lehman Minibonds Crisis - Report to the Financial Secretary" issued by the SFC and "Report of the Hong Kong Monetary Authority on Issues Concerning the Distribution of Structured Products Connected to Lehman Group Companies" issued by the HKMA, both in December 2008

- 1.11 Finally, in support of the Government internship programme for university graduates, launched last year to support the economy during this period of economic stress, we propose to continue the programme we started last year of offering graduates internship positions at the SFC. While we have not historically taken staff at this level, based on our experience in running the first year of this programme we believe that we can expand this programme to 30 graduates and offer them a two year internship. At the end of this period they will either be recruited by the SFC or else released. We believe that this programme provides a win-win proposition both for those offered internships and also for the SFC as we will create a pipeline of junior staff at the end of the programme (see also para 3.5 and 4.2.8 below) which we can use to fill full time junior positions.

## 2. Executive summary

2.1 Set out below is a summary of the Commission's forecast for 2009/10 and proposed budget for 2010/11. This summary is intended to give an overview of the key factors influencing the Commission's forecast for 2009/10 and budget for 2010/11. For more detailed explanations reference should be made to sections 3 and 4 of this budget book.

|                                 | 2010/11         | 2009/10      |                 | Variance           |            |                    |            |
|---------------------------------|-----------------|--------------|-----------------|--------------------|------------|--------------------|------------|
|                                 | Proposed Budget | Forecast     | Approved Budget | vs. forecast       |            | vs. budget         |            |
|                                 | (a)<br>HK\$m    | (b)<br>HK\$m | (c)<br>HK\$m    | d = (a-b)<br>HK\$m | (d/b)<br>% | e = (a-c)<br>HK\$m | (e/c)<br>% |
| <b>Income</b>                   | <b>1,662.77</b> | 1,787.65     | 1,513.83        | (124.88)           | (7.0%)     | 148.94             | 9.8%       |
| <b>Expenditure</b>              |                 |              |                 |                    |            |                    |            |
| - Operating expenditure         | 890.75          | 788.62       | 812.38          | 102.13             | 13.0%      | 78.37              | 9.6%       |
| - Funding to external parties   | 4.59            | 4.39         | 4.39            | 0.20               | 4.6%       | 0.20               | 4.6%       |
| Total Expenditure               | 895.34          | 793.01       | 816.77          | 102.33             | 12.9%      | 78.57              | 9.6%       |
| <b>Surplus for the year</b>     | <b>767.43</b>   | 994.64       | 697.06          | (227.21)           | (22.8%)    | 70.37              | 10.1%      |
| Reserves brought forward        | 5,948.12        | 4,953.48     | 4,981.01        | 994.64             | 20.1%      | 967.11             | 19.4%      |
| <b>Reserves carried forward</b> | <b>6,715.55</b> | 5,948.12     | 5,678.07        | 767.43             | 12.9%      | 1,037.48           | 18.3%      |
| <b>Capital Expenditure</b>      | <b>44.18</b>    | 63.07        | 65.51           | (18.89)            | (30.0%)    | (21.33)            | (32.6%)    |
| <b>Headcount</b>                | <b>587</b>      | 540          | 536             | 47                 | 8.7%       | 51                 | 9.5%       |

## 2.2 Income

2.2.1 2009/10 income is forecast to be \$1,787.7 million. This is 18.1% above budget due to higher than budgeted market turnover and the recognition in 2009/10 of the unamortised portion of licensing annual fees received in 2008/09.

2.2.2 For 2010/11 we project that income will decline by \$124.9 million (7%) primarily as a result of the proposed 25% reduction in levy rates, which is assumed to become effective from mid 2010/11, tentatively 1 October 2010 for budget purposes. The SFC's income is principally derived from stock market levies and therefore subject to variances in market activity. However, our stress tests based on various "worst possible" scenarios indicate that at the proposed reduced levy rates the SFC will continue to have sufficient sources of funding to cover its operating costs and will continue to generate substantial additions to reserves.

## 2.3 Expenditure

Changes in budgeted expenditure levels are explained in detail within the body of this budget book. However, the following table highlights the key areas which contribute to the increase in budgeted expenditure for 2010/11.

|                                  | 2010/11             | 2009/10      |                     | Variance     |        |            |        |
|----------------------------------|---------------------|--------------|---------------------|--------------|--------|------------|--------|
|                                  | Proposed Budget (a) | Forecast (b) | Approved Budget (c) | vs. forecast |        | vs. budget |        |
|                                  | HK\$m               | HK\$m        | HK\$m               | d = (a-b)    | (d/b)  | e = (a-c)  | (e/c)  |
|                                  |                     |              |                     | HK\$m        | %      | HK\$m      | %      |
| <b>Personnel expenses</b>        | <b>633.83</b>       | 558.95       | 566.99              | 74.88        | 13.4%  | 66.84      | 11.8%  |
| <b>Premises</b>                  | <b>90.00</b>        | 82.46        | 84.81               | 7.54         | 9.1%   | 5.19       | 6.1%   |
| <b>Information &amp; systems</b> | <b>31.78</b>        | 29.77        | 29.73               | 2.01         | 6.8%   | 2.05       | 6.9%   |
| <b>Professional &amp; others</b> | <b>47.80</b>        | 42.26        | 52.49               | 5.54         | 13.1%  | (4.69)     | (8.9%) |
| <b>Internship programme</b>      | <b>4.65</b>         | 2.07         | 2.07                | 2.58         | 124.6% | 2.58       | 124.6% |
| <b>Depreciation</b>              | <b>45.00</b>        | 38.00        | 40.00               | 7.00         | 18.4%  | 5.00       | 12.5%  |
| <b>Other operating costs</b>     | <b>42.28</b>        | 39.50        | 40.68               | 2.78         | 7.0%   | 1.60       | 3.9%   |
| <b>Total Expenditure</b>         | <b>895.34</b>       | 793.01       | 816.77              | 102.33       | 12.9%  | 78.57      | 9.6%   |

- 2.3.1 2009/10 expenditure is forecast to be \$23.76 million (3%) below approved budget mainly due to savings in personnel expenses (see para 4.2.2 (a)) and below budget external professional service fees and legal fees (see para 4.2.6).
- 2.3.2 Total expenditure for 2010/11 is expected to increase by \$102.3 million (12.9%) over 2009/10 forecast. This increase is substantially driven by increases in personnel costs. We have added 4 new positions in 2009/10 to meet immediate and urgent needs and propose the addition of 47 new positions in 2010/11 to cope with increased work load driven by issues arising from regulatory reform and policy work. Details of these increases are set out within the body of this report (section 3). Secondly, we have budgeted an average 3.0% salary adjustment for our staff plus a further 0.5% provision for promotions. This provision is based on information available to us at this time regarding remuneration in comparable organizations. As previously recommended by the remuneration committee a further 0.5% strategic adjustment has been made to correct the historic distortion that has arisen in some of our middle and junior pay bands. However, final decisions regarding the level of pay awards to each grade of staff will not be made until early 2010 when our regular pay survey data will be available. The Executive will then determine the specific pay policy and present this to the Remuneration Committee for discussion and to the Commission for approval.
- 2.3.3 Premises expenses are expected to increase by \$7.5 million (9.1%) due to plans to lease additional office space at Chater House (gross area around 5,500 sq. ft.) as previously endorsed by the Board. As the expected headcount expansion is higher than had been anticipated two years ago

when our space requirements were initially calculated, we will need this additional space to accommodate our revised expectations of headcount growth.

- 2.3.4 We have included a 6.8% increase in information & systems expenses for additional software charges relating to the new Licensing Business Re-engineering Project and Document Management System and new market data subscription to assist enforcement and supervision activities.
- 2.3.5 Our professional costs for 2009/10 were lower than budget as the legal fees incurred in relation to the sub-committee enquiry into Lehman Minibond sales were lower than anticipated, fees in the PCCW case, which started as we finalised last year's budget, were also lower than expected and we have also continued to take work in-house wherever possible. However, the trend seen in recent years of more complex and significant enforcement actions, which in turn result in increased numbers of complex and expensive civil cases, will continue to drive our legal costs upwards. We also expect that there will be more enforcement actions as most of the resources allocated to the investigation of Lehman related matters have now been reallocated to other investigations. Professional and others expenses are consequently expected to increase in 2010/11 as compared with the forecast.

## 2.4 **Operating result**

- 2.4.1 We forecast a surplus of \$994.6 million at the end of 2009/10.
- 2.4.2 Following a proposed downward adjustment to the levy rate of 25%, a surplus of approximately \$767.4 million is expected in 2010/11 leaving our overall reserves at \$6.7 billion at the end of that financial year, approximately 7.5 times our operating costs after depreciation.

## **Assumptions**

### 2.5 **Investor levy rates**

- 2.5.1 We have included in a 25% cut in levy rate with effect from mid 2010/11, tentatively 1 October 2010 for budget purposes, as proposed by ExCo i.e.
- (a) Investor Levy Rate – Securities will be reduced from 0.004% to 0.003%; and
  - (b) Investor Levy Rate - Future/Options contracts will be reduced from \$0.8/\$0.16 per contract to \$0.6/\$0.12 per contract, depending on the type of contract.

### 2.6 **Market turnover**

- 2.6.1 Equity market
- (a) Based on the SFC Research Department's latest forecast, using a basis consistent with prior years, the average securities market

turnover is assumed to be \$69 billion/day for the remainder of 2009/10 and \$74 billion/day for 2010/11.

#### 2.6.2 Futures and Options market

- (a) Based on transaction volume for the past six month (Apr 09 – Sep 09), futures/options market turnover is assumed to be an average of 180,000 contracts per day for the rest of 2009/10. For forecasting purposes we have assumed that volume will increase in line with estimated increase in the securities market turnover. On this basis, futures/options market turnover is assumed to be an average 187,000 contracts per day in 2010/11.

### 2.7 Fees and charges

- 2.7.1 The waiver of licensing annual fees will come to an end on 31<sup>st</sup> March 2010. Licensing annual fees will resume from 1 April with no changes to the underlying rates of fees and charges.

### 2.8 Rate of return

- 2.8.1 The average return on investment of our reserve funds is assumed to be 2% p.a. for the year 2010/11.

### 2.9 Remuneration adjustment

- 2.9.1 A provision of 3.0% of personnel costs has been included on the assumption that there will be a salary adjustment for staff and a further 0.5% provision is included for the impact of annual promotions (see also 4.2.2 (b)(ii)).

### 2.10 Inflation

- 2.10.1 Where an estimate of general price level increases is required we have assumed 2%.<sup>2</sup> This is used where we do not have specific data and/or quotes on which to estimate our future costs.

### 2.11 Capital expenditure

- 2.11.1 Capital expenditure is budgeted based on the level of expenditure which will be 'committed to' within a financial year. However, actual expenditure incurred will differ from this and the approved estimates of capital expenditure for different capital projects will, as previously, be carried forward until the completion of the projects. In recent years the difference between commitment and actual expenditure within a financial year has become more marked as a result of the major efficiency projects, which have been embarked upon that straddle year ends.

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<sup>2</sup> The "HK Economy in Pictures" published by HSBC in October 2009 projected inflation rate for 2010 of 2.3%.



### 3. **Manpower plan – summary**

- 3.1 The manpower plan for 2010/11 is based on our assessment of the staff strength required to discharge the Commission's regulatory functions as they are known at this time. Four (0.8%) additional full time positions have been created during the year to meet urgent needs and a further 47 (8.7 %) full time positions have been included in the 2010/11 budget.
- 3.2 In this period of regulatory volatility, the increased possibility of unanticipated resource requirements must be recognised. Should any such matters arise they will be dealt with either through the existing latitude for budget variances or through a separate interim budget request depending on their significance. In this connection we note the ongoing discussions regarding the introduction of legislation governing disclosure of Price Sensitive Information. For the purposes of this budget it has been assumed that the legislative process will not be completed in time for these provisions to be introduced in the coming financial year and consequently will have no significant resource implications for this budget.
- 3.3 Our proposals for additional headcount reflect our long term strategy of trying to reshape the staffing structure of the organisation by increasing the percentage of staff at a junior level. This strategy will:
- 3.3.1 Allow us to develop in-house talent to fill middle management vacancies as they arise. At present a high percentage of vacancies at middle grades have to be filled externally, which is also the area where we have the greatest turnover and difficulty in recruiting.
  - 3.3.2 Allow us to develop and offer a clearer career progression to our staff by having a more balanced organisational structure.
  - 3.3.3 Ensure that we operate efficiently by matching tasks to staff competency levels and not having senior staff perform tasks that could be appropriately delegated to more junior personnel.
- 3.4 The implementation of our strategy will take several years but will be achieved by ensuring that each year we recruit an increased percentage of junior staff. This has been reflected in our proposed headcount increases this year where 25% (13 out of 51) new headcount are at the junior professional level (assistant manager).
- 3.5 We propose to continue the initiative we took last year, to offer internships to local graduates, in support of the Government's Internship Programme for university graduates to support the local economy during the financial crisis. Our experience this year indicates that we can accommodate additional numbers of graduates within various areas of the organisation. However, we believe that it would be more beneficial to the SFC if we were to try and develop these interns so that after a period of time they become employable at junior professional grades, which would complement our strategy of reshaping our staffing structure noted above. We therefore propose to extend the intern period to a fixed two year period and to offer them increased training opportunities in the hope that a percentage of these graduates will be able to be offered full time employment as SFC employees at the end of this period. The success of this programme will be reviewed annually to determine whether or not it should continue.

3.6 Last year, we commenced a two-year process re-engineering project for all Licensing related processes and systems. We are in the final phase of this project which will continue through 2010/11. The project is expected to deliver significant value to the Commission by improving internal efficiency, increasing job satisfaction for staff and significantly improving our external interface with the market. Surplus clerical headcount are anticipated when the project becomes fully functional. We have therefore been filling clerical vacancies in Licensing with temporary staff and redeployment of clerical staff to other divisions will be made when suitable opportunities arise in the future.

3.7 Our proposed manpower plan is outlined below:

| Division  | Headcount        |                  |                             |            |           |
|---|------------------|------------------|-----------------------------|------------|-----------|
|   | Approved 2009/10 | Proposed 2010/11 | Position upgrades           | Net Change | Para /ref |
| CEO's Office & Commission Secretariat                 | 16               | 17               |                             | +1         | 3.8       |
| Corporate Finance <sup>Note 1</sup>                   | 52               | 54               | 4                           | +2         | 3.9       |
| Enforcement   | 115              | 125              | -1                          | +10        | 3.10      |
| Intermediaries Supervision                            | 92               | 104              | 2                           | +12        | 3.11      |
| Licensing   | 56               | 60               | 2                           | +4         | 3.12      |
| Legal Services  | 20               | 24               | 4                           | +4         | 3.13      |
| Policy, China & Investment Products <sup>Note 1</sup> | 67               | 75               | 3                           | +8         | 3.14      |
| Supervision of Markets                                | 25               | 30               | 3                           | +5         | 3.15      |
| Corporate Affairs                                     | 93               | 98               | 7                           | +5         | 3.16      |
| <b>TOTAL</b>  | <b>536</b>       | <b>587</b>       | <b>24</b> <sup>Note 2</sup> | <b>51</b>  |           |

Note 1: 8 headcount from Corporate Finance Division were transferred to Policy, China and Investment Products Division to form the Structured Products Team effective from 1 Sep 2009.

Note 2: The 24 position upgrades cost less than 1% of the total personnel cost increase over forecast.

3.8 One additional executive headcount has been added, as agreed with Financial Services and Treasury Bureau (FSTB), to allow for a senior manager secondment to the FSTB.

3.9 Two additional headcount at executive level are proposed for the Corporate Finance Division. There has been a very significant increase in new IPO applications filed with the Exchange. In the 3rd quarter of 2009, there were 48 applications – an all time record. This compares with total applications of 121 in 2008 and 111 in 2007. On an annualised basis, this represents an increase of 58% and 73% over 2008 and 2007. In addition to these volume increases the nature of IPO candidates and the more severe economic environment have made reviews more demanding and time consuming. The

existing resources in this area are therefore stretched and additional resources are required. The four upgrades are required to reflect the expansion of job scope and the increase in responsibility/complexity of the work in the Division in dealing with complaints about listed companies, on-going breaches of s.384 of the SFO and the higher level liaison work with SEHK, Mainland and Taiwan.

3.10 A total of ten new positions, including six executives and four non-executives, are proposed by the Enforcement Division to further develop their market surveillance capacity. Additional resources are required to deal with the increase in mis-selling cases following from our Minibond and Lehman-related investigations as well as the increased complexity in our corporate governance work. We have seen, over the course of this year, the number of mis-selling and intermediary misconduct cases increase to approximately 60% of our total case load. This is a doubling of workload in this area. The Minibond cases only account for about 25% of this increase (although they account for more than 25% of our resource capacity). The resourcing of these cases has led to a reduction in our capacity to take on market misconduct and corporate governance cases. The number of actionable complaints about intermediaries is likely to remain stable and so the resourcing of these cases needs to be addressed. In addition, we need to recruit more junior staff to support our document/evidence management process which handles the registration of all seized and produced evidence. The downgrade of one Senior Director to a Director position is to align the personal grade of the replacement to the job grade of the re-graded position.

3.11 Twelve new positions at professional grade and above are proposed for Intermediaries Supervision to increase the department's capacity in the face of increased challenges for the regulation and supervision of licensed corporations. These additional resources will be utilized to proactively manage the following market issues:

3.11.1 Inspection: step up inspections of sponsors and fund managers - Listing quality has been highlighted in recent months and we must ensure that we have adequate resources to oversee the quality of due diligence work performed by sponsors in relation to SEHK listing applications. In addition, the Madoff fraud overseas and the Descartes case locally have indicated the need for regulators to give higher priority to supervising fund managers in particular hedge fund managers.

3.11.2 Inspection: in general - Given that we adopt a risk-based approach to select inspection targets out of our licensed corporations, some of the firms are subject to very long inspection cycles. The changing financial landscape following the financial tsunami requires us to supplement our risk-based approach with additional routine periodic inspections and increase the overall number of inspections conducted each year.

3.11.3 IOSCO work – Addition resources is required to support the workload generated by the appointment of the Senior Director – IS as Chairman of Standing Committee 3, requires additional administrative support and staff experience in international work and regulation of market intermediaries at different levels.

The two upgrades are required to reflect the expansion of job scope in assessing the financial position of brokers in inspection and to mitigate risks by identifying FRR breaches.

- 3.12 Four new positions (one at executive level and the remaining at non-executive level) are proposed for Licensing to: (i) replace one manager who has been assigned to work full time on the Licensing Process Re-engineering Project and (ii) three assistant managers to assist in conducting preliminary licensing-related investigations. Additional resources are required to maintain adequate level of service and performance as well as to handle core operations and other priority projects in the Licensing Department. The two upgrades are required to enhance the Division's operational efficiency and provide leadership and guidance to the team.
- 3.13 Two executive and two non-executive positions are proposed for Legal Services to assist with the growing work in litigation and also the large legislative programme, and to assist with advisory work as we are currently short staffed in this area. Given the amount of high level litigation (particularly civil) that Legal Services now handles, we also need to upgrade our back office staffing arrangements, which date from a time when the Commission conducted very little civil litigation (we would normally have had fewer than 5 civil cases on foot at any one time, we currently have 33 plus 22 criminal cases). The level of work and volume of cases justify additional resources at junior professional and administrative levels. The upgrade of one Executive position is required to assist with the large legislative programme and to provide more in-house advisory work flowing from the increasing number of litigation cases generated by other Divisions. The three non-Executive upgrades are required to reflect the expansion of job scope of three administrative positions due to the need to revamp the Legal Services back office.
- 3.14 Five executive and three junior professional positions are proposed for Policy, China and Investment Products division, for Investment Products Team, Policy Team and Structured Products Team. Additional headcount is needed to meet the challenges brought about by significant changes in the operating landscape, arising from changes in public expectation, the regulatory environment and the Government's policy making approach. Some of the key areas of focus include: (i) joint efforts between Policy and Products Departments to consult the public on the Products Handbook in Q3; (ii) implementing the Products Handbook and educating the industry on the new requirements and compliance; (iii) providing policy support to the Government, particularly on Mainland-related issues; (iv) handling major issuers of various structured products in the retail market, including banks issuing Equity-Linked Deposits (ELDs) and Equity-Linked Instruments (ELIs), investment banks' ELI programmes and those previously unauthorised products; and (v) roll out of new Code on Structured Products. Two upgrades are required to strengthen the Structured Product Team's capability as more complex skills are required in mini-bond and prospectus related matters. The remaining upgrade is to reflect the increase in job scope of an Executive position in the China Affairs Team in involving in high level Mainland related meetings such as CEPA and RMB internationalisation and other liaison work with the Mainland authorities.
- 3.15 Two additional executive positions are proposed for the Supervision of Markets Division to cope with various new initiatives and market development underway that will require more resources and new skill sets for the SFC to be able to effectively discharge its regulatory functions and provide regulatory responses in a more timely manner. These include supervision of the Hong Kong Mercantile Exchange which is likely to commence its operations in 2010. More resources will be required to supervise and monitor this new exchange including its daily operations, rule amendments, new products and market activities. In addition, the rapid development

of alternative trading venues and dark pools (ATSs), the increasing use of direct market access and the need to develop a new policy on OTC derivatives clearing will also have significant resources implications for us. We have already received eight applications for Part III ATS and some of these are relatively complex in terms of their business models. To closely monitor the ATS development and enhance our current regulatory approach, we believe additional resources are required.

Two additional executive positions and one junior professional position are proposed to strengthen the research team in the Supervision of Markets Division. There are many new market developments and regulatory challenges in the pipeline which necessitate additional resources to cope with an increasing volume and complexity of research projects in the next financial year. The three upgrades required are to enhance our research capability in the ongoing assessment of the financial markets.

- 3.16 One executive position is proposed by the External Relations Department. The Lehman Brothers collapse has heightened investors' awareness of their rights and we have seen an increase in core complaints (excluding Lehman's related complaints). Given the diverse nature of the enquiries and the increasing number of complaints involving complex investment products and sophisticated investors, there is a need for additional experienced staff with good regulatory knowledge to handle these cases. One executive position is proposed by the Information Technology Department to strengthen our web technology usage and support the increasing number of web related projects such as the new Licensing portal, Short Selling Info Collection platforms, increased internal knowledge sharing facilities and a revamp of the SFC Website. One additional permanent position is also proposed for IT to convert an existing long term contract staff to permanent staff. However, there is no actual additional resource as a result of this conversion of contract terms. One non-executive position is proposed for Finance & Administration Department to provide an additional office assistant to cope with the additional work arising from the second office in Li Po Chun Chambers. Moreover, an additional non-executive headcount is proposed by the Human Resources Department to assist with the Corporate Social Responsibility programme and expanding staff retention programmes. The seven upgrades in Human Resources and IT are required to put an appropriate structure in place to drive various functional initiatives and projects planned for 2010/2011, including talent development, culture building, staff engagement, SAP projects, document management and the revamp of the SFC intranet site. Among the seven upgrades, two are to align the job grades of the re-graded positions to the personal grades of the job holders which took place this year. The remaining ones are for relatively junior positions.

#### 4. Income and expenditure

Summary of major budget items :-

|   |             | (A)  | (B)  | (C)  | (A)-(B)<br>(B)                                 | (B)-(C)<br>(C)                                 |
|---|-------------|--|--|--|--|--|
|   |             | Proposed<br>Budget<br>For Year<br><u>2010/11</u><br>HK\$'000 | Forecast<br>For Year<br><u>2009/10</u><br>HK\$'000 | Approved<br>Budget<br>For Year<br><u>2009/10</u><br>HK\$'000 | Proposed<br>Budget<br>Over/(under)<br>Forecast | Forecast<br>Over/(Under)<br>Approved<br>Budget |
| <u>Para.</u>                              | <u>Ref.</u> |  |  |  | %  | %  |
| <b><u>INCOME</u></b>                      |             |  |  |  |  |  |
| Investor Levy                             | 4.1.2       |  |  |  |  |  |
| Securities                                |             | 1,284,640  | 1,407,792  | 1,249,920  | -8.7%  | 12.6%  |
| Futures/Options Contracts                 |             | 64,926   | 71,340   | 51,584   | -9.0%  | 38.3%  |
| Fees & Charges                            | 4.1.3       | 191,600  | 164,900  | 84,000   | 16.2%  | 96.3%  |
| Investment Income                         | 4.1.4       | 116,100  | 138,613  | 124,325  | -16.2%   | 11.5%  |
| Other Income                              | 4.1.5       | 5,500  | 5,000  | 4,000  | 10.0%  | 25.0%  |
| <b>Total</b>                              |             | <b>1,662,766</b>   | <b>1,787,645</b>                                   | <b>1,513,829</b>   | <b>-7.0%</b>                                   | <b>18.1%</b>                                   |
| <b><u>OPERATING EXPENDITURE</u></b>       |             |  |  |  |  |  |
| Premises                                  | 4.2.1       | 90,000   | 82,462   | 84,810   | 9.1%   | -2.8%  |
| Personnel Expenses                        | 4.2.2       | 633,828  | 558,950  | 566,986  | 13.4%  | -1.4%  |
| Info. & Sys. Services                     | 4.2.3       | 31,779   | 29,772   | 29,733   | 6.7%   | 0.1%   |
| General Office & Insurance                | 4.2.4       | 7,137  | 7,111  | 6,793  | 0.4%   | 4.7%   |
| Training & Development                    | 4.2.5       | 7,600  | 6,955  | 6,955  | 9.3%   | 0.0%   |
| Professional & Others                     | 4.2.6       | 47,804   | 42,257   | 52,491   | 13.1%  | -19.5%   |
| External Relations                        | 4.2.7       | 19,955   | 19,540   | 19,540   | 2.1%   | 0.0%   |
| Internship Programme                      | 4.2.8       | 4,650  | 2,070  | 2,070  | 124.6%   | 0.0%   |
| Contingency                               | 4.2.9       | 3,000  | 1,500  | 3,000  | 100.0%   | -50.0%   |
| Depreciation                              | 4.2.10      | 45,000   | 38,000   | 40,000   | 18.4%  | -5.0%  |
| <b>Total (1)</b>                          |             | <b>890,753</b>   | <b>788,617</b>                                     | <b>812,378</b>   | <b>13.0%</b>                                   | <b>-2.9%</b>                                   |
| <b><u>FUNDING TO EXTERNAL PARTIES</u></b> |             |  |  |  |  |  |
| Funding to FRC                            | 4.3.1       | 4,200  | 4,000  | 4,000  | 5.0%   | 0.0%   |
| Funding to IASC Foundation                | 4.3.2       | 390  | 390  | 390  | 0.0%   | 0.0%   |
| <b>Total (2)</b>                          |             | <b>4,590</b>   | <b>4,390</b>                                       | <b>4,390</b>   | <b>4.6%</b>                                    | <b>0.0%</b>                                    |
| <b>TOTAL EXPENDITURE (1)+(2)</b>          |             | <b>895,343</b>   | <b>793,007</b>                                     | <b>816,768</b>   | <b>12.9%</b>                                   | <b>-2.9%</b>                                   |
| <b><u>CAPITAL EXPENDITURE</u></b>         |             |  |  |  |  |  |
| Furniture & Fixtures                      |             | 10,000   | 3,000  | 3,000  | 233.3%   | 0.0%   |
| Office Equipment                          |             | 14,275   | 18,666   | 9,458  | -23.5%   | 97.4%  |
| Process Review Project                    |             | 0  | 26,500   | 28,000   | -100.0%  | -5.4%  |
| Computer Sys. Development                 |             | 15,890   | 11,388   | 19,096   | 39.5%  | -40.4%   |
| Sub-total                                 |             | 40,165   | 59,554   | 59,554   | -32.6%   | 0.0%   |
| Contingency                               |             | 4,016  | 3,515  | 5,955  | 14.3%  | -41.0%   |
| <b>Total</b>                              | 4.4.1-4.4.2 | <b>44,181</b>  | <b>63,069</b>                                      | <b>65,509</b>  | <b>-29.9%</b>                                  | <b>-3.7%</b>                                   |

4.1 **Income**

4.1.1 **Annual grant from government**

S.14 of the Securities and Futures Ordinance provides that: “For each financial year of the Commission, the Government shall pay to the Commission out of the general revenue the moneys appropriated by the Legislative Council for that purpose.” As in previous years, the Commission proposes that the Government does not request any appropriation from the Legislative Council for the financial year 2010/11. 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.

4.1.2 **Investor levy**

- (a) The investor levy was introduced at a time when the total capitalisation of the stock market and the related turnover were at much lower levels. Since then there has been a very significant increase in both with the result that the SFC has and will continue to generate significant surpluses at current levy rates.
- (b) Given the substantial surpluses accumulated by the Commission (\$5.6 billion as at 31 October 2009, 6.9 times of the approved 2009/10 annual operating expenditure estimate), and the significant buffer which current levy rates provide, we believe that it is appropriate to recommend a reduction in the levy rate. Having taken into consideration the time required to amend the Securities and Futures (Levy) Order, for budgetary purpose, we have budgeted for a 25% reduction in both the securities and futures levy rates with effect from mid 2010/11, tentatively 1 October 2010 for budget purposes.
- (c) The following turnover and levy rate assumptions have been utilised in preparing income estimates:

|                                  | 2009/10 |                  |                      | 2010/11 |         |
|----------------------------------|---------|------------------|----------------------|---------|---------|
|                                  | Budget  | Apr-Sep (actual) | Oct-Mar (assumption) | Apr-Sep | Oct-Mar |
| <b>Securities</b>                |         |                  |                      |         |         |
| Daily turnover (billion/day)     | \$63.0  | \$73.0           | \$69.0               | \$74.0  | \$74.0  |
| Levy rate                        | 0.004%  | 0.004%           | 0.004%               | 0.004%  | 0.003%  |
| <b>Futures/Options Contracts</b> |         |                  |                      |         |         |
| Daily turnover (contracts)       | 130,000 | 180,000          | 180,000              | 187,000 | 187,000 |
| Levy Rate                        | \$0.8   | \$0.8            | \$0.8                | \$0.8   | \$0.6   |

- (d) The 2009/10 Forecast of Investor Levy – Securities is higher than the Approved Budget by 12.6% (\$157.9 million) and for Investor levy – Futures and Options by 38.3% (\$19.8 million). These increases

reflect the higher market turnover compared to the estimates underlying the Approved Budget as noted above.

- (e) The daily turnover assumption for the 2010/11 Proposed Budget is based on estimates made by our Research Department on a basis consistent with prior years. We project the average market turnover for 2010/11 will be marginally higher than the turnover assumed for the remainder of 2009/10.

#### 4.1.3 Fees and charges

- (a) The Forecast aggregate fees and charges income for 2009/10 is 96.3% (\$81 million) higher than the Approved Budget. This increase arises from the recognition in 2009/10 of the unamortised portion of licensing annual fees received in 2008/09 and the licensing application fees being significantly (53%) higher than had been assumed in the 2009/10 budget.
- (b) The 2010/11 Budget shows an increase in fee income of 16% against Forecast for 2009/10. This increase arises from the resumption of licensing annual fees after the fee holiday granted in 2009/10. Due to the amortisation of licensing fees over the lifetime of the license period the full effect of the resumption on recorded income will not be felt until the following year.

#### 4.1.4 Investment income

- (a) Investment income for 2009/10 is forecast to be \$14.3 million, 11.5% higher than the Approved Budget due to a higher actual rate of return (2.75%) than the 2.5% assumption used in preparing the budget. For the remainder of the year, the average return on dated securities and fixed deposits has been assumed to be 2.5% p.a.
- (b) 2010/11 investment income is budgeted to be \$116.1 million, 16.2% (\$22.5 million) lower than the 2009/10 Forecast. The expected increase in funds available for investment, as a result of continued growth in reserves, is partially offset by an expected lower rate of return. In today's market the average rate of return will fall as maturing securities are replaced with securities at lower interest rates. The average rate of return for the year is assumed to be 2% p.a.

#### 4.1.5 Other income

- (a) Other income represents net income generated from FinNet, recoveries from investigation cases and sale of SFC publications.

### 4.2 Operating expenditure

#### 4.2.1 Premises

- (a) Premises expenses for 2009/10 have been revised downward by 2.8% (\$2.3 million) to reflect the lower than budgeted rates for the Chater House office.



- (b) Expenses for 2010/11 are budgeted to be 9.1% (\$7.5 million) higher than 2009/10 Forecast mainly due to the costs associated with the lease of additional office space of around 5,500 sq. ft. (gross area) in Chater House, at an estimated rental of \$90/sq.ft..

#### 4.2.2 Personnel expenses

- (a) The overall personnel expenses for 2009/10 are forecast to be lower than budget by 1.4% (\$8 million) due to the deferral of formation of the decision making panel while attention was focussed on more immediate issues, vacancies being filled later than expected and a number of positions being under-filled by lower grades.
- (b) The projected headcount at 31 March 2011 is 587, a net increase of 51 (9.5 %) over the approved headcount included in the 2009/10 budget. Please see paras. 3.8 - 3.16 for detailed explanations of this increase in headcount. The projected personnel expenses for 2010/11 are 13.4% (\$74.9 million) higher than the 2009/10 Forecast and 11.8% (\$67 million) higher than the 2009/10 Budget.

A breakdown of the underlying sources of this overall increase is set out below:

| <b><u>Source of increase in personnel costs</u></b> | HK\$m       | Increase over forecast | % impact      | Note       |
|---|-------------|------------------------|---------------|------------|
| New headcount and promotions                        | 45.5        | 8.1%                   | 60.8%         | <i>i</i>   |
| Annual pay review                                   | 18.9        | 3.4%                   | 25.2%         | <i>ii</i>  |
| Strategic adjustment                                | 2.5         | 0.4%                   | 3.3%          | <i>iii</i> |
| Retirement benefits                                 | 5.3         | 1.0%                   | 7.1%          | <i>iv</i>  |
| Insurance premium increase                          | 1.4         | 0.3%                   | 1.9%          | <i>v</i>   |
| Recruitment   | 1.3         | 0.2%                   | 1.7%          | <i>vi</i>  |
| <b>Total increase over forecast</b>                 | <b>74.9</b> | <b>13.4%</b>           | <b>100.0%</b> |            |

- (i) 30 executive positions and 21 non-executive positions are proposed to ensure that the Commission has adequate resources to deliver its priorities in 2010/11, in particular in the areas of regulatory reform, enhanced enforcement and supervisory capabilities and organizational improvements.

Changes in remuneration levels during the year arising from filling vacant positions at higher salary rates than the previous incumbents, promotions to fill existing vacancies and some small mid-year salary adjustments in October 2009, also contribute to increases in the 2010/11 budget as the full-year remuneration cost of these changes takes effect. The increase also reflects the full year remuneration of the four additional headcount employed/to be employed in the current financial year.

- (ii) The budget includes provision for an average 3.0% pay increase for Commission staff plus a further 0.5% to cover annual promotions. This is based on market information from external parties including pay consultants and professional associations. Detailed proposals for the actual pay increase between grades will be formulated in Q1 2010. These proposals will be presented to the Remuneration Committee for endorsement and subsequently to the Commission for final approval. The allocations between grades will be determined based on an analysis of external data and in particular pay level surveys by two external consultants (Hay and McLagan), which are only received after approval of this budget by the Commission.

Other sources of increment include provisions made for possible mid-term review for some of the Executive Directors.

- (iii) A “strategic adjustment” provision of \$2.5 million has been made to correct historical anomalies in certain mid-level pay bands that have fallen behind market norms. This annual ‘catch up’ provision was agreed by the Remuneration Committee as a strategy to resolve these anomalies over a period of several years. The provision was first made in 2008/09 but was removed at the Government’s request in 2009/10 having regard to the economic downturn. Given the economic environment we have not sought to increase this provision but believe that it is essential to reinstate it in the current year to allow us to mitigate what we expect to be a rapid increase in turnover as the financial sector emerges from the current downturn.
- (iv) This represents the increased retirement benefit cost that flows directly from increases in underlying fixed pay costs including the provision for new headcount in 2010/11.
- (v) The higher insurance expenses for 2010/11 reflect increases in overall payroll as a result of the proposed increases in salary and headcount. Part of this increase in costs has been offset by a minor downward adjustment of the premium rate for medical benefit insurance due to satisfactory claims history.
- (vi) Additional recruitment expenses have been provided to cover the increased expenses due to expected headcount changes and possible search fees for senior staff in 2010/11.

#### 4.2.3 Information and systems services

- (a) The Information and Systems Services expenses forecast for 2009/10 are on budget.
- (b) For 2010/11, we project a 6.8% (\$2 million) increase due to additional maintenance costs for new software and increases in subscriptions for market data to support enforcement and supervision activities.

#### 4.2.4 **General office and insurance**

- (a) General Office & Insurance expenses for 2009/10 are 4.7% (\$0.3 million) higher than budget due to increases in printing costs and office security support related to Lehman Minibonds events.
- (b) We expect similar levels of expenses for 2010/11.

#### 4.2.5 **Training and development**

- (a) Forecast training related expenses for 2009/10 are on budget.
- (b) Training expenses for 2010/11 are 9.3% (\$0.6 million) higher than Forecast due to the projected increase in headcount. Training for 2010/11 will continue to focus on executive development and talent management.

#### 4.2.6 **Professional & others**

- (a) Professional & Others expenses for 2009/10 are forecast to be lower than budget by 19.5% (\$10.2 million). Major savings are in legal fees and external professional services because of lower-than-projected legal costs (see para 2.3.5) and deferral of some projects.
- (b) Professional and Others expenses for 2010/11 are expected to increase by 13.1% (\$5.5 million) as a result of more enforcement and civil litigation cases, which are expensive, and external expert services required for investigation and supervision of intermediaries (see also para 2.3.5).

#### 4.2.7 **External relations**

- (a) Forecast External Relations expenses for 2009/10 are on budget and expenses for 2010/11 have an overall budget increase of 2.1% (\$0.4 million) due primarily to a small increase in investor education expenses.

#### 4.2.8 **Internship programme**

- (a) This represents the salary cost for hiring university graduates in support of the Government's internship for university graduate programme. Based on experience in the current year the programme will be expanded to provide more places but also structured to provide the possibility that 'graduates' of this programme might be able to qualify for future full time junior positions with the SFC.

#### 4.2.9 **Contingency**

- (a) A contingency of \$1.5 million is provided for the remainder of 2009/10 and \$3 million provided for 2010/11 to cover unforeseen expenses arising from changes in the operating environment or unforeseen special requirements. This is consistent with prior years' practice.

#### 4.2.10 **Depreciation**

- (a) Forecast depreciation expense for 2009/10 is expected to be 5% (\$2 million) below budget because of less-than-expected capital expenditure actually incurred in current year.
- (b) We expect that the depreciation expenses for 2010/11 will be \$7 million higher due to increases in capital expenditure incurred in 2010/11 when the second phase of the new licensing system will be implemented.

### 4.3 **Funding to external parties**

4.3.1 To continue our support for the work of the Financial Reporting Council, the SFC will continue to provide annual funding of \$4.2 million in 2010/11.

4.3.2 To continue our support for the work of the International Accounting Standards Committee Foundation the SFC will again provide funding of US\$50,000.

4.3.3 We note that as explained in sections 1.9 and 1.10 above no provision has been made for possible funding that may be required for either the proposed new Investor education body or the proposed new financial dispute resolution body. These matters will need to be separately considered once the government's proposals have been finalised and the matters considered by the Commission.

### 4.4 **Capital expenditure commitment**

4.4.1 The total capital expenditure forecast for 2009/10 has been reduced from \$65.5 million to \$63.1 million principally as a result of the reduction of the contingency provision by \$2.4 million.

4.4.2 The total capital expenditure budget commitment for 2010/11 is \$44.2 million, 29.9% (\$18.9 million) lower than 2009/10 Forecast. This decrease is mainly attributable to the commitment of the expenses related to Phase 2 of the Licensing Business Process Review project being in 2009/10 but expenditure on this major project occurring in 2010/11. The planned capital expenditure commitment comprises the following:-

| <b>Capital expenditure</b>  | <b>Amount<br/>HK\$ m</b> | <i>Note</i> |
|-----------------------------|--------------------------|-------------|
| Office furniture & fixtures | 10.00                    | <i>i</i>    |
| Office equipment            | 14.27                    | <i>ii</i>   |
| Front end technology        | 15.89                    | <i>iii</i>  |
| Contingency (10%)           | <u>4.02</u>              | <i>iv</i>   |
| Total                       | <u><u>44.18</u></u>      |             |

*Notes :-*

- (i) office renovation and furniture for additional office space to be leased (\$8 million) and replacement of obsolete office furniture and fixtures due to normal wear and tear (\$2 million).
- (ii) for office equipment:
- \$1 million for replacement of obsolete office equipment due to normal wear and tear; and
  - \$13.3 million for investment in storage technology and data base capacity in response to increased market activities plus costs relating to the normal replacement of obsolete servers and computer equipment for the additional headcount.
- (iii) for “front-end” technology to upgrade our market surveillance capabilities, improve access and exchange of information between stakeholders and the Commission, and enhance various IT systems including investigation management system and investment product monitoring system etc..
- (iv) a contingency of \$4 million, which, as in prior years, is set at 10% of the budgeted capital expenditure.

## 5. Projected income and expenditure statement

|   | <b>Proposed<br/>Budget<br/>2010/2011<br/>HK\$</b> | <b>Forecast<br/>2009/2010<br/>HK\$</b> | <b>Change over/(under)<br/>Forecast 2009/2010</b> |                |
|---|---|--|---|----------------|
|   |   |  | HK\$  | %              |
| <b>INCOME</b>                             |   |  |   |                |
| Investor Levy - Securities                | 1,284,640,000                                     | 1,407,792,000                          | (123,152,000)                                     | -8.75%         |
| Investor Levy - Futures/Options Contracts | 64,926,000  | 71,340,000                             | (6,414,000)                                       | -8.99%         |
| Fees & Charges                            | 191,600,000                                       | 164,900,000                            | 26,700,000  | 16.19%         |
| Investment Income                         | 116,100,000                                       | 138,613,000                            | (22,513,000)                                      | -16.24%        |
| Other Income                              | 5,500,000   | 5,000,000                              | 500,000   | 10.00%         |
| <b>Total Income</b>                       | <b>1,662,766,000</b>                              | <b>1,787,645,000</b>                   | <b>(124,879,000)</b>                              | <b>-6.99%</b>  |
| <b>OPERATING EXPENDITURE</b>              |   |  |   |                |
| Premises                                  | 90,000,000  | 82,462,000                             | 7,538,000   | 9.14%          |
| Personnel Expenses                        | 633,828,000                                       | 558,950,000                            | 74,878,000  | 13.40%         |
| Information & Systems Services            | 31,779,000  | 29,772,000                             | 2,007,000   | 6.74%          |
| General Office & Insurance                | 7,137,000   | 7,111,000                              | 26,000  | 0.37%          |
| Training & Development                    | 7,600,000   | 6,955,000                              | 645,000   | 9.27%          |
| Professional & Others                     | 47,804,000  | 42,257,000                             | 5,547,000   | 13.13%         |
| External Relations                        | 19,955,000  | 19,540,000                             | 415,000   | 2.12%          |
| Internship Programme                      | 4,650,000   | 2,070,000                              | 2,580,000   | 124.64%        |
|   | 842,753,000                                       | 749,117,000                            | 93,636,000  | 12.50%         |
| Contingency                               | 3,000,000   | 1,500,000                              | 1,500,000   | 100.00%        |
| Depreciation                              | 45,000,000  | 38,000,000                             | 7,000,000   | 18.42%         |
| <b>Total operating expenditure (1)</b>    | <b>890,753,000</b>                                | <b>788,617,000</b>                     | <b>102,136,000</b>                                | <b>12.95%</b>  |
| <b>FUNDING TO EXTERNAL PARTIES (2)</b>    | <b>4,590,000</b>                                  | <b>4,390,000</b>                       | <b>200,000</b>                                    | <b>4.56%</b>   |
| <b>Total expenditure (1) + (2)</b>        | <b>895,343,000</b>                                | <b>793,007,000</b>                     | <b>102,336,000</b>                                | <b>12.90%</b>  |
| <b>RESULT FOR THE YEAR</b>                | <b>767,423,000</b>                                | <b>994,638,000</b>                     | <b>(227,215,000)</b>                              | <b>-22.84%</b> |
| <b>BEGINNING RESERVES</b>                 | <b>5,948,120,865</b>                              | <b>4,953,482,865</b>                   | <b>994,638,000</b>                                | <b>20.08%</b>  |
| <b>ENDING RESERVES</b>                    | <b>6,715,543,865</b>                              | <b>5,948,120,865</b>                   | <b>767,423,000</b>                                | <b>12.90%</b>  |