

NOTE FOR FINANCE COMMITTEE

The Budget of the Securities and Futures Commission for the Financial Year 2012-13

PURPOSE

In accordance with the consultation procedures agreed with the Legislative Council (LegCo) when the Securities and Futures Commission (SFC) was established¹, this note briefs Members on the main features of the budget of SFC for 2012-13².

BACKGROUND

2. Section 13(2) of the Securities and Futures Ordinance (Cap. 571) (SFO) requires SFC to submit 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 (FS). In accordance with section 13(3) of SFO, FS shall cause the budget to be laid on the table of LegCo. On 6 February and 2 March 2012, this Bureau and SFC briefed the Panel on Financial Affairs (FA Panel) on SFC's proposed and amended budgets for 2012-13. A copy of the amended budget for 2012-13 is at **Enclosure**.

Encl.

FUNDING OF SFC

3. Section 14 of SFO provides that the Government shall provide funding to SFC as appropriated by LegCo. In practice, SFC has not requested appropriation from LegCo since 1993-94. The funding of SFC comes from the market in the form of transaction levies, and fees and charges on services rendered to market operators and participants.

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¹ Members may wish to refer to FCR(89-90)12 for details.

² The financial year of SFC starts on 1 April and ends on 31 March.

4. Over the years, levies on securities transactions and futures and options contracts trading have been the main source of income for SFC. The current rate of levy³ on securities transactions is 0.003% while that on futures/options contracts is \$0.6 or \$0.12 per leviable transaction, depending on the type of contracts.

BUDGET FOR 2012-13

5. SFC projects a surplus budget of \$145.12 million for 2012-13 in the amended budget. With the projected budget surplus and sizable reserves, for the twentieth year in a row, SFC does not request any appropriation from LegCo for 2012-13. The main features of the 2012-13 budget are set out in paragraphs 6 to 14 below.

Estimated Revenue

6. The estimated revenue for 2012-13 is \$1,500.16 million, which is \$2.29 million (0.2%) more than the revised estimates for 2011-12 (\$1,497.87 million), assuming that for 2012-13 the average securities market turnover will be \$77 billion/day, and the average futures/options market turnover will be 250 000 contracts/day.

7. Having regard to the fact that market participants have been operating in a stressed environment amid high levels of volatility, uncertainty in the global economy and sluggish turnover over the past months, SFC proposes in its amended budget a two-year holiday for annual licensing fees⁴ commencing 1 April 2012. This would offset the projected increase in levy income generated by higher assumed securities market turnover, and result in a reduction in income for each of the next two years by \$165 million, i.e., \$330 million in total. On an amortized basis, annual licensing fee income will be reduced by about \$91 million in 2012-13. The total income in 2012-13 will be \$1,500.16 million, which is \$91.94 million less than the initial proposed estimates.

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³ Under section 394 of SFO, the Chief Executive in Council may specify the rates of levy for sale and purchase of securities recorded on a recognised securities market or futures contracts traded on a recognised futures market.

⁴ The fee holiday is not applicable to new licence applications.

Estimated Expenditure

8. The estimated expenditure for 2012-13 is \$1,355.04 million, which is \$343.41 million (33.9%) above the 2011-12 revised estimates (\$1,011.63 million). The increase is mainly attributable to –

- (a) increase in expenditure respectively on premises by \$116.86 million (113.5%) and depreciation by \$19 million (35.2%) as a result of the relocation of the current offices at Li Po Chun Chambers and Chater House to Cheung Kong Center in November 2011 / September 2012;
- (b) increase in staff cost by \$113.31 million (16.3%) arising mainly from –
 - (i) a provision of \$45.7 million for 43 new headcount and 17 junior positions for placement of graduate trainees to meet various regulatory and supervisory challenges resulting from expansion of market activities and regulatory scope, global financial reforms, and market development and Mainland China's continuing opening up to integrate with global financial markets;
 - (ii) a provision of \$40.5 million for annual pay adjustment, i.e. an amount equivalent to 5.8% of staff payroll; and
 - (iii) a provision of \$3.2 million as special pay adjustment for high performing staff with retention risk;
- (c) increase in professional and others expenses by \$16.8 million (28.7%) due to the high demand for external legal and expert services, especially in the areas of investigation, supervision of intermediaries and new products;
- (d) increase in expenses on information and systems services by \$11.45 million (33.7%) due to higher software and hardware maintenance costs after the lapse of the warranty period and increases in subscriptions for market data to support enforcement and supervision activities; and

/(e)

- (e) increase in funding to external parties by \$58.87 million (376.1%). For the wholly owned subsidiary to be established under SFC for performing its education functions, funding in 2011-12 has been reduced from \$37 million to \$1.65 million to cover only preparatory expenses required for its set-up. In 2012-13, a provision of \$50.5 million is made, assuming that the subsidiary will start its operation from October 2012, with \$7.5 million as start-up costs and \$43 million as capital and operating costs. Other commitments include provision for the annual operating costs of the Financial Dispute Resolution Centre (\$14 million), and supporting the project led by the Hong Kong Exchanges and Clearing Limited on the development of a Hong Kong Extensible Business Reporting Language taxonomy for financial reporting by Hong Kong listed companies (\$5 million).

Staff Establishment

9. SFC has an establishment of 648 posts under the approved estimates for 2011-12. SFC proposes an additional 43 new posts in the budget of 2012-13 (paragraph 8(b)(i) above refers), and the total headcount of SFC will be increased to 691. The new positions are required mainly to cope with the increase in workload in the following areas –

- (a) **Policy, China & Investment Products Division** (12 posts) – to meet the regulatory challenges and increase in workload arising from increasing number of Renminbi products and product complexity and Mainland-related policy work;
- (b) **Intermediaries Supervision Division** (11 posts) – to enhance its efforts to strengthen its delivery capability and supervisory framework. Specifically, to conduct more on-site inspections proportionate to the increase in the number of licensed corporations and to perform focussed assessments of the financial soundness and the adequacy of systems and controls of licensed corporations in safeguarding their clients' assets. Also to step up the inspection of sponsors for initial public offerings (IPOs) resulting from banks transferring their sponsor work to licensed corporations and develop related rules and regulations such as Financial Resources Rules, margin rules and business conduct associated with the complex over-the-counter derivative reform initiative;

/(c)

- (c) **Enforcement Division** (five posts) – to handle an increasing number of labour intensive investigations into sponsors’ misconduct and the subsequent disciplinary proceedings against them, to cope with extra investigation work arising from the Anti-money Laundering legislation and the need to support criminal prosecutions resulting from the new legislation, and to co-ordinate the collection and assessment of centralized management information to enhance the efficiency of the Division;
- (d) **Licensing Division** (five posts) – to cope with the projected workload and additional work generated by the increased number of Type 6 licensees conducting sponsor work;
- (e) **Corporate Finance Division and Supervision of Markets Division** (four posts) – to support the substantially increased workload of IPO work and policy matters, to handle the workload for completing the review of automated trading services (ATS) applications and applications from overseas exchanges for ATS, and to assist in various research work;
- (f) **Legal Services Division** (three posts) – to cope with the increasing civil litigation workload; and
- (g) **Corporate Affairs Division** (three posts) – to allow for the conversion of three existing contract staff in the Information Technology Department to become permanent staff.

10. In addition to the 43 new posts, SFC proposes that 17 junior positions be provided for placement of graduate trainees under the Graduate Trainee Programme in 2012-13. The programme is a three-year talent development programme. On completion of training in the first two years, graduate trainees will be placed in a specific division and their employment will be converted into a permanent role. Depending on their potential and performance, graduate trainees will be considered for promotion to Assistant Managers on satisfactory completion of the three-year programme.

11. Given the highly uncertain environment in which SFC operates, SFC has registered the possibility of unanticipated additional manpower requirements closer to the time of the introduction of new or expanded regulatory mandates. These initiatives include the statutory regime for the disclosure of price sensitive information by listed corporations, vetting of which has recently been completed by a LegCo Bills Committee; the new Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance which has come into effect since 1 April 2012; the proposed legislative changes on the statutory regime governing Mandatory Provident Fund intermediaries and the consultation on the new rules for the sponsor regime for IPOs. Should these arise, SFC submits that they will be dealt with through a separate interim budget request.

Surplus and Reserves

12. As at end December 2011, the reserves of SFC reached \$7,375.08 million⁵. SFC estimates that by 31 March 2012, the reserves will reach \$7,411.87 million, which is 7.3 times of the expenditure of the 2011-12 revised estimates (\$1,011.63 million). A surplus of approximately \$145.12 million is expected in 2012-13, leaving the overall reserves at \$7,556.98 million at the end of the financial year, or 5.6 times the expenditure estimates.

13. According to section 396 of SFO, SFC may consult FS with a view to recommending to the Chief Executive in Council that the rate or amount of levy be reduced if the reserves of SFC are more than twice its operating expenses for that financial year. SFC effected a levy reduction of 20% in December 2006 and a further 25% in October 2010. SFC does not propose any reduction in levy rates in 2012-13 having regard to the unstable global market, the uncertainty in local market turnover levels and the necessity to deploy resources to deal with regulatory reform and initiatives after the financial crisis. SFC will continue to closely monitor the level of its reserves.

Estimated Capital Expenditure

14. The total capital expenditure budget proposed for 2012-13 is \$150.03 million, representing an increase of \$89.06 million (146.1%) above the revised estimates for 2011-12 (\$60.97 million). Provisions for major capital items include the following and a 10% contingency –

(a)

⁵ This is an unaudited figure.

- (a) provision for office furniture and fixtures at the new office and a back-up office, and replacement of obsolete furniture and fixtures due to normal wear and tear, etc. (\$77.14 million);
- (b) provision for office equipment at the new office, replacement of obsolete equipment due to normal wear and tear, and provision for investment in storage technology and database capacity in response to increased market activities plus costs relating to normal replacement of obsolete servers and computer equipment for the additional headcount (\$36.48 million); and
- (c) provision for “front-end” technology to upgrade market surveillance capabilities, improve access to and exchange of information between stakeholders and SFC and enhance various IT systems including investigation management system and market surveillance system, etc. (\$22.77 million).

COMPARISON OF THE APPROVED ESTIMATES WITH THE REVISED ESTIMATES FOR 2011-12

Revenue

15. The revised estimated revenue for 2011-12 is \$1,497.87 million, representing an 8.9% decrease from the approved estimates of \$1,644.24 million, due to lower-than-expected market activities⁶. The surplus for the year is estimated to be \$486.24 million, which is 17.5% below the original estimates of \$589.06 million.

Expenditure

16. The revised estimated expenditure is \$1,011.63 million, which is \$43.55 million (4.1%) below the approved estimates (\$1,055.18 million). The decrease is mainly due to the time lag in filling vacancies, and the reduction of funding to the wholly owned subsidiary to be established under SFC for performing its education functions by \$35.35 million.

/Capital

⁶ The revised estimates for 2011-12 assumed the average daily turnover of securities transactions to be \$69 billion for the second half of the year (actual turnover of \$74 billion for the first half) as against the original estimate of \$81 billion.

Capital Expenditure

17. The total capital expenditure estimate is expected to increase from \$58.12 million to \$60.97 million (4.9%), mainly arising from higher-than-expected spending on office furniture and fixtures and office equipment to cover the renovation costs of the new office.

PUBLIC CONSULTATION

18. The Administration and SFC briefed FA Panel on SFC's 2012-13 budget on 6 February 2012. Members expressed dissatisfaction in respect of (a) the level of reserves held by SFC and hence a call to reduce the levy; (b) the significant increase in expenditure; and (c) the high rental payment for office accommodation in Central. A motion was passed at the meeting, stating that the budget should not be submitted to FS for approval at the present stage and requesting SFC to put forward its budget afresh within a short time for consideration by FA Panel before submission to FS for approval.

19. To address FA Panel's concerns and after reconsideration by the board of SFC on 16 February 2012, an amended budget with further elaboration on related issues was presented to FA Panel for discussion at its 2 March 2012 meeting. At that meeting SFC elaborated on the expenditure requirement and proposed a two-year holiday for annual licensing fees commencing 1 April 2012 (see paragraph 7 above).

20. SFC has also examined FA Panel's concern on the reserves and request for reduction in levy rates. SFC projects that a further reduction of 0.001% would result in an operating deficit in 2012-13. It also stated that the current levy of 0.003% is at a level where the benefit of any further reduction is likely to be immaterial for investors, and would unlikely result in any increase in turnover, or assist market intermediaries or investors in a meaningful way. SFC has however committed to conducting a holistic review on the purpose and use of its reserves before considering the way forward, including whether there is room for levy adjustment or an adjustment to the SFC's funding model. While it has not proposed any levy adjustment in 2012-13, it has committed to reaching a concluded view on the review of the reserves within 2012, the results of which are to be reflected in the next budget exercise.

21. FA Panel generally supported the amended budget, in particular the waiver of licence fees. It has asked for completion of the review of the reserves in time for the results to be reported to FA Panel in the context of the next SFC budget.

ADMINISTRATION'S VIEWS

22. The Administration has examined SFC's proposed budget for 2012-13. SFC has projected a surplus in its budget, and as in the past years, it has not requested appropriation from LegCo. We note that SFC has taken into account FA Panel's views and amended the budget accordingly to address FA Panel's concerns. We also note that SFC has committed to conducting a holistic review on the use of its reserves in the coming year. We would work closely with SFC and monitor development in this regard. With regard to a possible interim budget request by SFC, the Administration has asked that SFC should exhaust all possible options in meeting its additional resource requirements, such as the redeployment of existing resources including the new posts to be created in 2012-13.

Financial Services and the Treasury Bureau
May 2012



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

Securities and Futures Commission
Budget of Income and Expenditure
for the financial year 2012/2013

23 February 2012

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1. Executive summary

- 1.1 Set out below is a summary of the Commission's forecast for 2011/12 and proposed budget for 2012/13. This summary is intended to give an overview of our proposed budget. For more detailed explanations, reference should be made to sections 4 and 5 of this budget book.

| | 2012/13 | 2011/12 | Variance | |
|------------------------------------|----------------------------------|--------------------|--|---------|
| | Proposed Budget (a) HK\$m | Forecast (b) HK\$m | Proposed Budget vs. Forecast (c) = (a-b) HK\$m | (c/b) % |
| Income | 1,500.16 | 1,497.87 | 2.29 | 0.2% |
| Recurrent expenditure | | | | |
| Staff cost | 807.09 | 693.78 | 113.31 | 16.3% |
| Premises expenses | 219.81 | 102.95 | 116.86 | 113.5% |
| Other recurrent expenses | 253.62 | 199.25 | 54.37 | 27.3% |
| Total recurrent expenditure | 1,280.52 | 995.98 | 284.54 | 28.6% |
| Funding to external parties | 74.52 | 15.65 | 58.87 | 376.2% |
| Total expenditure | 1,355.04 | 1,011.63 | 343.41 | 33.9% |
| Surplus for the year | 145.12 | 486.24 | (341.12) | (70.2%) |

- 1.2 For 2012/13 we project that income will remain at around the same level as 2011/12 forecast. Projected increase in levy income generated by higher assumed securities market turnover is offset by the proposed annual fee holiday for licensees (see also 2.12, 3.3.1 and 5.3.3(b) below).
- 1.3 The expenditure for 2012/13 is expected to increase by \$343.41 million (33.9%) over the 2011/12 forecast. The increase is mainly attributable to increases in staff cost (\$113.31 million), premises expenses (\$116.86 million) and funding to external parties (\$58.87 million).
- 1.4 Having critically reviewed the Commission's manpower needs for 2012/13 in different divisions, a net increase of 43 full time positions (6.6%) over the current approved headcount has been included in the budget. In deliberating the Commission's manpower needs for the coming year, the SFC Executives have vigorously debated different approaches through several rounds of internal discussions. The new positions are required mainly to cope with the increase in workload in the following areas:
- 1.4.1 Intermediaries Supervision Department (11 posts) - to strengthen its delivery capability and supervisory framework and to step up the inspection of sponsors resulting from banks transferring their sponsor work to licensed corporation.
- 1.4.2 Policy, China & Investment Product Division (12 posts) - to meet regulatory challenges posed by the proliferation of RMB products, increasing product complexity and policy/Mainland-related work.

- 1.4.3 The remaining 20 additional headcount requests from Enforcement and other Divisions are mainly driven by an envisaged increase in workload in different divisions. In addition, extra resources which are legislation dependent (e.g. OTC derivatives, price sensitive information, MPF intermediaries and direct access to the Market Misconduct Tribunal) may be requested at a later date to manage specific regulatory projects.
- 1.4.4 Taking into account the historical lead time in recruitment, a net increase of 43 full time positions over the current approved headcount would essentially translate into an “effective” manpower addition of 34 headcount for the full year of 2012/13. A more realistic staff cost provision on such basis has therefore been included in this budget book.
- 1.5 In addition, the Commission has earmarked in the 2012/13 budget a total of seventeen junior positions for the placement of graduate trainees to support the Government’s initiative of providing job opportunities for young talent. A similar approach was taken last year to place eleven performing graduate trainees in different divisions of the SFC once they had completed three rotations within the first two years of the Graduate Trainee Programme.
- 1.6 We will relocate our two offices at Li Po Chun Chambers and Chater House to Cheung Kong Centre in two phases when the existing leases expire in January 2012 and June 2013 respectively. Our premises cost will be substantially increased following relocation of our offices by \$116.86 million for 2012/13 as compared to 2011/12 forecast.
- 1.7 Increase in funding to external parties is mainly attributable to half year estimates (\$50.5 million) provided for a proposed wholly owned subsidiary under SFC for performing its education functions (“NewSub”) which is expected to start its operation in Q4 2012.
- 1.8 A surplus of approximately \$145.12 million is expected in 2012/13 leaving our overall reserves at \$7.56 billion at the end of that financial year.

2. Approach and overview

2.1 Each year the budget is prepared based on a policy of tightly controlling all expenditures, 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 and objectives or to support new initiatives and regulatory development. Strict controls are applied to ensure that costs stay within budget commitments.

2.2 The budget this year follows a period of intense activity for the Commission and reflects our views about the workload that the organization will be required to deal with in the next financial year. The regulatory agenda continues to be stretching because of the need to respond to the enduring global financial crisis and to advance elements of our work that address to local issues arising from the crisis or which contribute to the formation of supra-national solutions which then must be implemented in Hong Kong. This budget represents our best estimate of the resource implications for the organisation based on information available at the time of preparation.

2.3 Given the highly uncertain environment in which we currently operate, there is a need to recognize the possibility of unanticipated additional resource requirements, which will call for extra manpower needs in various divisions closer to the time of the introduction of new or expanded regulatory mandates. Should any such matters arise, they will be dealt with through a separate interim budget request.

2.4 Looking ahead, global financial markets pose significant challenges in the face of prevailing uncertainty and heightened risks emanating from the euro zone sovereign debt problems that, if unresolved, could destabilize financial markets and worsen economic conditions. Our resources plans need to recognise the additional workload required to supervise and regulate financial firms and other areas of Commission responsibility in an age of heightened risk.

2.5 Global financial reforms that were agreed in the aftermath of the “first phase” of the global financial crisis, such as those relating to OTC derivatives, are moving on to the implementation phase. This means making the necessary legislative and rule changes to give effect to the relevant reforms, which may involve taking on new or expanded mandates for previously unregulated areas. In addition, Mainland China’s growing integration with global financial markets, its contribution to global growth and Hong Kong’s role as a centre for RMB internationalisation will also shape the financial landscape in Hong Kong and our human resource requirements.

2.6 The three main drivers of the Commission’s staff requirements are:

2.6.1 First, expansion of market activities and regulatory scope

- (a) Asia, in particular Mainland China, is expected to be the major contributor to global economic growth. Hong Kong, as the bridge to Mainland China and the hub for international finance in Asia, will continue to attract international capital and financial institutions to set up operations in Hong Kong as they seek to benefit from the investment and growth opportunities in Asia. The evidence is that the financial crisis in the West is accelerating, this trend, including the possibility of more risk being booked in Hong Kong rather than in, say, New York or London. The demands on the daily operations of the

Commission – licensing, supervision, product authorization, listing activities, and enforcement – will grow in tandem, and the Commission has to ensure that it is adequately resourced to maintain effective regulation and supervision.

- (b) Subject to legislative and rule changes, the Commission’s regulatory regime may need to be enhanced to deal with certain legislation-dependent initiatives. Given the uncertainty in the timing of legislative and rule changes, we have not budgeted for the additional headcount needs for these initiatives:
 - (i) The statutory regime for the disclosure of PSI, which is now before the legislature, will make the Commission the enforcement agency and the Market Misconduct Tribunal (MMT) will determine whether a breach of the PSI disclosure requirement has occurred. The Commission will be empowered to conduct investigations into suspected breaches.
 - (ii) In order to streamline the process for enforcement of the statutory PSI disclosure requirement and to deal with the existing six types of market misconduct stipulated in the Securities and Futures Ordinance (SFO), it was proposed that the Commission be empowered to institute proceedings before the MMT directly.
 - (iii) The new Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance will come into effect on 1 April 2012. The Commission will be given enhanced supervisory and enforcement powers and will introduce supplementary guidelines to the new legislation.
 - (iv) The Administration plans to introduce legislative changes in 2012 for a statutory regime governing MPF intermediaries, which will also clarify the regulatory scope, supervisory and disciplinary powers of the Commission for MPF intermediaries that are Licensed Corporations under the SFO.
 - (v) The Commission plans to consult the market on new rules for the Sponsor regime for initial public offerings to enhance the regulation of sponsors in the interest of maintaining Hong Kong as a quality market.

2.6.2 Second, global financial reforms

- (a) In the wake of the “first phase” of the global financial crisis, the G20 introduced financial reforms that its members and other non-G20 members of the Financial Stability Board (FSB), which includes Hong Kong, have agreed to implement, as appropriate, in their respective jurisdictions.
- (b) One major global financial reform is to subject the presently unregulated OTC derivatives market to regulation. The reforms include mandatory clearing requirements for standardized derivatives

through a central counterparty and trading on an exchange (where appropriate), as well as reporting obligations starting no later than the end of 2012. The Commission has issued a consultation paper with a view to introducing the necessary legislative amendments to the SFO in 2012. This is a very major reform that will expand the perimeter of regulation to cover an entirely unregulated segment of the financial system.

2.6.3 Third, market development and Mainland China's continuing opening up to integrate with global financial markets

- (a) Hong Kong will continue to be an attractive platform for Mainland enterprises to raise capital, and for the Mainland to invest savings. Mainland financial firms will also look to Hong Kong to gain the necessary market and operational experience before further expanding overseas.
- (b) The Mainland's experiment to internationalize the RMB through Hong Kong as the pilot offshore RMB centre has been encouraging. This initiative presents both exciting opportunities and challenges to the Mainland and Hong Kong, recognizing that there is a need to ensure that the benefits of market development and the risks to market stability are appropriately balanced.
- (c) The Commission will continue to facilitate the development of Hong Kong as a leading fund raising centre, an international asset management centre and an offshore RMB centre and maintain a robust regulatory framework for Hong Kong to remain an attractive international financial centre. The Commission needs to be sufficiently resourced in order to be in a position to proactively respond to both immediate and future regulatory challenges.

2.7 To deal with the above regulatory and supervisory challenges, our manpower plan for 2012/13 has been critically reviewed to identify 43 new posts driven by the envisaged increase in workload for the coming year (see section 4 for further details). However, additional resources may be requested at a later date to manage specific regulatory projects which are legislation-dependent.

2.8 Part of the Commission's HR strategy is to build a more sustainable workforce by hiring both local and overseas university graduates and accelerate their development to fill more senior roles. This strategy has started to pay off. We now have a total of 42 graduates who have been recruited since the inception of the Graduate Trainee Programme in 2009 and eleven of them have now been absorbed by the Commission into operational roles. Next year, seventeen of them will join different divisions in the capacity as junior professionals as they progress through the Graduate Trainee Programme.

2.9 Past experience shows that junior staff turnover increases substantially when market conditions improve. It is important for us to build up a stronger, more committed and broader based workforce to counter a potential "brain drain" in future. With the full support of the Remuneration Committee, the Commission did some work during the year to narrow identified pay gaps for staff in high turnover grades (assistant managers and managers). Implementation of strategic pay increases to targeted employees

yielded good results. Staff turnover rates in these grades declined from 22.5% in April to 16.8% in October this year, against a benchmarked industry staff turnover rate of 18.3%. The average pay median of staff in our high turnover grades has been increased by an average of 8.8%, which is now much closer to the market median.

- 2.10 In light of the constant demand for legal and compliance talent in the financial services industry (despite a slowing economy) we propose to include a modest provision of 0.5% of payroll cost in the 2012/13 budget to mitigate the risk of losing our high performing managers who are absolutely critical to provide day-to-day coaching to and leadership of our junior professionals in an expanding organisation. A failure to proactively mitigate the risk of losing our experienced managers could have a significant impact on the delivery capacity of the Commission.
- 2.11 Other than leveraging pay as a retention tool, the Commission has made significant progress this year in the areas of culture and engagement. We devoted much effort to define and communicate our corporate values, through the "Living our Values" culture campaign. In so doing, we hope to attract, motivate, and retain our best talent.
- 2.12 Finally, we are mindful that market participants have been operating in a stressed environment amid high level of volatility, uncertainty in global economy and sluggish turnover over the past months. Smaller brokers have been under great pressure to lower commission rates and their market share has decreased to below 10%. We therefore propose granting a two-year fee holiday for all annual license fees payable during the two-year period commencing 1 April 2012.

3. Budget assumptions

3.1 Investor levy rates

3.1.1 The levy rates will remain unchanged for the year 2012/13, i.e.

- (a) Investor Levy Rate - Securities, at 0.003% and
- (b) Investor Levy Rate - Future/Options contracts, at \$0.6/\$0.12 per contract.

3.2 Market turnover

3.2.1 Equity market

- (a) Based on the SFC research team'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 2011/12 and \$77 billion/day for 2012/13.

3.2.2 Futures and Options market

- (a) Based on transaction volume for the first six month of 2011/12 (Apr – Sep 11), futures/options market turnover is assumed to be an average of 230,000 contracts per day for the rest of 2011/12. 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 250,000 contracts per day in 2012/13.

3.3 Fees and charges

3.3.1 We propose to introduce a two-year annual fee waiver for licensees for 2012/13 and 2013/14. This will apply to all annual fees payable during the two-year period commencing 1 April 2012 on terms that will be announced during March 2012. The underlying rates of fees and charges, which will continue to apply to all new license applications, are assumed to remain unchanged.

3.4 Rate of return

3.4.1 The average return on investment of our reserve funds is assumed to be 1.5% p.a. for the year 2012/13.

3.5 Remuneration adjustment

3.5.1 A provision of 5.8% of personnel costs has been included on the assumption that there will be a salary adjustment for staff (see also 5.4.2 (c)).

3.6 Inflation

3.6.1 Where an estimate of general price level increases is required we have assumed 6% when we do not have specific data and/or quotes on which to estimate our future costs.

3.7 Capital expenditure

3.7.1 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.

4. Manpower plan

4.1 The manpower plan for 2012/13 is based on our assessment of the staff strength required to discharge those of the Commission's regulatory functions which we know will need to be carried out during the year. Having critically reviewed our manpower requirements, a net increase in approved headcount of 43 full time posts (6.6%) has been included in this budget. Furthermore, additional resources may be requested later in the year to support future initiatives that are legislation dependent.

4.2 Our proposed manpower plan is outlined below:

| Division | Headcount | | | | |
|---------------------------------------|------------------|------------------|-----------------------------|-----------------------------|-----------|
| | Approved 2011/12 | Proposed 2012/13 | Net Change | Position upgrades | Para /ref |
| CEO's Office & Commission Secretariat | 19 | 19 | - | 2 | 4.3 |
| Corporate Finance | 56 | 57 | +1 | - | 4.4 |
| Enforcement | 140 | 145 | +5 | 6 | 4.5 |
| Intermediaries Supervision | 116 | 127 | +11 | 3 | 4.6 |
| Licensing | 66 | 71 | +5 | 4 | 4.7 |
| Legal Services | 26 | 29 | +3 | 1 | 4.8 |
| Policy, China & Investment Products | 89 | 101 | +12 | -3 | 4.9 |
| Supervision of Markets | 30 | 33 | +3 | 1 | 4.10 |
| Corporate Affairs | 106 | 109 | +3 | - | 4.11 |
| TOTAL | 648 | 691 | 43 ^{Note 1} | 14 ^{Note 2} | |

Note 1 : Excluding seventeen graduate trainees as set out in paragraph 1.5 above.

Note 2 : The fourteen position upgrades in 2012/13 is expected to cost less than 1% of the total staff cost increase over the 2011/12 forecast.

4.3 Two position upgrades in the CEO's Office are requested to reflect the increasingly complex nature of the work.

4.4 One executive post is proposed by the Corporate Finance Division (CFD) to support the substantially increased workload of IPO work and policy matters. There were only 177 IPO applications received in 2010 but for 11 months up to November 2011, CFD has already received 214 IPO applications.

4.5 Three executive posts are proposed by the Enforcement to handle an increasing number of labour intensive investigations into sponsors' misconduct and the subsequent disciplinary proceedings against them.

One executive post is proposed to cope with extra investigation work arising from the Anti-money Laundering legislation and the need to support criminal prosecutions resulting from the new legislation.

In addition, a non-executive position is proposed to co-ordinate the collection and assessment of centralized management information to enhance the efficiency of the

Division. The six upgrades are required to provide career progression to high performing qualified staff in the junior professional ranks.

- 4.6 The Intermediaries Supervision Department (ISD) requested a total of eleven new headcount. Six executives and two non-executives are required to enhance its efforts to strengthen its delivery capability and supervisory framework. Specifically, this additional headcount is needed to conduct more on-site inspections proportionate to the increase in the number of licensed corporations (the number of on-site inspections conducted is projected to increase substantially by 31% from 235 in 2010/11 to an annualized figure of 309 in 2011/12). The complexity of the business models of licensed corporations requires the breadth and depth of inspections to be adjusted to properly assess the risks involved. ISD is also responding to the extremely volatile and stressed financial markets environment (which is expected to continue) by performing more vigilant assessment of the financial soundness and the adequacy of systems and controls of licensed corporations in safeguarding their clients' assets.

Furthermore, one additional executive post is required to step up the inspection of sponsors resulting from banks transferring their sponsor work to licensed corporation. These banks account for around \$28.6 billion in value of the IPO market in the 11 months ended 30 November 2011. In addition, two executive posts are required for developing all related rules and regulations (such as Financial Resources Rules, margin rules and business conduct) associated with the complex OTC reform initiative.

Finally, three upgrades are proposed to reflect the expansion of responsibilities underpinned by the heightened supervisory framework described above.

- 4.7 Four executive and one non-executive posts are proposed by the Licensing Department (LIC) to cope with (i) the projected workload and (ii) additional work generated by the increased numbers of Type 6 licensees conducting sponsor work.

During the period from March 2005 to September 2011, the compounded annual growth rates of SFC licenses and new licensing applications were 7.4% and 8.1% respectively. During the nine months of 2011, the number of hedge fund managers reached an all time high of 338 licensed firms and the uptrend is expected to continue. Mainland-based intermediaries are also expected to further expand their business activities in Hong Kong in light of the upcoming launch of RQFII scheme. Added to these are the additional work generated by the transfer of sponsor work from banks to licensed corporations. The extra headcount requested are therefore essential for LIC to cope with the projected increase in workload while being able to meet our performance pledge. In addition, four upgrades are required to reflect the expansion of job scope in managing challenging workload in LIC.

- 4.8 The Legal Services Division (LSD) requested a total of three new executive posts to cope with the increasing civil litigation workload, which has increased by 81% year over year (from 77 cases in September 2010 to 140 cases in September 2011).

One clerical upgrade is requested to reflect the added scope of a general grade post in LSD.

- 4.9 The Policy, China & Investment Product (PCIP) Division requested a total of twelve additional headcount, comprising four executive and eight non-executive posts, to meet the following regulatory challenges and increase in workload:

Proliferation of RMB products

Increasing amount of RMB deposits and impending launch of RQFII has led to a substantial demand for RMB products. In the first six months of 2011/12, RMB fund applications represented 9.1% of total fund applications, in comparison to 5.9% in 2010/11. There are 1,800 SFC-authorized funds that are being offered to the public and some of them have been enquiring about the possibility of adding RMB offerings in future. Processing RMB product applications is resource-intensive. These generally require more time for review as they are a new product category and RMB is a restricted currency. In addition, some of the new policies and rules will have to be studied and clarified with the relevant Mainland authorities.

Increasing product complexity

There is an across-the-board increase in complexity of products that are seeking the SFC's authorization. Many of the complex products use derivatives to achieve certain return patterns or market access, thereby exposing investors to additional risks. Therefore, reviewing applications of complex products requires advanced technical knowledge.

Policy/Mainland-related work

PCIP continually receives a large number of requests for analytical and policy inputs and to participate in high-level policy/Mainland-related meetings. Many of the Mainland-Hong Kong cooperation initiatives in the securities sector, particularly those related to RMB, have very broad implications both in the Mainland and Hong Kong.

Using existing, already-overstretched staff to undertake these tasks is not tenable. Hence, the proposed additional resources are to cope with these key operational areas which require staff with advanced technical knowledge and a stable workforce at a junior level to handle more routine tasks (i.e. product risk monitoring work and routine regulatory review).

The three posts to be re-graded in PCIP are to align the personal grade of the incumbents to the job grade of the posts in question.

- 4.10 Two executive posts are proposed by the Supervision of Markets Division (SoM) to handle the workload for completing the review of automated trading services (ATS) applications and applications from overseas exchanges for ATS under Part III.

One additional executive post is proposed to help the research team (i) to study the issues related to the newly formed IOSCO Standing Committee on Risk and Research, which focuses on potential systemic risks and their implications for market stability; (ii) to conduct analysis on the upcoming implementation of short-selling position reporting system and publish regular reports on short-selling positions; and (iii) to deal with the increased workload of monitoring of various market segments including the OTC derivatives market.

One non-executive upgrade is required to reflect the expansion of SoM's activities.

- 4.11 Three new headcount are proposed by the Information Technology Department to allow for the conversion of three existing contract staff, who have been with the

Commission for many years, to become permanent staff. This is another step towards a smooth execution of the IT roadmap.

5. Financials

5.1 Income and expenditure statement

| | | (a) | (b) | (c) | (d) | (d) | (e) | (e) |
|---|--------|------------------|------------------|------------------|---------------------|---------------|-----------------------|---------------|
| | | Proposed | Forecast | Approved | =(a)-(b) | (d)/(b) | =(b)-(c) | (e)/(c) |
| | Para. | Budget | For Year | Budget | Proposed | Forecast | Forecast over/(under) | Approved |
| | Ref. | For Year | 2011/12 | For Year | Over/(under) Budget | | Budget | Budget |
| | | 2012/13 | 2011/12 | 2011/12 | Over/(under) Budget | % | Approved | Budget |
| | | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | % | HK\$'000 | % |
| Income | | | | | | | | |
| Investor Levy | 5.3.2 | | | | | | | |
| Securities | | 1,145,760 | 1,062,610 | 1,205,280 | 83,150 | 7.8% | (142,670) | -11.8% |
| Futures/Options Contracts | | 74,400 | 68,517 | 61,008 | 5,883 | 8.6% | 7,509 | 12.3% |
| Fees & Charges | 5.3.3 | 167,930 | 239,900 | 242,800 | (71,970) | -30.0% | (2,900) | -1.2% |
| Investment Income | 5.3.4 | 106,572 | 121,343 | 129,650 | (14,771) | -12.2% | (8,307) | -6.4% |
| Other Income | 5.3.5 | 5,500 | 5,500 | 5,500 | - | 0.0% | - | 0.0% |
| Total | | 1,500,162 | 1,497,870 | 1,644,238 | 2,292 | 0.2% | (146,368) | -8.9% |
| Recurrent expenditure | | | | | | | | |
| Premises | 5.4.1 | 219,810 | 102,951 | 92,421 | 116,859 | 113.5% | 10,530 | 11.4% |
| Staff cost | 5.4.2 | 807,085 | 693,776 | 728,000 | 113,309 | 16.3% | (34,224) | -4.7% |
| Info. & Sys. Services | 5.4.3 | 45,408 | 33,962 | 32,187 | 11,446 | 33.7% | 1,775 | 5.5% |
| General Office & Insurance | 5.4.4 | 9,130 | 8,809 | 7,376 | 321 | 3.6% | 1,433 | 19.4% |
| Training & Development | 5.4.5 | 10,500 | 8,420 | 8,400 | 2,080 | 24.7% | 20 | 0.2% |
| Professional & Others | 5.4.6 | 75,415 | 58,616 | 56,935 | 16,799 | 28.7% | 1,681 | 3.0% |
| External Relations | 5.4.7 | 24,050 | 24,438 | 16,714 | (388) | -1.6% | 7,724 | 46.2% |
| Internship Programme | 5.4.8 | 10,125 | 9,508 | 8,150 | 617 | 6.5% | 1,358 | 16.7% |
| Contingency | 5.4.9 | 6,000 | 1,500 | 3,000 | 4,500 | 300.0% | (1,500) | -50.0% |
| Depreciation | 5.4.10 | 73,000 | 54,000 | 51,000 | 19,000 | 35.2% | 3,000 | 5.9% |
| Total (1) | | 1,280,523 | 995,980 | 1,004,183 | 284,543 | 28.6% | (8,203) | -0.8% |
| Funding to external parties | | | | | | | | |
| Funding to FRC | 5.5.1 | 4,631 | 4,410 | 4,410 | 221 | 5.0% | - | 0.0% |
| Funding to IASC Foundation | 5.5.2 | 391 | 391 | 390 | - | 0.0% | 1 | 0.3% |
| Funding to NewSub | 5.5.3 | 50,500 | 1,650 | 37,000 | 48,850 | 2960.6% | (35,350) | -95.5% |
| Funding to FDRC | 5.5.4 | 14,000 | 8,000 | 8,000 | 6,000 | 75.0% | - | 0.0% |
| Funding to HKSI | | - | 1,200 | 1,200 | (1,200) | -100.0% | - | 0.0% |
| Funding for the establishment of the HK XBRL Taxonomy | 5.5.5 | 5,000 | - | - | 5,000 | N/A | - | N/A |
| Total (2) | | 74,522 | 15,651 | 51,000 | 58,871 | 376.1% | (35,349) | -69.3% |
| Total expenditure (1)+(2) | | 1,355,045 | 1,011,631 | 1,055,183 | 343,414 | 33.9% | (43,552) | -4.1% |
| Surplus for the year | | 145,117 | 486,239 | 589,055 | (341,122) | -70.2% | (102,816) | -17.5% |
| Reserves brought forward | | 7,411,867 | 6,925,628 | 6,749,624 | 486,239 | 7.0% | 176,004 | 2.6% |
| Reserves carried forward | | 7,556,984 | 7,411,867 | 7,338,679 | 145,117 | 2.0% | 73,188 | 1.0% |

5.3 Income

5.3.1 Annual grant from government

- (a) 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 2012/13. The Commission’s decision is made without prejudice to the funding principles established when the Commission was formed, and has no implications for requests for appropriations in future years.

5.3.2 Investor levy

- (a) The following turnover and levy rate assumptions have been used in preparing levy income estimates:

| | 2011/12 | | 2012/13 |
|----------------------------------|--------------|------------------|----------------------|
| | Budget | Apr-Sep (actual) | Apr-Mar (projection) |
| Securities | | | |
| Daily turnover (billion/day) | \$81.0 | \$74.0 | \$77.0 |
| Levy rate | 0.003% | 0.003% | 0.003% |
| Futures/Options Contracts | | | |
| Daily turnover (contracts) | 205,000 | 230,000 | 250,000 |
| Levy rate (per contract) | \$0.6/\$0.12 | \$0.6/\$0.12 | \$0.6/\$0.12 |

- (b) The 2011/12 Forecast of Investor Levy – Securities is lower than the Approved Budget by 11.8% (\$142.67 million) whereas Investor levy – Futures and Options is higher than the Approved Budget by 12.3% (\$7.51 million). These variations reflect the differences in market turnover in the first six months of 2011/12 when compared to the estimates underlying the Approved Budget as noted above.
- (c) The daily turnover assumption for the 2012/13 Proposed Budget is based on estimates made by our research team on a basis consistent with prior years. We project the average securities market turnover for 2012/13 will be 7% higher than that of 2011/12.
- (d) We do not propose any reduction in levy rates in 2012/13 having regard to the unstable global market, the uncertainty in local market turnover levels and the necessity to deploy resources to deal with regulatory reform and initiatives after the financial crisis.

5.3.3 Fees and charges

- (a) The Forecast aggregate fees and charges income for 2011/12 is 1.2% (\$2.9 million) lower than the Approved Budget as fees from Corporate Finance are lower than expected.
- (b) The 2012/13 Budget shows a reduction of fee income of 30% (\$71.97 million) against Forecast for 2011/12. This reduction arises from our proposal to grant a two-year annual fee holiday. We expect that this will result in a reduction in our income for each of the next two years by \$165 million. On an amortised basis (i.e. allocating the holiday over the lifetime of license periods) we estimate that our annual licensing fee income as reflected in our audited accounts will be reduced by about \$91 million in 2012/13, by about \$165 million in 2013/14 and by about \$74 million in 2014/15.

5.3.4 Investment income

- (a) Investment income for 2011/12 is forecasted to be \$121.34 million, 6.4% lower than the Approved Budget as we have revised downward the average rate of return from 2% to 1.75% p.a..
- (b) 2012/13 investment income is budgeted to be \$106.57 million, 12.2% (\$14.77 million) lower than the 2011/12 Forecast. The average rate of return for the year is assumed to be 1.5% p.a..

5.3.5 Other income

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

5.4 Recurrent expenditure

5.4.1 Premises

- (a) The leases of our offices at Li Po Chun Chambers and Chater House will expire in January 2012 and June 2013 respectively. In August 2011, we have entered into a new lease for office premises at Cheung Kong Centre. We will integrate and move the two offices to Cheung Kong Centre in two phases to match the expiry dates of the two existing leases. The new office space is about 10% larger than current office space to cater for the future growth of the Commission as well as the space expected to be required by the newly established subsidiary(see para 5.5.3).
- (b) Forecast premises expenses for 2011/12 are expected to be higher than the approved budget by \$10.53 million (11.4%) due to increase in rental and related premises expenses for the new lease at Cheung Kong Centre. We will move the existing office in Li Po Chun Chambers to Cheung Kong Centre by the end of year 2011 and take up about 20,000 sq ft.

- (c) Expenses for 2012/13 are budgeted to be \$116.86 million (113.5%) higher than 2011/12 Forecast. The increase is mainly due to the second phase take-up of the Cheung Kong Centre office (around 100,000 sq ft) and the full year effect of the phase one take-up, which took place in November 2011. As part of the business continuity plan, we plan to set up a backup office (around 2,000 sq. ft.) to serve as a first port of call/command centre in case of emergency from September 2012, when the existing two offices are merged within a single building.

5.4.2 Staff cost

- (a) The overall staff cost for 2011/12 is forecasted to be lower than the 2011/12 budget by 4.7% (\$34.22 million) mainly due to the time lag experienced in filling management vacancies and a number of positions being under-filled at lower grades.
- (b) The projected headcount at 31 March 2013 is 691¹, a net increase of 43 (6.6%) over the approved headcount included in the 2011/12 budget. Please see section 4 for detailed explanations of this increase in headcount. The projected staff cost for 2012/13 is 16.3% (\$113.31 million) higher than the 2011/12 Forecast and 10.9% (\$79.09 million) higher than the 2011/12 budget.
- (c) The 2012/13 budget includes the provision for an average 5.8% pay increase for Commission staff. This is based on market information from external parties including pay consultants and professional associations. Detailed proposals for the actual pay increase will be formulated in Q1, 2012.
- (d) A “special pay adjustment” provision of \$3.2 million (0.5% of payroll cost) for high performing staff with retention risk has been made in this budget. Our focus in the coming year is to enhance our ability to retain our core group of high performing managers (see also para 2.9 to 2.11).
- (e) The Executive will determine the specific pay policy and present this to the Remuneration Committee for discussion and to the Commission for approval.

5.4.3 Information and systems services

- (a) The information and systems services expenses forecast for 2011/12 is 5.5% (\$1.78 million) higher than the approved budget due to the higher than expected information services and systems contract services costs.
- (b) For 2012/13, we project a 33.7% (\$11.45 million) increase due to higher software and hardware maintenance costs after the lapse of

¹ Excluding seventeen graduate trainees as set out in paragraph 1.5 above.

the warranty period and increases in subscriptions for market data to support enforcement and supervision activities.

5.4.4 General office and insurance

- (a) General office and insurance expenses forecast for 2011/12 is 19.4% (\$1.43 million) higher than the approved budget mainly due to minor office reconfiguration required to meet operational and growth needs.
- (b) Expenses for 2012/13 are expected to be higher than 2011/12 Forecast by 3.6% (\$0.32 million) due to higher printing, vehicle and office services expenses.

5.4.5 Training and development

- (a) Forecast training related expenses for 2011/12 are on budget.
- (b) Training and development expenses for 2012/13 are 24.7% (\$2.08 million) higher than forecast due to the projected increase in headcount. Training for 2012/13 will continue to focus on executive development and talent management.

5.4.6 Professional and others

- (a) Professional and others expenses for 2011/12 are 3% (\$1.68 million) above the approved budget. Legal fees and external translation expenses are expected to be higher than the original budget due to more complex enforcement cases.
- (b) Professional and others expenses for 2012/13 are expected to increase by 28.7% (\$16.8 million) as the demand for external legal and expert services will remain high, especially in the areas of investigation, supervision of intermediaries and new products.

5.4.7 External relations

- (a) In the 2011/12 approved budget, we have assumed that the NewSub would start its operation in October 2011 and part of the education initiatives undertaken by the Commission would be transferred to the NewSub. As a result, we have only included in the 2011/12 approved budget education expenses for the first six months of 2011/12. The education expenses for the second half of 2011/12 were reflected in the funding to NewSub. Owing to the delay in the passage of the NewSub legislation, we now assume that the NewSub will commence operation in October 2012. This will have financial impact in both financial years 2011/12 and 2012/13.
- (b) Forecast external relations expenses for 2011/12 are higher than the approved budget by 46.2% (\$7.72 million) due to additional resources required to take up the education activities in the second half of year 2011/12.

- (c) Education expenses for the first six months of 2012/13 are included in this budget. As a result, aggregate education expenses will be \$5.85 million lower than the 2011/12 forecast. On the other hand, we have increased the overseas travelling budget by \$2.37 million as more overseas business trips are expected to be taken to enhance the Mainland and international relationships, promote collaboration and keep abreast of international development of securities and futures markets and regulatory trends. We have increased our PR programme cost by \$2.58 million principally to provide for the making of a new TV drama series to enhance public understanding of the SFC's enforcement work. We have also increased our seminars and hospitality budget by \$0.48 million for hosting meetings for our overseas counterparties. These items have all led to a net 1.6% (\$0.39 million) reduction in 2012/13 Budget over the Forecast.

5.4.8 Internship programme

- (a) This represents the salary cost of hiring university graduates in support of the Government's internship for university graduates programme. We expect that more resources will be required to provide for a more competitive packages to recruit and retain the capable workforce.

5.4.9 Contingency

- (a) A contingency of \$1.5 million is provided for the remainder of 2011/12 and \$6 million (equivalent to 0.5% of annual estimated operating expenses) for 2012/13 to cover unforeseen expenses arising from changes in the operating environment or unforeseen special requirements.

5.4.10 Depreciation

- (a) Forecast depreciation expense for 2011/12 is expected to be 5.9% (\$3 million) above budget because of the capital expenditure on office relocation in the current year (see also para 5.6.1).
- (b) We expect that the depreciation expenses for 2012/13 will be 35.2% (\$19 million) higher than 2011/12 Forecast due to increases in capital expenditure on furniture and fixtures and office equipment (see also para 5.6.2) as a result of the phase-2 office relocation.

5.5 Funding to external parties

- 5.5.1 To continue our support for the work of the Financial Reporting Council, the Commission will provide annual funding of \$4.6 million in 2012/13.
- 5.5.2 To continue our support for the work of the International Accounting Standards Committee Foundation, the Commission will again provide funding of US\$50,000.
- 5.5.3 We have reduced our funding to NewSub from \$37 million to \$1.65 million in 2011/12 to cover only those preparatory expenses required for the set-up

of the NewSub. In 2012/13, we have provided \$50.5 million for funding the NewSub on the assumption that the NewSub will start its operation from October 2012. \$7.5 million is provided for its start up costs and \$43 million for capital and operating costs for the half year. The funding estimation has not taken into account the rental cost for the space occupied by NewSub at our Cheung Kong Centre office (\$1.4 million) and the staff costs of those who are currently performing education function in the Commission. These staff will be transferred to the NewSub when it commences operation and the estimated staff cost for a 6-month period is around \$2.7 million.

5.5.4 Assuming that the FDRC will start its operation in 2012 and the Commission will share 1/4 of its start up and annual operating costs, we have provided \$8 million for the funding in 2011/12. We will continue to support the FDRC by sharing 1/4 of its annual operating costs in 2012/13 (\$14 million).

5.5.5 A project on the development of a Hong Kong XBRL² taxonomy³ for financial reporting by Hong Kong listed companies is initiated as a joint effort by the HKEx, HKICPA and the Commission. To support the development of the project, we have provided \$5 million in our 2012/13 budget.

5.6 Capital expenditure

5.6.1 The total capital expenditure forecast for 2011/12 has been increased from \$58.12 million to \$60.97 million. Spending on furniture and fixtures and office equipment will be higher than the original budget by \$14.9 million to cover mainly the renovation costs of the new office in Cheung Kong Centre. On the other hand, we have trimmed down our expenditure on computer systems development by \$13.05 million due to the deferral of certain projects and the lower than expected development costs of some projects.

5.6.2 The total capital expenditure budget for 2012/13 is \$150.03 million, 146.1% (\$89.06 million) higher than 2011/12 Forecast. This increase is mainly due to the provision for office renovation and office equipment costs for the second phase take-up of office premises in Cheung Kong Centre. The planned capital expenditure commitment for 2012/13 comprises the following:-

² XBRL (Extensible Business Reporting Language) is an open standard that is developed and maintained by XBRL International, a global non-profit consortium of over 650 major companies, organisations and government agencies from 30 countries, including China, UK and the US. It aims at standardizing financial reporting in order to promote transparency and improve quality and comparability of business information.

³ XBRL taxonomies are the dictionaries which the computer languages use. They define the specific tags for individual items of financial data. Due to the differences in accounting regulations, each jurisdiction may have its own taxonomy for financial reporting.

| Capital expenditure | Amount HK\$ m | Note |
|------------------------------|------------------|------------|
| Office furniture & fixtures | 77.14 | <i>i</i> |
| Office equipment | 36.48 | <i>ii</i> |
| Computer systems development | 22.77 | <i>iii</i> |
| Contingency (10%) | <u>13.64</u> | <i>iv</i> |
| Total | <u>150.03</u> | |

Notes :-

- (i) for office furniture and fixtures:
- \$75.24 million for Cheung Kong Centre office fitting out project (phase 2 take-up)
 - \$0.9 million for second back up office fitting out project
 - \$1 million for replacement of obsolete furniture due to normal wear and tear
- (ii) for office equipment:
- \$18.81 million for Cheung Kong Centre office (phase 2 take-up)
 - \$0.53 million for second back up office
 - \$1 million for replacement of obsolete office equipment due to normal wear and tear; and
 - \$16.14 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 market surveillance system etc.
- (iv) as in prior year, contingency is set at 10% of the aggregate budgeted capital expenditure.