For information **FCRI(2015-16)1**

NOTE FOR FINANCE COMMITTEE

The Budget of the Securities and Futures Commission for the Financial Year 2015-16

PURPOSE

With regard to the consultation procedures agreed with the Legislative Council (LegCo) when the Securities and Futures Commission (SFC) was established[1], the Government has prepared this note to brief Members on the main features of the budget of the SFC for 2015-16[2].

BACKGROUND

2. Section 13(2) of the Securities and Futures Ordinance (Cap. 571) (SFO) requires the SFC to submit estimates of its income and expenditure (the budget) for each financial year to the Chief Executive (CE) for approval. CE has delegated the authority to the Financial Secretary (FS). In accordance with section 13(3) of the SFO, FS shall cause the budget to be laid on the table of LegCo. On 2 February 2015, this Bureau and the SFC briefed the Panel on Financial Affairs (FA Panel) on the SFC's proposed budget for 2015-16. A copy of the budget for 2015-16 is at Enclosure.

Encl.

FUNDING OF THE SFC

3. Section 14 of the SFO provides that the Government shall provide funding to the SFC as appropriated by LegCo. In practice, the SFC has not requested appropriation from LegCo since 1993-94. Its funding basically 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 refer to FCR(89-90)12 for details.

[2] The financial year of the SFC starts on 1 April 2015 and ends on 31 March 2016.

4. Over the years, levies on securities transactions and futures and options contracts trading have been the main source of income for the SFC. The current rate of levy[3] on securities transactions is 0.0027%, while that on futures and options contracts is $0.54 or $0.1 per leviable transaction, depending on the type of contracts.

BUDGET FOR 2015-16

5. The SFC has projected a budget deficit of $416.94 million for 2015-16. As in past years, the SFC does not request any appropriation from LegCo for the 2015-16 budget. The main features of the 2015-16 budget are set out in paragraphs 6 to 15 below.

Income

6. The estimated income for 2015-16 is $1,325.40 million, which is $28.04 million (2.2%) above the forecast income for 2014-15 ($1,297.36 million). The SFC has adopted the following assumptions in projecting the estimated income –

(a) the average securities market turnover will be $78 billion per day and the average futures and options market turnover will be 233 000 contracts per day; and

(b) the annual licensing fee holiday will continue in 2015-16.

Expenditure

7. The estimated expenditure for 2015-16 is $1,742.34 million, which is $219.77 million (14.4%) above the forecast expenditure for 2014-15 ($1,522.56 million). The increase is mainly attributable to –

(a) increase in staff cost by $164.90 million (16.5%) arising mainly from –

(i) a provision of $55.80 million for 39 new headcounts to enable the SFC to properly regulate a rapidly evolving and more

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3 Under section 394 of the 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.

complex financial market in Hong Kong, in particular to enhance its litigation capacity for the enforcement of securities regulation and to strengthen the supervision of intermediaries. Details are set out in paragraph 8;

(ii) a provision of $51.05 million for annual pay adjustment, i.e. an amount approximately equivalent to 5.5% of personnel costs;

(iii) a provision of $18.44 million for 51 position upgrades for different divisions and departments; and

(iv) a provision of $17 million as special pay adjustment for high performing and experienced staff with retention risk;

(b) increase in expenses on professional and others by $18.22 million (29.5%) as the demand for external legal and expert services remains high, especially in the areas of investigation, supervision of intermediaries and authorization of new products;

(c) increase in expenses on information and systems services by $8.86 million (18.6%) due to higher software and hardware maintenance costs after the lapse of warranty periods, and increases in subscriptions for market data to support enforcement and supervision activities. New systems are required by the operating divisions to manage their caseloads and to enhance their investigatory and supervisory capabilities;

(d) increase in expenses on regulatory and external activities by $7.67 million (48.2%) due to hosting of a bi-annual SFC Forum, increasing overseas travel in pursuing global and domestic regulatory reforms and launching of a new TV drama series on the SFC's enforcement work; and

(e) increase in funding to external parties by $3.02 million (3.7%). This includes a potential funding to the Hong Kong Securities and Investment Institute for phase II of the e-learning platform development and support for other education programmes. The training initiatives are intended to help intermediaries, particularly small and medium-sized firms, to meet the challenges arising from a changing market landscape.

/Manpower …..

Manpower Plan

8. In addition to the originally proposed 51 headcount increase for 2014-15, the SFC added seven posts as interim headcount addition during the year to support the work resulting from the expansion of its regulatory remit and the additional regulatory and oversight responsibilities. With this interim headcount addition, the SFC now has a total headcount of 852. The SFC proposes another 39 new posts in the budget of 2015-16, and the total headcount will be 891. Key points of the manpower requests are set out below –

(a) **Enforcement Division** (15 posts) – to address the need for more staff to provide support for resource intensive work resulting from the increasing number and complexity of investigations undertaken by the Division;

(b) **Intermediaries Division** (12 posts) – to keep pace with the anticipated increase in the number of licensed corporations and to maintain the cycle of on-site inspections, to cater for the expansion of the anti-money laundering team, and to deal with the marked and steady increase in licensing applications;

(c) **Investment Products Division** (3 posts) – to support work relating to regional cooperation initiatives, including the proposed Mainland-Hong Kong mutual recognition of funds initiative, to deal with more complex investment products proposals, and to process an increasing number of applications for authorization of investment products;

(d) **Corporate Affairs Division** (4 posts) – to cater for the increase in workload which has arisen from expansion of office space and the headcount, increase in workload arising from enquiries from the public following the introduction of the Stock Connect, and to provide support to technology initiatives; and

(e) **Corporate Finance Division** (2 posts) – to provide the necessary support structure for the Division and to facilitate more efficient distribution of work within the Division.

9. In addition, the Supervision of Markets Division, Legal Services Division, Centralised Services each requests the addition of one post to deal with anticipated workload and/or development needs.

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10. The SFC remarks that given the highly uncertain environment in which they currently operate, there is a need to recognize the possibility of unanticipated additional resource requirements closer to the time of the implementation of new or expanded regulatory mandates. Should any such matters arise, they will be dealt with through a separate interim budget request.

Capital Expenditure

11. The total capital expenditure proposed for 2015-16 is $60.80 million, which is $1.36 million (2.3%) above the forecast expenditure for 2014-15 ($59.43 million). Provisions for major capital items include the following and a 10% contingency –

(a) computer systems development – for “front-end” technology to upgrade market surveillance capabilities, improve access and exchange of information between stakeholders and the SFC, and enhance various information technology systems ($34.22 million);

(b) office equipment – for replacement of obsolete office equipment due to normal wear and tear and for investment in storage technology and data base capacity plus costs relating to the normal replacement of obsolete servers and computer equipment for the additional headcount ($18.05 million); and

(c) office furniture and fixtures – for minor alteration of office configuration and for replacement of obsolete furniture due to normal wear and tear ($3 million).

Reserves

12. The SFC has estimated that by 31 March 2015, the reserves will reach $7,091.78 million, which is 4.66 times of its projected operating expenditure for 2014-15 ($1,522.56 million).

13. According to section 396 of the SFO, the SFC may, after consultation with FS, recommend to the CE-in-Council that the rate or amount of levy be reduced if the reserves of the SFC are more than twice its estimated operating expenses for that financial year. The SFC effected a levy reduction of 20% in December 2006, 25% in October 2010 and a further 10% in November 2014. The SFC considers that the levy rate should not be changed again in 2015-16, but will continue to review the situation annually and include recommendations to FS in each future budget for any changes considered necessary.

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14. The SFC offered an annual licensing fee holiday for one year effective on 1 April 2009, for two years effective on 1 April 2012, and for another two years effective on 1 April 2014. The annual licensing fee holiday will continue in 2015-16.

15. The SFC estimates that by 31 March 2016, the reserves will be reduced to $6,674.84 million, which is 3.83 times of its projected expenditure for 2015-16 ($1,742.34 million). The SFC will continue to keep its reserves level under review in accordance with section 396 (1) of the SFO.

COMPARISON OF THE ORIGINAL BUDGET WITH THE FORECAST BUDGET FOR 2014-15

Income

16. The forecast income for 2014-15 is $1,297.36 million, which is $135.57 million (11.7%) more than the original budget of $1,161.79 million. The higher income is mainly due to higher than budgeted market turnover[4], investment income and fee income.

Expenditure

17. The forecast expenditure is $1,522.56 million, which is $147.91 million (8.9%) below the original budget of $1,670.47 million. The underspending is mainly due to time lag experienced in filling vacancies, deferment of consultancy projects, recovery of legal costs, and lower-than-expected actual cost for maintenance contracts in information and systems services.

Capital Expenditure

18. The forecast capital expenditure is $59.43 million, which is $4.13 million (6.5%) below the original budget of $63.56 million, as a result of savings in computer systems development, which is partially offset by the renovation costs for new office space leased in September 2014 to accommodate new headcounts.

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[4] The revised income for 2014-15 is projected based on the prevailing market performance and the assumption that the average daily turnover of securities transactions and futures/options contracts transactions is $78 billion and 216 000 from November 2014 to March 2015. The original budget is made based on assumptions of $65 billion per day and 270 000 per day.

PUBLIC CONSULTATION

19. We and the SFC briefed the FA Panel on the SFC's 2015-16 budget on 2 February 2015. Members generally raised no objection to the budget.

THE GOVERNMENT'S VIEWS

20. We have examined the budget of the SFC for 2015-16. We note that the SFC has not requested appropriation from LegCo as in the past years although it has projected a deficit in its budget.

21. It is a public commitment of the SFC, as a publicly funded organization, to deploy its resources and control its expenditures in a prudent manner. We look forward to the SFC's continued effort in redeploying its existing resources to deal with extra workload and new regulatory initiatives.

Financial Services and the Treasury Bureau
May 2015

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

SFC
證監會

Enclosure to FCRI(2015-16)1

Securities and Futures Commission

Budget of Income and Expenditure

for the financial year 2015/2016

19 December 2014

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1. Executive summary

1.1 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 used as a benchmark except in areas where additional resources have 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. As in previous years, we have engaged an external consultant to conduct an annual review of the relevant financial controls and policies to ensure that they are robust and practical.

1.2 Set out below is a summary of the Commission's forecast for 2014/15 and proposed budget for 2015/16. For more detailed explanations, reference should be made to sections 4 and 5 of this budget book.

	2015/16	2014/15	Variance	
	Proposed Budget	Forecast	Proposed Budget vs. Forecast	
	(a)	(b)	(c) = (a-b)	(c/b)
	HK$'m	HK$'m	HK$'m	%
Income	**1,325.40**	1,297.36	28.04	2.2%
Recurrent expenditure				
Staff cost	**1,163.27**	998.37	164.90	16.5%
Premises expenses	**248.22**	233.95	14.27	6.1%
Other recurrent expenses	**245.10**	207.52	37.58	18.1%
Total recurrent expenditure	**1,656.59**	1,439.84	216.75	15.1%
Funding to external parties	**85.75**	82.73	3.02	3.7%
Total expenditure	**1,742.34**	1,522.57	219.77	14.4%
Deficit for the year	**(416.94)**	(225.21)	(191.73)	

1.3 For 2015/16 we project that income will increase by $28.04 million (2.2%) over the 2014/15 Forecast as a result of higher assumed securities market turnover and fees and charges, offset by the full year impact of reduced levy rate.

1.4 We have reduced the Commission's transaction levy by 10% with effect from November 2014. We consider that the levy rate should not be changed again in 2015/16 but will continue to review the situation annually and include recommendations to the Financial Secretary in each future budget for any changes considered necessary.

1.5 The two year annual licence fee holiday that commenced in April 2014 is still in force for 2015/16. We will, depending on the market condition and our medium term financial projection, review our fees and charges level when the 2-year licensing annual fee waiver period ends in April 2016.

1.6 Total expenditure for 2015/16 is expected to increase by $219.77 million (14.4%) over the 2014/15 Forecast. The increase is mainly attributable to increases in staff costs ($164.9 million), premises expenses ($14.27 million) and other recurrent expenses ($37.58 million).

1.7 As set out in Section 3, the Commission's budget for 2015/16 is premised on the need to ensure that the Commission is adequately resourced to effectively and efficiently carry out its responsibilities amid an increasingly demanding and evolving local and global regulatory landscape.

1.8 Hong Kong is on track in different stages of market consultation or legislative changes to implement global financial reforms such as OTC derivatives regulation, resolution regime and cross-border supervisory cooperation. To maintain the integrity and reputation of our market, the Commission will continue with its focus on the conduct of market participants and intermediaries, strictly enforce the law, and ensure that clients and investors are fairly treated.

1.9 Specific initiatives such as the ongoing supervision and development of the Shanghai-Hong Kong Stock Connect (Stock Connect) and the uptick in the number of enforcement and litigation cases in terms of volume and complexity (up 43% YTD from the prior year) will inevitably require more resources in the coming year.

1.10 Having critically reviewed the manpower needs of the Commission's operating divisions and departments for 2015/16, a net increase of 39 full time posts (4.6 %) over the Commission approved headcount of 2014/15 has been included in the budget. Apart from this, 51 position upgrades are requested to reflect the expansion in scope and complexity of our work.

1.11 Given the highly dynamic environment in which we currently operate and the uneven pace of the global economic recovery, there is a need to recognize the possibility of unanticipated additional resource requirements closer to the time of the implementation of new or expanded regulatory mandates. Should any such matters arise, they will be dealt with through a separate interim budget request.

1.12 The Commission has attempted, wherever possible, to redeploy existing resources to deal with extra workload or new regulatory initiatives anticipated in the next budget year. For initiatives that are currently in a consultative or preliminary stage, existing resources will be deployed to the extent possible. Please refer to Section 4 for more detailed information about the Commission's 2015/16 manpower plan.

1.13 Other recurrent expenses for 2015/16 are expected to increase by $37.58 million over the 2014/15 Forecast. This increase is mainly driven by higher professional and other similar expenses ($18.22 million), information and systems services expenses ($8.86 million) and regulatory and external activities expenses ($7.67 million).

1.14 We have set aside $9 million and $15 million in our 2014/15 Forecast and 2015/16 budget respectively for funding training initiatives for intermediaries, particularly small and medium-sized firms, to meet the challenges arising from a changing market landscape.

1.15 A deficit of approximately $416.94 million is expected in 2015/16 leaving our overall reserves at $6.68 billion at the end of that financial year, approximately 3.8 times our annual costs including depreciation and funding to various external parties.

2. Assumptions

2.1 Investor levy rates

2.1.1 Our levy rate was reduced by 10% with effect from 1 November 2014.

(a) Investor Levy Rate – Securities remains at 0.0027%; and

(b) Investor Levy Rate - Future/Options contracts remains at $0.54/$0.1 per contract, depending on the type of contract.

2.2 Market turnover

2.2.1 Equity market

(a) Based on the prevailing market performance and the recent market activity and initiatives, including the Stock Connect initiative which commenced in November 2014, the average securities market turnover is assumed to be around $78 billion/day for the remainder of 2014/15. The securities market turnover is averaged to approximately $72 billion/day for the full year (see also para 5.3.2(a)).

(b) For 2015/16, we assume that the average securities market turnover will increase by 8%, from $72 billion/day to around $78 billion/day.

2.2.2 Futures and Options market

Based on the transaction volumes for the first half of 2014/15, the futures/options market turnover is assumed to be an average of 216,000 contracts per day for the rest of 2014/15. For forecasting purposes we have assumed that volumes will increase by 8%, which is in line with the estimated increase in the securities market turnover. On this basis, the futures/options market turnover is assumed to be an average of 233,000 contracts per day in 2015/16.

2.3 Fees and charges

2.3.1 Licensing annual fee holiday will continue in 2015/16. The underlying rates of fees and charges, which will continue to apply to all new license applications, are assumed to remain unchanged.

2.4 Rate of return

2.4.1 The average gross return on investment of our reserve funds before investment management fees is assumed to be 1.5% p.a. for the year 2015/16.

2.5 Remuneration adjustment

2.5.1 A provision of 5.5% of personnel costs has been included as salary adjustments for staff (see also 5.4.2 (c)).

2.5.2 In arriving at the provision, the Commission has considered a number of factors including, but not limited to, macro-economic factors (projected CPI & GDP), relevant industry remuneration trends for 2015/16, the labour market demand for the type of expertise required by the Commission as well as merit adjustments.

2.6 Inflation

2.6.1 Where an estimate of general price level increases is required we have assumed 4.3%[1] when we do not have specific data and/or quotes on which to estimate our future costs.

2.7 Capital expenditure

2.7.1 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.

[1] Based on the Third Quarter Economic Report 2014 released by the Government in November 2014, the latest forecast rate of headline CPI for 2014 is 4.3%.

3. Global and domestic regulatory challenges

3.1 Key challenges faced by the Commission are:

3.1.1 Continually increasing market complexity

(a) The sophistication and complexity of the securities and futures market, and its participants continues to increase as (i) the Hong Kong market evolves and expands; and (ii) Hong Kong responds to post-financial crisis global regulatory reforms and responses.

(b) The unique nature of the Hong Kong market, with an increasing and diverse number of small to medium size intermediaries, with significant retail penetration, requires a resource intensive supervisory approach.

(c) Market participants are increasingly becoming more sophisticated. The growth of particular segments of the market (e.g. asset management), and increasing automation of trading and operations, as well as the international nature of many licensed corporations (LCs) require the Commission to be more sophisticated and specialized in response.

3.1.2 Relationships with Mainland China

(a) As the world's largest offshore renminbi centre, as well as the global hub for both renminbi trade settlement and offshore renminbi financing and wealth management, Hong Kong continues to play an important role in facilitating the transformation of the renminbi into an internationally accepted and widely used currency.

(b) The Stock Connect programme has commenced in November 2014. The launch of Stock Connect will present new opportunities and challenges for managing capital flows into and from Mainland China through Hong Kong. At the same time, it has also created challenges and uncertainties. It is vital that our ability to protect investors and enforce effectively is maintained. The Commission will closely monitor financial stability risks and financial conduct risks as the two markets become more inter-connected.

(c) The proposed mutual recognition of funds arrangement (MRF) between Mainland China and Hong Kong is another initiative to support Hong Kong to develop into an offshore renminbi centre and an international asset management centre.

3.1.3 International regulatory developments

(a) International financial regulators and standard setters such as the Financial Stability Board (FSB) and International Organizations of Securities Commissions (IOSCO) are all committed to a fundamental reform of the financial system to correct the fault lines that led to the global financial crisis and to rebuild a safer, more resilient financial system that better serves real economies. These reforms are essential components of the G20's primary objective of strong, sustainable and balanced growth.

(b) A major area of reform is to make OTC derivatives markets safer by introducing requirements for reporting of all OTC derivatives trades to trade repositories, adopting rules for central clearing and trading on organised platforms, where appropriate, and adopting resolution regimes for systemically important financial institutions and financial market infrastructures (FMIs) such as central counterparties (CCP). The Securities and Futures (Amendment) Ordinance to cater for the OTC derivative regime was passed in April 2014 and we aim to table the subsidiary legislation in the first quarter of 2015.

(c) The Commission continues to promote regional collaboration amongst Asian jurisdictions on matters of common interest which enables Asia to influence global policy making and to ensure it takes account of different types of markets and aspirations in the region. We always ensure that our involvement in international policy work is fully aligned with Hong Kong's interest as a leading financial centre.

4. Manpower plan

4.1 Proposed headcount changes 2015/16 vs 2014/15

Division	Headcount					
	Commission Approved 2014/15	Proposed 2015/16	Net Change	Executive Posts	Non-Executive Posts	*Para /ref*
Centralised Services [Note 1]	32	33	+1	1	-	*4.3.3-4.3.4*
Corporate Finance	84	86	+2	-	2	*4.3.5-4.3.6*
Enforcement	181	196	+15	5	10	*4.3.7-4.3.9*
Intermediaries	244	256	+12	12	-	*4.3.10*
Legal Services	44	45	+1	-	1	*4.3.11-4.3.12*
Investment Products	111	114	+3	2	1	*4.3.13-4.3.15*
Supervision of Markets	49	50	+1	-	1	*4.3.16-4.3.17*
Corporate Affairs	107	111	+4	3	1	*4.3.18-4.3.21*
TOTAL [Note 4]	**852**[Note 2]	**891**	**39**[Note 3]	**23**	**16**	

Note 1 : Include CEO's Office, Risk and Strategy Unit, International & China Unit, Secretariat and Press Office

Note 2 : The Commission approved headcount includes 7 interim headcount

Note 3 : Including 7 posts for the placement of graduate trainees

Note 4 : The Commission has proposed 51 post upgrades for 2015/16

4.1.1 General overview

(a) The Commission has increased its resources over the past few years in order to properly regulate a rapidly evolving and more complex financial market in Hong Kong, and thereby enhance the Commission's ability to meet its statutory objectives.

(b) As can be seen from the table presented in para 4.1 above, all manpower requests for 2015/16 from all but the Enforcement and Intermediaries Divisions are fairly minimal.

(c) The Enforcement Division's headcount requests for next year are focused on the junior and middle levels as more resources are required to support the volume (+43% in caseload YTD over 2013/14) and complexity of the cases under investigation, including actions designed to remediate investors and those where we now manage cases directly in the Market Misconduct Tribunal (MMT).

(d) The headcount requests from Intermediaries involve the creation of more senior posts in order to (i) provide the right level of senior supervision of more junior staff in order to correct the current staff leverage imbalance; and (ii) introduce greater specialization and policy capacity.

4.1.2 The external employment market

(a) The cycle of downsizing within the Hong Kong financial services market experienced in the past few years has markedly slowed and is expected to now enter a phase of cautious headcount growth. Regulatory focus and pressure remains intense as global financial services firms upgraded their compliance functions through expansion and recruitment at all levels. As in prior years, the demand for legal and compliance professionals remains high and is expected to continue.

(b) The upsurge in demand for legal and compliance professionals continues to present the Commission with challenges in its attempts to recruit certain types of specialists from the market. Additionally, the demand presents a challenge to the Commission's ability to retain our existing junior and middle management professionals, as they are becoming increasingly sought after in the market.

4.1.3 The Commission's people strategy

(a) Employee engagement - Building upon the conclusions of the Commission's employee engagement survey, we have implemented a number of initiatives which reflect the areas of opportunities for further engagement enhancement. These initiatives include providing additional career development opportunities for our junior professionals, offering customized training programmes for people managers and launching a competency-based development planning process to help our employees focus on acquiring the right skills to succeed.

(b) Building a talent pipeline - Recognising the importance of nurturing a strong, committed and diverse workforce, the Commission continues to develop its talent pipeline through the Commission's Graduate Trainee Programme (GTP). Since the inception of the GTP in 2009, we have a total of 88 graduates who were recruited by the Commission and some of them have progressed to junior professionals within the Commission based on their own merits.

4.2 Interim headcount – 2014/15

4.2.1 During 2014/15, the Commission approved an interim request of 7 additional posts to support work resulting from the expansion of the Commission's regulatory remit and the additional regulatory and oversight responsibilities. The initiatives include:

(a) The need to improve inspections coverage, particularly around high-risk focus areas and to allow for increased focus on Anti-Money Laundering (AML) and Combating the Financing of Terrorism (CFT) supervision;

(b) The need for more active engagement with and management of the Commission's external stakeholders from the Legislative Council and the various political parties and industry groups in Hong Kong;

(c) The need for resources to undertake the significant increase in civil litigation work both in terms of scale and complexity; and

(d) The need to provide regulatory oversight to the Stock Connect initiative which came into effect in mid November 2014.

4.3 New headcount requests – 2015/16

4.3.1 Having taken into consideration the approved interim headcount, the Commission has undertaken a comprehensive workload analysis for 2015/16. It should be noted that a critical assessment of areas for potential re-training and redeployment of staff and process re-engineering or streamlining has been undertaken. Consequently, a net increase of 39 full time posts has been included within this budget.

4.3.2 Approximately 59% of the proposed new headcount relates to executive grade positions with the remaining 41% being non-executive grade[2]. The need for executive grade staff reflects the Commission's assessment of the optimal resource mix required to undertake our regulatory responsibilities and is principally driven by the increasingly complexity of applications, cases and matters that have been brought to the attention of the Commission.

Centralised Services

4.3.3 The International & China Unit within Centralized Services has proposed 1 executive post for China affairs. This request is to support the further development of closer and more frequent liaison that will be required between Mainland China and Hong Kong.

4.3.4 3 executive and 4 non-executive upgrades are proposed to reflect the increased sophistication of the work undertaken and to provide a progression path for high performing staff.

Corporate Finance Division

4.3.5 The Corporate Finance Division (CFD) proposes 2 new non-executive posts to provide the necessary support structure for the Division. The creation of these posts will allow a more efficient distribution of work within the various functions of the Division.

4.3.6 1 executive and 1 non-executive upgrade are requested by CFD to provide a more appropriate supervisory structure to handle work of increasing complexity and diversity in the Dual Filing Team of the Division.

Enforcement Division

4.3.7 The Enforcement Division (ENF) plays a critical role in a robust supervisory regime, allowing the Commission to send the right signals to the market as to the practices that are not tolerated and are detrimental to the development of a healthy securities and futures market in Hong Kong. There

[2] Executive grade refers to positions from Manager grade and above, while non-executive refers to positions below Manager grade

has been a significant increase in workload in 2014: investigation caseload (+43% YTD in 2014/15) and total man hours spent on cases (+17% YTD in 2014/15) relative to the whole of 2013/14.

4.3.8 2014/15 has witnessed a notable increase in the number of cases that have been referred and/or come to the attention of ENF for further investigation. This in part is a result of increased s181 notices (+140% YTD in 2014/15); an increase in boiler room activity; an increase in referrals, including disclosure cases from CFD's Corporate Regulator Team and Intermediaries Division and complaints being referred more directly to ENF. This, coupled with the fact that ENF is currently engaged in a number of more complex cases, including those at the MMT, has resulted in an increase in litigation work as part of preparations for court proceedings. A request for 5 executive posts is proposed by ENF to lead teams of more junior staff to handle an increasing number of investigations. In addition, 1 non-executive post is proposed to provide essential in-house support for High Court litigation cases.

4.3.9 9 non-executive posts are proposed to provide the necessary support structure for the Surveillance Team within ENF to deal with a significant increase in processing S.181 returns.

Intermediaries Division

4.3.10 The Intermediaries Division (INT) proposes 12 new posts. The headcount requests for INT are detailed below:

(a) Intermediaries Supervision Department (ISD), Intermediaries

(i) 6 new executive posts are proposed to keep pace with the anticipated increase in the number of LCs and to maintain the cycle of on-site inspections. Additionally, the new posts reflect the need for additional resources to supervise areas of expansion and focus, such as the supervision of the Stock Connect, internet distribution and sales platforms and the increasing electronification of markets. The above-mentioned market developments and resultant complexity will require enhancements to our inspections so as to properly address the risks involved.

(ii) Anti-Money Laundering (AML) - 1 executive post is required for the expansion of the AML team to enhance the Commission's supervisory programme for AML. The increased AML supervisory intensity is in preparation for the upcoming FATF Mutual Evaluation of Hong Kong's AML regime which is due to commence in 2015/16. The additional headcount will also align the Commission's AML team with that of the other peer regulators, which have also seen a notable growth.

(iii) 10 executive and 3 non-executive upgrades are proposed to reflect the increased sophistication and range of supervisory work as described above.

(b) Licensing Department, Intermediaries

(i) 5 executive posts are proposed by the Licensing Department (LIC – INT) to deal with the marked and steady increase in applications that LIC INT is experiencing, including as a consequence of the Stock Connect initiative. The requirement of executive posts reflects the increasing complexity of LCs in terms of their activities and the increasing electronification of the markets and controls systems.

(ii) Additionally, these posts will have dual functions – to lead the various teams within the department and to contribute to policy development within INT and to work closely with other divisions within the Commission (particularly via the new Policy & Regulatory Coordination Unit).

(iii) 3 executive and 3 non-executive upgrades are proposed to promote and retain high quality staff within the department.

Legal Services Division

4.3.11 The Legal Services Division (LSD) proposes 1 non-executive post to provide additional legal support to the Division. The significant increase in the number and complexity of High Court litigation cases undertaken by the Commission as well as preparation of proceedings before the MMT, have consequently increased the quantum of legal support work required in preparation for these proceedings. The addition of a non-executive staff member will address the current shortage in support staff and will ensure that professional staff are not occupied with time-consuming administrative intensive work.

4.3.12 1 non-executive upgrade is proposed to allow for internal promotion to a level that better reflects the work being done.

Investment Product Division

4.3.13 The Investment Product Division (IP) proposes a total of 2 executive posts in response to the developments below:

(a) Regional co-operation initiatives and more complex products

(i) Apart from the mutual recognition of funds with the Mainland, IP has been exploring and evaluating the possibility of mutual recognition arrangements to facilitate the cross-border offering of SFC-authorized funds to retail investors in other regional markets. Complex regulatory issues are expected to arise from our preparatory and evaluation work in relation to these potential co-operation arrangements and initiatives when negotiating with the overseas regulators and formulating detailed arrangements.

(ii) It is envisaged that significant practical and technical issues may arise in the implementation phase following the launch of Mainland-Hong Kong mutual recognition of funds initiative, which is now at the final stage subject to obtaining necessary approvals in the Mainland.

(iii) In addition, IP has to deal with more complex investment product proposals, such as Islamic ETFs and REITs, US grantor trusts and UIT ETF products, leveraged and inverse ETF products etc. which require more senior resources with the pre-requisite skills and experience to undertake a comprehensive and thorough assessment.

(b) Processing of an increasing number of applications for authorization of investment products

(i) During the first nine months of 2014, the number of applications for unit trusts and mutual funds has increased by 20% as compared to the same period in 2013. Whilst, the number of HK domiciled funds authorised by us in the first 9 months in 2014 has doubled as compared to the same period in 2013.

(ii) 41 new ILAS applications were submitted during the first nine months of 2014 so as to comply with the enhanced requirements imposed by the Insurance Authority and the Commission's Guidance on Internal Product Approval Process.

(iii) The introduction of "core funds" proposed by the MPFA, the existing 38 MPF issuers would be required to set up at least the same number of core funds for the Commission and MPFA approval and there would be more consolidation of underlying funds for processing within a tight timeframe.

(iv) IP will continue to keep in view the number of applications after the implementation of the Mainland-Hong Kong mutual recognition of funds initiative and the manpower needs of IP during the interim review in view of the fact that there will be a minimum of 500 Mainland funds qualified under the mutual recognition.

4.3.14 Additionally, IP has proposed 1 non-executive post to improve the current operating structure within the division in order to ensure that adequate administrative support is available to the professional staff in order to address the growing number of applications and complexity as described above.

4.3.15 In addition, 5 executive and 3 non-executive upgrades are requested by IP to handle work of increasing complexity including the implementation of mutual recognition of funds with the Mainland and the authorization of more complex investment product applications.

Supervision of Markets Division

4.3.16 The Supervision of Markets Division (SOM) plays a pivotal role in the oversight and supervision of the financial market infrastructure which underpins Hong Kong's position as an international financial centre.

4.3.17 The 1 new non-executive post, 2 executive and 3 non-executive posts upgrade proposed by SOM are part of a progression path for high performing graduate trainees to take up junior professional roles within the division.

Corporate Affairs Division

4.3.18 For Corporate Affairs Division (CA), 1 new executive post is proposed by the External Relations Department (ER/CA). This is in response to the anticipated increase in enquiries from the public following the introduction of the Stock Connect.

4.3.19 Additionally, 1 non-executive support post is requested by Planning & Administration (PA/CA) to cater for the increase in workload which has arisen from the expansion of office space and the headcount within the Commission.

4.3.20 The Information Technology Department (IT/CA) proposes 2 new executive posts in order to have available adequate information technology specialists to support the various Commission-wide and division/department-specific technology initiatives.

4.3.21 The 9 upgrades comprising 1 in Corporate Affairs Divisional Management (CA), 1 in External Relations Department (ER/CA), 1 in the Human Resources Department (HR/CA), 3 in the Information Technology Department (IT/CA), 1 in the Finance Department (F/CA) and 2 in the Planning & Administration Department (PA/CA) are required to maintain an appropriate CA structure to ensure continued efficiency in service delivery to the operating divisions.

5. Financials

5.1 Income and expenditure statement

	Para. Ref.	(a) **Proposed Budget For Year 2015/16**	(b) Forecast For Year 2014/15	(c) Approved Budget For Year 2014/15	Proposed Budget (a) over/(under) Forecast (b)		Forecast (b) over/(under) Approved Budget (c)	
		HK$'000	HK$'000	HK$'000	HK$'000	%	HK$'000	%
Income								
Investor Levy	5.3.2							
Securities		**1,047,254**	1,020,096	918,840	27,158	2.7%	101,256	11.0%
Futures/Options Contracts		**62,406**	61,392	76,334	1,014	1.7%	(14,942)	-19.6%
Fees & Charges	5.3.3	**118,440**	111,570	89,700	6,870	6.2%	21,870	24.4%
Investment Income	5.3.4	**89,657**	96,657	68,236	(7,000)	-7.2%	28,421	41.7%
Other Income	5.3.5	**7,646**	7,646	8,680	-	0.0%	(1,034)	-11.9%
Total		**1,325,403**	**1,297,361**	**1,161,790**	**28,042**	2.2%	135,571	11.7%
Recurrent expenditure								
Premises	5.4.1	**248,220**	233,953	227,791	14,267	6.1%	6,162	2.7%
Staff cost	5.4.2	**1,163,266**	998,366	1,073,099	164,900	16.5%	(74,733)	-7.0%
Info. & Sys. Services	5.4.3	**56,561**	47,700	54,388	8,861	18.6%	(6,688)	-12.3%
General Office & Insurance	5.4.4	**9,400**	7,910	8,697	1,490	18.8%	(787)	-9.0%
Learning & Development	5.4.5	**9,666**	8,985	9,950	681	7.6%	(965)	-9.7%
Professional & Others	5.4.6	**80,030**	61,810	105,125	18,220	29.5%	(43,315)	-41.2%
Regulatory and external activities	5.4.7	**23,605**	15,933	15,456	7,672	48.2%	477	3.1%
Internship Programme	5.4.8	**8,840**	8,180	9,461	660	8.1%	(1,281)	-13.5%
Contingency	5.4.9	**3,000**	3,000	4,000	-	0.0%	(1,000)	-25.0%
Depreciation	5.4.10	**54,000**	54,000	65,000	-	0.0%	(11,000)	-16.9%
Total (1)		**1,656,588**	**1,439,837**	**1,572,967**	**216,751**	15.1%	(133,130)	-8.5%
Funding to external parties								
Funding to FRC	5.5.1	**7,340**	6,990	5,106	350	5.0%	1,884	36.9%
Funding to IFRS Foundation	5.5.2	**390**	390	390	-	0.0%	-	0.0%
Funding to IEC	5.5.3-4	**63,020**	55,847	60,506	7,173	12.8%	(4,659)	-7.7%
Funding to FDRC	5.5.5	**-**	10,500	10,500	(10,500)	N/A	-	0.0%
Funding to HKSI and other training initiatives	5.5.6-7	**15,000**	9,000	20,000	6,000	66.7%	(11,000)	-55.0%
Funding for the establishment of the HK XBRL Taxonomy		**-**	-	1,000	-	N/A	(1,000)	N/A
Total (2)		**85,750**	**82,727**	**97,502**	**3,023**	3.7%	(14,775)	-15.2%
Total expenditure (1)+(2)		**1,742,338**	**1,522,564**	**1,670,469**	**219,774**	14.4%	(147,905)	-8.9%
Deficit for the year		**(416,935)**	(225,203)	(508,679)	(191,732)		283,476	
Reserves brought forward		**7,091,773**	7,316,976	7,154,923	(225,203)	-3.1%	162,053	2.3%
Reserves carried forward		**6,674,838**	7,091,773	6,646,244	(416,935)	-5.9%	445,529	6.7%

5.2 Capital expenditure statement

	Para. Ref.	**(a) Proposed Budget For Year 2015/16**	(b) Forecast For Year 2014/15	(c) Approved Budget For Year 2014/15	Proposed Budget (a) over/(under) Forecast (b)		Forecast (b) over/(under) Approved Budget (c)	
		HK$'000	HK$'000	HK$'000	HK$'000	%	HK$'000	%
Capital expenditure	5.6							
Furniture & Fixtures		**3,000**	15,800	7,600	(12,800)	-81.0%	8,200	107.9%
Office Equipment		**18,050**	22,095	15,170	(4,045)	-18.3%	6,925	45.6%
Vehicles		**0**	0	1,200	-	N/A	(1,200)	N/A
Computer Sys. Development		**34,220**	16,136	33,810	18,084	112.1%	(17,674)	-52.3%
Sub-total		**55,270**	54,031	57,780	1,239	2.3%	(3,749)	-6.5%
Contingency		**5,527**	5,403	5,780	124	2.3%	(377)	-6.5%
Total		**60,797**	**59,434**	**63,560**	**1,363**	2.3%	(4,126)	-6.5%

5.3 Income

5.3.1 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 2015/16. 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:

	2014/15			**2015/16**
	Budget	Apr-Oct (actual)	Nov-Mar	Apr-Mar
Securities				
Daily turnover (billion/day)	$65.0	$66.0	$78.0	$78.0
Levy rate [Note 1]	0.003%/ 0.0027%	0.003%	0.0027%	0.0027%
Futures/Options Contracts				
Daily turnover (contracts)	270,000	216,000	216,000	233,000
Levy rate [Note 1]	$0.6/$0.54	$0.6	$0.54	$0.54

[Note 1] The levy rates were reduced by 10% from 0.003% and $0.6/contract to 0.0027% and $0.54/contract with effect from 1 November 2014.

(b) The 2014/15 Forecast of Investor Levy – Securities is higher than the Approved Budget by 11% ($101.26 million) whereas Investor levy – Futures and Options is below the Approved Budget by 19.6% ($14.94 million). These variances reflect the variations in actual market turnover in the first half of 2014/15 when compared to the estimates underlying the Approved Budget.

(c) Based on estimates made by our research team on a basis consistent with prior years, we project that the average securities market turnover for 2015/16 will be 8% higher than that of 2014/15. Volume of future contracts will increase in line with the estimated increase in the securities market turnover.

5.3.3 Fees and charges

(a) The Forecast aggregate fees and charges income for 2014/15 is 24.4% ($21.87 million) higher than the Approved Budget as fees from Corporate Finance are higher than expected.

(b) The 2015/16 Budget shows an increase in fee income of 6.2% ($6.87 million) against the Forecast for 2014/15. This increase arises mainly from a projected increase in licensing application fees, including application fees for the new regime in respect of the regulation of OTC derivatives, which is expected to be implemented in 2015/16.

5.3.4 Investment income

(a) Investment income for 2014/15 is forecasted to be $96.66 million, 41.7% ($28.42 million) higher than the Approved Budget. The outsource of investment is deferred to the 4^{th} quarter of 2014/15, leading to lower than expected investment advisory fees and hence higher net investment income.

(b) 2015/16 investment income is budgeted to be $89.66 million, 7.2% ($7 million) lower than the 2014/15 Forecast. The lower income is attributable to the full year impact of the engagement of external investment advisory service. For budget purpose, we assume that the average rate of return for 2015/16 is 1.5%. The actual rate of return may vary, depending primarily on market performance and the investment strategy to be adopted.

5.3.5 Other income

Other income for 2014/15 and 2015/16 represents license fees and service fees received from IEC and ICC for providing office space, accountancy, human resources and IT support services, recoveries from enforcement cases and sale of Commission publications.

5.4 Recurrent expenditure

5.4.1 Premises

(a) Forecast premises expenses for 2014/15 are expected to be higher than the approved budget by $6.16 million (2.7%) primarily due to the lease of larger than planned office space. We have entered into a new lease for around 14,000 sq. ft. of office space from September 2014. The larger office space will allow us to accommodate the headcount growth.

(b) Expenses for 2015/16 are budgeted to be $14.27 million (6.1%) higher than our 2014/15 Forecast. This is mainly due to the full year effect of the lease of new office mentioned in (a) above.

5.4.2 Staff cost

(a) The overall staff cost for 2014/15 is forecasted to be lower than the 2014/15 Budget by 7.0% ($74.73 million). This is principally due to the time lag experienced in filling vacancies and a number of positions being filled at lower grades.

(b) The projected headcount at 31 March 2016 is 891, a net increase of 39 (4.6%) over the 2014/15 Commission approved headcount. Please see section 4 for detailed explanations. The projected staff cost for 2015/16 is 16.5% ($164.9 million) higher than the 2014/15 Forecast and 8.4% ($90.17 million) higher than the 2014/15 Approved Budget.

(c) The 2015/16 Budget includes provision for an average 5.5% pay increase for Commission staff. This is based on preliminary market information from external parties including pay consultants and professional associations (as at 1 November 2014). Detailed proposals for the actual pay increase will be formulated in Q1, 2015.

(d) The detailed pay policy will be presented to the Commission's 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 2014/15 is 12.3% ($6.69 million) lower than the approved budget due to lower than expected actual costs for software and hardware maintenance contracts and cancellation of subscription services.

(b) For 2015/16, we project a 18.6% ($8.86 million) increase due to higher software and hardware maintenance costs after the lapse of warranty periods and increases in subscriptions for market data to support enforcement and supervision activities. New systems are required by our operating divisions to manage their caseloads and to enhance their investigatory and supervisory capabilities.

5.4.4 General office and insurance

(a) The general office and insurance expenses forecast for 2014/15 is 9% ($0.79 million) lower than the approved budget mainly reflecting the lower than expected actual spending in printing, stationery and vehicle expenses in the first six months of 2014/15.

(b) Expenses for 2015/16 are higher than 2014/15 Forecast by 18.8% ($1.49 million). The increase is mainly due to the projected increase in demand for general printing. Repairs and maintenance expense is also projected to be higher in 2015/2016 as provision is made for minor office reconfiguration work.

5.4.5 Learning and development

(a) Forecast learning and development related expenses for 2014/15 are 9.7% ($0.97 million) lower than the approved budget. This is mainly due to a change of project priorities and event format/location.

(b) Learning and development expenses for 2015/16 are 7.6% ($0.68 million) higher than the 2014/15 Forecast. We are expecting the China Program to take place in China and Overseas Regulator Training to be held in Hong Kong as in previous years. More leadership training programs will also be launched in 2015/16 compared with 2014/15.

5.4.6 Professional and others

(a) Forecast professional and others expenses for 2014/15 are 41.2% ($43.32 million) below the approved budget mainly due to the deferral of consultancy projects and legal costs recovered.

(b) Professional and others expenses for 2015/16 are expected to increase by 29.5% ($18.22 million) as the demand for external legal and expert services remains high, especially in the areas of investigation, supervision of intermediaries and authorization of new products.

5.4.7 Regulatory and external activities

(a) Expenses relating to the Commission's regulatory and international commitments, including hosting regulatory forums and attending international meetings, are included under this heading.

(b) Forecast regulatory and external activities for 2014/15 are higher than the approved budget by 3.1% ($0.48 million). We are planning to launch a new TV drama series to enhance public understanding of the Commission's enforcement work in 2015. Expenses relating to the preparatory work will be absorbed in 2014/15.

(c) The 2015/16 budget is 48.2% ($7.67 million) higher than the 2014/15 Forecast. This is attributable to the hosting of the bi-annual SFC Forum and the increase in the need for overseas travelling in pursuing global and domestic regulatory reforms and promoting collaboration. We have increased our PR programme cost by $2 million to provide for the remaining balance of the costs for the making of a new TV drama series mentioned in (b) above.

5.4.8 Internship programme

This represents the salary cost of hiring university graduates in support of the Government's internship for university graduates programme and for the Commission to develop a pipeline of talent for the future. Our proposed expenditure for 2015/16 to recruit and retain these individuals represents an increase of $0.66 million (8.1%) over the 2014/15 Forecast.

5.4.9 Contingency

A contingency of $3 million is provided for the remainder of 2014/15 and the full year of 2015/16 respectively to cover unforeseen expenses arising from changes in the operating environment or unforeseen special requirements.

5.4.10 Depreciation

(a) Forecast depreciation expenses for 2014/15 are expected to be 16.9% ($11 million) lower than budget because of lower than expected capital expenditure actually incurred in the current year.

(b) Depreciation expenses for 2015/16 will be comparable to our 2014/15 Forecast.

5.5 Funding to external parties

5.5.1 To continue our support for the work of the Financial Reporting Council, the Commission will increase the 2014/15 annual funding from $5.11 million to $6.99 million in 2014/15. The funding for 2015/16 will be increased to $7.34 million to include a 5% price adjustment.

5.5.2 To continue our support for the work of the International Financial Reporting Standards Foundation, the Commission will again provide funding of US$50,000 (or HK$390,000).

5.5.3 We have reduced our funding to Investor Education Centre (IEC) from $60.51 million to $55.85 million in 2014/15 based on the latest forecast prepared by IEC. In 2015/16, IEC proposed total expenditure of $63.02 million. A budget summary is provided below:

	Budget 2015/16	Forecast 2014/15	Budget 2014/15
	$'m	$'m	$'m
Education programmes	27.54	24.72	23.45
Staff costs	23.08	20.25	22.69
Premises costs	3.40	3.35	3.36
Professional & other services	4.56	3.27	4.99
Publicity & external relations	2.54	2.60	2.57
General office & others	1.90	1.66	3.45
Total	63.02	55.85	60.51

5.5.4 IEC projects higher expenditure for 2015/16 based on experience of the actual costs of its key operations in 2014/15 (e.g. website maintenance and development, conducting high quality and rigorous research etc) as well as proposals for projects in 2015/16 to increase the awareness, effectiveness and reach of education work.

5.5.5 According to the Memorandum of Understanding (MoU) signed between Commission and the other parties, the Commission has committed to share 1/4 of the the Financial Dispute Resolution Centre's (FDRC) annual operating costs in 2014/15. We have fully provided for the funding requirement as set out in the MoU and do not expect any further budget requirement in 2015/16.

5.5.6 In 2014/15 Forecast, we have provided $9 million for funding training initiatives for intermediaries, particularly small and medium-sized firms, to meet the challenges arising from a changing market landscape. Part of the training initiatives includes a proposed funding to the Hong Kong Securities and Investment Institute (HKSI) to assist with the development of HKSI's proposed e-learning platform.

5.5.7 In 2015/16, we have provided $15 million for training initiatives, including the potential funding to HKSI for phase II of the e-learning platform development and support for other education programmes.

5.6 Capital expenditure

5.6.1 The total capital expenditure forecast for 2014/15 has been trimmed from $63.56 million to $59.43 million. Savings in computer systems development projects is partially offset by the renovation costs for our 46/F office, which was leased in September 2014 (see also para 5.4.1(a)), and higher computer hardware and software costs.

5.6.2 The total capital expenditure budget for 2015/16 is $60.80 million, 2.3% ($1.36 million) higher than the 2014/15 Forecast. This is the combined effect of projected higher computer systems development costs, offset by lower office renovation costs. The planned capital expenditure commitment for 2015/16 comprises the following:

Capital expenditure	Amount HK$ m	Note
Office furniture & fixtures	3.00	(a)
Office equipment	18.05	(b)
Computer systems development	34.22	(c)
Contingency (10%)	5.53	(d)
Total	60.80	

Notes :-

(a) We have provided $2 million for minor alteration of office configuration and $1 million for replacement of obsolete furniture due to normal wear and tear.

(b) for office equipment:

(i) $1 million for replacement of obsolete office equipment due to normal wear and tear; and

(ii) $17.05 million for investment in storage technology and data base capacity plus costs relating to the normal replacement of obsolete servers and computer equipment for the additional headcount.

(c) 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 Intermediaries and market surveillance systems).

(d) as in the prior year, contingency is set at 10% of the aggregate budgeted capital expenditure.