**For information** **FCRI(2016-17)2**

# NOTE FOR FINANCE COMMITTEE

## The Budget of the Securities and Futures Commission for the Financial Year 2016-17

### 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 2016-17[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, the FS shall cause the budget to be laid on the table of LegCo. On 15 February 2016, this Bureau and the SFC briefed the Panel on Financial Affairs (FA Panel) on the SFC's proposed budget for 2016-17. A copy of the budget for Encl. 2016-17 is at Enclosure.

### 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, 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 2016 and ends on 31 March 2017.

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 2016-17

5. The SFC has projected a budget deficit of $398.28 million for 2016-17. As in past years, the SFC does not request any appropriation from LegCo for the 2016-17 budget. The main features of the 2016-17 budget are set out in paragraphs 6 to 17 below.

### Income

6. The estimated income for 2016-17 is $1,460.29 million, which is $251.71 million (14.7%) below the forecast income for 2015-16 ($1,712.00 million). The SFC has adopted the following assumptions in projecting the estimated income –

(a) the average securities market turnover will be $87 billion per day and the average futures and options market turnover will be 372 000 contracts per day; and

(b) the annual licensing fee holiday will be extended for another period of two years, with effect from 1 April 2016.

### Expenditure

7. The estimated expenditure for 2016-17 is $1,858.57 million, which is $192.69 million (11.6%) above the forecast expenditure for 2015-16 ($1,665.88 million). The increase is mainly attributable to –

(a) increase in staff cost by $131.10 million (11.9%) arising mainly from –

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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.

(i) a provision of $31.56 million for new headcount[4] to enable the SFC to handle an increasing number of enforcement and litigation cases and maintain adequate supervision of a growing number of intermediaries within the Hong Kong market. Details are set out in paragraph 8;

(ii) a provision of $50.83 million for annual pay adjustment, i.e. an amount approximately equivalent to 5% of personnel costs;

(iii) a provision of $24.23 million for 58 position upgrades for different divisions and departments; and

(iv) a provision of $5 million as special pay adjustment for rectification of pay anomalies and provision of market adjustments for selected general/administrative staff with identified remuneration gaps compared to the market rates;

(b) increase in expenses on premises by $13.22 million (5.3%) as a result of leasing additional office space of 5 000 square feet to accommodate headcount growth and an increase in property management fee;

(c) increase in expenses on professional fees by $11.47 million (23.9%) as the demand for external expert services remains high, especially in the areas of investigation, supervision of intermediaries and authorization of new products;

(d) increase in expenses on legal fees by $10.59 million (23.6%) due to the size of the caseload and the increased complexity of the cases;

(e) increase in expenses on information and systems services by $7.55 million (14.8%) 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;

(f) increase in expenses on regulatory and external activities by $3.11 million (16.7%) due to hosting of a Board Meeting of International Organization of Securities Commissions, increase in overseas travelling to engage in global and domestic regulatory reforms and promoting collaboration; and

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4 Including 24 new headcount proposed for 2016-17 and two interim headcount approved by the Securities and Futures Commission for 2015-16.

(g) increase in funding to external parties by $11.45 million (14.7%). This includes a potential funding to Investor Education Centre (IEC) based on the experience of costs for the IEC's key operations in 2015-16 and for projects in 2016-17 to increase the awareness, effectiveness and reach of education work, and to the Hong Kong Securities and Investment Institute (HKSI) for phase III of the Advanced Learning Platform project 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 Plan

8. In addition to the originally proposed 39 headcount increase for 2015-16, the SFC added two posts as interim headcount during the year to support the work resulting from the expansion of its interactions with the Mainland regulators and a significant increase in takeovers activity. With this interim headcount addition, the SFC now has a total headcount of 893. The SFC proposes another 24 new posts in the budget of 2016-17, and the total headcount will be 917. Key points of the manpower requests are set out below –

(a) **Intermediaries Division** (8 posts) – to handle the continued growth in regulated activities conducted by licensed corporations, to enhance its supervisory programme for anti-money laundering, to monitor the financial position of vulnerable licensed firms against a background of increased market volatility and to deal with the steady increase in the number of licensing applications;

(b) **Enforcement Division** (6 posts) – to handle the significant increase in investigation caseload and to cater for the increasing complexity of investigations undertaken by the Division;

(c) **Investment Products Division** (4 posts) – to support the work relating to the introduction of the open-ended fund company framework and initiatives to enhance the regulation of the Hong Kong asset management industry; and

(d) **Corporate Affairs Division** (4 posts) – to cater for the increase in workload arising from the expansion of office premises and the headcount, increase in workload arising from enquiries from the public, to support the increase in recruitment activities and to provide support to technology initiatives.

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9. In addition, the Corporate Finance Division and Centralised Services each requests the addition of one post to handle the continued growth in the number of Initial Public Offering applications and to support risk data strategy and risk analytics projects.

10. The SFC considers that given the highly uncertain environment in which it currently operates, there is a need to recognize the possibility of urgent unanticipated additional resource requirements in response to 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 2016-17 is $73.61 million, which is $44.51 million (152.9%) above the forecast expenditure for 2015-16 ($29.11 million) –

(a) computer systems development – for "front-end" technology to streamline the business process, upgrade market surveillance capabilities, improve access and exchange of information between stakeholders and the SFC, and enhance various information technology systems ($36.57 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, replacement of the resources system plus costs relating to the normal replacement of obsolete servers and computer equipment needed for additional headcount ($31.69 million); and

(c) office furniture and fixtures – for replacement of furniture and fixtures due to normal wear and tear and renovation costs for the additional office space to be leased ($5.35 million).

**Reserves**

12. The SFC has estimated that by 31 March 2016, the reserves are $7,287.31 million, which is 4.37 times of its projected operating expenditure for 2015-16 ($1,665.88 million).

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13. According to section 396 of the SFO, the SFC may, after consultation with the 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 remain the same in 2016-17, but it will continue to review the situation annually and include recommendations to the FS in each future budget for any changes considered necessary.

14. The SFC has also proposed to extend the annual licensing fee holiday for another period of two years starting from 1 April 2016 (paragraph 6(b) above). 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.

15. The SFC estimates that by 31 March 2017, the reserves will be reduced to $6,889.04 million, which is 3.71 times of the projected expenditure for 2016-17 ($1,858.57 million). The SFC will continue to keep its reserves level under review in accordance with section 396(1) of the SFO.

16. The SFC's lease of its current premises has provided for termination rights in 2017 and 2020, at which times its rent will be reviewed should the SFC continue with its lease. The SFC has advised that purchasing its own property would eliminate the risk of future rental increases and the net annual savings in rental is approximately $200 million. The SFC therefore plans to conduct a detailed accommodation strategy review to map out the options.

17. As part of the long-term accommodation strategy, the SFC has decided to set aside around $3 billion from the current reserves for the possible acquisition of office premises. This has made reference to the need to maintain a reserve level at least equivalent to two years of the SFC's operating expenses[5]. The remaining reserves will be used to support the SFC's operations, which the SFC will seek to maintain at an amount at least equivalent to two years of its operating expenses.

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[5] Section 396 of the SFO stipulates that if during a financial year of the SFC, the reserves of the SFC are more than twice its estimated operating expenses for the financial year, the SFC shall consult the FS with a view to recommending to the Chief Executive in Council that the rate or amount of a levy be reduced. The SFC may after consultation with the Financial Secretary recommend to the Chief Executive in Council that the rate or amount of a levy be reduced under section 394 of the SFO.

## COMPARISON OF THE ORIGINAL BUDGET WITH THE FORECAST BUDGET FOR 2015-16

### Income

18. The forecast income for 2015-16 is $1,712.00 million, which is $386.60 million (29.2%) more than the original budget of $1,325.40 million. The higher income is mainly due to higher than budgeted market turnover[6] and fee & charges income.

### Expenditure

19. The forecast expenditure is $1,665.88 million, which is $76.46 million (4.4%) below the original budget of $1,742.34 million. The underspending is mainly due to time lag experienced in filling vacancies, lower-than-expected actual cost for maintenance contracts in information and systems services and lower than expected overseas travelling and annual report production cost.

### Capital Expenditure

20. The forecast capital expenditure is $29.11 million, which is $31.69 million (52.1%) below the original budget of $60.80 million, as a result of deferred projects of computer systems development and computer software.

## PUBLIC CONSULTATION

21. We and the SFC briefed the FA Panel on the SFC's 2016-17 budget on 15 February 2016. Members generally indicated support to the budget.

## THE GOVERNMENT'S VIEWS

22. We have examined the budget of the SFC for 2016-17. We note that the SFC has proposed to extend the annual licensing fee holiday for another two years with effect from 1 April 2016, and will continue to provide financial support for training initiatives offered by the HKSI and other institutions. The SFC has not requested appropriation from LegCo as in the past years although it has projected a deficit in its budget.

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[6] The revised income for 2015-16 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 $87 billion and 355 000 from November 2015 to March 2016. The original budget is made based on assumptions of $78 billion per day and 233 000 per day.

23. 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 existing resources to deal with extra workload and new regulatory initiatives.

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Financial Services and the Treasury Bureau
April 2016

**Enclosure to FCRI(2016-17)2**

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

SFC
證監會

# Securities and Futures Commission

# Budget of Income and Expenditure

# for the financial year 2016/2017

23 December 2015

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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 to meet our regulatory obligations and objectives or to support new initiatives and regulatory developments. Strict controls are applied to ensure that costs stay within budget commitments. As in previous years, we have engaged an independent external consultant to conduct an annual review of financial controls and policies to ensure that they are robust and practical. No material findings were highlighted.

1.2 Set out below is a summary of the Commission's forecast for 2015/16 and proposed budget for 2016/17. For more detailed explanations, reference should be made to sections 3 and 4 of this budget book.

| | **2016/17** | 2015/16 | Variance | |
|---|---|---|---|---|
| | **Proposed Budget** | Forecast | Proposed Budget vs. Forecast | |
| | **(a)** | (b) | (c) = (a-b) | (c/b) |
| | **HK$'m** | HK$'m | HK$'m | % |
| **Income** | **1,460.29** | 1,712.00 | (251.71) | -14.7% |
| **Recurrent expenditure** | | | | |
| Staff cost | **1,234.36** | 1,103.26 | 131.10 | 11.9% |
| Premises expenses | **262.40** | 249.18 | 13.22 | 5.3% |
| Other recurrent expenses | **217.00** | 190.67 | 26.33 | 13.8% |
| **Total recurrent expenditure** | **1,713.76** | 1,543.11 | 170.65 | 11.1% |
| **Legal fees** | **55.37** | 44.78 | 10.59 | 23.6% |
| **Funding to external parties** | **89.44** | 77.99 | 11.45 | 14.7% |
| **Total expenditures** | **1,858.57** | 1,665.88 | 192.69 | 11.6% |
| **Result for the year** | **(398.28)** | 46.12 | (444.40) | |

1.3 For 2016/17 we forecast that income will decrease by $251.71 million (14.7%) over the 2015/16 Forecast as a result of assumed lower securities market turnover. Income for 2015/16 has been significantly affected by record daily market turnover during the first half of 2015, which declined during the second half. Average daily market turnover for the 4 months ended July 2015 was $157 billion, representing a 152% increase over the average of $62 billion for the same period last year, whilst the average daily turnover for the 4 months ended November 2015 was only $84 billion.

1.4 The levy rate will remain the same in 2016/17 but we 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. The annual licence fee holiday will provide a degree of financial relief for licensed intermediaries, particularly smaller firms. We propose to extend the waiver for another two years in 2016/17 and 2017/18.

1.6 Total expenditure for 2016/17 is expected to increase by $192.69 million (11.6%) over the 2015/16 Forecast. The increase is mainly attributable to increases in staff costs ($131.10 million), premises expenses ($13.22 million), legal fees ($10.59 million), other recurrent expenses ($26.33 million) and funding to external parties ($11.45 million).

1.7 The budget hinges on the need to ensure that the Commission is adequately resourced to effectively and efficiently discharge its responsibilities as the market develops and the regulatory environment changes.

1.8 The Commission's need to maintain adequate supervision of a growing number of intermediaries within the Hong Kong market, coupled with the increase in the number of enforcement and litigation cases in terms of volume and complexity (up 24% YTD from the prior year) will inevitably require more resources in the coming year.

1.9 In the first half of 2015, the Commission added 2 new posts to address urgent resource requirements. Having critically reviewed the manpower needs of the Commission's operating divisions and departments for 2016/17, a net increase of 24 full time posts over the Commission approved headcount of 2015/16 has been included in the budget. The total proposed headcount increase for 2016/17 is 26 (24 budgeted headcount + 2 interim headcount), which represents a total headcount increase of 2.9% for the next financial year.

1.10 58 position upgrades are requested to reflect the changing scope and complexity of our work.

1.11 There is a need to recognize the possibility of urgent unanticipated additional resource requirements in response to new or expanded regulatory mandates. These would be dealt with through a separate interim budget request after a critical review of need and any resourcing alternatives to additional headcount.

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. The Commission has also worked to improve operational and process efficiencies. For initiatives that are currently in a consultative or preliminary stage, existing resources are deployed to the extent possible. Please refer to Section 3 for more detailed information about the Commission's 2016/17 manpower plan.

1.13 We have set aside $10 million and $12 million in our 2015/16 Forecast and 2016/17 Budget respectively for funding training initiatives for intermediaries, particularly small and medium-sized firms.

1.14 A deficit of approximately $398.28 million is expected in 2016/17 leaving our overall reserves at $6.89 billion at the end of that financial year, approximately 3.7 times our annual costs including funding to various external parties.

1.15 The Commission's lease with Cheung Kong Center provides for termination rights in 2017 and 2020, at which times our rent will be reviewed should we continue with our lease. Purchasing our own property would eliminate the risk of future rental increases, and net annual savings in rental could amount to approximately $200 million. With this in mind we plan to conduct a detailed accommodation strategy review in the run up to 2020.

1.16 As part of its long-term accommodation strategy, the Commission has decided to set aside part of the current reserves for the possible acquisition of office premises. By taking into account the statutory obligation of the Commission to consider a levy reduction when our reserves are more than twice our annual operating expenses, we propose ring-fencing reserves of around $3 billion. Reserves available to support our operations will consist of the non-ring fenced portion, which we will seek to maintain at an amount which will be at least equivalent to two years of operating expenses.

## 2. Assumptions

2.1 Investor levy rates

2.1.1 The levy rates will remain unchanged for the year 2016/17, i.e.

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

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

2.2 Market turnover

2.2.1 Equity market

(a) The average securities market turnover is assumed to be around $87 billion/day for the remainder of 2015/16. The securities market turnover is expected to average approximately $110 billion/day for the full year (see also para 4.3.2(a)).

(b) For 2016/17, we assume that the average securities market turnover will remain at around $87 billion/day.

2.2.2 Futures and Options market

Based on the transaction volumes for the first half of 2015/16, the futures/options market turnover is assumed to be an average of 355,000 contracts per day for the rest of 2015/16. For forecasting purposes we have assumed that volumes will increase by 5% in 2016/17. On this basis, the futures/options market turnover is assumed to be an average of 372,000 contracts per day in 2016/17.

2.3 Fees and charges

2.3.1 The Licensing annual fee holiday will continue in 2015/16. We propose to extend the waiver for another two years. 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% p.a. for the year 2016/17.

2.5 Remuneration adjustment

2.5.1 A provision of 5% of personnel costs has been included as salary adjustments for staff (see also 4.4.2 (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 (e.g. projected CPI), relevant industry remuneration trends for 2016/17, 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 3.4% 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.

## 3. Manpower plan

### 3.1 Proposed headcount changes 2016/17 vs 2015/16

| Division | Headcount | | | | | |
|---|---|---|---|---|---|---|
| | Commission Approved 2015/16 | Proposed 2016/17 | Net Change | Executive Posts | Non-Executive Posts | *Para /ref* |
| Centralised Services [Note 1] | 34 | 35 | +1 | 1 | - | *3.6.1-3.6.2* |
| Corporate Finance | 87 | 88 | +1 | 1 | - | *3.6.3-3.6.4* |
| Enforcement | 196 | 202 | +6 | 6 | - | *3.6.5-3.6.6* |
| Intermediaries | 256 | 264 | +8 | 8 | - | *3.6.7* |
| Legal Services | 45 | 45 | - | - | - | *3.6.8* |
| Investment Products | 114 | 118 | +4 | 4 | - | *3.6.9-3.6.10* |
| Supervision of Markets | 50 | 50 | - | - | - | *3.6.11-3.6.12* |
| Corporate Affairs | 111 | 115 | +4 | 3 | 1 | *3.6.13-3.6.17* |
| **TOTAL** [Note 3] | **893**[Note 2] | **917** | **24** | **23** | **1** | |

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

Note 2 : The Commission approved headcount includes 2 interim headcount

Note 3 : The Commission has proposed 58 post upgrades for 2016/17

3.1.1 Having made a critical assessment of its manpower needs for 2016/17, a net increase of 24 full time posts has been included in this budget. As can be seen from the table in para 3.1 above, the manpower requests for 2016/17 are centered upon the Enforcement and Intermediaries Divisions with other Divisions recording minimal growth or keeping their headcount at 2015/16 level.

3.1.2 The Enforcement Division's headcount requests for next year are focused on middle level professionals. More resources are required at this level to support the increase in the number of cases (+24% in caseload YTD over 2015/16) and the increase in complexity of the cases under investigation.

3.1.3 The headcount requests from Intermediaries is to try and minimize the gap between Intermediaries' resourcing and the continued growth of both licensees and regulated activities.

3.1.4 Detailed justifications for additional headcount and upgrades are set out in paragraph 3.6.

### 3.2 The external market environment

3.2.1 The evolving regulatory landscape, increased interconnections with the Mainland, global financial reforms and an uncertain economic climate will continue to present challenges to the Commission.

3.3 The external employment market

3.3.1 There appears to have been an improvement in employer sentiment in 2015/16. Financial institutions in particular continue to strengthen headcount within their compliance, legal and risk functions. The demand for these professionals remains high and is expected to continue.

3.3.2 This continues to present the Commission with challenges in recruitment as well as the retention of junior and middle level professional staff.

3.4 The Commission's people strategy

3.4.1 Employee engagement - Taking into account the competition for talent in the external employment market, the Commission is progressing with a number of initiatives to further improve employee engagement, retention and productivity. These include providing career development support for our junior professionals, skills training for our people managers, the introduction of platforms to enhance communication between our junior professionals and more senior colleagues and the launch of SFC Women's Network.

3.4.2 Building a talent pipeline - In line with the Government of HKSAR's initiatives to develop employment opportunities for graduates, the Commission is committed to developing its talent pipeline through its Graduate Trainee Programme (GTP). Since the inception of the GTP, a total of 94 graduates were recruited by the Commission.

3.4.3 Succession planning - Significant progress has been made to ensure that a succession plan is in place to safeguard leadership continuity within the Commission.

3.5 Interim headcount – 2015/16

3.5.1 During 2015/16, the Commission approved an interim request of 2 additional posts to support work resulting from the expansion of the Commission's interactions with Mainland regulators and increases in workload. This included:

(a) The need for more active engagement and collaboration with the Commission's regulatory counterparts in Mainland China to support and enhance the Commission's regulatory oversight of the Stock Connect and other initiatives; and

(b) The need for resources to handle a significant increase in takeovers activity both in scale and complexity.

3.6 New headcount requests – 2016/17

**Centralised Services**

3.6.1 The Risk and Strategy unit (R&S) has proposed 1 executive post to support the Commission-wide risk data strategy and risk analytics projects.

3.6.2 In addition, 4 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**

3.6.3 The Corporate Finance Division (CFD) proposes 1 new executive post for the Dual Filing team. This responds to continued growth in the number of IPO applications.

3.6.4 2 executive upgrades are proposed in light of the increased complexity of CFD's work.

**Enforcement Division**

3.6.5 There has been a significant increase in the Enforcement Division's (ENF) investigation caseload (+24% YTD in 2015/16).

Cases also are increasingly complex and therefore more resource intensive. A request for 6 executive posts is being made.

3.6.6 10 executive upgrades are also proposed to reflect the increased sophistication of the work of ENF and to provide progression paths for high performing staff.

**Intermediaries Division**

3.6.7 The Intermediaries Division (INT) proposes 8 new posts.

(a) Intermediaries Supervision Department (ISD), Intermediaries

(i) 3 new executive posts are proposed to handle the continued growth in regulated activities conducted by licensed corporations (LCs) and the increase in number of enquiries.

(ii) Anti-Money Laundering (AML) - 1 executive post is requested to enhance the Commission's supervisory programme for AML. The appointee will lead a team to conduct inspections and other outreach work as part of the ongoing Hong Kong ML/TF risk assessment (National Money Laundering and Terrorist Financing Risk Assessment), in preparation for the next FATF mutual evaluation of Hong Kong's AML system.

(iii) Monitoring Vulnerable Brokers/Financial Resources Rules (FRR) – 1 executive post is required for ongoing monitoring of the financial position of vulnerable licensed firms, against a background of increased market volatility, an expansion of Mainland intermediaries in the local market, and increases in margin lending. This executive will also be responsible for assisting in the drafting of FRR amendment rules as part of the major OTC derivative reform. The executive will also lead in the design of FRR modifications or variations (under s.145A of SFO) required to be granted or applied to risky firms as well as reviewing financial models and risk management of major firms in light of Basel capital rules and FRR.

(iv) 10 executive and 5 non-executive upgrades are proposed to reflect the increasing sophistication and range of supervisory work as described above.

(b) Licensing Department (LIC), Intermediaries

(i) 3 executive posts are proposed by the Licensing Department (LIC – INT) to deal with the steady increase in the number of applications (including a 29% year-on-year increase in new corporate licensing applications and 14% in new individual licensing applications). The request also reflects the increasing complexity of LCs as well as the need to correct staff leverage ratios.

(ii) 3 executive and 4 non-executive upgrades are proposed to promote and retain high quality staff within the department.

**Legal Services Division**

3.6.8 The Legal Services Division (LSD) proposes 1 executive upgrade to reflect the broader and more strategic nature of work and to provide career progression for high performing staff.

**Investment Product Division**

3.6.9 The Investment Product Division (IP) proposes a total of 4 executive posts in response to the introduction of the open-ended fund company (OFC) framework as well as significant initiatives to enhance the regulation of the Hong Kong asset management industry.

(a) Introduction of the OFC framework

(i) The Commission has been assisting the Government to introduce a legal and regulatory framework for OFCs. OFC will be a new corporate vehicle for investment funds to be established under the SFO and regulated by the Commission.

(ii) It is currently intended that the draft Bill to amend the SFO (together with consequential amendments to at least five other Ordinances) will be introduced to the Legislative Council in early 2016. A significant increase in substantive technical input to the Government is expected in connection with the legislative process.

(iii) In addition, IP will be heavily involved in the preparation for the OFC subsidiary legislation and the OFC Code as well as the associated consultation targeted for release in 2016/17. As the subsidiary legislation and OFC Code will set out the detailed regulations governing the OFC framework, the workload involved is expected to be much heavier than the current phase.

(iv) IP will take a primary role in devising granular legislative and regulatory detail, responding to Legco's enquiries and interfacing with the FSTB, other relevant Government agencies/departments as well as external parties.

(v) IP will keep in view the actual workload requirement of this project after the legislative process has commenced and the ongoing resources needs of IP in view of the fact that more senior resources may have to be devoted to the project given its technical and complex nature.

(b) Enhancing the regulation of the Hong Kong Asset Management Industry

(i) The Commission is conducting a review of the asset management business in Hong Kong with a view to enhancing the regulation of the Hong Kong asset management industry

(ii) The global financial crisis has led to significant regulatory reform, with profound implications for the asset management industry in relation to issues such as systemic risks, liquidity and risk management, enhanced custody requirements, securities lending and repurchase agreements, conflicts of interest and product design. One of the key objectives of the review is to capture international standards of regulation of asset managers and enhance investor protection where appropriate.

(iii) To further strengthen Hong Kong's standing as a premier international asset management centre, the Commission is also working closely with the industry to encourage the development and use of alternative distribution platforms with a view to lowering costs and broadening investors' choice.

(iv) In pursuing the above, resources will have to be deployed in formulating the regulatory framework and detailed rules, researching into overseas regulations, communicating with other regulators and stakeholders and also conducting consultations.

3.6.10 In addition, 4 executive and 1 non-executive upgrades are requested by IP to reflect the increase in investment product applications.

**Supervision of Markets Division**

3.6.11 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.

3.6.12 3 executive and 2 non-executive post upgrades are proposed to allow for internal promotions to a level that better reflects the work being done.

**Corporate Affairs Division**

3.6.13 For Corporate Affairs Division (CA), 1 new executive post is proposed by the External Relations Department (ER/CA). This is in response to the notable increase in enquiries from the public.

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

3.6.15 The Information Technology Department (IT/CA) proposes 1 new executive post to support Commission-wide and division or department-specific technology initiatives.

3.6.16 The Human Resources Department (HR/CA) proposes 1 new executive post to ensure that the department is able to support increased recruitment activity as well as Commission-wide and division or department-specific human resource initiatives.

3.6.17 A total of 9 upgrades (3 in External Relations Department (ER/CA), 3 in the Human Resources Department (HR/CA), 1 in the Finance Department (F/CA) and 2 in the Planning & Administration Department (PA/CA)) are requested to maintain an appropriate CA structure for quality service delivery to the operating divisions.

# 4. Financials

## 4.1 Income and expenditure statement

| | Para. Ref. | **(a) Proposed Budget For Year 2016/17 HK$'000** | (b) Forecast For Year 2015/16 HK$'000 | (c) Approved Budget For Year 2015/16 HK$'000 | Proposed Budget (a) over/(under) Forecast (b) HK$'000 | % | Forecast (b) over/(under) Approved Budget (c) HK$'000 | % |
|---|---|---|---|---|---|---|---|---|
| **Income** | | | | | | | | |
| Investor levy | | | | | | | | |
| Securities | 4.3.2 | **1,165,104** | 1,472,880 | 1,047,254 | (307,776) | -20.9% | 425,626 | 40.6% |
| Futures/Options contracts | | **99,703** | 94,952 | 62,406 | 4,751 | 5.0% | 32,546 | 52.2% |
| Fees & charges | 4.3.3 | **124,050** | 132,410 | 118,440 | (8,360) | -6.3% | 13,970 | 11.8% |
| Net investment income | 4.3.4 | **63,780** | 4,100 | 89,657 | 59,680 | N/A | (85,557) | -95.4% |
| Other income | 4.3.5 | **7,656** | 7,656 | 7,646 | - | 0.0% | 10 | 0.1% |
| **Total** | | **1,460,293** | 1,711,998 | 1,325,403 | (251,705) | -14.7% | 386,595 | 29.2% |
| **Recurrent expenditures** | | | | | | | | |
| Premises | 4.4.1 | **262,400** | 249,180 | 248,220 | 13,220 | 5.3% | 960 | 0.4% |
| Staff cost | 4.4.2 | **1,234,356** | 1,103,263 | 1,163,266 | 131,093 | 11.9% | (60,003) | -5.2% |
| Information & systems services | 4.4.3 | **58,521** | 50,974 | 56,561 | 7,547 | 14.8% | (5,587) | -9.9% |
| General office & insurance | 4.4.4 | **9,760** | 8,800 | 9,400 | 960 | 10.9% | (600) | -6.4% |
| Learning & development | 4.4.5 | **7,650** | 7,000 | 9,666 | 650 | 9.3% | (2,666) | -27.6% |
| Professional fees | 4.4.6 | **59,480** | 48,011 | 48,030 | 11,469 | 23.9% | (19) | 0.0% |
| Regulatory and external activities | 4.4.7 | **21,650** | 18,545 | 23,605 | 3,105 | 16.7% | (5,060) | -21.4% |
| Internship programme | 4.4.8 | **4,940** | 5,331 | 8,840 | (391) | -7.3% | (3,509) | -39.7% |
| Contingency | | **-** | - | 3,000 | - | N/A | (3,000) | N/A |
| Depreciation | 4.4.9 | **55,000** | 52,000 | 54,000 | 3,000 | 5.8% | (2,000) | -3.7% |
| | | **1,713,757** | 1,543,104 | 1,624,588 | 170,653 | 11.1% | (81,484) | -5.0% |
| Legal fees | 4.4.10 | **55,370** | 44,784 | 32,000 | 10,586 | 23.6% | 12,784 | 39.9% |
| Operating expenditure (1) | | **1,769,127** | 1,587,888 | 1,656,588 | 181,239 | 11.4% | (68,700) | -4.1% |
| **Funding to external parties** | | | | | | | | |
| Funding to the FRC | 4.5.1 | **7,710** | 7,340 | 7,340 | 370 | 5.0% | - | 0.0% |
| Funding to the IFRS Foundation | 4.5.2 | **390** | 390 | 390 | - | 0.0% | - | 0.0% |
| Funding to IEC | 4.5.3-4 | **69,340** | 60,260 | 63,020 | 9,080 | 15.1% | (2,760) | -4.4% |
| Funding to the HKSI and other education initiatives | 4.5.5-6 | **12,000** | 10,000 | 15,000 | 2,000 | 20.0% | (5,000) | -33.3% |
| Total (2) | | **89,440** | 77,990 | 85,750 | 11,450 | 14.7% | (7,760) | -9.0% |
| **Total expenditure (1) + (2)** | | **1,858,567** | 1,665,878 | 1,742,338 | 192,689 | 11.6% | (76,460) | -4.4% |
| Result for the year | | **(398,274)** | 46,120 | (416,935) | (444,394) | -963.6% | 463,055 | -111.1% |
| Reserves brought forward | | **7,287,314** | 7,241,193 | 7,091,773 | 46,121 | 0.6% | 149,420 | 2.1% |
| Reserves carried forward | | **6,889,040** | 7,287,313 | 6,674,838 | (398,273) | -5.5% | 612,475 | 9.2% |

Note: With reference to the two-times 2016/17 annual operating expenditure threshold, the portion of the ring-fenced reserves will be around $3 billion.

## 4.2 Capital expenditure statement

| | Para. Ref | (a) Proposed Budget For Year 2016/17 HK$'000 | (b) Forecast For Year 2015/16 HK$'000 | (c) Approved Budget For Year 2015/16 HK$'000 | Proposed Budget (a) over/(under) Forecast (b) HK$'000 | % | Forecast (b) over/(under) Approved Budget (c) HK$'000 | % |
|---|---|---|---|---|---|---|---|---|
| **Capital expenditure** | 4.6 | | | | | | | |
| Furniture & fixtures | | **5,350** | 1,000 | 3,000 | 4,350 | 435.0% | (2,000) | -66.7% |
| Office equipment | | **31,690** | 12,917 | 18,050 | 18,773 | 145.3% | (5,133) | -28.4% |
| Computer systems development | | **36,570** | 15,188 | 34,220 | 21,382 | 140.8% | (19,032) | -55.6% |
| Sub-total | | **73,610** | 29,105 | 55,270 | 44,505 | 152.9% | (26,165) | -47.3% |
| Contingency | | **-** | - | 5,527 | - | N/A | (5,527) | N/A |
| Total | | **73,610** | 29,105 | 60,797 | 44,505 | 152.9% | (31,692) | -52.1% |

4.3 Income

4.3.1 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 2016/17. 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.

4.3.2 Investor levy

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

| | **2015/16** | | | **2016/17** |
|---|---|---|---|---|
| | Budget | Apr-Sep (actual) | Oct-Mar | Apr-Mar |
| **Securities** | | | | |
| Daily turnover (billion/day) | $78.0 | $134.5 | $87.0 | $87.0 |
| Levy rate | 0.0027% | 0.0027% | 0.0027% | 0.0027% |
| **Futures/Options Contracts** | | | | |
| Daily turnover (contracts) | 233,000 | 355,000 | 355,000 | 372,000 |
| Levy rate | $0.54 | $0.54 | $0.54 | $0.54 |

(b) The 2015/16 Forecast of Investor Levy – Securities is higher than the Approved Budget by 40.6% ($425.63 million) whereas Investor levy – Futures and Options is higher than the Approved Budget by 52.2% ($32.55 million). These variances reflect variations in actual market turnover in the first half of 2015/16 when compared to the estimates underlying the Approved Budget.

(c) Securities market turnover has been volatile in 2015. It reached $202 billion/day in April but dropped to $83 billion/day in September. In view of the subdued turnover in the second half of 2015, we project that the turnover for the next 6 months of 2015/16 and year 2016/17 would be around $87 billion/day.

(d) For budget purposes, we assume that the volume of future contracts will increase by 5% in 2016/17.

4.3.3 Fees and charges

(a) The Forecast aggregate fees and charges income for 2015/16 is 11.8% ($13.97 million) higher than the Approved Budget as fees from Corporate Finance are higher than expected.

(b) The 2016/17 Budget shows a decrease in fee income of 6.3% ($8.36 million) against the Forecast for 2015/16. We propose to extend the waiver of the Licensing annual fee for another two years in 2016/17 and 2017/18. The annual licensing fee foregone, based on Licensing's estimate, is $180 million.

4.3.4 Net investment income

(a) Budgeted investment income was $89.66 million which comprised of $75.6 million of Fixed Income & deposit interest and $25.4 million gains from Equity pooled funds. Due to short term volatility in our pooled equity fund investments, we have recorded a mark-to-market loss of $73.5 million during the first half of 2015/16. The forecast loss for the whole year is around $62 million. As a result, we have revised our 2015/16 Forecast net investment income to $4.1 million, after netting off Fixed Income and deposit interest and investment management fees.

(b) 2016/17 investment income is budgeted to be $63.78 million. For budgeting purpose, we assume that the average gross return on investment before investment management fees is 1%. The actual rate of return may vary, depending primarily on market performance and the investment strategy to be adopted.

4.3.5 Other income

Other income for 2015/16 and 2016/17 represents license fees and service fees received from the IEC and ICC for providing office space, accountancy, human resources and IT support services, recoveries from enforcement cases and sales of Commission publications.

4.4 Recurrent expenditure

4.4.1 Premises

(a) Forecast premises expenses for 2015/16 are expected to be close to the approved budget.

(b) We plan to lease additional office space of around 5,000 sq. ft. in 2016/17. This will allow us to accommodate budgeted headcount growth.

(c) Expenses for 2016/17 are budgeted to be $13.22 million (5.3%) higher than our 2015/16 Forecast. This is mainly due to the lease of the new office space mentioned in (b) above and an increase in the property management fee.

4.4.2 Staff cost

(a) The overall staff cost for 2015/16 is forecasted to be lower than the 2015/16 Budget by 5.2% ($60 million). This is principally due to the time lag experienced in filling vacancies and a number of positions being filled in lower grades.

(b) The projected headcount at 31 March 2017 is 917, a net increase of 24 (2.7%) over the 2015/16 Commission approved headcount. Please see section 3 for detailed explanations. The projected staff cost for 2016/17 is 11.9% ($131.09 million) higher than the 2015/16 Forecast.

(c) The 2016/17 Budget includes provision for an average 5% pay increase for Commission staff. This is based on preliminary market information from external parties including pay consultants and professional associations. Detailed proposals for the actual pay increase will be formulated in Q1, 2016.

(d) The detailed pay policy will be presented to the Commission's Remuneration Committee for discussion and to the Commission for approval.

4.4.3 Information and systems services

(a) The information and systems services expenses forecast for 2015/16 is 9.9% ($5.59 million) lower than the Approved Budget due to lower than expected actual costs for software and hardware maintenance contracts, delay in projects and cancellation of subscription services.

(b) For 2016/17, we project a 14.8% ($7.55 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.

4.4.4 General office and insurance

(a) The general office and insurance expenses for Forecast 2015/16 is 6.4% ($0.6 million) lower than the approved budget mainly reflecting the lower than expected actual spending in printing, stationery and repairs and maintenance in the first six months of 2015/16.

(b) Budgeted expenses for 2016/17 are higher than 2015/16 Forecast by 10.9% ($0.96 million). The increase is mainly due to the projected increase in demand for general printing. Repairs and maintenance expenses are also projected to be higher in 2016/17 as provision is made for minor office reconfiguration work.

4.4.5 Learning and development

(a) Forecast learning and development related expenses for 2015/16 are 27.6% ($2.67 million) lower than the approved budget. Volatile markets since June 2015 have postponed planning work for the China Program in the current year. In addition, there has been a change in staff development priorities this year.

(b) The learning and development budget for 2016/17 will be 9.3% ($0.65 million) higher than the 2015/16 Forecast. As the capital market and products are constantly changing and our workforce continues to grow, more technical and leadership development opportunities will be provided to the Commission staff to enhance their professional knowledge and competencies. The further integration of the Hong Kong and China capital markets requires the Commission staff to learn more about China directly from our cross-border counterparts, market makers and key players. More leadership and management training programs have also been planned for 2016/17 compared with 2015/16.

4.4.6 Professional fees

(a) Forecast professional fees for 2015/16 is close to the approved budget.

(b) Professional fees for 2016/17 are expected to increase by 23.9% ($11.47 million) as the demand for external expert services remains high, especially in the areas of investigation, supervision of intermediaries and authorization of new products.

(c) Key projects in 2016/17 include cyber security and dark pool trading review of brokers and a consultancy on the uncertificated securities market.

4.4.7 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 2015/16 are lower than the approved budget by 21.4% ($5.06 million) mainly due to lower than expected overseas travelling and annual report production cost.

(c) The 2016/17 budget is 16.7% ($3.11 million) higher than the 2015/16 Forecast. This is attributable to the hosting of an IOSCO Board Meeting and the increase in the need for overseas travelling to engage in global and domestic regulatory reforms and promoting collaboration.

4.4.8 Internship programme

This represents the salary cost of hiring university graduates in support of the Government's internship programme and for the Commission to develop a pipeline of talent for the future. Our proposed expenditure for 2016/17 to recruit and retain graduates represents a decrease of $0.39 million (7.3%) against the 2015/16 Forecast.

4.4.9 Depreciation

(a) Forecast depreciation expenses for 2015/16 are expected to be 3.7% ($2 million) lower than budget because of lower than expected capital expenditure incurred in the current year.

(b) The budget for 2016/17 is 5.8% ($3 million) higher than the 2015/16 Forecast due to the expected increase in capital expenditure incurred in 2016/17.

4.4.10 Legal fees

(a) The forecast for 2015/16 is 39.9% ($12.78 million) higher than the approved budget for 2015/16 due to an increased caseload, increased complexity of cases and additional briefing out to better manage the workload of our Legal Services Division.

(b) The budget for 2016/17 is projected to be 23.6% ($10.59 million) higher than forecast because of the size of the caseload and the increased complexity of the cases.

4.5 Funding to external parties

4.5.1 To continue our support for the work of the Financial Reporting Council, the Commission will increase the 2015/16 annual funding from $7.34 million to $7.71 million in 2016/17, with a 5% price adjustment.

4.5.2 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) in 2016/17.

4.5.3 Funding to Investor Education Centre (IEC) is reduced from $63.02 million to $60.26 million in 2015/16 based on the latest forecast prepared by IEC. In 2016/17, IEC proposed total expenditure of $69.34 million. Major expenses are summarised below:

| | Budget 2016/17 | Forecast 2015/16 | Budget 2015/16 |
|---|---|---|---|
| | $'m | $'m | $'m |
| Education programmes | 36.61 | 29.03 | 27.54 |
| Staff costs | 24.81 | 23.26 | 23.08 |
| Premises costs | 3.40 | 3.40 | 3.40 |
| Professional & other services | 2.10 | 2.22 | 4.56 |
| Publicity & external relations | 0.55 | 0.55 | 2.54 |
| General office & others | 1.87 | 1.80 | 1.90 |
| Total | 69.34 | 60.26 | 63.02 |

4.5.4 IEC projects higher expenditure for 2016/17 based on its experience of the costs of its key operations in 2015/16 (e.g. website maintenance and development, conducting quality and rigorous research etc) as well as proposals for projects in 2016/17 to increase the awareness, effectiveness and reach of education work.

4.5.5 In the 2015/16 Forecast, we have provided $10 million for funding training initiatives for intermediaries, particularly small and medium-sized firms, to meet the challenges arising from a changing market landscape. One of the training initiatives requires funding to the Hong Kong Securities and Investment Institute (HKSI) to assist with the development of HKSI's Advanced Learning Platform project.

4.5.6 In 2016/17, we have provided $12 million for training initiatives, including the potential funding to HKSI for phase III of the Advanced Learning Platform project and support for other education programmes.

4.6 Capital expenditure

4.6.1 The total capital expenditure for the 2015/16 Forecast has been reduced from $60.8 million to $29.11 million. Lower capital expenditure in computer systems development and computer software are due to deferred projects.

4.6.2 The total capital expenditure budget for 2016/17 is $73.61 million, 152.9% ($44.51 million) higher than the 2015/16 Forecast mainly due to projected higher computer systems development costs. The planned capital expenditure commitment for 2015/16 comprises the following:

| Capital expenditure | Amount $ m | Note |
|---|---|---|
| Office furniture & fixtures | 5.35 | (a) |
| Office equipment | 31.69 | (b) |
| Computer systems development | 36.57 | (c) |
| Total | 73.61 | |

Notes :-

(a) Includes a provision of $4 million for furniture and fixtures and renovation costs for the additional office space to be leased.

(b) office equipment:

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

  (ii) $30.69 million for investment in storage technology and data base capacity, replacement of the resources system plus costs relating to the normal replacement of obsolete servers and computer equipment needed for additional headcount.

(c) $36.57 million is provided for front-end technology to streamline the business process, upgrade our market surveillance capabilities, improve access and exchange of information between stakeholders and the Commission and enhance various IT systems.