For information **FCRI(2017-18)3**

NOTE FOR FINANCE COMMITTEE

Securities and Futures Commission
Budget for the Financial Year 2017-18

PURPOSE

With regard to the consultation procedures agreed with the Legislative Council (LegCo) when the Securities and Futures Commission (SFC) was established[1] in 1989, the Government has prepared this note to brief Members on the main features of the budget of the SFC for 2017-18[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 6 February 2017, this Bureau and the SFC briefed the Panel on Financial Affairs (FA Panel) on the SFC's proposed budget for 2017-18. A copy of
Encl. the budget for 2017-18 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 the 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 2017 and ends on 31 March 2018.

4. Under section 394 of the SFO, the CE-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. 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 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 2017-18

5. The SFC has projected a budget deficit of $534.53 million for 2017-18. As in past years, the SFC does not request any appropriation from LegCo for the 2017-18 budget. The main features of the 2017-18 budget are set out in paragraphs 6 to 15 below.

Income

6. The estimated income for 2017-18 is $1,418.53 million, which is $107.22 million (8.2%) above the forecast income for 2016-17 ($1,311.31 million). The SFC has adopted the following assumptions in projecting the estimated income –

(a) the average securities market turnover will be $81 billion per day and the average futures and options market turnover will be 433 000 contracts per day; and

(b) the annual licensing fee holiday will continue in 2017-18.

Expenditure

7. The estimated expenditure for 2017-18 is $1,953.06 million, which is $134.48 million (7.4%) above the forecast expenditure for 2016-17 ($1,818.58 million). The increase is mainly attributable to –

(a) increase in staff cost by $115.13 million (9.5%) arising mainly from –

(i) a provision of $30.50 million for 28 new headcount to enable the SFC to improve the efficiency in the commencement and progress of legal proceedings as a result of enforcement actions and to maintain adequate supervision in the light of a continued growth in the number of intermediaries in the Hong Kong market. Details are set out in paragraph 9 below;

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(ii) a provision of $49.24 million for annual pay adjustment, i.e. an amount approximately equivalent to 4.5% of personnel costs; and

(iii) a provision of $20.10 million for 59 position upgrades for different divisions and departments to facilitate the recruitment of more specialised staff, to efficiently handle the increased complexity of work in certain areas and to provide a progression path for high performing staff;

(b) increase in expenses on information and systems services by $17.87 million (33.1%) due to higher costs for system contract services and software maintenance, and increase in subscriptions for market data to support enforcement and supervision activities. New systems are required by the operating divisions to manage their caseload and to enhance their investigatory and supervisory capabilities;

(c) increase in expenses on legal fees by $5.64 million (9.2%) due to the size of the caseload and the increased complexity of the cases;

(d) increase in expenses on general office items and insurance by $0.96 million (9.9%) due to the projected increase in demand for general printing, as well as higher expenses for repairs and maintenance and vehicle expenses; and

(e) increase in expenses for learning and development by $0.76 million (9.6%) due to the provision of more technical and leadership development programmes to the SFC's staff, in order to enhance their professional knowledge and leadership competencies and to help them cope with a constantly changing capital market and new products.

8. The increase in expenditure is partially offset by the decrease in expenditure on the following items –

(a) premises expenses by $3.62 million (1.4%) due to a combination of factors, including –

(i) rental reduction as agreed with the landlord of its Cheung Kong Center (CKC) office for the period from September 2017 to August 2020; and

/(ii) …..

(ii) additional expenses arising from the lease of new office space of 3 000 sq. ft. at CKC to accommodate the budgeted headcount growth, and extra storage space outside CKC of around 4 000 sq. ft. for storage of exhibits seized from search operations for enforcement purpose; and

(b) funding to external parties by $2.94 million (3.4%) as less contribution will be provided for training initiatives to support other education programmes.

Manpower Plan

9. The SFC proposes 28 new headcount in the budget for 2017-18, bringing its total headcount to 945, with details as follows –

(a) **Intermediaries Division** (8 posts) – to handle the continued growth in regulated activities carried out by licensed corporations (LCs), to cope with the increase in depth, coverage and complexity of LCs' risks and operations, to reflect the need to adjust the current supervisory structure to ensure quality of deliverables, and to deal with the increasing workload including a significant increase in new corporate license applications and the new manager in charge regime;

(b) **Legal Services Division** (8 posts) – to assist the Enforcement Division to further enhance efficiency in terms of commencing and progressing legal proceedings as a result of enforcement actions, to assist in providing legal advice in relation to ongoing, complex and serious investigation and litigation cases, and to provide adequate legal clerical support as a consequence of the additional litigation workload;

(c) **Investment Products Division** (4 posts) – to engage with overseas regulators on potential mutual recognition of funds arrangements, and to enhance the fund monitoring work;

(d) **Corporate Finance Division** (3 posts) – to handle the continued growth in the number of Initial Public Offering applications submitted under the Dual Filing regime and the increase in thematic monitoring work and more complex cases handled by the Corporate Regulation team;

(e) **Corporate Affairs Division** (3 posts) – to accommodate individuals converted from contract staff currently providing information technology (IT) expertise in specific technical areas; and

/(f) .....

(f) **Centralised Services** (2 posts) – to support the SFC's risk analytics project, the increased workload associated with International Organization of Securities Commissions' related activities and the SFC's interactions with other regulatory bodies.

10. The SFC considers that given the highly uncertain environment in which it currently operates, there is a need to recognise 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 2017-18 is $57.41 million, which is $3.62 million (5.9%) below the forecast expenditure for 2016-17 ($61.03 million), comprises the following key items –

(a) **computer system development** – adoption of "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 IT systems ($37.59 million);

(b) **office equipment** – replacement of obsolete office equipment due to normal wear and tear, investment in storage technology and data base capacity, replacement of the resources system plus costs relating to the replacement of obsolete servers and computer equipment needed for additional headcount ($13.27 million); and

(c) **office furniture and fixtures** – renovation for the additional office space to be leased to accommodate new headcount ($6.20 million).

Reserves

12. The SFC estimated that by 31 March 2017, the reserves (after ring-fencing $3,000 million for possible acquisition of office premises as reported in its 2016-17 budget[3]) would be $3,770.27 million, which is 2.07 times of the projected expenditure for 2016-17 ($1,818.58 million).

/13. …..

[3] The SFC's current lease will expire in 2022. The SFC is open to all cost effective accommodation options and will conduct a detailed assessment of the various property strategy options before deciding how to make the best use of the amount ring-fenced.

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, another 25% in October 2010 and a further 10% in November 2014. The SFC considers that the levy rate should remain the same in 2017-18, 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 will continue to offer an annual licensing fee holiday in 2017-18 as it has committed in the 2016-17 budget[4]. The SFC will, depending on the market condition and its medium-term financial projection, review its fees and charges level when the two-year licensing annual fee waiver period ends.

15. The SFC estimates that by 31 March 2018, the non-ring-fenced reserves will be reduced to $3,235.74 million, which is 1.66 times of the projected expenditure for 2017-18 ($1,953.06 million). The SFC will continue to keep its reserves level under review in accordance with section 396(1) of the SFO. The SFC considers that in the longer term, if turnover does not increase substantially, the SFC will continue to incur an operating deficit and its reserves will decrease. By then, the SFC will need to revisit options to ensure adequate funding, including the possibility of raising the levy rate and ending the concessionary annual licensing fee holiday.

COMPARISON OF THE ORIGINAL BUDGET WITH THE FORECAST BUDGET FOR 2016-17

Income

16. The forecast income for 2016-17 is $1,311.31 million, which is $148.98 million (10.2%) less than the original budget of $1,460.29 million. The lower income is mainly due to a lower-than-budgeted market turnover[5].

/Expenditure …..

4 The SFC has committed in the 2016-17 budget to offer a two-year licensing annual fee holiday from 1 April 2016 to 31 March 2018.

5 The revised income for 2016-17 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 $71 billion and 400 600 contracts for the year. The original budget is made based on assumptions of a turnover of $87 billion per day and 372 000 contracts per day.

Expenditure

17. The forecast expenditure is $1,818.58 million, which is $39.98 million (2.2%) below the original budget of $1,858.57 million. The underspending is mainly due to time lag experienced in filling vacancies, as well as lower-than-expected actual costs for information search and hardware maintenance contracts, external professional services, and overseas travelling and seminar expenses.

Capital Expenditure

18. The forecast capital expenditure is $61.03 million, which is $12.58 million (17.1%) below the original budget of $73.61 million. This is due to lower expenditure in computer system and software as some projects have been deferred.

PUBLIC CONSULTATION

19. We and the SFC briefed the FA Panel on the SFC's proposed budget for 2017-18 on 6 February 2017. Members indicated support to the budget.

THE GOVERNMENT'S VIEWS

20. We have examined the budget of the SFC for 2017-18. We note that the annual licensing fee holiday will last for another year in 2017-18, and 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 organisation, to deploy its resources and control its expenditures in a prudent manner. Given that the SFC's income is subject to market fluctuation, the SFC should continue to exercise stringent cost control and endeavour to cope with extra workload and new regulatory initiatives through redeployment of existing resources where possible.

Financial Services and the Treasury Bureau
May 2017

Enclosure to FCRI(2017-18)3

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 2017/2018

22 December 2016

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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 2016/17 and proposed budget for 2017/18. For more detailed explanations, reference should be made to sections 3 and 4 of this budget book.

	2017/18	2016/17	Variance	
	Proposed Budget	Forecast	Proposed Budget vs. Forecast	
	(a)	(b)	(c) = (a - b)	(c / b)
	HK$'m	HK$'m	HK$'m	%
Income	**1,418.53**	1,311.31	107.22	8.2%
Recurrent expenditure				
Staff cost	**1,325.79**	1,210.66	115.13	9.5%
Premises expenses	**256.05**	259.67	(3.62)	-1.4%
Other recurrent expenses	**220.50**	200.23	20.27	10.1%
Total recurrent expenditure	**1,802.34**	1,670.56	131.78	7.9%
Legal fees	**66.84**	61.20	5.64	9.2%
Funding to external parties	**83.88**	86.82	(2.94)	-3.4%
Total expenditures	**1,953.06**	1,818.58	134.48	7.4%
Result for the year	**(534.53)**	(507.27)	(27.26)	

1.3 The turnover of the securities market is one of the key drivers of the Commission's income. The unpredictable and volatile nature of the market turnover component presents an unavoidable degree of uncertainty in the annual budget compilation. Any fluctuation of $1 billion in average daily turnover will have an impact of around $13 million in our 2017/18 income.

1.4 For 2017/18 we forecast that income will increase by $107.22 million (8.2%) over the 2016/17 Forecast as a result of the latest securities market turnover assumption. Securities market turnover for the 1st 6 months was $67 billion/day and we assume the market turnover is approximately $71 billion/day for 2016/17. For 2017/18, the average securities market turnover is assumed around $81 billion/day.

1.5 The levy rate will remain the same in 2017/18. We will continue to review the situation annually and include recommendations to the Financial Secretary in each future budget for any changes considered necessary.

1.6 The two year annual licence fee holiday that commenced in April 2016 will be in force until March 2018. 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. Based on the input from divisions, fees income for 2017/18 will be $1m (1%) higher than the Forecast.

1.7 Total expenditure for 2017/18 is expected to increase by $134.48 million (7.4%) over the 2016/17 Forecast. The increase is mainly attributable to increases in staff costs ($115.13 million), other recurrent expenses ($20.27 million) and legal fees ($5.64 million) but will be partially offset by the decrease in premises expenses ($3.62 million) and funding to external parties ($2.94 million).

1.8 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.

1.9 The continued growth in the number of intermediaries in the Hong Kong market, coupled with the Commission's commitment to improving efficiency in the commencement and progress of legal proceedings resulting from enforcement action serves to underpin its requirement for resources in 2017/18.

1.10 Having critically reviewed the manpower needs of the Commission's operating divisions for 2017/18, a net increase of 28 full time posts over the Government approved headcount of 2016/17 has been included in the budget. This represents a total headcount increase of approximately 3% for the next financial year.

1.11 59 position upgrades are requested to reflect the changing scope of work and the increase in regulatory responsibilities, as well as to provide a career path for the Commission's high performing staff.

1.12 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.

1.13 The Commission continually reviews its resourcing needs and organisation structure. Wherever possible, the Commission seeks 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 2017/18 manpower plan.

1.14 A deficit of approximately $534.53 million is expected in 2017/18 leaving our non-ringfenced reserves at $3.24 billion at the end of that financial year, which is approximately 1.66 times our annual costs including funding to various external parties.

1.15 The Commission's reserves have been built up over a number of years, the high market volatility from 2006 to 2008 being the main contributor. In response to the accumulation of large reserves, we have reduced our levy rate 3 times since 2006, from the original level of 0.005% to the current level of 0.0027%. We have also waived our annual licensing fees for 7 financial years since 2009. The impact of the levy reductions and fee waiver has pushed the Commission into an operating deficit as it has grown to meet the regulatory demands of the market.

1.16 At the current levy rate, to achieve a breakeven position in 2017/18, we will need an average daily market turnover of around $120 billion. In the longer term, if turnover does not increase substantially, the Commission will continue to incur an operating deficit and our reserves will decrease. By then the Commission will need to revisit options to ensure adequate funding including the possibility of raising the levy rate and ending the concessionary licence fee holiday.

2. Assumptions

2.1 Investor levy rates

2.1.1 The levy rates will remain unchanged for the year 2017/18, 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 around $67 billion/day for the first 6 months of 2016/17. Based on the SFC Research Department's latest statistical analysis result, the average daily securities market turnover is approximately $71 billion/day for the year 2016/17 (see also para 4.3.2(a)).

(b) For 2017/18, the average securities market turnover is assumed around $81 billion/day.

2.2.2 Futures and Options market

Based on the transaction volumes for the first half of 2016/17, the futures/options market turnover is assumed to be an average of 400,600 contracts per day for the rest of 2016/17. For forecasting purposes we have assumed that volume will increase in line with estimated increase in the securities market turnover. On this basis, the futures/options market turnover is assumed to be an average of 433,000 contracts per day in 2017/18.

2.3 Fees and charges

2.3.1 Licensing annual fee holiday will continue in 2017/18. 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 1.3% p.a. for the year 2017/18.

2.5 Remuneration adjustment

2.5.1 A provision of 4.5% 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 2017/18, 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 2.3% 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 2017/18 vs 2016/17

Division	Headcount					
	Government Approved 2016/17	Proposed 2017/18	Net Change	Executive Posts	Non-Executive Posts	*Para /ref*
Centralised Services [Note 1]	35	37	+2	1	1	*3.4.1-3.4.3*
Corporate Finance	88	91	+3	3	-	*3.4.4-3.4.5*
Enforcement	202	202	-	-	-	*3.4.6-3.4.7*
Intermediaries	264	272	+8	6	2	*3.4.8*
Legal Services	45	53	+8	6	2	*3.4.9-3.4.11*
Investment Products	118	122	+4	4	-	*3.4.12-3.4.13*
Supervision of Markets	50	50	-	-	-	*3.4.14-3.4.15*
Corporate Affairs	115	118	+3	2	1	*3.4.16-3.4.18*
TOTAL [Note 2]	**917**	**945**	**28**	**22**	**6**	

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

Note 2 : The Commission has proposed 59 post upgrades for 2017/18

3.1.1 Having made a critical assessment of its manpower needs for 2017/18, a net increase of 28 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 2017/18 are centered upon the Legal Services and Intermediaries Divisions with other Divisions recording minimal growth or keeping their headcount at the 2016/17 level.

3.1.2 The Legal Services Division's headcount requests for next year are focused on middle level professionals. These additional resources are required to support the increase in litigation work as a result of action brought by the Enforcement Division. This increase also aims at improving the efficiency in relation to the commencement and progression of legal proceedings of cases currently 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 3.4.

3.2 The external employment market

3.2.1 The uncertain economic and political environment in 2016/17 will continue to present challenges to the Commission. The rapid pace of technological advancement and the advent of disruptive technology will also overlay greater complexity and sophistication to the financial sector.

3.2.2 Faced with underlying weakness in the market, employers are more conservative in making hiring decisions. But due to global and local regulatory requirements however, the demand for compliance, legal and risk professionals remains high and is expected to continue.

3.2.3 Additionally, the expansion of public sector employment opportunities offered by newly formed statutory/regulatory bodies and the expansion of clerical and general administrative roles within the Government, have created a solid demand for individuals with a sense of public service.

3.2.4 These developments present the Commission with challenges in recruitment as well as the retention of junior and middle level professional staff.

3.3 The Commission's people strategy

3.3.1 Employee development – In response to increasing competition from the external employment market for compliance, legal and risk professionals, the Commission is continuing and further refining its human resources initiatives to improve employee engagement, retention and productivity. These include enhancing two-way communication, leadership training for our people managers and increasing career development opportunities for our junior and middle level professionals through secondment opportunities, job rotation and job related project assignments.

3.3.2 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) on an ongoing basis.

3.4 New headcount requests – 2017/18

Centralised Services

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

3.4.2 The International Affairs unit (IA) has proposed 1 non-executive post to support the increased workload resulting from IOSCO related activity and the Commission's interactions with other regulatory bodies/forums such as G20 and FSB.

3.4.3 In addition, 2 executive and 2 non-executive upgrades are proposed to reflect the increased responsibilities in supporting SFC CEO's leadership role in IOSCO work and to provide progression for high performing staff.

Corporate Finance Division

3.4.4 The Corporate Finance Division (CFD) proposes 3 new executive posts for the Dual Filing and Corporate Regulation team. This corresponds to the continued growth in the number of IPO applications submitted under the Dual Filing regime and the increase in thematic monitoring work and more complex cases handled by the Corporate Regulation team.

3.4.5 1 executive and 2 non-executive upgrades are proposed in light of the increase in the scope of work undertaken by CFD and to provide a progression path for high performing staff.

Enforcement Division

3.4.6 No new headcount for 2017/18 is requested.

3.4.7 13 executive and 1 non-executive upgrades are proposed following a strategic review of Enforcement Division's practices and processes which aims to facilitate quicker enforcement actions to be taken in the future.

Intermediaries Division

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

(a) Intermediaries Supervision Department (ISD), Intermediaries

(i) 5 new executive posts are proposed to handle the continued growth in regulated activities conducted by licensed corporations (LCs) and to cope with the increase in depth, coverage and complexity of LCs risks and operations. The request also reflects the need to adjust its current supervisory structure to ensure quality of deliverables.

(ii) 6 executive and 2 non-executive upgrades are proposed to allow the recruitment of more specialized staff to effectively handle more complex inspection work.

(b) Licensing Department (LIC), Intermediaries

(i) 1 executive and 2 non-executive posts are proposed in order to respond to the increasing workload including a significant increase in new corporate license applications and the new manager in charge regime.

(ii) 4 non-executive upgrades are proposed to promote and retain high quality staff within the department for the implementation of new system and special projects.

Legal Services Division

3.4.9 The Legal Services Division (LSD) has proposed 6 executive posts to assist ENF to further enhance efficiency in terms of commencing and progressing legal proceedings of enforcement actions. These posts will also assist in providing legal advice in relation to ongoing, complex and serious investigation and litigation cases.

3.4.10 2 non-executive posts are proposed to provide adequate legal clerical support for LSD as a consequence of the additional litigation workload.

3.4.11 LSD also proposes 1 executive and 1 non-executive upgrades to reflect the broader and more strategic nature of work and to provide career progression for high performing staff.

Investment Product Division

3.4.12 The Investment Product Division (IP) proposes a total of 4 executive posts in response to the need for additional resources to engage with multiple European regulators on potential mutual recognition of funds (MRF) arrangements and the enhancement of IP's fund monitoring work.

(a) Engagement with multiple European regulators on potential MRF arrangements

(i) With a view to enhancing the attractiveness of Hong Kong domiciled funds, the Commission is in discussion with a number of European authorities about potential MRF arrangements, which would allow each market's local public funds to be sold in the other's market through a streamlined approval process.

(ii) For every MRF arrangement with a European jurisdiction, the Commission has to complete a regulatory standards mapping exercise to determine if the regulatory standards and level of investor protection in the two markets are broadly equivalent. This would involve comprehensively reviewing the overseas rules/regulations and meticulously comparing them against each and every HK requirements in our product code.

(iii) For each MRF arrangement, the Commission would also need to take the lead in discussing and resolving numerous technical, operational and implementation related matters and issues with the relevant European regulators and in preparing and negotiating a memorandum of understanding between the two regulators and all MRF-related documents, implementation rules and circulars.

(b) Enhancement of fund monitoring work

In line with international regulatory and reporting requirements on the asset management sector, the Commission is expanding its scope and depth of its current fund monitoring work. To this end, the following resources are needed to:

(i) devise and build a new integrated system to capture the data collected in respect of SFC-authorised funds (including NAV, leverage, liquidity profile, subscription and redemption, general portfolio information);

(ii) develop a monitoring matrix and risk alerts system to, and perform regular monitoring and analysis of data submitted to, detect non-compliance, emerging risks and irregularities; and

(iii) conduct focused analysis on issues identified for case teams to follow up with the relevant fund houses for appropriate actions.

3.4.13 In addition, 5 executive and 4 non-executive upgrades are requested by IP to reflect the increasing complexity in investment product applications and to provide career progression for high performing staff.

Supervision of Markets Division

3.4.14 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.

3.4.15 4 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

3.4.16 The Information Technology Department (IT/CA) proposes 2 new executive and 1 non-executive posts to convert individuals currently contracted to the Commission who provide expertise in specific technical areas. The retention of this knowledge will be imperative in developing and supporting Commission wide and division specific technology requirements such as electronic submission initiatives, enhancement of market surveillance infrastructure and introduction of technology to increase collaboration and operational efficiency.

3.4.17 A total of 9 upgrades are requested in order to maintain an appropriate CA structure to support the Commission's constituent divisions/departments in discharging their regulatory responsibilities and to provide career progression for high performing staff.

3.4.18 The upgrades comprise 1 executive upgrade in External Relations Department (ER/CA), 2 non-executive upgrades in the Human Resources Department (HR/CA), 1 executive and 1 non-executive upgrade in the Finance Department (F/CA), 3 non-executive upgrades in Information Technology Department (IT/CA) and 1 non-executive upgrade in the Planning & Administration Department (PA/CA).

4. Financials

4.1 Income and expenditure statement

	Para. Ref.	(a) Proposed Budget For Year 2017/18 HK$'000	(b) Forecast For Year 2016/17 HK$'000	(c) Approved Budget For Year 2016/17 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	**1,084,752**	951,198	1,165,104	133,554	14.0%	(213,906)	-18.4%
Futures/Options contracts		**114,955**	106,440	99,703	8,515	8.0%	6,737	6.8%
Fees & charges	4.3.3	**135,262**	134,172	124,050	1,090	0.8%	10,122	8.2%
Net investment income	4.3.4	**76,560**	112,500	63,780	(35,940)	-31.9%	48,720	76.4%
Other income	4.3.5	**7,000**	7,000	7,656	-	0.0%	(656)	-8.6%
Total		**1,418,529**	1,311,310	1,460,293	107,219	8.2%	(148,983)	-10.2%
Recurrent expenditures								
Premises	4.4.1	**256,046**	259,672	262,400	(3,626)	-1.4%	(2,728)	-1.0%
Staff cost	4.4.2	**1,325,793**	1,210,657	1,234,356	115,136	9.5%	(23,699)	-1.9%
Information & systems services	4.4.3	**71,942**	54,071	58,521	17,871	33.1%	(4,450)	-7.6%
General office & insurance	4.4.4	**10,667**	9,710	9,760	957	9.9%	(50)	-0.5%
Learning & development	4.4.5	**8,649**	7,890	7,650	759	9.6%	240	3.1%
Professional fees	4.4.6	**56,130**	55,980	59,480	150	0.3%	(3,500)	-5.9%
Regulatory and external activities	4.4.7	**18,044**	19,025	21,650	(981)	-5.2%	(2,625)	-12.1%
Internship programme	4.4.8	**5,070**	5,056	4,940	14	0.3%	116	2.3%
		1,752,341	1,622,061	1,658,757	130,280	8.0%	(36,696)	-2.2%
Legal fees	4.4.9	**66,840**	61,200	55,370	5,640	9.2%	5,830	10.5%
		1,819,181	1,683,261	1,714,127	135,920	8.1%	(30,866)	-1.8%
Depreciation	4.4.10	**50,000**	48,500	55,000	1,500	3.1%	(6,500)	-11.8%
Operating expenditure (1)		**1,869,181**	1,731,761	1,769,127	137,420	7.9%	(37,366)	-2.1%
Funding to external parties								
Funding to the FRC	4.5.1	**8,090**	7,710	7,710	380	4.9%	-	0.0%
Funding to the IFRS Foundation	4.5.2	**390**	390	390	-	0.0%	-	0.0%
Funding to IEC	4.5.3-4	**73,396**	68,722	69,340	4,674	6.8%	(618)	-0.9%
Funding to the HKSI and other education initiatives	4.5.5-6	**2,000**	10,000	12,000	(8,000)	-80.0%	(2,000)	-16.7%
Total (2)		**83,876**	86,822	89,440	(2,946)	-3.4%	(2,618)	-2.9%
Total expenditure (1) + (2)		**1,953,057**	1,818,583	1,858,567	134,474	7.4%	(39,984)	-2.2%
Result for the year		**(534,528)**	(507,273)	(398,274)	(27,255)	5.4%	(108,999)	27.4%
Reserves brought forward		**3,770,267**	4,277,540	7,287,314	(507,273)	-11.9%	(3,009,774)	-41.3%
		3,235,739	3,770,267	6,889,040	(534,528)	-14.2%	(3,118,773)	-45.3%
Reserve for property acquisition		**-**	-	(3,000,000)	-	N/A	3,000,000	-100.0%
Reserves carried forward		**3,235,739**	3,770,267	3,889,040	(534,528)	-14.2%	(118,773)	-3.1%

4.2 Capital expenditure statement

	Para. Ref	(a) **Proposed Budget For Year 2017/18**	(b) Forecast For Year 2016/17	(c) Approved Budget For Year 2016/17	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	4.6							
Furniture & fixtures		**6,200**	5,350	5,350	850	15.9%	-	0.0%
Office equipment		**13,270**	20,380	31,690	(7,110)	-34.9%	(11,310)	-35.7%
Vehicles		**350**	-	-	350	N/A	-	N/A
Computer systems development		**37,590**	35,300	36,570	2,290	6.5%	(1,270)	-3.5%
Total		**57,410**	61,030	73,610	(3,620)	-5.9%	(12,580)	-17.1%

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 2017/18. 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:

	2016/17			**2017/18**
	Apr 16–Mar 17 (Budget)	Apr-Sep 16 (Actual)	Apr 16-Mar 17 (Forecast)	Apr 17-Mar 18
Securities				
Daily turnover (billion/day)	$87.0	$67.0	$71.0	$81.0
Levy rate	0.0027%	0.0027%	0.0027%	0.0027%
Futures/Options Contracts				
Daily turnover (contracts)	372,000	400,600	400,600	433,000
Levy rate	$0.54	$0.54	$0.54	$0.54

(b) The 2016/17 Forecast of Investor Levy – Securities is lower than the Approved Budget by $213.91 million (18.4%) whereas Investor levy – Futures and Options is higher than the Approved Budget by $6.74 million (6.8%). These variances reflect variations in actual market turnover in the first half of 2016/17 when compared to the estimates underlying the Approved Budget.

(c) We assume that the securities market turnover for 2016/17 and 2017/18 would be around $71 billion/day and $81 billion/day respectively.

(d) For budget purposes, we assume that the volume of future contracts will increase by 8% in 2017/18.

4.3.3 Fees and charges

(a) The Forecast aggregate fees and charges income for 2016/17 is $10.12 million (8.2%) higher than the Approved Budget as fees from Corporate Finance are higher than expected.

(b) The 2017/18 Budget shows an increase in fee income of $1.09 million (0.8%) against the Forecast for 2016/17. The 2-year licensing annual fee waiver period ends in April 2018. The annual licensing fee foregone, based on Licensing's estimate, is $192 million.

4.3.4 Net investment income

(a) Budgeted investment income was $63.78 million which comprised of $56.6 million of fixed income and deposit interest and $7.2 million gains from equity pooled funds. Due to short term volatility in our pooled equity fund investments, we have recorded a mark-to-market gain of $52.89 million during the first half of 2016/17. The forecast gain for the whole year is around $59.95 million. As a result, we have revised our 2016/17 Forecast net investment income to $112.5 million, after netting investment management fees.

(b) 2017/18 investment income is budgeted to be $76.56 million. For budgeting purpose, we assume that the average gross return on investment before investment management fees is 1.3%. 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 2016/17 and 2017/18 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 2016/17 are expected to be close to the approved budget.

(b) We plan to lease additional office space of around 3,000 sq. ft. in our Cheung Kong Center office (CKC) in 2017/18. This will allow us to accommodate budgeted headcount growth. Also, office space of around 4,000 sq. ft. will be leased to set up an extended exhibit room outside CKC for Enforcement Division. The extended exhibit room will be used for safe-keeping of seizures and electronic devices obtained from search operations.

(c) Expenses for 2017/18 are budgeted to be $3.62 million (1.4%) lower than our 2016/17 Forecast. This is due to the combination of (i) a rental lower than the existing level as agreed with the landlord of CKC for the first rent review period, which covers the period from September 2017 to August 2020; (ii) the additional leases mentioned in (b) above; and (iii) a projected increase in the property management fee.

4.4.2 Staff cost

(a) The overall staff cost for 2016/17 is forecasted to be lower than the 2016/17 Budget by $23.7 million (1.9%). 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 2018 is 945, a net increase of 28 (3%) over the 2016/17 Government approved headcount. Please see section 3 for detailed explanations. The projected staff cost for 2017/18 is $115.14 million (9.5%) higher than the 2016/17 Forecast.

(c) The 2017/18 Budget includes provision for an average 4.5% pay increase for Commission staff. This recommendation is based on market information from independent parties including pay consultants and professional associations. In arriving at the proposed increase, additional consideration is given to data relevant to the financial services sector and more specifically, the functional areas from which the Commission is competing for talent from (i.e. compliance, legal and risk). The anticipated supply and demand in the external employment market for the forthcoming year, as well as macroeconomic indicators are also taken into account. Detailed proposals for the actual pay increase will be formulated in Q1, 2017.

(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 2016/17 is $4.45 million (7.6%) lower than the Approved Budget due to lower than expected actual costs for information search and hardware maintenance contracts, delay in projects and cancellation of subscription services.

(b) For 2017/18, we project a $17.87 million (33.1%) increase due to higher system contract services and software maintenance costs 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) Forecast general office and insurance for 2016/17 is close to the approved budget.

(b) Budgeted expenses for 2017/18 are higher than 2016/17 Forecast by $0.96 million (9.9%). The increase is mainly due to the projected increase in demand for general printing and higher repairs and maintenance and vehicles expenses.

4.4.5 Learning and development

(a) Forecast learning and development related expenses for 2016/17 are $0.24 million (3.1%) higher than the approved budget due to a new 3-day Shanghai Study Trip in September 2016, which incurred additional funding.

(b) The learning and development budget for 2017/18 will be $0.76 million (9.6%) higher than the 2016/17 Forecast. As the capital market and products are constantly changing and our workforce continues to grow, more technical and leadership development programmes will be provided to Commission staff to enhance their professional knowledge and leadership competencies. Along with the growing importance of Hong Kong as a leading international financial centre and a premier capital formation hub for Mainland China, asset management, FinTech and other China-related training will continue to be our focus in the next fiscal year.

4.4.6 Professional fees

(a) Forecast professional fee for 2016/17 is $3.5 million (5.9%) lower than the Approved Budget due to lower than expected external professional services.

(b) The 2017/18 budget is close to the 2016/17 Forecast.

(c) Key projects in 2017/18 include self-money laundering risk assessments, thematic review of prime services business and equity derivatives business, data analytics, investor ID model and 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 2016/17 are lower than the approved budget by $2.63 million (12.1%) mainly due to lower than expected overseas travelling and seminars expenses.

(c) The 2017/18 budget is $0.98 million (5.2%) lower than the 2016/17 Forecast. This is attributable to the combination of fewer seminars planned and an increase in the need for overseas travelling to engage in 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 2017/18 is close to the 2016/17 Forecast.

4.4.9 Legal fees

(a) The forecast for 2016/17 is $5.83 million (10.5%) higher than the approved budget for 2016/17 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 2017/18 is projected to be $5.64 million (9.2%) higher than forecast because of the size of the caseload and the increased complexity of the cases.

4.4.10 Depreciation

(a) Forecast depreciation expenses for 2016/17 are expected to be $6.5 million (11.8%) lower than budget because of lower than expected capital expenditure incurred in the current year.

(b) The budget for 2017/18 is $1.5 million (3.1%) higher than the 2016/17 Forecast to cover the projected capital expenditure in 2017/18.

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 2016/17 annual funding from $7.71 million to $8.09 million in 2017/18, 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 2017/18.

4.5.3 Funding to Investor Education Centre (IEC) is reduced from $69.34 million to $68.72 million in 2016/17 based on the latest forecast prepared by IEC. In 2017/18, IEC proposed total expenditure of $73.40 million. Major expenses are summarised below:

	Budget 2017/18	Forecast 2016/17	Budget 2016/17
	$'m	$'m	$'m
Education programmes	39.81	36.59	36.61
Staff costs	25.72	24.20	24.81
Premises costs	3.40	3.40	3.40
Professional & other services	1.78	1.85	2.10
Publicity & external relations	0.58	0.58	0.55
General office & others	2.11	2.10	1.87
Total	73.40	68.72	69.34

4.5.4 IEC projects higher expenditure for 2017/18 based on its experience of the costs of its key operations in 2016/17 as well as proposals for projects in 2017/18 to increase the awareness, effectiveness and reach of education work.

4.5.5 In the 2016/17 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 (phase III).

4.5.6 In 2017/18, we have provided $2 million for training initiatives to support other education programmes.

4.6 Capital expenditure

4.6.1 The total capital expenditure for the 2016/17 Forecast has been reduced from $73.61 million to $61.03 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 2017/18 is $57.41 million, $3.62 million (5.9%) lower than the 2016/17 Forecast mainly due to the combination of lower spending in computer hardware and higher spending in computer systems development and office furniture & fixtures. The planned capital expenditure commitment for 2017/18 comprises the following:

Capital expenditure	Amount $'m	Note
Office furniture & fixtures	6.20	(a)
Office equipment	13.27	(b)
Vehicles	0.35	(c)
Computer systems development	37.59	(d)
Total	57.41	

Notes :-

(a) Includes a provision of $6.2 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) $12.27 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) $0.35m is provided for a Commission van to support the transportation between CKC and the extended exhibit room. The additional vehicle will also provide a more convenient and timely day-to-day document delivery service to the Commission.

(d) $37.59 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.