

## **NOTE FOR FINANCE COMMITTEE**

### **Securities and Futures Commission Budget for the Financial Year 2019-20**

#### **PURPOSE**

With regard to the consultation procedures agreed with the Legislative Council (LegCo) when the Securities and Futures Commission (SFC) was established in 1989, the Government has prepared this note to brief Members on the main features of the budget of the SFC for 2019-20<sup>1</sup>.

#### **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. The 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 19 February 2019, this Bureau and the SFC briefed the Panel on Financial Affairs (FA Panel) on the SFC's proposed budget for 2019-20. A copy of the budget for 2019-20 is at Enclosure.

Encl.

#### **FUNDING OF THE SFC**

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

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<sup>1</sup> The financial year of the SFC starts on 1 April of a year and ends on 31 March of the following year.

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 2019-20**

5. The SFC has projected a budget deficit of \$229.76 million for 2019-20. As in past years, the SFC does not request any appropriation from LegCo for the 2019-20 budget. The main features of the 2019-20 budget are set out in paragraphs 6 to 13 below.

### **Income**

6. The estimated income for 2019-20 is \$1,949.51 million, which is \$264.04 million (15.7%) above the forecast income for 2018-19 (\$1,685.47 million). The SFC has adopted the following assumptions in projecting the estimated income –

- (a) the average securities market turnover will be \$106 billion per day and the average futures and options market turnover will be 558 000 contracts per day; and
- (b) the collection of annual licence fee will be resumed through a phased approach by providing a discount of 50% in 2019-20<sup>2</sup>.

### **Expenditure**

7. The estimated expenditure for 2019-20 is \$2,179.27 million, which is \$219.27 million (11.2%) above the forecast expenditure for 2018-19 (\$1,960 million). The increase is mainly attributable to –

- (a) increase in staff cost by \$106.15 million, arising mainly from –

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<sup>2</sup> The annual licence fee waiver ended in end-March 2019. The SFC has advised that after reviewing its fees and charges level, its overall financial situation, as well as the market conditions, it will provide a discount of 50% in the annual licence fee for 2019-20 and 2020-21. The annual licence fee will be fully reinstated from 2021-22 onwards.

- (i) a provision of \$32.6 million for 23 new headcount to ensure that the SFC is adequately staffed for the effective and efficient discharge of its responsibilities in response to market development and the changes in the regulatory environment. Details are set out in paragraph 8 below;
  - (ii) a provision of \$48.74 million budgeted for the annual pay adjustment. This amount is approximately equivalent to an average of 4% pay increase; and
  - (iii) a provision of \$8.94 million for the upgrade of 28 positions to reflect the change in the scope of work and the increase in regulatory responsibilities, and to provide a career path for high-performing staff;
- (b) increase in expenses on premises by \$40.83 million as there will be a need to make a one-off provision for the rental of both the office at Cheung Kong Center and a new office at One Island East<sup>3</sup> for three months in 2019-20 to allow fitting-out work to be carried out in the new office;
- (c) increase in expenses on information and system services by \$18 million due to a significant growth in software and market data subscription costs and enhancement in in-house search engine capabilities to support enforcement and supervision activities, more systems control services to meet the increasing demand of helpdesk support, and new systems for operating divisions to manage their caseloads and enhance their investigatory and supervisory capabilities; and
- (d) others by \$54.29 million, which include depreciation, legal and professional fees, funding to external parties and on external activities, as well as learning and development programmes.

### Manpower Plan

8. The SFC proposes 23 new headcount in the budget of 2019-20, bringing its total headcount to 988, with details as follows –

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<sup>3</sup> The SFC has taken out a new lease at One Island East, Quarry Bay. The eight-year lease, at a unit rent at approximately half of that paid under the existing lease, will begin in January 2020.

- (a) **Intermediaries Division** (nine posts) – to provide support to the adoption of the internal models approach under the Securities and Futures (Financial Resources) Rules for risk identification and measurement, to build a specialised inspection team in light of the inclusion of virtual assets trading platform operators and fund managers in the SFC’s sandbox, to respond to the increasing workload resulting from the growth in licensees, and to handle inspection and ongoing supervision matters of licensed corporations under the SFC’s front-loaded regulatory approach;
- (b) **Enforcement Division** (six posts) – to handle the growing number of complex disciplinary cases and high-priority referrals from the SFC’s ICE Working Group<sup>4</sup>, to handle a large number of active cases which include a number of high-priority cases involving court proceedings, to handle complex corporate fraud cases, and to provide support for the initial assessment of cases referred to the Enforcement Division;
- (c) **Corporate Finance Division** (three posts) – to cope with the substantial increase in the number of listing applications, to handle workload resulting from the greater use of the Securities and Futures (Stock Market Listing) Rules following the SFC’s adoption of a front-loaded regulatory model, and to handle the increased workload in relation to takeovers;
- (d) **Investment Product Division** (one post) – to provide support to the enhancement and market development work in relation to existing and new mutual recognition of funds arrangements as well as policy-related work; and
- (e) **Corporate Affairs Division** (four posts) – to provide expertise in specific technical areas, to support the implementation of various information technology (IT) systems being rolled out across the SFC, and to handle an increasing number of complaints.

9. The SFC considers that given the highly uncertain environment in which it 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 as may be needed.

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<sup>4</sup> This is an inter-divisional working group comprising officers of the Intermediaries, Corporate Finance and Enforcement Divisions.

## Capital Expenditure

10. The total capital expenditure proposed for 2019-20 is \$258.77 million, which is \$178.98 million (224.3%) above the forecast expenditure for 2018-19 (\$79.79 million). It comprises the following key items –

- (a) **office furniture and fixtures** – a one-off renovation cost for the new office (\$140.4 million);
- (b) **computer systems development** – adoption of front-end technology to streamline the business process; upgrade of market surveillance capabilities; improvement of the access and the exchange of information between stakeholders and the SFC; and enhancement of various IT systems (\$86.23 million); and
- (c) **office equipment** – investment in storage technology and data base capacity, as well as software upgrade; replacement of the resources system plus costs relating to the normal replacement of obsolete servers; purchase of computer equipment for the additional headcount; and replacement of obsolete office equipment due to normal wear and tear (\$32.14 million).

## Reserves

11. The SFC estimates that by 31 March 2019, the reserves (after ring-fencing \$3,000 million for possible acquisition of office premises as a long-term accommodation strategy since 2016-17<sup>5</sup>) will be \$3,890.24 million, which is 1.98 times of the forecast expenditure for 2018-19 (\$1,960 million).

12. 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 (0.0027%) in 2019-20. But the SFC will continue to review the situation annually in accordance with section 396(1) of the SFO, taking into consideration the prevailing market conditions, its expected resource requirements and its financial projections for the near to medium term. The SFC will include its recommendations to the FS in each future budget for any changes that it considers necessary.

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<sup>5</sup> The expense on premises is a key expenditure item for the SFC. Notwithstanding that it has secured an eight-year lease at a new office premises (see Footnote 3 above), it remains the longer-term goal for the SFC to purchase its own office premises. This should allow the SFC to have a more effective control over its expenditure on premises.

13. The SFC estimates that by 31 March 2020, the non-ring-fenced reserves will be reduced to \$3,660.48 million, which is 1.68 times of the projected expenditure for 2019-20 (\$2,179.27 million).

## **COMPARISON OF THE ORIGINAL BUDGET WITH THE FORECAST BUDGET FOR 2018-19**

### **Income**

14. The forecast income for 2018-19 is \$1,685.47 million, which is \$185.38 million (9.9%) less than the original budget of \$1,870.85 million. The lower income is mainly due to a lower-than-budgeted market turnover<sup>6</sup> and lower income from fees, charges and investment.

### **Expenditure**

15. The forecast expenditure is \$1,960 million, which is \$38.46 million (1.9%) below the original budget of \$1,998.46 million. The underspending is mainly due to time lag in filling vacancies, and lower expenses on legal fees and premises. The savings were partially offset by an increase mainly in expenses on professional fees and depreciation.

### **Capital Expenditure**

16. The forecast capital expenditure is \$79.79 million, which is \$22.83 million (40.1%) higher than the original budget of \$56.96 million. The higher expenditure is mainly due to the spending on computer hardware, computer software and computer systems development in relation to the enhancement of various projects for 2018-19.

## **PUBLIC CONSULTATION**

17. We and the SFC briefed the FA Panel on the SFC's proposed budget for 2019-20 on 19 February 2019. Members indicated support for the budget.

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<sup>6</sup> The revised income for 2018-19 is projected based on the prevailing market performance and an assumption that the average daily turnover of securities transactions is \$104 billion and that of futures and options contracts transactions is 547 000 contracts. The original budget is made based on assumptions of a turnover of \$109 billion per day and 410 000 contracts per day.

**THE GOVERNMENT'S VIEWS**

18. We have examined the budget of the SFC for 2019-20. We note that the regulator has not requested appropriation from LegCo as in the past years.

19. 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. We note that the SFC, after reviewing the market conditions, is reinstating the collection of the annual licence fee by 50% for two years from 2019-20 to 2020-21, instead of making an immediate full reinstatement when the annual licence fee waiver for 2018-19 expires. We also note that the SFC will move to a new office and through that, the unit rent to be paid by the SFC can be reduced by about half. Meanwhile, the SFC's main source of income is subject to market fluctuation. On the whole, the SFC should continue to exercise stringent cost control and make its best effort to cope with extra workload and new regulatory initiatives through redeployment of existing resources, re-engineering and automation of its processes.

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Financial Services and the Treasury Bureau  
June 2019

**Securities and Futures Commission**  
**Budget of income and expenditure**  
**for the financial year 2019/20**

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17 December 2018



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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. We will also scrutinise and re-deploy resources from areas that are not expected to recur in the next financial year. 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 2018/19 and proposed budget for 2019/20. For more detailed explanations, reference should be made to sections 3 and 4 of this budget book.

	2019/20	2018/19	Variance	
	Proposed Budget	Forecast	Proposed Budget vs. Forecast	
	(a)	(b)	(c) = (a-b)	(c/b)
	HK\$m	HK\$m	HK\$m	%
<b>Income</b>	<b>1,949.51</b>	1,685.47	264.04	15.7%
<b>Recurrent expenditure</b>				
Staff cost	1,454.51	1,348.36	106.15	7.9%
Premises expenses	290.10	249.27	40.83	16.4%
Other recurrent expenses	284.92	233.40	51.52	22.1%
<b>Total recurrent expenditure</b>	<b>2,029.53</b>	1,831.03	198.50	10.8%
<b>Legal fees</b>	<b>60.00</b>	45.27	14.73	32.5%
<b>Funding to external parties</b>	<b>89.74</b>	83.70	6.04	7.2%
<b>Total expenditure</b>	<b>2,179.27</b>	1,960.00	219.27	11.2%
<b>Result for the year</b>	<b>(229.76)</b>	(274.53)	44.77	

- 1.3 For 2019/20 we forecast that income will increase by \$264.04 million (15.7%) over the 2018/19 Forecast as a result of the latest securities market turnover and investment return assumptions. We assume that the securities market turnover for 2018/19 and 2019/20 would be approx. \$104 billion/day and \$106 billion/day respectively. This assumed securities market turnover level is derived from an internal statistical analysis model and for budgeting purposes only, it does not constitute any implication or prediction of the future securities market. The actual securities market turnover for the first 7 months of 2018/19 averaged \$104 billion/day.
- 1.4 The unpredictable nature of market turnover 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 income.

- 1.5 The levy rate will remain the same at 0.0027% in 2019/20. 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 one year annual licence fee waiver that commenced in April 2018 will end by March 2019. After reviewing our fees and charges level and market conditions, we recommend to resume the collection of annual license fee through a phased approach by providing a discount of 50% in 2019/20 and 2020/21 which is estimated at \$112 million each year. The annual licence fee will be fully reinstated from 2021/22 onwards.
- 1.7 Total expenditure for 2019/20 is expected to increase by \$219.27 million (11.2%) over the 2018/19 Forecast. The increase is mainly attributable to increases in staff costs (\$106.15 million).
- 1.8 The budget reflects the resource needs of the Commission in order to effectively and efficiently discharge its responsibilities as the market continues to develop and the regulatory environment changes.
- 1.9 Having critically reviewed the manpower needs of the Commission's operating divisions for 2019/20, a net increase of 23 full time posts over the Commission approved headcount of 2018/19 has been included in the budget. This represents a total headcount increase of approximately 2.4% for the next financial year. Please refer to Section 3 for more detailed information about the Commission's 2019/20 manpower plan.
- 1.10 28 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.
- 1.11 In preparing the 2019/20 budget, the Commission seeks to re-deploy existing resources to deal with extra workload or new regulatory initiatives anticipated in the next budget year wherever possible.
- 1.12 However, 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 thorough review of needs and any resourcing alternatives to that of additional headcount.
- 1.13 The Commission's lease at the Cheung Kong Center provides for a termination right in 2020. We have entered into a new eight-year lease at One Island East, Quarry Bay where the rental will be approximately half of that paid under our existing lease. The new lease will commence in January 2020 and renovation work will start once the space is vacated. There will be a period during the fitting-out and transition to the new premises when we will inevitably pay rent under both leases.
- 1.14 A deficit of approximately \$229.76 million is expected in 2019/20 leaving our non-ringfenced reserves at \$3.66 billion at the end of that financial year, which is approximately 1.7 times our annual costs, including funding to various external parties.
- 1.15 We will review our reserves and the levy annually, taking into consideration prevailing market conditions, our expected resource requirements and medium term financial projections.

## 2. Assumptions

### 2.1 Investor levy rates

2.1.1 The levy rates will remain unchanged for the year 2019/20, 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 \$104 billion/day for the first 7 months of 2018/19. Based on the latest internal statistical analysis result, the average daily securities market turnover is assumed to be \$104 billion/day for the remainder of the year (see also para 4.3.2(a)).
- (b) The average securities market turnover is estimated to be approximately \$106 billion/day for 2019/20 for budgeting purposes.

#### 2.2.2 Futures and Options market

Based on the transaction volumes for the first 7 months of 2018/19, the futures/options market turnover is assumed to be an average of 547,000 contracts per day for the rest of 2018/19. For budgeting 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 558,000 contracts per day in 2019/20.

### 2.3 Fees and charges

- 2.3.1 Licensing annual fee waiver will end in 2018/19. We recommend to resume the collection of annual license fee in 2019/20 through a phased approach by providing a discount of 50% in 2019/20 and 2020/21. The annual licence fee will be fully reinstated from 2021/22 onwards.
- 2.3.2 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

The average gross return on investment of our reserve funds before investment management fees is assumed to be 2.58% p.a. for the year 2019/20.

### 2.5 Remuneration adjustment

- 2.5.1 A provision of 4.0% of personnel costs has been included as salary adjustments for staff (see also 4.4.1 (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 2019/20, the labour market demand for the type of expertise required by the Commission as well as merit adjustments.

2.6 Inflation

Where an estimate of general price level increases is required we have assumed 2.4% when we do not have specific data and/or quotes on which to estimate our future costs.

2.7 Capital expenditure

Capital expenditure is budgeted based on the level of expenditure which will be spent 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 2018/19 vs 2019/20

Division	Headcount				Para /ref
	Commission Approved 2018/19	Proposed 2019/20	Net Change	Upgrades	
Centralised Services <sup>Note 1</sup>	30	30	-	4	3.2.1
Corporate Finance	95	98	+3	1	3.2.2 – 3.2.3
Enforcement	211	217	+6	2	3.2.4-3.2.5
Intermediaries	282	291	+9	11	3.2.6 – 3.2.7
Legal Services	53	53	-	2	3.2.8
Investment Products	122	123	+1	3	3.2.9 – 3.2.10
Supervision of Markets	51	51	-	1	3.2.11
Corporate Affairs	121	125	+4	4	3.2.12 -3.2.14
<b>TOTAL</b> <sup>Note 2</sup>	<b>965</b>	<b>988</b>	<b>23</b>	<b>28</b>	

Note 1 : Includes International Affairs, Mainland Affairs, Secretariat and Press Office and CEO's Office.

Note 2 : The Commission has proposed 23 new executive posts and 28 post upgrades for 2019/20

3.1.1 Having made a critical assessment of its manpower needs for 2019/20, a net increase of 23 full time posts have been included in this budget. The need for new headcount is due to the overall growth of the market in terms of the number of participants as well as the sophistication of their business models. The increasing complexity faced by the Commission has driven the need for more experienced staff as well as greater cross-divisional collaboration to tackle issues that arise.

3.1.2 Detailed justifications for additional headcount and upgrades are set out in paragraphs below.

#### 3.2 New headcount requests – 2019/20

##### Centralised Services

3.2.1 No new headcount for 2019/20 is requested. 2 executive and 2 non-executive upgrades are proposed to provide progression for high performing staff.

##### Corporate Finance Division

3.2.2 The Corporate Finance Division proposes 3 new executive posts for the Takeovers, Pre-IPO and Post-IPO teams. These include:

- (a) 1 new executive post for the Post-IPO Team following the Commission's adoption of a front loaded regulatory model which will result in the greater use of SMLR;

- (b) 1 new executive post for Pre-IPO due to the substantial increase in the number of applications submitted under the Dual Filing regime; and
- (c) 1 new executive post for Takeovers to address increased workload as a result of the continuing growth in the number and complexity of cases under management and will also include several disciplinary cases

3.2.3 One non-executive upgrade is proposed to provide progression for high performing staff.

### **Enforcement Division**

3.2.4 The Enforcement Division proposes 6 new executive posts. These requests consist of:

- (a) 1 executive post for the Insider Dealing and Market Manipulation Team in response to the large number of active cases of which a proportion are high priority cases involving court proceedings;
- (b) 3 executive posts for the Intermediaries Misconduct Team to handle the continued growth complex disciplinary cases and high priority referrals from the Commission's ICE Working Group;
- (c) 1 executive post for the Corporate Fraud and Misfeasance Team to handle complex corporate fraud cases; and
- (d) 1 executive post for the Case Intake Team which will provide dedicated support for the initial assessment of cases referred to ENF

3.2.5 2 executive post upgrades are proposed to reflect the increasing complexity and difficulty of the cases encountered by ENF which will require the expertise of more experienced staff.

### **Intermediaries Division**

3.2.6 The Intermediaries Division proposes 9 new posts.

- (a) Intermediaries Supervision Department, Intermediaries
  - (i) 1 new executive post to primarily focus on market risk and to provide support to the introduction of the internal models approach into the FRR for risk identification and measurement, as part of the promotion of Hong Kong as a booking hub for Asian derivatives;
  - (ii) 1 new executive post to build a specialized inspection team covering Virtual Assets trading platform operators and fund manager in the Commission's sandbox; and
  - (iii) 4 new executive post are proposed to support the inspection and other ongoing supervision matters of licensed corporations

with the emphasis on earlier and more targeted intervention under the Commission's front loaded regulatory approach.

(b) Licensing Department, Intermediaries

3 executive posts are proposed to respond to the increasing workload resulting from the growth in licensees.

- 3.2.7 3 executive post upgrades and 8 non-executive post upgrades are requested by INT to allow career progression for junior professional and support staff.

**Legal Services Division**

- 3.2.8 No new headcount for 2019/20 is requested. 2 non-executive upgrade are proposed to provide career progression for high performing staff.

**Investment Product Division**

- 3.2.9 1 new executive post is proposed to provide support in the enhancement and market development work in relation to existing and new mutual recognition of funds arrangements, as well as policy related work.
- 3.2.10 3 executive post upgrades are requested by IP to allow career progression and recruitment of specialized staff required to address the increase in volume and breadth of policy and other initiatives in market facilitation, policy formulation and application processing and monitoring.

**Supervision of Markets Division**

- 3.2.11 No new headcount is requested in 2019/20. 1 non-executive post upgrade is proposed to provide career progression for high performing staff.

**Corporate Affairs Division**

- 3.2.12 The Information Technology Department proposes 3 new executive posts to provide expertise in specific technical areas and to support and implement various systems currently being rolled out across the Commission.
- 3.2.13 The External Relations Department proposes 1 executive post to assist in handling the increasing number of complaints, which have more than doubled over the past year.
- 3.2.14 A total of 4 upgrades are requested in order to maintain an appropriate Corporate Affairs structure to support the Commission's constituent divisions/departments in discharging their regulatory responsibilities and to provide career progression for high performing staff. The upgrades comprise 1 executive post in Human Resources Department, and 1 executive post and 2 non-executive posts in Information Technology Department.



## 4. Financials

### 4.1 Income and expenditure statement

		(a) Proposed Budget For Year 2019/20 HK\$'000	(b) Forecast For Year 2018/19 HK\$'000	(c) Approved Budget For Year 2018/19 HK\$'000	Proposed Budget (a) over/(under) Forecast (b) HK\$'000 %		Forecast (b) over/(under) Approved Budget (c) HK\$'000 %	
Para Ref.								
<b>Income</b>								
Investor levy								
Securities	4.3.2	1,425,276	1,377,306	1,442,070	47,970	3.5%	(64,764)	-4.5%
Futures/Options contracts		148,339	145,430	109,000	2,909	2.0%	36,430	33.4%
Fees & charges	4.3.3	202,545	143,408	146,250	59,137	41.2%	(2,842)	-1.9%
Net investment income	4.3.4	166,350	1,337	166,530	165,013	N/A	(165,193)	-99.2%
Other income	4.3.5	7,000	17,990	7,000	(10,990)	-61.1%	10,990	157.0%
<b>Total</b>		<b>1,949,510</b>	<b>1,685,471</b>	<b>1,870,850</b>	<b>264,039</b>	<b>15.7%</b>	<b>(185,379)</b>	<b>-9.9%</b>
<b>Recurrent expenditure</b>								
Staff cost	4.4.1	1,454,510	1,348,360	1,384,922	106,150	7.9%	(36,562)	-2.6%
Premises	4.4.2	290,103	249,266	253,666	40,837	16.4%	(4,400)	-1.7%
Information & systems services	4.4.3	90,681	72,681	71,792	18,000	24.8%	889	1.2%
General office & insurance	4.4.4	11,247	12,180	10,400	(933)	-7.7%	1,780	17.1%
Learning & development	4.4.5	10,378	8,824	9,448	1,554	17.6%	(624)	-6.6%
Professional fees	4.4.6	82,530	74,752	68,075	7,778	10.4%	6,677	9.8%
Regulatory and external activities	4.4.7	22,078	19,311	17,738	2,767	14.3%	1,573	8.9%
Internship programme	4.4.8	6,003	5,650	6,084	353	6.2%	(434)	-7.1%
		<b>1,967,530</b>	<b>1,791,024</b>	<b>1,822,125</b>	<b>176,506</b>	<b>9.9%</b>	<b>(31,101)</b>	<b>-1.7%</b>
Legal fees	4.4.9	60,000	45,270	57,555	14,730	32.5%	(12,285)	-21.3%
		<b>2,027,530</b>	<b>1,836,294</b>	<b>1,879,680</b>	<b>191,236</b>	<b>10.4%</b>	<b>(43,386)</b>	<b>-2.3%</b>
Depreciation	4.4.10	62,000	40,000	35,000	22,000	55.0%	5,000	14.3%
Operating expenditure (1)		<b>2,089,530</b>	<b>1,876,294</b>	<b>1,914,680</b>	<b>213,236</b>	<b>11.4%</b>	<b>(38,386)</b>	<b>-2.0%</b>
<b>Funding to external parties</b>								
Funding to the FRC	4.5.1	8,920	8,495	8,495	425	5.0%	-	-
Funding to the IFRS Foundation	4.5.2	394	394	392	-	-	2	0.5%
Funding to IFEC	4.5.3-4	80,428	74,811	74,892	5,617	7.5%	(81)	-0.1%
Total (2)		<b>89,742</b>	<b>83,700</b>	<b>83,779</b>	<b>6,042</b>	<b>7.2%</b>	<b>(79)</b>	<b>-0.1%</b>
<b>Total expenditure (1) + (2)</b>		<b>2,179,272</b>	<b>1,959,994</b>	<b>1,998,459</b>	<b>219,278</b>	<b>11.2%</b>	<b>(38,465)</b>	<b>-1.9%</b>
Result for the year		<b>(229,762)</b>	<b>(274,523)</b>	<b>(127,609)</b>	<b>44,761</b>	<b>-16.3%</b>	<b>(146,914)</b>	<b>115.1%</b>
Reserves brought forward		<b>3,890,241</b>	<b>4,164,764</b>	<b>3,877,354</b>	<b>(274,523)</b>	<b>-6.6%</b>	<b>287,410</b>	<b>7.4%</b>
Reserves carried forward		<b>3,660,479</b>	<b>3,890,241</b>	<b>3,749,745</b>	<b>(229,762)</b>	<b>-5.9%</b>	<b>140,496</b>	<b>3.7%</b>

## 4.2 Capital expenditure statement

Para. Ref	(a) <b>Proposed Budget For Year 2019/20</b> HK\$'000	(b) Forecast For Year 2018/19 HK\$'000	(c) Approved Budget For Year 2018/19 HK\$'000	Proposed Budget (a) over/(under) Forecast (b) HK\$'000      %		Forecast (b) over/(under) Approved Budget (c) HK\$'000      %	
<b>Capital expenditure</b>							
	4.6						
Furniture & fixtures	<b>140,400</b>	2,300	2,000	138,100	N/A	300	15.0%
Office equipment	<b>32,135</b>	31,872	18,610	263	0.8%	13,262	71.3%
Computer systems development	<b>86,230</b>	45,615	36,345	40,615	89.0%	9,270	25.5%
Total	<b>258,765</b>	<b>79,787</b>	<b>56,955</b>	<b>178,978</b>	<b>224.3%</b>	<b>22,832</b>	<b>40.1%</b>

### 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 2019/20. 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:

	2018/19		2019/20
	Apr 18-Mar 19 (Budget)	Apr 18-Mar 19 (Forecast)	Apr 19-Mar 20 (Budget)
<b>Securities</b>			
Daily turnover (billion/day)	\$109.0	\$104.0	\$106.0
Levy rate	0.0027%	0.0027%	0.0027%
<b>Futures/Options</b>			
<b>Contracts</b>			
Daily turnover (contracts)	410,000	547,000	558,000
Levy rate	\$0.54	\$0.54	\$0.54

- (b) The 2018/19 Forecast of Investor Levy – Securities is lower than the Approved Budget by \$64.76 million (4.5%) whereas Investor levy – Futures and Options is higher than the Approved Budget by \$36.43 million (33.4%). These variances reflect variations in actual securities market turnover for the first 7 months of 2018/19 (around \$104 billion/day) when compared to the estimates underlying the Approved Budget.
- (c) We assume that the securities market turnover for 2018/19 and 2019/20 would be around \$104 billion/day and \$106 billion/day respectively.
- (d) For budget purposes, we assume that the volume of future contracts will increase by 2% in 2019/20.

#### 4.3.3 Fees and charges

- (a) The Forecast aggregate fees and charges income for 2018/19 is \$2.84 million (1.9%) lower than the Approved Budget as fees from Corporate Finance are lower than expected.
- (b) The 2019/20 Budget shows an increase in fee income of \$59.14 million (41.2%) against Forecast for 2018/19. This increase arises from the resumption of annual licensing fees in 2019/20 after the fee holiday ended in 2018/19. We will take a phased approach to resume our annual fee by providing a 50% discount in 2019/20 and 2020/21. The estimated revenue under this scenario will be \$112 million and \$56 million will be recognised in 2019/20 on an accruals basis. The annual licence fee will be fully reinstated from 2021/22 onwards.

#### 4.3.4 Net investment income

- (a) Budgeted investment income was \$166.5 million which comprised of \$89.0 million of fixed income and deposit interest and \$77.5 million gains from equity pooled funds. Due to volatility in our pooled equity fund investments, we have recorded a mark-to-market loss of \$116 million during the first 7 months of 2018/19. We have revised our 2018/19 Forecast net investment income to \$1.3 million, after netting investment management fees.
- (b) 2019/20 investment income is budgeted to be \$166.3 million. For budgeting purpose, we assume that the average gross return on investment before investment management fees is 2.58%. 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 2018/19 and 2019/20 represents license fees and service fees received from the Investor and Financial Education Council (Formerly known as Investor Education Council) and Investor Compensation Company Limited 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 Staff cost

- (a) The overall staff cost for 2018/19 is forecasted to be lower than the 2018/19 Budget by \$36.56 million (2.6%). 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 2020 is 988, a net increase of 23 (2.4%) over the 2018/19 Commission approved headcount. Please see section 3 for detailed explanations. The projected staff

cost for 2019/20 is \$106.15 million (7.9%) higher than the 2018/19 Forecast.

- (c) The 2019/20 Budget includes provision for an average 4.0% 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.
- (d) A detailed pay policy proposal will be presented to the Commission's Remuneration Committee for discussion and to the Commission for approval in Q1, 2019.

#### 4.4.2 Premises

- (a) Forecast premises expenses for 2018/19 are lower than the Approved Budget as we have not occupied additional space we budgeted for. Existing space have been reshuffled to cater for the additional headcount.
- (b) To save on rental expenses, we have recently entered into a new lease for office premises at One Island East, Quarry Bay which is scheduled to start from January 2020. The rental expense will be approximately half of that paid under our existing lease at Cheung Kong Center.
- (c) Rental for 2019/20 is budgeted to be \$40.84 million (16.4%) higher than 2018/19 Forecast. The increase is mainly due to the overlapping of three months rental related expenses for the new office in this financial year. We will adopt HKFRS 16 when it becomes effective in 2019/20.

#### 4.4.3 Information and systems services

- (a) The information and systems services expenses forecast for 2018/19 is \$0.9 million (1.2%) higher than the Approved Budget due to higher than expected actual costs for systems contract services and IT operating supplies.
- (b) For 2019/20, we project an \$18.0 million (24.8%) increase owing to a significant growth of software subscription costs, higher library research facilities for increasing subscriptions for market data to support enforcement and supervision activities and higher systems control services to meet the increasing demand of helpdesk support. 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 2018/19 is \$1.78 million (17.1%) higher than the Approved Budget due to the need to replace outdated office signage and the provision of ergonomic equipment for staff.
- (b) Budgeted expenses for 2019/20 is \$0.9 million (7.7%) below the 2018/19 Forecast.

#### 4.4.5 Learning and development

- (a) Forecast learning and development related expenses for 2018/19 are \$0.62 million (6.6%) lower than the Approved Budget. This is mainly due to changes in some planned training and development events.
- (b) The learning and development budget for 2019/20 is estimated to be \$1.56 million (17.6%) higher than the 2018/19 Forecast. As the capital markets and products are constantly changing and the development needs of 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. Key focus areas for the next fiscal year will include: bilateral staff exchanges and training between SFC and CSRC; the delivery of digital, real time learning to all SFC staff through a newly-launched technology platform; the provision of more training/seminars on data science including Regtech and Fintech.

#### 4.4.6 Professional fees

- (a) Forecast professional fees for 2018/19 are \$6.68 million (9.8%) higher than the Approved Budget due to higher demand for professional services rendered by external forensic accounting firms and external support for investigations.
- (b) Budget for 2019/20 is \$7.78 million (10.4%) higher than the Forecast 2018/19 to meet higher demand for external expert services, which remains high, especially in the areas of investigation and supervision of intermediaries.
- (c) Key projects in 2019/20 include anti-money laundering, cybersecurity, trading data analytics, virtual asset exchanges, investor ID model, Uncertificated Securities Market, review of benefits disclosure and other selling practices and review of monetary thresholds under the Professional Investors Rules.

#### 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 2018/19 are higher than the Approved Budget by \$1.57 million (8.9%) mainly due to the cost of a campaign to encourage the public to report suspected listed company fraud and market misconduct to us.
- (c) The 2019/20 budget is \$2.77 million (14.3%) higher than the 2018/19 Forecast. This is attributable to the combination of the increase in the need for overseas travelling to engage in regulatory reforms and seminars offset by the lower public relations programme.

#### 4.4.8 Internship programme

This represents the salary cost of hiring university graduates in support of our internship and graduate trainee programme and for the Commission to develop a pipeline of talent for the future. Our proposed expenditure for 2019/20 to recruit these individuals represents an increase of \$0.35 million over the 2018/19 Forecast.

#### 4.4.9 Legal fees

- (a) The forecast for 2018/19 is \$12.3 million (21.3%) lower than the original budget as the actual amount of recovery was higher in the first 7 months of the year.
- (b) The budget for 2019/20 is 14.73 million (32.5%) higher than forecast because of (i) the size of the caseload and the increased complexity of the cases; (ii) recovery of legal fee will not be as high as in 2018/19.

#### 4.4.10 Depreciation

- (a) Forecast depreciation expenses for 2018/19 are estimated to be \$5 million (14.3%) higher because of higher spending on computer hardware and computer system development in current year (see also para 4.6.1).
- (b) We expect that the depreciation expenses for 2019/20 will be 22 million (55%) higher than 2018/19 Forecast as more resources have been invested into technologies (see also para 4.6.2).

### 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 annual funding from \$8.5 million in 2018/19 to \$8.92 million in 2019/20, 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 \$394,000) in 2019/20.

- 4.5.3 Funding to Investor and Financial Education Council (IFEC) is revised to \$74.81 million in 2018/19 based on the latest forecast prepared by IFEC. In 2019/20, IFEC proposed total expenditure of \$80.43 million. Major expenses are summarised below:

	<b><u>Budget 2019/20</u></b>	<b><u>Forecast 2018/19</u></b>	<b><u>Budget 2018/19</u></b>
	\$'m	\$'m	\$'m
<b>Education programmes</b>	43.11	40.56	39.78
<b>Staff costs</b>	29.17	26.65	26.65
<b>Premises costs</b>	3.35	3.35	3.35
<b>Professional &amp; other services</b>	1.93	1.73	1.80
<b>Publicity &amp; external relations</b>	0.48	0.38	0.58
<b>General office &amp; others</b>	2.39	2.14	2.73
<b>Total</b>	<u>80.43</u>	<u>74.81</u>	<u>74.89</u>

- 4.5.4 IFEC projects higher expenditure for 2019/20 based on its experience of the costs of its key operations in 2018/19 as well as proposals for projects in 2019/20 to increase the awareness, effectiveness and reach of financial education work.

#### 4.6 Capital expenditure

- 4.6.1 The total capital expenditure forecast for 2018/19 has been increased from \$56.96 million to \$79.79 million. Spending on computer hardware, computer software and computer systems development have increased by \$9.8 million, \$3.8 million and \$9.3 million respectively due to enhancements of various projects, new projects not included in the original budget and additional costs incurred for planned 2018/19 projects.

- 4.6.2 The total capital expenditure budget for 2019/20 is \$258.77 million. Breakdown is as follows:

<b>Capital expenditure</b>	<b>Amount \$'m</b>	<b>Note</b>
Office furniture & fixtures	140.40	(a)
Office equipment	32.14	(b)
Computer systems development	<u>86.23</u>	(c)
<b>Total</b>	<u><u>258.77</u></u>	

Notes :-

- (a) \$140.4 million is provided for the renovation costs for the new office.
- (b) office equipment:
- (i) \$1 million for replacement of obsolete office equipment due to normal wear and tear; and



- (ii) \$31.14 million for investment in storage technology and data base capacity, software upgrades, replacement of the resources system plus costs relating to the normal replacement of obsolete servers and computer equipment needed for additional headcount.
- (c) \$86.23 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.