

## NOTE FOR FINANCE COMMITTEE

### Securities and Futures Commission Budget for the Financial Year 1999-2000

#### INTRODUCTION

Encl. In accordance with the procedure set out in FCR(89-90)12, we submit the budget of the Securities and Futures Commission (SFC) for 1999-2000 at the Enclosure for Members' information. This note highlights the main features of the 1999-2000 budget and compares the approved budget with the revised estimates for 1998-99. Members may wish to note that, for the seventh consecutive year, the SFC has requested for Government not to make an appropriation for the financial year 1999-2000.

#### BACKGROUND

2. On 12 April 1989, Members noted the following procedures for the approval of the SFC budget (FCR(89-90)12) -

- (a) the SFC will submit its budget to the Administration for the next financial year before 31 December;
- (b) the Administration will examine the SFC budget in January and present it to Finance Committee for information in January/February;
- (c) the Administration will then submit the SFC budget to the Chief Executive for approval in February; and
- (d) the Administration will table the approved SFC budget in the Legislative Council and will, at the same time, submit the request for recurrent Government grant in the context of the draft Estimates.

In 1995, the authority for approval of SFC budgets was delegated to the Financial Secretary.

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**FUNDING OF THE SFC**

3. Part VII of the SFC Ordinance provides that the SFC may be financed by transaction levies, government appropriation and fees and charges on services rendered to market operators and participants. Since 1993-94, the SFC has not requested for government appropriation. As a result, the funding of the SFC today has practically come entirely from the market in the form of levies and fees and charges.

4. SFC's levies incomes come from the securities and futures markets. With effect from 1 April 1998, the rate of levy on securities transaction is 0.011% and is shared between the SFC and the Stock Exchange of Hong Kong (SEHK) in the ratio of 4:7. For futures contracts, the current levy is \$1 per leviable transaction.

5. As regards fees and charges, the SFC adopts, to the extent possible, the principle of full cost recovery when setting the level of its fees and charges. The rates of SFC fees and charges have not been revised since 1994. Despite two attempts to adjust the rates of fees and charges to maintain the full cost recovery principle against inflation, the amendment rules for the proposed fees and charges revision were revoked twice by the then Provisional Legislative Council on 15 October 1997 and 26 March 1998.

6. As regards funding by the Government, it is in the form of an annual grant to the SFC as a stable source of income to offset the more volatile income from the levy and from fees and charges. In accordance with FCR(89-90)12, such a grant should be equivalent to the cost to the Government in 1988 of funding the former Office of the Commissioner for Securities and Commodities Trading, less income. The Government will provide the provisional grant at the beginning of each financial year, with a reconciliation and, if necessary, adjustment made for the previous financial year. The grant in 1992-93 amounted to \$60 million. There is also an emergency fall-back whereby the SFC can seek loans with the approval of the Finance Committee to enable the SFC to survive any exceptionally prolonged period of low market activities.

7. Owing to buoyant market activities since 1993 and a handsome level of reserves, the SFC has for the seventh consecutive year not requested for government grant.

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**BUDGET FOR 1999-2000**

8. The main features of the 1999-2000 budget are as follows -
- (a) estimated revenue for 1999-2000 is \$310 million, which represents about 4% or \$12 million above the revised estimate for 1998-99 (please see a comparison of the approved budget for 1998-99 and the revised estimates in paragraph 9 below). This is mainly attributable to (i) a higher estimated average daily SEHK turnover for 1999-2000 at \$6 billion (or 5% higher than that assumed in the revised estimate for 1998-99); (ii) a higher average daily revised turnover of the Hong Kong Futures Exchange (HKFE) for 1999-2000 at 42 000 contracts per day (or about 11% higher than the average daily HKFE turnover for the estimates assumed for 1998-99); and (iii) a projected increase by 18.6% in the aggregate fees and charges income largely as a result of the introduction of new fees proposed for insurance intermediaries which are engaged in the promotion of securities linked Mandatory Provident Fund (MPF) schemes in 1999.
  - (b) estimated operating expenditure will increase to \$421 million, about \$18 million or 4.5% more than the revised estimates for 1998-99. As SFC assumes no salary adjustment in the coming financial year, the marginal increase is mainly due to increase in head-counts by eight (or 2.5%) to cope with additional workload arising from the market reform review and the related legislative work for the Composite Securities and Futures Bill, the vetting of MPF-related products and the additional maintenance costs for the newly installed market surveillance system, which is partly offset by reduction in the operating expenditure for other items including general office and insurance expenses (less \$0.9 million), professional and other expenses (less \$8.4 million) and the funding for the Hong Kong Securities Institute (less \$1 million) as well as by the postponement of its provision of funding for the Investment Resources Centre pending allocation of site by the Land Development Corporation;
  - (c) an estimated deficit at \$131 million is expected, as compared to an anticipated deficit of \$122 million in the 1998-99 revised estimates; and

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- (d) estimated reserves are expected to fall from \$843 million to \$712 million by the end of the 1999-2000 financial year. If the \$300 million contribution to the Unified Exchange Compensation Fund<sup>1</sup> is taken into consideration, the reserves will be further reduced to \$412 million, equivalent to about an 11-month operating expenditure of the SFC.

A projected income and expenditure statement and a projected balance sheet for the year 1999-2000 are on pages 4.1 and 4.2 of the Enclosure.

### **COMPARISON OF THE APPROVED BUDGET WITH THE REVISED ESTIMATES FOR 1998-99**

9. The agreement between the Government and the SFC is that the actual total expenditure of the SFC should not exceed the approved budget by more than 10% without the prior approval of the Financial Secretary. The table on page 2.4 of the Enclosure provides a comparison of the approved budget and the revised estimates for 1998-99. The salient features are -

**(a) Revenue**

The SFC has projected that the total revenue would decrease by 22.8% in the 1998-99 revised estimates owing to a lower than expected market turnover in the SEHK. The total revenue in the first six months of 1998-99 was only \$6.3 billion, as opposed to the original estimate in the approved budget of \$10.9 billion. Given the dim outlook of the economy and the cautious sentiment in the investment market, SFC does not expect a significant upsurge of turnover in the market in the remaining months of 1998-99 financial year. Accordingly, SFC adjusted its estimate for the latter half of the budget year to \$5 billion, which gives a revised average daily turnover of \$5.7 billion for the whole financial year.

**(b) Operating Expenditure**

The total operating expenditure (including inflation) has been revised downward from \$413 million to \$403 million

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<sup>1</sup> The injection of fund was a public commitment made jointly by the SFC and SEHK subsequent to the collapse of the C.A. Pacific Group in January 1998. Under the commitment, the SFC and SEHK would each inject up to \$300 million to the Unified Exchange Compensation Fund from their respective reserves to maintain the Fund at a prudential level.

following a general decrease of costs including in particular the personnel expenses (from \$285 million to \$266 million).

**(c) Capital Expenditure**

The estimated expenditure on "furniture and fixtures" and "office equipment" have increased slightly in the revised estimate by \$1.45 million due to an office expansion project. The additional expenditure will be absorbed by contingency provision under capital expenditure and as a result the capital expenditure for the revised estimates for 1998-99 remained unchanged as that in the approved 1998-99 Budget.

**GOVERNMENT'S VIEWS**

10. The Government has carefully examined the SFC budget for 1999-2000 and is satisfied that the SFC has made efforts to reduce expenditure as far as possible without adversely affecting its service quality and regulatory functions.

11. Notwithstanding the \$131 million deficit in the estimate, the SFC has for the seventh consecutive year decided not to request an appropriation of annual grant from the Government. The SFC has also considered increasing its income from the transaction levy for trading on the two Exchanges as well as re-adjusting the fees and charges of its services in the 1999-2000 financial year so as to partly offset its budgeted deficit. However, taking into account the current economic situation and the sluggish market environment, the SFC has decided not to pursue those ideas (except for introducing several new fees and charges for MPF-related services).

12. The budgeted deficit will be absorbed by SFC's reserves, which are expected to decrease to \$712 million by the end of 1999-2000, or 1.6 times of the total operating expenditure (including depreciation) for 1999-2000. If the contribution of \$300 million to the Unified Exchange Compensation Fund is taken into account, the reserve level will be further reduced to \$412 million, or 11-month's operating expenditure of the SFC.

13. Despite the erosion of the reserve due to the budgeted deficit, the Government considers that SFC's level remains at a prudential level and should not have any significant adverse effect on its normal operations or the

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performance of its statutory functions. We expect that in the longer term as the securities and futures markets recover from the financial turmoil, the financial position of the SFC would also improve.

14. The SFC budget has also been tabled for discussion at the Financial Services Panel at its meeting on 1 March 1999 during which Members of the Panel only sought clarifications on certain items without expressing any objection. On this basis, we have recommended the budget to the Financial Secretary for approval under delegated authority from the Chief Executive.

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Financial Services Bureau  
March 1999