

## **NOTE FOR FINANCE COMMITTEE**

### **Securities and Futures Commission Budget for the Financial Year 2004-05**

#### **PURPOSE**

In accordance with the consultation procedures as agreed with the Legislative Council when the Securities and Futures Commission (SFC) was first established<sup>1</sup>, we would like to draw Members' attention to the main features of the SFC budget for 2004-05. Members may wish to note that, for the twelfth consecutive year, the SFC has not requested the Government to make an appropriation to fund its operation.

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

2. Part XVI of the Securities and Futures Ordinance (Cap. 571) ("SFO") provides that the SFC may be financed by transaction levies, fees and charges on services rendered to market operators and participants. Section 14 of the SFO further provides that the Government may provide funding to the SFC as appropriated by the Legislative Council. In practice, the SFC has not requested for government appropriation since 1993-94, and the funding of the SFC today has practically come largely from the market in the form of levies and fees and charges.

3. SFC's levy income comes from the securities and futures markets. The current rate of levy on securities transactions is 0.005%. For futures contracts trading, the current levy is \$1.0 or \$0.2 per leviable transaction, for different categories of contracts.

4. As regards fees and charges, the SFC adopts, to the extent possible, the principle of full cost recovery. The rates of SFC fees and charges have not been revised since 1994. Two attempts were made in 1997 and 1998 to adjust the rates of fees and charges to achieve full cost recovery but were rejected by the then Provisional Legislative Council.

**/BUDGET .....**

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<sup>1</sup> Members may wish to refer to FCR(89-90)12 considered by Legislative Council on 12 April 1989 for details.

**BUDGET FOR 2004-05**

Encl. 5. The SFC submitted on 15 December 2003 its budget for 2004-05 to the Financial Secretary<sup>2</sup> (Enclosure).

6. The robust market activities in the second half of 2003 has turned the SFC budget from an estimated deficit (-\$93.34 million) to a surplus (+ \$49.95 million) in 2003-04. Taking a cautiously optimistic view of the stock market in 2004-05, the SFC proposed a surplus budget in 2004-05 (+ \$3.93 million).

7. With the surplus budget and a reasonable size of reserves, for the twelfth year in a row the SFC did not request any appropriation from the Legislative Council as provided under section 14 of the SFO. The SFC estimated that its reserves would amount to \$615.56 million (as at 31 March 2004) and increase to \$619.49 million (as at 31 March 2005). The estimated reserves as at 31 March 2005 will be equivalent to about 17 months of the proposed annual operating expenses for 2004-05. With the reserves, the SFC anticipated that it would be able to withstand financial pressure in the event of any lower than assumed average daily turnover of the Stock Exchange of Hong Kong (SEHK), thereby not requesting for appropriation.

8. The main features of the 2004-05 budget are set out in paragraphs 9 to 17 below.

***Estimated Revenue***

9. The estimated revenue for 2004-05 is \$447.30 million, 8.3% or \$40.42 million below the revised estimated revenue for 2003-04, mainly for the following reasons –

- (a) the average daily turnover of the SEHK is projected to be \$11 billion for 2004-05, compared to the revised estimate of \$12.4 billion in 2003-04<sup>3</sup>; and
- (b) fees and charges income is expected to decrease by \$4.85 million, as licensing fee income is projected to drop as a result of existing licensees' consolidation of businesses.

*/Estimated .....*

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<sup>2</sup> The Chief Executive has delegated the authority to approve the SFC budget under the Securities and Futures Ordinance (Cap. 571) to the Financial Secretary.

<sup>3</sup> The estimated reduction in levy income (securities) in 2004-05 as a result of a more moderate estimated daily turnover is \$34.79 million.

*Estimated Operating Expenditure*

10. Estimated operating expenditure for 2004-05 is \$416.37 million, which represents about 2% or \$8.40 million above the revised expenditure estimates of 2003-04 (\$407.97 million). The increase is attributable to –

- (a) an increase in professional fees of \$6.21 million due to increase in legal fees in anticipation of more market manipulation and corporate misconduct cases;
- (b) an increase in corporate communications and external relations expenses at \$1.48 million, due to an increase in public relations programmes and in overseas travelling expenses relating to the Commission's liaison with overseas regulators;
- (c) an increase in general office and insurance expenses of \$1.09 million mainly due to the expected increase in professional indemnity insurance;
- (d) an increase in information system and services of \$0.96 million mainly due to growing demand for system maintenance service; and
- (e) an increase in training and development expenses (\$0.70 million) and an increase in contingency (\$0.30 million).

11. The above increases are partly offset by a decrease of premises expenses (\$2.34 million) given the lower rent of the new office, and that the one-off expenses incurred for the office relocation in July 2003 would not be repeated.

*Staff establishment*

12. The SFC proposed to increase ten posts in its establishment in 2004-05 from the approved establishment in 2003-04 (an increase of 14 permanent established posts partly offset by a deletion of four temporary established posts). The total establishment will become 402 (comprising 394 permanent established posts and 8 temporary established posts).

13. The main reasons for the proposed increase in staff establishment are as follows –

- (a) to cope with on-going and increasing needs related to international regulatory policies and China-related work (turning three temporary posts permanent in the Chairman's Office);

/(b) .....

- (b) to cope with increasing workload from dual filing, which is a new responsibility under the SFO (+ three posts);
- (c) to cope with new market and product development (+ four posts);  
and
- (d) to handle administration and IT support (+ four posts).

The detailed justifications are described at paragraph 17 of the budget at Enclosure.

14. The SFC considers that it is important to have the staff increase in order to perform the new responsibilities and keep up with market developments. The SFC also advises that redeployment of internal resources from other divisions to cope with this on-going work is not feasible due to the limited availability of qualified experts and their tight manpower situation.

#### *Staff salary*

15. The SFC did not propose any adjustment to staff salary. Since April 2001, SFC has frozen staff salary. The SFC advised that their staff have not received any variable pay award for 2001-02 and 2002-03 which represents an average of 8% reduction in overall take home pay of the SFC staff compared to the 2000-01 level. When compared to the recommended remuneration figures of the top three tiers (namely Chairman, Executive Directors and Senior Directors) in the Hay Report, the remuneration of the SFC senior executives is also below the recommended figures for all three levels. The SFC will continue to benchmark its pay levels with the prevailing market rates of comparable organisations and review its salary level annually with reference to the findings of the pay level survey.

#### *Estimated capital expenditure*

16. The total capital expenditure budget proposed for 2004-05 is \$13.08 million. The proposed budget includes (a) a provision of \$7.26 million for the development of web-based application systems and further enhancement of system infrastructure and knowledge-based management; (b) a provision of \$3.63 million for office equipment including PCs and other PC peripherals and software; and (c) a provision of \$1 million for the replacement of furniture due to wear and tear. A contingency equal to 10% of the estimated capital expenditure (\$1.19 million) is also included.

17. A projected income and expenditure statement and a projected balance sheet for the year 2004-05 are on pages 4.1 and 4.2 of the budget at Enclosure.

**/COMPARISON .....**

**COMPARISON OF THE APPROVED BUDGET WITH THE REVISED ESTIMATES FOR 2003-04**

18. The table on page 2.4 of the budget at Enclosure provides a comparison of the approved budget and the revised estimates for 2003-04. The salient features are set out in paragraphs 19 to 21 below.

***Revenue***

19. The SFC's revenue in 2003-04 has grown significantly, mainly a result of an increase in levy income due to the revised estimated average daily SEHK turnover of \$12.4 billion for 2003-04, 77% higher than the \$7 billion average daily turnover assumed in the approved 2003-04 budget<sup>4</sup>. The revised estimated revenue for 2003-04 is \$487.72 million, which represents 43.47% or \$147.78 million higher than the approved estimated revenue of \$339.94 million for 2003-04.

***Operating expenditure***

20. The total operating expenditure has been projected at \$407.97 million, which is comparable with the approved one of \$407.88 million (marginal increase of \$0.084 million). The major changes are –

- (a) premises expenses increase by about \$1.62 million (+5.13%) due to the unbudgeted office relocation expenses of \$2.59 million, partially offset by the rental savings achieved on relocation to the new office since July 2003;
- (b) professional and other expenses increase by about \$0.88 million (+7.3%) due to increases in legal fees and recruitment in anticipation of more litigation in respect of unfair prejudice to interests of members of listed corporations and more executive search fees respectively; and
- (c) external relations, corporation communication and training and development increase of about \$0.84 million.

The above increases are partially offset by a reduction of expenditure on information and system services (\$0.67 million), general office and insurance (\$0.79 million) and contingency (\$1.8 million).

*/Capital .....*

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<sup>4</sup> The increase in levy income (securities) in 2003-04 as a result of the increase in daily turnover is \$133.99 million.

*Capital expenditure*

21. The total capital expenditure estimate is reduced slightly from \$23.1 million to \$22.8 million.

**ADMINISTRATION'S VIEWS**

22. The Administration is pleased to note that the SFC has prepared a surplus budget, the first time since 1994-95<sup>5</sup>, and that the SFC has not requested for Government appropriation as a result.

23. The Administration has examined the SFC budget for 2004-05, and is generally satisfied that the SFC has made efforts to control expenditure without undermining the delivery of its services or performance of its regulatory functions.

24. We note that the SFC has taken on more responsibilities as a result of the commencement of the SFO on 1 April 2003 (e.g. dual filing, new licensing regime), as well as increasing international and China-related work. At the same time, we have expressed concern to SFC about the proposed staff increase despite the general trend of downsizing in the public and private sectors. In response, the SFC considers that it is important to have the staff increase in order to perform the new responsibilities and keep up with market developments. In considering the budget, we have urged the SFC to be vigilant in managing its staff resources.

25. Under the SFO, the SFC levies may be reduced if the SFC has accumulated reserves equivalent to twice its annual operating expenses. As the SFC reserves are below this threshold, there is no plan to review the levies for funding the SFC operation for the moment. Nonetheless, the Administration will keep in view the reserves level of the SFC and review the level of levies once the threshold has been reached.

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Financial Services and the Treasury Bureau  
April 2004

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<sup>5</sup> The SFC has proposed a deficit budget since financial year 1994-95, although in reality the SFC ran into deficits in 1998-99, 2001-02 and 2002-03 only.

**Enclosure to FCRI(2004-05)1**

**SECURITIES & FUTURES COMMISSION**  
**PROPOSED ESTIMATES OF INCOME & EXPENDITURE**  
**FOR THE FINANCIAL YEAR 2004/2005**

**20 February 2004**

## CONTENT

<u>Section</u>	<u>Description</u>	<u>Page</u>
1	Executive Summary	1.1 - 1.3
2	Bases of Proposed Estimates and Highlights	2.1 - 2.10
3	Proposed Estimates of Income & Expenditure	
	- Income	3.1
	- Operating Expenditure	3.2
	- Capital Expenditure	3.3
4	Projected Financial Statements	
	- Income & Expenditure Statement	4.1
	- Balance Sheet	4.2



**EXECUTIVE SUMMARY****Extract of Proposed Estimates for the Year 2004/2005**

	Proposed Estimates <u>2004/2005</u> HK\$'M	Revised Estimates <u>2003/2004</u> HK\$'M	Approved Estimates <u>2003/2004</u> HK\$'M
<b>Revenue</b>	447.30	487.72	339.94
<b>Operating Expenditure</b>	416.37	407.97	407.88
<b>Depreciation</b>	27.00	29.80	25.40
<b>Surplus / (Deficit)</b>	3.93	49.95	(93.34)
<b>Projected reserves at beginning of the year</b>	615.56		545.25
<b>Actual reserves at beginning of the year</b>		565.61	
<b>Reserves at end of the year</b>	619.49	615.56	451.91
<b>Capital Expenditure</b>	13.08	22.77	23.10
<b>Headcount</b>			
<b>Permanent established post</b>	<b>394</b>	<b>392</b>	<b>380</b>
<b>Temporary established post-Special Advisers</b>	<b>2</b>	<b>2</b>	<b>6</b>
<b>Temporary established post-Manager Trainees</b>	<b>6</b>	<b>6</b>	<b>6</b>

**Budgetary Strategy**

- As a result of our continuous cost control effort in three consecutive years since 2000/2001 despite the growing market complexity that had strained the Commission's capacity, we managed to keep our operating expenditure (before depreciation) for 2001/2002 (\$392 million) and 2002/2003 (\$372 million) below 2000/2001 level of \$400 million. In 2003/2004, we envisage that our revised budget, including the additional capacity needed for the newly added dual filing functions, will be \$407.97 million, only 2% over 2000/2001 level. In 2004/2005, we shall continue this strategy to tightly control all expenditure having regard to 2003/2004 expenditure level as a benchmark except for areas where additional resources are considered necessary to improve market quality through further strengthening the Commission's existing teams of staff and focusing on certain regulatory functions.
- On the revenue side, we assume that our share of the securities levy rate will remain at 0.005% for 2004/2005. Fees and charges will remain at the 2003/2004 level. Same as prior years, we propose not to request for the annual grant from the Government for 2004/2005.

## **Revenue**

3. The estimated revenue for 2004/2005 is \$447.30 million, 8.3% (\$40.43 million) below the revised estimates. In comparison with the revised estimates in 2003/2004, securities levy income will decrease by \$34.79 million as the average daily SEHK turnover for 2004/2005 is assumed to be \$11 billion versus \$12.4 billion assumed in 2003/2004 revised estimate; levy income from futures/options contracts will decrease by 3% (\$0.58 million) as the projected turnover is expected to decrease marginally from about 39,100 contracts per day as projected in the revised estimates for 2003/2004 to 38,000 contracts per day in 2004/2005.
4. Fees and charges income is expected to be lower than the revised estimates of 2003/2004 by \$4.85 million. Fee income from Licensing is projected to be lower as it is envisaged that the number of licensed corporations and individuals will be reduced gradually owing to consolidation of businesses and departure of some existing registrants from the industry. Investment income is expected to remain at the 2003/2004 revised estimate level as it is expected that interest rates will remain low in 2004/2005, despite the increase in investment funds resulting from the projected surplus for the years 2003/2004 and 2004/2005.
5. Furthermore, for the twelfth year in a row, the Commission will invite the Government not to request any appropriation from the Legislative Council. This decision is made without prejudice to the funding principles established when the Commission was formed, and has no implication for requests for appropriation in future years. It is estimated that the annual government grant foregone by the Commission for 2004/2005 would be c.\$86 million, and that the total annual grant foregone since 1993/94 amounted to \$968 million.

## **Operating Expenditure**

6. The total estimated operating expenditure for 2004/2005 before depreciation is \$416.37 million, about \$8.4 million (2.06%) above the revised estimates for 2003/2004. The general price increase for the year 2004/2005 is assumed to be at 0%. The major changes are noted as follows :
  - (i) increase in professional & others expenses (\$6.21 million) in anticipation of higher legal fees and higher demand for external professional consultancy services;
  - (ii) increase in general office and insurance expenses (\$1.09 million) mainly due to the projected increase in professional indemnity premium; and
  - (iii) increase in external relations expenses (\$0.85 million) mainly due to the anticipated increase in overseas business travel in connection with the Commission's international work and liaison with overseas regulatory bodies;
  - (iv) increase in training and development expenses (\$0.7 million) due to the slightly more intensive training activities planned for 2004/2005.

### **Capital Expenditure**

7. The total capital expenditure budget proposed for 2004/2005 is \$13.08 million. The proposed budget includes (i) a provision of \$7.26 million for the development of web-based application systems and further enhancement of system infrastructure and knowledge-based management; (ii) a provision of \$3.63 million for office equipment including PCs and other PC peripherals and software; and (iii) a provision of \$1 million for the replacement of furniture due to wear and tear. A contingency equal to 10% of the estimated capital expenditure (\$1.19 million) is also included.

### **Operating Result**

8. The projections result in a surplus of \$3.93 million, which will increase the projected reserves from \$615.56 million (31<sup>st</sup> March 2004) to \$619.49 million (31<sup>st</sup> March 2005). On this basis, the projected reserves at 31<sup>st</sup> March 2005 will be equivalent to about 17 months of the proposed annual operating expenditure (including depreciation) for 2004/2005.
9. As always, the projected financial position of the Commission is largely dependent on the level of turnover on the SEHK. It is worth noting that at the prevailing levy rate of 0.005%, any change of \$1 billion in the average daily turnover will result in a fluctuation of about \$24.8 million in the total levy received by the Commission for the year 2004/2005, i.e. \$12 billion or \$10 billion turnover would result in a variation of  $\pm$  \$24.8 million in levy income from the budget and increase the projected surplus to \$28.73 million or reduce it to a deficit of \$20.87 million.
10. The estimates of revenue are subject to considerable market uncertainty, as they depend on the performance of the major markets and the Hong Kong economy. We shall continue our cost control measures with a view to containing our operating expenditure within our financial means, in particular, the personnel costs notwithstanding the anticipated increasing workload arising from new regulatory initiatives and implementation of the Securities & Futures Ordinance.

## **BASES OF PROPOSED ESTIMATES AND HIGHLIGHTS**

The proposed estimates for the year 2004/2005 are prepared on the following bases :-

### **Strategy**

11. Although market sentiment has improved and the financial position of the Commission has reversed from a projected deficit to a surplus in the first seven months of 2003/2004, we will continue to exercise stringent controls on our expenditure in 2004/2005. Except for areas where additional resources are considered necessary to improve market quality through further strengthening the Commission's teams of staff and focusing on certain regulatory functions, all expenses are restrained having regard to 2003/2004 revised estimates as a benchmark.
12. On the revenue side, the major income source of the Commission is still investor levies which are dependent on market turnovers. The Commission's share of levy rates will remain at 0.005% on each stock exchange transaction and \$1 per futures contract. The Commission proposes not to request for the annual grant from the Government for 2004/2005. The fee levels will remain unchanged though they have not been revised since 1993/1994.

### **Assumptions**

#### 13. Price Increase

The general price increase for the year 2004/2005 is assumed to be at zero %.

#### 14. Remuneration Adjustment

No salary adjustment is provided for in the proposed 2004/2005 budget.

#### 15. Interest Rate

The average return of dated securities on hand is 3%-3.5% p.a. and the yield on deposit/dated securities is assumed to be 0.5% to 1% p.a. for the year 2004/2005.

#### 16. Capital Expenditure

It is assumed that the approved estimates of capital expenditure for different capital projects will, as previously, be carried forward until the completion of the projects.

17. Manpower Plan

The manpower plan for 2004/2005 which is based on the assessment of staff strength required to discharge duties efficiently and effectively is outlined below :

<b>Division</b>	<b>Function</b>	<b>Establishment per Approved 2003/2004 Budget</b>	<b>Proposed Establishment for 2004/2005 (Note)</b>	<b>Changes</b>
Chairman's Office	Division Management & Commission Secretariat	9	<b>12</b>	+3
Corporate Finance	Corporate Finance	44	<b>47</b>	+3
Intermediaries & Investment Products	Division Management	5	<b>6</b>	+1
	Licensing	32	<b>33</b>	+1
	Intermediaries Supervision	65	<b>65</b>	-
	Investment Products	27	<b>28</b>	+1
Enforcement	Enforcement	89	<b>89</b>	-
Supervision of Markets	Supervision of Markets	18	<b>19</b>	+1
	Research	4	<b>4</b>	-
Legal Services	Legal Services	16	<b>16</b>	-
Corporate Affairs	Corporate Communications	13	<b>13</b>	-
	Investor Education & Communications	13	<b>13</b>	-
	Information Technology	17	<b>18</b>	+1
	Finance & Administration	17	<b>19</b>	+2
	Human Resources & Training & Development	11	<b>12</b>	+1
Permanent Established Posts		380	<b>394</b>	+14
Temporary Established Posts:	Special Advisers	6	<b>2</b>	-4
	Manager Trainees	6	<b>6</b>	-
<b>TOTAL</b>		392	<b>402</b>	+10

Note : The staff complement is 394 Permanent Established Posts plus 8 Temporary Established Posts (2 Special Advisers and 6 Manager Trainees) and 19 temporary staff.

Separately, 14 executive trainees are included in and funded out of the SFC Internship Programme under Training and Development expenditure.

**Chairman's Office**

Three Temporary Established Posts of Special Adviser will be converted to Permanent Established Posts to deal with on-going regulatory policies and China-related work.

**Corporate Finance**

It is proposed to add three additional posts to deal with the increasing workload arising from dual filing, which is important for improving the quality of disclosure by listing applicants, and listed companies.

### **Intermediaries and Investment Products – Division Management**

Two additional posts are proposed to deal with policy work related to new SFO and IOSCO projects and to assist the Division in terms of projects, research and day-to-day coordination work. One post was transferred back from this area to Licensing on 1 September 2003. Hence, the net increase for this area is one additional post.

### **Intermediaries and Investment Products –Investment Products**

One additional post is proposed to deal with an increased operational workload in the light of the launching of the REITs Code and the increasing complexity of structured investment products seeking SFC authorization.

### **Supervision of Markets**

One Temporary Established Post of Special Adviser will be converted to Permanent Established Post to formulate market related policies and facilitate the implementation of market and product development initiatives and the enhancement of market infrastructure.

### **Corporate Affairs – Information Technology**

One temporary staff for handling day-to-day network operation will be converted to Permanent Established Post.

### **Corporate Affairs – Finance & Administration**

It is proposed to add one post to directly manage the team of Office Assistants and to perform other administrative functions in the Administration Department. One temporary staff for on-going imaging work will be converted to Permanent Established Post.

### **Corporate Affairs – Human Resources and Training & Development**

One post was created on 1 April 2003 to cope with the additional workload arising from the implementation of the recommendations of the Audit Committee Report.

### **Special Advisers**

Following the conversion of four Temporary Established Posts of Special Adviser (three in Chairman's Office and one in Supervision of Markets) to Permanent Established Posts, a provision of two Special Advisers on term contract will be retained for China-related projects, new initiatives, new products and market development, and listing regulation.

18. Following is a summary of major estimate items :-

	(A)	(B)	(C)	(A)-(B) (B)	(B)-(C) (C)
	Proposed Estimates For Year <u>2004/2005</u> HK\$'000	Revised Estimates For Year <u>2003/2004 *</u> HK\$'000	Approved Estimates For Year <u>2003/2004</u> HK\$'000	Proposed Estimates Over/(Under) Revised Estimates %	Revised Estimates Over/(Under) Approved Estimates %
<b>REVENUE</b>					
Investor Levy					
Securities	272,800	307,587	173,600	(11.31)	77.18
Futures/Options Contracts	18,848	19,430	12,400	(3.00)	56.69
Fees & Charges	132,350	137,200	127,984	(3.53)	7.20
Investment Income	21,500	21,500	24,152	--	(10.98)
Other Income	<u>1,800</u>	<u>2,000</u>	<u>1,800</u>	(10.00)	11.11
Total	<u>447,298</u>	<u>487,717</u>	<u>339,936</u>	(8.29)	43.47
<b>OPERATING EXPENDITURE</b>					
Premises	30,823	33,166	31,549	(7.07)	5.13
Personnel Expenses	327,000	327,000	327,000	--	--
Info. & Sys. Services	17,223	16,260	16,929	5.92	(3.95)
General Office & Insurance	7,405	6,315	7,100	17.26	(11.06)
Training & Development	3,550	2,850	2,800	24.56	1.79
Professional & Others	19,088	12,881	12,005	48.19	7.30
Corporate Communications	3,036	2,405	2,100	26.24	14.52
External Relations	3,140	2,290	1,800	37.12	27.22
SCEFI	<u>3,600</u>	<u>3,600</u>	<u>3,600</u>	--	--
Sub-total	414,865	406,767	404,883	1.99	0.47
Contingency	<u>1,500</u>	<u>1,200</u>	<u>3,000</u>	25.00	(60.00)
Total	<u>416,365</u>	<u>407,967</u>	<u>407,883</u>	2.06	0.02
<b>DEPRECIATION</b>	27,000	29,800	25,400	(9.40)	17.32
<b>SURPLUS / (DEFICIT)</b>	3,933	49,950	(93,347)	(92.13)	153.51
<b>CAPITAL EXPENDITURE</b>					
Furniture & Fixtures	1,000	17,518	18,000	(94.29)	(2.68)
Office Equipment	3,630	4,453	3,000	(18.48)	48.43
Computer Sys. Development	<u>7,260</u>	<u>300</u>	<u>-</u>	2,320	N/A
Sub-total	11,890	22,271	21,000	(46.61)	6.05
Contingency	<u>1,189</u>	<u>500</u>	<u>2,100</u>	137.80	(76.19)
Total	<u>13,079</u>	<u>22,771</u>	<u>23,100</u>	(42.56)	(1.42)

\* The revised estimates for the year 2003/2004 were derived from a review undertaken in November 2003 of the approved estimates for the year 2003/2004.

## REVENUE

### **Annual Grant from Government**

19. 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 general revenue the moneys appropriated by the Legislative Council for that purpose.” The Commission will ask the Government not to request an appropriation from the Legislative Council for the financial year 2004/2005. The Commission’s decision is made without prejudice to the funding principles established when the SFC was formed, and has no implications for requests for appropriations in future years.
20. Should a request for an appropriation be made, it would be provisionally assessed at about \$86 million. The assessment is based on the principle that the annual grant would be equivalent to the net cost to Government for funding the former Office of the Commissioner of Securities, adjusted annually from 1988/89 prices by reference to adjustments in levels of Government civil service salaries, rent and the general rate of inflation in Hong Kong. Since 1993/94, the Commission had foregone annual grant amounting to \$968 million.

### **Investor Levy - Securities**

21. The revised estimate of Investor Levy-Securities is expected to be higher than the approved estimates for 2003/2004 by about 77.18% (\$133.99 million). The robust market activities for the past few months and the optimistic market sentiment pushed the securities market average daily turnover in the first seven months of 2003/2004 to about \$11.6 billion, 66% higher than the \$7 billion / day assumed in the approved estimate. The average daily turnover for the rest of the year is assumed to be \$13.5 billion. This brings the annual average daily turnover for 2003/2004 to \$12.4 billion.
22. The average daily turnover for projecting Investor Levy - Securities for 2004/2005 is assumed to be \$11 billion, which is 11% lower than the average daily turnover of \$12.4 billion of the revised estimates for 2003/2004. The Commission’s transaction levy rate will remain at 0.005%. Levy income from SEHK is projected to be \$272.8 million, about 11% lower than the 2003/2004 revised estimate. 248 trading days are assumed in the proposed estimates for 2004/2005.

### **Investor Levy - Futures / Options Contracts**

23. The revised estimate of Investor Levy - Futures / Options Contracts is higher than the approved estimate by about 56.69% (\$7.03 million). The increase reflects the higher than expected average daily turnover on the Futures Exchange (Average 40,000 contracts cf. 25,000 contracts in the approved estimates) during the first seven months of the year 2003/2004. Daily turnover for the period November 2003 to March 2004 (103 trading days) is assumed at 38,000 contracts.



24. The average daily turnover for 2004/2005 is assumed at the level of 38,000 contracts. The contract levy rate is assumed to remain at \$1 per contract.

### **Fees and Charges**

25. The revised estimates of overall fees and charges for the year 2003/2004 are higher than the approved estimate of \$127.98 million by 7.2% (\$9.22 million). The increase in corporate finance fee income is expected to more than offset the projected decrease in licensing fees having regard to the first seven months receipt.
26. For 2004/2005, the fees and charges income is projected to be about \$132.35 million, lower than the revised 2003/2004 estimate by 3.53% (\$4.85 million). The projected fee income from Licensing for 2004/2005 is lower than the 2003/2004 revised estimate by \$5.3 million as it is envisaged that the number of licensed corporations and individuals will be reduced gradually owing to consolidation of businesses and departure of some existing registrants from the industry under the new Licensing regime. The projected income from Investment Products for 2004/2005 is higher than the 2003/2004 revised estimate by \$0.6 million. Fee income from Corporate Finance for 2004/2005 is comparable to the level assumed in the 2003/2004 revised estimate.

### **Investment Income**

27. Investment income includes the return on the investment portfolio operated under the advice of an external advisor after taking into account the amortization of premium or discount on purchases of dated securities. It also includes interest earned on deposits placed out of in-house funds.
28. The revised estimate for 2003/2004 is lower than the approved estimate by about 10.98% (\$2.65 million) because interest rates remained low in the first seven months of the year and the trend is expected to persist for the rest of the year.
29. Having taken into account the operating results projected for 2003/2004 and 2004/2005, and the continuous softening of interest rates, we expect that the projected investment income for 2004/2005 will remain at the 2003/2004 level.

### **Other Income**

30. Based on historical data after adjustment for extraordinary items, other income for 2003/2004 and 2004/2005 is expected to be \$2 million and \$1.8 million respectively, comprising mainly costs awarded to the Commission by the Court and sale proceeds of SFC publications.

## **OPERATING EXPENDITURE**

### **Premises**

31. The revised estimate of premises expenses is expected to be about \$33.17 million, about 5.13% (\$1.62 million) higher than the approved estimate. We moved from Edinburgh Tower to Chater House in July 2003. The net effective rental for the new lease was concluded at \$20.23/sq. ft., slightly lower than the \$23/sq. ft. in the old lease. The net increase in premises expenses is mainly due to unbudgeted office relocation expenses of \$2.59 million incurred in June and July 2003, which was partially offset by the rental savings achieved on relocation to the new office since July 2003.
32. Premises estimate for 2004/2005 is revised downward from the revised estimate by 7.07% (\$2.34 million) mainly because the office relocation expenses of \$2.59 million incurred in 2003/2004 will not be repeated in 2004/2005.

### **Personnel Expenses**

33. Personnel expenses will remain the same as the approved budget. Salary level was frozen at 2001/2002 level. In comparison with the approved 2003/2004 establishment, 12 permanent posts are established including 3 posts for dual filing and the conversion of 4 temporary established posts of special advisers into permanent posts. The revised establishment at the end of 2003/2004 will be 400 (including 8 temporary established posts).
34. For 2004/2005, we have not provided for salary adjustment. The proposed establishment for 2004/2005 is 402 (including 8 temporary established posts). Comparing with the revised establishment of 400 for 2003/2004, the 2 additional permanent posts are converted from existing temporary staff to reflect the actual operational needs of the Commission. Nevertheless, personnel expenses for 2004/2005 will be kept at the 2003/2004 level.

### **Information and Systems Services**

35. The revised 2003/2004 estimate is lower than the approved estimate by 3.95% (\$0.67 million). The downward revision is mainly due to the under-spending in software and hardware maintenance and the rationalisation of the usage of information services, such as Reuters, Bloomberg etc.
36. The proposed 2004/2005 information and systems services expenses are 5.92% (\$0.96 million) higher than the revised estimate. The increase is mainly attributable to the growing demand for systems maintenance service to cope with the gradual migration of application systems developed in past years into production mode. Higher library related expenses is also expected to facilitate internal research work.

### **General Office and Insurance**

37. The revised general office & insurance expenses are lower than the approved estimate by about 11.06% (\$0.79 million). The saving is mainly derived from lower than expected professional indemnity insurance premium concluded with the insurer.
38. The estimates of general office and insurance expenses for 2004/2005 are expected to be higher than its revised estimate of 2003/2004 by 17.26% (\$1.09 million). The increase is mainly due to the expected premium increase for professional indemnity. Repairs and maintenance expense is projected to be higher in 2004/2005 as provision is made for minor office reconfiguration work.

### **Training and Development**

39. The revised 2003/2004 estimate is comparable to that of the approved estimate.
40. The proposed 2004/2005 estimate is higher than the revised estimate by 24.56% (\$0.7 million). The full year effect for the internship programme covering 14 executive trainees and the slightly more intensive training activities expected in 2004/2005 largely explain the increase.

### **Professional & Others**

41. Professional & Others expenses are revised upward by about 7.3% (\$0.88 million). The main increases are in legal fees and recruitment in anticipation of more litigation in respect of unfair prejudice to interests of members of listed corporations (S.214 of the Securities & Futures Ordinance) and more executive search fees respectively.
42. Professional and Others expenses for 2004/2005 are higher than the revised estimate by 48.19% (\$6.21 million). Legal fees will be increased by \$5 million in anticipation of more market manipulation and corporate misconduct cases that will be put to the court. More external professional services are anticipated to help divisions discharge their operational duties and advise on policy issues, particularly in the areas of intermediaries supervision and enforcement.

### **Corporate Communications**

43. The revised 2003/2004 estimate is adjusted upward by 14.52% (\$0.31 million) mainly due to the increase in public relations publications.
44. The proposed 2004/2005 estimate is higher than the 2003/2004 revised estimate by 26.24% (\$0.63 million). The increase is mainly noted in public relations programme and community education to enhance investors' knowledge about the Commission's functions and securities/futures market operations.

### **External Relations**

45. The revised 2003/2004 expenses are adjusted upward by 27.22% (\$0.49 million) to reflect mainly the projected increase in overseas travelling activities and the unbudgeted preparation cost for hosting the 2006 IOSCO Annual Conference.
46. External Relations expenses for 2004/2005 are higher than the revised estimate by 37.12% (\$0.85 million). Major increase is in overseas travelling expenses relating to anticipated increase in the Commission's international work and liaison with overseas regulators.

### **SCEFI**

47. The 2003/2004 estimate of SCEFI is retained to cover the recurring network operation and support expenses plus the launching of new services (such as e-cert) in the next 5 months.
48. The estimate of 2004/2005 is \$3.6 million, same as the revised estimate for 2003/2004. The estimates cover the operating cost of the FinNet and also costs for further developing the services range of FinNet and promoting the use of FinNet to market participants.

### **CONTINGENCY**

49. A contingency of \$1.5 million is provided for the year 2004/2005 to cover unforeseen expenses arising from abrupt changes of environment or unforeseen special requirements.

## **CAPITAL EXPENDITURE**

### **Revised Estimates**

50. The total capital expenditure estimate is reduced slightly from \$23.1 million to \$22.8 million, with major movements in various sub-heads : (i) Office Equipment is revised upward by 48.43% (\$1.45 million) mainly to cover the 1<sup>st</sup> phase of the PC renewal programme; (ii) \$0.3 million is provided for the Placee Information project to be carried out in the second half of the year. As a result, contingency is reduced to \$0.5 million, about 10% of the estimate of capital expenditure for the next five months.

### **Proposed Estimates**

51. The total proposed capital expenditure budget for 2004/2005 is expected to be \$13.08 million, \$9.69 million lower than the revised 2003/2004 estimates. The 2004/2005 capital expenditure comprises the following :
- i. \$1 million is provided for replacement of existing loose furniture due to normal wear and tear;
  - ii. \$3.63 million for office equipment mainly for (i) the 2<sup>nd</sup> phase of the PC renewal programme; (ii) acquisition of office software, network management software and operating systems; and (iii) replacement of existing equipment due to obsolescence;
  - iii. \$7.26 million for costs relating to the systems development of internal and external workflow, knowledge base management and further enhancement of system infrastructure; and
  - iv. a contingency equal to 10% of the projected total capital expenditure.

**SECURITIES & FUTURES COMMISSION**  
**ESTIMATES OF INCOME FOR THE YEAR 2004/2005**

	<b>Proposed Estimates Year 2004/2005 HK\$</b>	<b>Revised Estimates Year 2003/2004 HK\$</b>	<b>Approved Estimates Year 2003/2004 HK\$</b>
<b>Annual Grant from Government</b>	-	-	-
<b>Investor Levy - Securities</b>	<b>272,800,000</b>	<b>307,587,000</b>	<b>173,600,000</b>
<b>Investor Levy - Futures / Options Contracts</b>	<b>18,848,000</b>	<b>19,430,000</b>	<b>12,400,000</b>
<b>Fees and Charges</b>	<b>132,350,000</b>	<b>137,200,000</b>	<b>127,984,000</b>
<b>Investment Income</b>	<b>21,500,000</b>	<b>21,500,000</b>	<b>24,152,000</b>
<b>Other Income</b>	<b>1,800,000</b>	<b>2,000,000</b>	<b>1,800,000</b>
<b>Total</b>	<b><u>447,298,000</u></b>	<b><u>487,717,000</u></b>	<b><u>339,936,000</u></b>

**SECURITIES & FUTURES COMMISSION  
ESTIMATES OF EXPENDITURE FOR THE YEAR 2004/2005**

**OPERATING EXPENDITURE**

	<b>Proposed Estimates Year 2004/2005</b>	<b>Revised Estimates Year 2003/2004</b>	<b>Approved Estimates Year 2003/2004</b>
	<b>HK\$</b>	<b>HK\$</b>	<b>HK\$</b>
Premises	30,822,760	33,166,000	31,549,000
Personnel Expenses	327,000,000	327,000,000	327,000,000
Information & Systems Services	17,223,000	16,260,000	16,929,000
General Office & Insurance	7,405,000	6,315,000	7,100,000
Training & Development	3,550,000	2,850,000	2,800,000
Professional & Others	19,088,000	12,881,000	12,005,000
Corporate Communications	3,036,000	2,405,000	2,100,000
External Relations	3,140,000	2,290,000	1,800,000
SCEFI	<u>3,600,000</u>	<u>3,600,000</u>	<u>3,600,000</u>
Sub-total	414,864,760	406,767,000	404,883,000
Contingency	<u>1,500,000</u>	<u>1,200,000</u>	<u>3,000,000</u>
<b>Total Operating Expenditure</b>	<b><u>416,364,760</u></b>	<b><u>407,967,000</u></b>	<b><u>407,883,000</u></b>

**SECURITIES & FUTURES COMMISSION  
ESTIMATES OF EXPENDITURE FOR THE YEAR 2004/2005**

**CAPITAL EXPENDITURE**

	<b>Proposed Estimates Year 2004/2005</b>	<b>Revised Estimates Year 2003/2004</b>	<b>Approved Estimates Year 2003/2004</b>
	<b>HK\$</b>	<b>HK\$</b>	<b>HK\$</b>
<b>Furniture &amp; Fixtures</b>	<b>1,000,000</b>	<b>17,518,000</b>	<b>18,000,000</b>
<b>Office Equipment</b>	<b>3,630,000</b>	<b>4,453,000</b>	<b>3,000,000</b>
<b>Computer Systems Development</b>	<b>7,260,000</b>	<b>300,000</b>	<b>-</b>
<b>Sub-total</b>	<b>11,890,000</b>	<b>22,271,000</b>	<b>21,000,000</b>
<b>Contingency (Note 1)</b>	<b>1,189,000</b>	<b>500,000</b>	<b>2,100,000</b>
<b>Total Capital Expenditure</b>	<b>13,079,000</b>	<b>22,771,000</b>	<b>23,100,000</b>

**Note 1 : Contingency is provided for at 10% of the total 2004/2005 capital expenditure (2003/2004 : 10%)**



**SECURITIES & FUTURES COMMISSION  
PROJECTED INCOME & EXPENDITURE STATEMENT  
FOR THE YEAR 2004/2005**

	<b>Proposed Estimates 2004/2005</b>	<b>Revised Estimates 2003/2004</b>
	<b>HK\$</b>	<b>HK\$</b>
<b>INCOME</b>		
Investor Levy - Securities	272,800,000	307,587,000
Investor Levy - Futures/Options Contracts	18,848,000	19,430,000
Fees & Charges	132,350,000	137,200,000
Investment Income	21,500,000	21,500,000
Other Income	1,800,000	2,000,000
	<hr/>	<hr/>
Total Income	447,298,000	487,717,000
	<hr/>	<hr/>
<b>EXPENDITURE</b>		
Operating Expenditure	416,364,760	407,967,000
Depreciation	27,000,000	29,800,000
	<hr/>	<hr/>
Total Expenditure	443,364,760	437,767,000
	<hr/>	<hr/>
<b>RESULT FOR THE YEAR</b>	<b>3,933,240</b>	<b>49,950,000</b>
	<hr/> <hr/>	<hr/> <hr/>

**SECURITIES & FUTURES COMMISSION  
PROJECTED BALANCE SHEET  
FOR THE YEAR 2004/2005**

	<b>Proposed Estimates 2004/2005</b>	<b>Revised Estimates 2003/2004</b>
	<b>HK\$</b>	<b>HK\$</b>
Fixed Assets	<u>34,800,000</u>	<u>41,000,000</u>
Net Current Assets	<u>584,697,313</u>	<u>574,564,073</u>
Net Assets	<u><u>619,497,313</u></u>	<u><u>615,564,073</u></u>
Representing :		
Reserves		
Government Start-up Grant	<u>42,840,429</u>	<u>42,840,429</u>
Income & Expenditure Account		
Beginning Balance	572,723,644	522,773,644
Result for the Year	<u>3,933,240</u>	<u>49,950,000</u>
	<u>576,656,884</u>	<u>572,723,644</u>
	<u><u>619,497,313</u></u>	<u><u>615,564,073</u></u>