

NOTE FOR FINANCE COMMITTEE

The Budget of the Securities and Futures Commission for the Financial Year 2005-06

PURPOSE

Encl.

In accordance with the consultation procedures agreed with the Legislative Council in 1989 when the Securities and Futures Commission (SFC) was established¹, this paper briefs Members on the main features of the SFC budget for 2005-06. A copy of the budget is at the Enclosure.

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 for approval. The Chief Executive has delegated the authority to the Financial Secretary. On 7 March 2005, the Administration and the SFC briefed the Legislative Council Panel on Financial Affairs (FA Panel) on SFC's proposed budget for 2005-06. In the light of the FA Panel's comments on the staffing proposal, minor revisions have been made to the budget. The SFC has also provided an update on its financial position for 2004-05.

FUNDING OF THE SFC

3. Part XVI of the SFO provides that the SFC may be financed by transaction levies, and fees and charges on services rendered to market operators and participants. Section 14 of the SFO further provides that the Government may allocate funding to the SFC as appropriated by the Legislative Council. In practice, SFC has not requested for government appropriation since 1993-94. The funding of the SFC basically comes from the market in the form of levies, and fees and charges.

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

4. Over the years, income from levies on securities and futures contracts has been the most important source of income for the SFC. 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 contracts². 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 1994³.

REVISED ESTIMATES FOR 2004-05

5. The revised estimates for 2004-05, as presented to the FA Panel on 7 March 2005, were derived from a review of the approved budget for 2004-05 conducted by the SFC in November 2004. Taking into account the actual position up to end February 2005, the SFC has provided an update on its financial position for 2004-05 attached as Appendix 2 to the budget. The salient features are set out in paragraphs 6 to 10 below.

Revenue

6. The SFC's revenue in 2004-05 has grown significantly as a result of a substantial increase in levy income due to robust market activities in 2004. The revised estimated average daily turnover of the stock market is \$14.3 billion, which is 30% higher than the \$11 billion average daily turnover assumed in the approved 2004-05 budget. As a result, the increase in securities levy income is \$78.94 million. As for futures contracts, the daily turnover of the Futures Exchange is revised to 49 000 contracts, which is also nearly 30% higher than the estimated turnover of 38 000 contracts assumed in the approved estimates, bringing an additional income of \$5.67 million. Taking these changes into account, the SFC has initially revised the estimated revenue for 2004-05 to \$554.77 million, which represents an increase of 24% or \$107.47 million above the approved estimated revenue of \$447.3 million for 2004-05. Due to even better market performance in the latter half of 2004-05 and the resultant higher-than-expected levy income, the actual revenue up to end February 2005 exceeded the revised estimated revenue of \$554.77 million and reached \$563.27 million. The SFC currently expects that the revenue for 2004-05 will further increase to \$616.46 million.

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² Under section 394 of the SFO, the Chief Executive in Council may specify the rates of levy for sale and purchase of securities recorded on a recognised securities market or futures contracts traded on a recognised futures market.

³ Under section 395 of the SFO, the Chief Executive in council may, after consultation with the SFC, make rules to prescribe fees.

Operating expenditure

7. Based on the review in November 2004, the revised estimates on operating expenditure for 2004-05 are \$450.44 million, which are 8.2% higher than the 2004-05 approved budget of \$416.37 million. The major changes are –

- (a) an increase in personnel expenses by 9.3% (\$30.28 million) to provide for 12 new posts (\$3.98 million) and variable pay award (\$26.3 million);
- (b) an increase in premises expenses by 8.8% (\$2.7 million) arising from leasing of additional office space at Chater House to cope with expansion with effect from July 2004 and for a new backup office in Kwun Tong with effect from October 2004;
- (c) an increase in training and development expenses by 45.6% (\$1.62 million) mainly to provide more intensive training that has been trimmed down in the past two years; and
- (d) an increase in external relations expenses by 36.9% (\$1.16 million) mainly for the projected increase in overseas travelling activities and for preparation for hosting of the 2006 International Organization of Securities Commissions (IOSCO) Annual Conference, which is not budgeted in the approved estimates.

The above increases are partially offset by a reduction of expenditure on general office and insurance (\$0.55 million), professional fees (\$0.55 million) and contingency (\$0.75 million).

8. Taking into account the actual expenditure up to end February 2005, the SFC currently expects that the estimated operating expenditure for 2004-05 would be \$434.05 million.

Surplus and Reserves

9. With a larger revenue, the estimated surplus of \$3.93 million in the approved 2004-05 budget has been revised upward to \$77.83 million in the revised estimates for 2004-05 (based on November 2004 review). The projected reserves of \$619.49 million by end March 2005 in the approved 2004-05 budget are also substantially revised upward to \$768.86 million. If the actual position up to end February 2005 is taken into account, the surplus for the year and reserves by end March 2005 are expected to go up to \$159.62 million and \$850.65 million respectively.

Capital expenditure

10. The total capital expenditure estimates are slightly reduced from \$13.08 million to \$12.47 million.

BUDGET FOR 2005-06

11. Notwithstanding the strong market performance last year, the SFC takes a cautiously optimistic view of the stock market in 2005-06 and estimates a surplus of \$4.78 million based on a projection of an average daily turnover of \$13 billion (versus \$14.3 billion assumed in the revised estimates for 2004-05). Accordingly, the SFC estimates that its reserves would rise from \$850.65 million by the end of 2004-05 to \$855.43 million by the end of 2005-06. With the projected budget surplus and a reasonable size of reserves, for the thirteenth year in a row, the SFC did not request appropriation from the Legislative Council as provided for under section 14 of the SFO.

12. The main items of the 2005-06 budget are set out in paragraphs 13 to 20 below.

Estimated Revenue

13. The estimated revenue for 2005-06 is \$512.92 million, which is 7.5% or \$41.85 million below the revised estimated revenue (based on November 2004 review) for 2004-05. This is mainly because –

- (a) income from securities levy is estimated to decrease by \$29.34 million, assuming the average daily turnover of the stock market is \$13 billion for 2005-06, versus the revised estimates of \$14.3 billion in 2004-05; and
- (b) fees and charges income is expected to decrease by \$8.78 million, as licensing fee income is projected to drop as a result of consolidation of businesses by existing licensees and departure of some existing registrants from the industry.

Estimated Operating Expenditure

14. Estimated operating expenditure for 2005-06 is \$481.64 million, which represents about 6.9% or 31.2 million above the revised expenditure estimates of 2004-05 (\$450.44 million, based on November 2004 review). The increase is mainly attributable to –

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- (a) an increase in personnel expenses by 5.2% (\$18.61 million) arising from seven new posts in the proposed estimates 2005-06 and the full-year effect of 12 new posts proposed in the revised estimates 2004-05;
- (b) an increase in premises expenses (\$1.68 million) to reflect the full-year effect of leasing of additional accommodation at Chater House with effect from July 2004 to cope with expansion and of leasing a new back-up office at Kwun Tong with effect from October 2004;
- (c) an increase in training and development expenses by 28.6% (\$1.48 million) to provide training to various level of staff and in new areas such as corporate regulation and conduct regulation that may call for training;
- (d) an increase in external relations expenses by 39.5% (\$1.7 million) mainly for the preparation for hosting the 2006 IOSCO Annual Conference, and increase in liaison work with overseas regulators;
- (e) an increase in professional and others expenses (\$0.61 million) to meet increase in demand for more executive search and external legal services required;
- (f) an increase in information and systems services expenses (\$0.71 million) owing to higher systems maintenance and information services costs; and
- (g) a provision of \$5 million for funding the proposed Financial Reporting Council⁴.

Staff establishment

15. Referring to the personnel expenses mentioned in paragraph 14(a) above, the SFC proposed to increase a total of 19 posts (12 in the 2004-05 revised estimates and seven in 2005-06) in its establishment. The total establishment will become 421 (comprising 413 permanent established posts and eight temporary established posts) by the end of 2005-06.

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⁴ The SFC, Hong Kong Exchanges and Clearing Limited, Hong Kong Institute of Certified Public Accountants and the Companies Registry Trading Fund have agreed to contribute to the funding of the proposed Financial Reporting Council (the Audit Investigation Board and Financial Reporting Review Committee(s)) on an equal share basis. It is agreed that, for the first three years, each party will contribute \$2.5 million per annum, plus a one-off contribution of up to \$2.5 million as reserve. The amount of contributions from the fourth year onward will be reviewed in the third year in the light of actual experience.

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

- (a) introduction of statutory backing to listing rules and dual filing (five posts in 2004-05 and two posts in 2005-06);
- (b) supervising and regulating the conduct and due diligence work of sponsors (two posts in 2004-05 and one post in 2005-06);
- (c) conduct issues of investment advisers (one post each in 2004-05 and 2005-06);
- (d) authorising documentation for structured product issues and policy issues arising from the public consultation on public offering (three posts in 2004-05 and one post in 2005-06);
- (e) disciplinary work arising from the expanded jurisdiction of the Market Misconduct Tribunal (one post in 2005-06); and
- (f) increase in prosecution work (one post each in 2004-05 and 2005-06).

The detailed justifications are described in paragraph 18 of the budget at the Enclosure.

17. The SFC considers it imperative to have the staff increase in order to perform the new responsibilities under the dual filing regime, and introduction of statutory backing to the listing rules, which would bring about concomitant increase in disciplinary and enforcement actions. The SFC also advises that internal redeployment of staff is not viable due to huge increase in new and on-going activities and the tight manpower situation.

Staff salary

18. The SFC did not make provision for general salary increase in the budget. There has been no general salary increase since April 2001 and its staff has not received variable pay award in 2001-02 and 2002-03. The SFC has a high staff turnover last year due to the recovery of the Hong Kong economy and improved market conditions. The overall staff turnover for the 12 months up to end November 2004 was 11.28%, compared with 6.84% for the same period in 2003. The turnover rate for executive and non-executive staff was 11.84% and 10.28%

/respectively

respectively. The problem was more serious at Manager and Assistant Manager ranks, which had a turnover ranging from 15.48% to 27.72%. Having regard to the high turnover rates, the SFC considered it necessary to award variable pay in 2004-05 to address the problem and a provision of \$26.3 million is now earmarked in the revised estimates for 2004-05 for the purpose. Detailed justifications are set out in paragraphs 35-38 of the budget at the Enclosure.

Estimated capital expenditure

19. The total capital expenditure budget proposed for 2005-06 is \$16.8 million, which includes –

- (a) a provision of \$10.41 million for the development of web-based application systems and further enhancement of system infrastructure and knowledge-based management;
- (b) a provision of \$3.86 million for office equipment including PCs and other PC peripherals and software; and
- (c) a provision of \$1 million for replacement of furniture due to wear and tear.

A contingency equal to 10% of the estimated capital expenditure (\$1.53 million) is also included.

20. A projected income and expenditure statement and a projected balance sheet for the year 2005-06 are on pages 4.1 and 4.2 of the budget at the Enclosure.

CONSULTATION WITH THE PANEL ON FINANCIAL AFFAIRS

21. The Administration and the SFC briefed the FA Panel on SFC's 2005-06 budget on 7 March 2005. At the meeting, Members raised concerns over the proposed substantial increase in staff establishment, i.e. a total of 20 posts in two years (12 posts in the revised estimates for 2004-05 and eight posts in the proposed estimates for 2005-06). In the light of members' comments, we have asked SFC to critically review its staffing requirements again. SFC now confirmed that it would trim down the proposed increase in staff establishment by one post (about \$0.42 million) in the proposed 2005-06 estimates. The revision has been reflected in the budget at the Enclosure and in paragraphs 15 and 16 above.

22. At the same meeting, FA Panel Members also enquired about the prospects for the SFC to reduce its levy as the SFC had accumulated a reasonable size of reserves. According to the SFO, the SFC levies may be reduced if the SFC has accumulated reserves equivalent to twice its annual operating expenses. According to the latest forecast at Appendix 2 to the budget, SFC's reserves are estimated to be \$850.65 million by end March 2005, which represents about 20 months of the operating expenditure for 2005-06 or \$166 million below the threshold. The Administration will closely monitor the situation of the accumulated reserves of the SFC vis-à-vis the market trend and discuss with the SFC on the possibility of levy reduction.

ADMINISTRATION'S VIEWS

23. The Administration has examined the SFC budget for 2005-06 and is pleased to note that the SFC has projected a surplus in the budget, and that the SFC, as in the past 12 years, has not requested appropriation from the Legislative Council.

24. We note that with an improved financial position, the SFC has included the necessary provisions to implement measures that had been substantially cut down in previous years when there were budget deficits. These measures such as award of variable pay and enhanced level of training are considered essential to sustain the quality of its workforce.

25. We note that the SFC has taken on more responsibilities arising from the initiatives to improve the regulatory functions (e.g. statutory backing to the listing rules and dual filing) and has proposed an increase in its staff establishment to cope with new demands. We have expressed our concern to the SFC about the proposed expansion in the light of the general trend of downsizing in public and private sectors. In response, the SFC considered it imperative to have the increase in order to perform the new responsibilities and keep up with market developments. Notwithstanding that, in the light of the comments from the Administration and the FA Panel, the SFC has trimmed down the proposed increase in staff establishment (paragraph 21 above) in the proposed budget for 2005-06. The Administration will continue to urge the SFC to be vigilant in managing its staff resources and to consider internal re-deployment of staff and streamlining of workflow to cope with new responsibilities and increase in demand.

SECURITIES & FUTURES COMMISSION
PROPOSED ESTIMATES OF INCOME & EXPENDITURE
FOR THE FINANCIAL YEAR 2005/2006

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Appendix 1 : Securities & Futures Commission - Activities Analysis for
2001/2002 to 2003/2004

Appendix 2 : Forecast of Financial Position for the Year 2004/2005

EXECUTIVE SUMMARY**Extract of Proposed Estimates for the Year 2005/2006**

	Proposed Estimates <u>2005/2006</u> HK\$'M	Revised Estimates <u>2004/2005</u> HK\$'M	Approved Estimates <u>2004/2005</u> HK\$'M
Revenue	512.92	554.77	447.30
Operating Expenditure	481.64	450.44	416.37
Depreciation	26.50	26.50	27.00
Surplus	4.78	77.83	3.93
Projected reserves at beginning of the year	768.86		615.56
Actual reserves at beginning of the year		691.03	
Reserves at end of the year	773.64	768.86	619.49
Capital Expenditure	16.80	12.47	13.08
Headcount			
Permanent established post	413	406	394
Temporary established post-Special Advisers	2	2	2
Temporary established post-Manager Trainees	6	6	6

Budgetary Strategy

1. In 2005/2006, we shall continue the strategy to tightly control all expenditure having regard to 2004/2005 expenditure level as a bench mark except for areas where additional resources are considered necessary to improve the market quality through further strengthening the Commission's existing teams of staff and to enhance Hong Kong's status as a preferred fund raising centre in the region.
2. On the revenue side, we assume that our share of the securities levy rate will remain at 0.005% for 2005/2006. Fees and charges will remain at the 2004/2005 level. Same as prior years, we propose not to request for the annual grant from the Government for 2005/2006.

Revenue

3. The estimated revenue for 2005/2006 is \$512.92 million, 7.54% (\$41.85 million) below the revised estimates. In comparison with the revised estimates in 2004/2005, securities levy income will decrease by \$29.34 million as the average daily SEHK turnover for 2005/2006 is assumed to be \$13 billion versus \$14.3 billion assumed in 2004/2005 revised estimate; levy income from futures/options contracts will be about the same level as assumed in 2004/2005 revised estimates, with a projected turnover at about 49,000 contracts per day.
4. Fees and charges income is expected to be lower than the revised estimates of 2004/2005 by 5.67% (\$8.78 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. Fee income from Corporate Finance is also projected to be lower owing to the projected decrease in corporate finance activities. Investment income is anticipated to drop as it is expected that interest rates will remain low in 2005/2006.
5. Furthermore, as in previous years, 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 2005/2006 would be c.\$84 million, and that the total annual grant foregone since 1993/94 amounted to \$1.1 billion.

Operating Expenditure

6. The total estimated operating expenditure for 2005/2006 before depreciation is \$481.64 million, about \$31.2 million (6.9%) above the revised estimates for 2004/2005. The general price increase for the year 2005/2006 is assumed to be at 0%. The major changes are noted as follows :
 - (i) increase in personnel expenses (\$18.61 million) due to the increase in 7 headcounts over the revised 2004/2005 establishment and the full year effect of the 12 additional posts created in the fourth quarter of 2004/2005. The new posts are established mainly to cope with the workload related to dual filing, preparation of new listing legislations and the regulation of sponsors and independent investment advisors;
 - (ii) increase in premises expenses (\$1.68 million) mainly to reflect the full year effect of the lease of additional office space at 5/F Chater House and the back up office at Kwun Tong with effect from July 2004 and October 2004 respectively;
 - (iii) increase in training and development expenses (\$1.48 million) mainly due to increase in staff turnover and provision of more intensive training activities for 2005/2006;
 - (iv) increase in external relations expenses (\$1.7 million) mainly to include the preparation costs for hosting the 2006 IOSCO Annual Conference and to cover the anticipated increase in overseas business travel in connection with the Commission's international work and liaison with overseas regulatory bodies;

- (v) increase in professional and others expenses (\$0.61 million) attributable to more executive search and external legal advice required;
- (vi) increase in information and systems services expenses (\$0.71 million) owing to higher systems maintenance and information services costs;
- (vii) increase in funding for the Financial Reporting Council (the Audit Investigation Board (AIB) and Financial Reporting Review Committee(s) (FRRC)) (\$5 million) as we have included an one-off start up contribution of \$2.5 million and recurrent annual contribution of \$2.5 million in 2005/2006 estimates.

Capital Expenditure

7. The total capital expenditure budget proposed for 2005/2006 is \$16.8 million. The proposed budget includes (i) a provision of \$10.41 million for the development of web-based application systems and further enhancement of system infrastructure and knowledge-based management; (ii) a provision of \$3.86 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 (\$1.53 million) is also included.

Operating Result

8. The projections result in a surplus of \$4.78 million, which will increase the projected reserves from \$768.86 million (31st March 2005) to \$773.64 million (31st March 2006). On this basis, the projected reserves at 31st March 2006 will be equivalent to about 18 months of the proposed annual operating expenditure (including depreciation) for 2005/2006.
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 2005/2006, i.e. \$12 billion or \$14 billion turnover would result in a variation of \pm \$24.8 million in levy income from the budget and increase the projected surplus further to \$29.58 million or reverse it to a deficit of \$20.02 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 2005/2006 are prepared on the following bases :-

Strategy

11. The Commission has always exercised stringent controls over its operating costs. Over the last 3 years, we managed to keep our actual staff costs below the level of year 2000/2001 and our operating costs other than premises and staff costs below the level of year 1999/2000.
12. Although market sentiment has improved and we envisage that the Commission is able to sustain a healthy financial position in the coming year, we will continue to exercise stringent controls on our expenditure in 2005/2006. 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 2004/2005 revised estimates as a benchmark.
13. 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 leviable contract, except for mini-Hang Seng Index Futures contracts, mini-Hang Seng Index Options contracts, Stock Futures contracts and Options on Stock Futures Contracts which are charged at \$0.2 per contract. The Commission proposes not to request for the annual grant from the Government for 2005/2006. Our fee levels will remain unchanged though they have not been revised since 1993/1994.

Assumptions

14. Price Increase

The general price increase for the year 2005/2006 is assumed to be at 0%.

15. Remuneration Adjustment

No provision is included for general salary increase in the proposed 2005/2006 budget.

16. Interest Rate

The average return of dated securities is assumed at 2.5% p.a. and the yield on deposits is assumed to be 0.5% p.a. for the year 2005/2006.

17. 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.

18. Manpower Plan

The manpower plan for 2005/2006 which is based on the assessment of staff strength required to discharge the Commission's functions efficiently and effectively is outlined below :

Division	Function	Proposed Establishment for 2005/2006 (Note)	Revised Establishment for 2004/2005 (Note)	Approved Establishment for 2004/2005
Chairman's Office	Division Management & Commission Secretariat	12	12	12
Corporate Finance	Corporate Finance	56	54	47
Intermediaries & Investment Products	Division Management	10	9	7 *
	Licensing	33	33	33
	Intermediaries Supervision	66	65	64 *
	Investment Products	28	28	28
Enforcement	Enforcement	92	91	89
Supervision of Markets	Supervision of Markets	19	19	19
	Research	4	4	4
Legal Services	Legal Services	17	16	16
Corporate Affairs	Corporate Communications	14	13	13
	Investor Education & Communications	13	13	13
	Information Technology	18	18	18
	Finance & Administration	19	19	19
	Human Resources & Training & Development	12	12	12
Permanent Established Posts		413	406	394
Temporary Established Posts:	Special Advisers	2	2	2
	Manager Trainees	6	6	6
TOTAL		421	414	402

* The approved establishment for IIP-Division Management and IIP-IS for 2004/2005 was 6 and 65 respectively. One executive post was subsequently transferred from IIP-IS to IIP-Division Management to take charge of risk management for financial conglomerates, co-ordination with internal and external parties and special projects, resulting in a change in headcount of IIP-Division Management and IIP-IS to 7 and 64 respectively.

Note : The revised staff complement for 2004/2005 is 406 Permanent Established Posts plus 8 Temporary Established posts (2 Special Advisers and 6 Manager Trainees) and 24 temporary staff.

The proposed staff complement for 2005/2006 is 413 Permanent Established Posts plus 8 Temporary Established Posts (2 Special Advisers and 6 Manager Trainees) and 24 temporary staff.

Separately, 14 executive trainees are included in and funded out of the SFC Internship Programme under Training and Development expenditure in both financial years 2004/2005 and 2005/2006.

Corporate Finance

Revised establishment for 2004/2005 (an increase of 7 headcount from the approved 2004/2005 establishment of 47 to 54)

Three executive posts and one non-executive post for Dual Filing are proposed to cope with the Commission's increasing emphasis on corporate misconduct, to handle the growth area in detecting, analysing and working with the Enforcement Division on cases of possible faulty disclosure that might give rise to liability under Section 384 of the Securities & Futures Ordinance, and to handle the policy project related to the introduction of statutory backing to Listing Rules through Section 36 rules made by the SFC.

Two executive posts are proposed for the Prospectuses Team to handle the significantly increased workload in authorising documentation for structured product issues. Moreover, "Phase III" consultation on the public offering of securities is being prepared and work will intensify once the consultation period ends and move towards policy decisions, consultation conclusions and further legislation.

One secretary post is proposed to provide the necessary secretarial support to the Division to cope with increased workload.

Proposed establishment for 2005/2006 (an increase of 2 headcount from the revised 2004/2005 establishment of 54 to 56)

One executive post is proposed to prepare for the commencement of the new statutory Listing Rules.

It is proposed to add one executive post for the Policy Team and the Prospectuses Team to cover the expected increase in workload.

Intermediaries and Investment Products – Division Management

Revised establishment for 2004/2005 (an increase of 2 headcount from the approved 2004/2005 establishment of 7 to 9)

It is proposed to create two executive posts for the IIP Division to set up a new team to supervise and regulate the conduct and due diligence work of sponsors. The new team will work closely with the Listing Division of the SEHK, the Licensing Department, the Corporate Finance Division and the Enforcement Division and will consider and implement numerous policy issues relating to sponsors and independent financial advisors. These staffs will perform research and market analysis, conduct routine on-site inspection together with the inspection staff of the Intermediaries Supervision Department, react to industry complaints and act on referrals from the Dual Filing team and the Listing Division of the SEHK.

Proposed establishment for 2005/2006 (an increase of 1 headcount from the revised 2004/2005 establishment of 9 to 10)

One executive post is proposed to create to cope with the expanded work scope of the IIP Division once the new SFC regulatory regime for sponsors is set up. This staff member will perform inspections of sponsors, including the on-site inspection, subsequent follow-up/referral work and continuous surveillance.

Intermediaries and Investment Products - Intermediaries Supervision

Revised establishment for 2004/2005 (an increase of 1 headcount from the approved establishment of 64 to 65)

One executive post is proposed to create for the purpose of tackling the conduct issues of the investment advisers that the Commission licenses. Staff members at senior level are needed to engage the Administration, to work closely with other regulators such as the Hong Kong Monetary Authority and Insurance Authority in order to guard against potential regulatory arbitrage and to explain and consult the industry on the major policy issues as well as to work with the Consumer Council.

Proposed establishment for 2005/2006 (an increase of 1 headcount from the revised establishment of 65 to 66)

One executive post is proposed to lead inspections once the policy issues (such as requiring all Investment Advisers to take Professional Indemnity Insurance) are settled and expectations on the conduct of the Investment Advisers have been communicated to the industry. This staff member will be instrumental in driving any theme inspections and preparing cases for referral to Enforcement.

Enforcement

Revised establishment for 2004/2005 (an increase of 2 headcount from the approved establishment of 89 to 91)

One executive post is proposed for the Surveillance Team to provide expert testimony in court and to relieve the increased workload of the current team of experts.

One executive post is proposed to handle the expansion of company inspections brought about by dual filing.

Proposed establishment for 2005/2006 (an increase of 1 headcount from the revised establishment of 91 to 92)

One executive post is proposed for the Discipline Team to direct and supervise the discipline work under Part IX of the Securities and Futures Ordinance due to the greatly increased profile and volume of disciplinary work over the last three years (and since the introduction of the Securities and Futures Ordinance in particular). With the advent of statutory backing for the listing rules, there will be a need of a senior decision maker to prepare cases for decision by the Commission or for referral to the Market Misconduct Tribunal.

Legal Services

Proposed establishment for 2005/2006 (an increase of 1 headcount from the approved (and revised) 2004/2005 establishment of 16 to 17)

It is proposed to add one post to cope with the increase in prosecution work.

Corporate Affairs - Corporate Communications

Proposed establishment for 2005/2006 (an increase of 1 headcount from the approved (and revised) establishment of 13 to 14)

One executive post will be created to maintain the SFC website, handle an increase in the need for communications both in terms of front end policies and back end enforcement as the Commission is taking on a clearer role as the statutory regulator of listed corporates, and work on new initiatives to coincide with the Corporate Plan.

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

	(A)	(B)	(C)	(A)-(B) (B)	(B)-(C) (C)
	Proposed Estimates For Year <u>2005/2006</u> HK\$'000	Revised Estimates For Year <u>2004/2005 *</u> HK\$'000	Approved Estimates For Year <u>2004/2005</u> HK\$'000	Proposed Estimates Over/(Under) Revised Estimates %	Revised Estimates Over/(Under) Approved Estimates %
<u>REVENUE</u>					
Investor Levy					
Securities	322,400	351,744	272,800	(8.34)	28.94
Futures/Options Contracts	24,304	24,523	18,848	(0.89)	30.11
Fees & Charges	146,016	154,800	132,350	(5.67)	16.96
Investment Income	18,400	19,700	21,500	(6.60)	(8.37)
Other Income	<u>1,800</u>	<u>4,000</u>	<u>1,800</u>	(55.00)	122.22
Total	<u>512,920</u>	<u>554,767</u>	<u>447,298</u>	(7.54)	24.03
<u>OPERATING EXPENDITURE</u>					
Premises	35,202	33,522	30,823	5.01	8.76
Personnel Expenses	375,893	357,280	327,000	5.21	9.26
Info. & Sys. Services	18,205	17,499	17,223	4.03	1.60
General Office & Insurance	7,280	6,859	7,405	6.14	(7.37)
Training & Development	6,650	5,170	3,550	28.63	45.63
Professional & Others	19,156	18,543	19,088	3.31	(2.86)
Corporate Communications	3,153	2,915	3,036	8.16	(3.99)
External Relations	6,000	4,300	3,140	39.53	36.94
SCEFI	3,600	3,600	3,600	--	--
Funding for the FRC (the AIB and FRRC)	<u>5,000</u>	--	--	N/A	N/A
Sub-total	480,139	449,688	414,865	6.77	8.39
Contingency	<u>1,500</u>	<u>750</u>	<u>1,500</u>	100.00	(50.00)
Total	<u>481,639</u>	<u>450,438</u>	<u>416,365</u>	6.93	8.18
DEPRECIATION	26,500	26,500	27,000	--	(1.85)
SURPLUS	4,781	77,829	3,933	(93.86)	1,878.87
<u>CAPITAL EXPENDITURE</u>					
Furniture & Fixtures	1,000	1,000	1,000	--	--
Office Equipment	3,860	3,630	3,630	6.34	--
Computer Sys. Development	<u>10,410</u>	<u>7,340</u>	<u>7,260</u>	41.83	1.10
Sub-total	15,270	11,970	11,890	27.57	0.67
Contingency	<u>1,527</u>	<u>500</u>	<u>1,189</u>	205.40	(57.95)
Total	<u>16,797</u>	<u>12,470</u>	<u>13,079</u>	34.70	(4.66)

* The revised estimates for the year 2004/2005 were derived from a review undertaken in November 2004 of the approved estimates for the year 2004/2005.

REVENUE

Annual Grant from Government

20. 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 2005/2006. 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.
21. Should a request for an appropriation be made, it would be provisionally assessed at about \$84 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 about \$1.1 billion.

Investor Levy - Securities

22. The revised estimate of Investor Levy-Securities is expected to be higher than the approved estimates for 2004/2005 by about 28.94% (\$78.94 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 2004/2005 to about \$14.3 billion, 30% higher than the \$11 billion / day assumed in the approved estimate. The average daily turnover for the rest of the year is assumed to be \$14.3 billion.
23. The average daily turnover for projecting Investor Levy - Securities for 2005/2006 is assumed to be \$13 billion, which is 9.09% lower than the average daily turnover of \$14.3 billion of the revised estimates for 2004/2005. The Commission’s transaction levy rate will remain at 0.005%. Levy income from SEHK is projected to be \$322.4 million, about 8% lower than the 2004/2005 revised estimate. 248 trading days are assumed in the proposed estimates for 2005/2006.

Investor Levy - Futures / Options Contracts

24. The revised estimate of Investor Levy - Futures / Options Contracts is higher than the approved estimate by about 30.1% (\$5.68 million). The increase reflects the higher than expected average daily turnover on the Futures Exchange during the first seven months of the year 2004/2005 (average 49,000 contracts cf. 38,000 contracts in the approved estimates). Daily turnover for the period November 2004 to March 2005 (103 trading days) is assumed at 49,000 contracts.

25. The average daily turnover for 2005/2006 is assumed at the level of 49,000 contracts. The contract levy rate is assumed to remain unchanged.

Fees and Charges

26. The revised estimates of overall fees and charges for the year 2004/2005 are higher than the approved estimate of \$132.35 million by 17% (\$22.45 million). Major increase stemmed from higher than expected licensing applications received and more corporate finance activities.
27. For 2005/2006, the fees and charges income is projected to be about \$146.02 million, lower than the revised 2004/2005 estimate by 5.67% (\$8.78 million). The projected fee income from Licensing for 2005/2006 is lower than the 2004/2005 revised estimate by \$4.5 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 2005/2006 is higher than the 2004/2005 revised estimate by \$0.6 million. Fee income from Corporate Finance for 2005/2006 is revised downward by \$4.9 million.

Investment Income

28. 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.
29. The revised estimate for 2004/2005 is lower than the approved estimate by about 8.37% (\$1.8 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.
30. Having taken into account the operating results projected for 2004/2005 and 2005/2006, and the continuous softening of interest rates, we expect that the projected investment income for 2005/2006 will drop by about 6.6% (\$1.3 million).

Other Income

31. Miscellaneous income for 2004/2005 is revised upward by 122% (\$2.2 million) as we have recovered \$2.5 million legal costs from one of the investigation case in July 2004.
32. Based on historical data after adjustment for extraordinary item in 2004/2005, other income for 2005/2006 is expected to be \$1.8 million, comprising mainly costs awarded to the Commission by the Court and sale proceeds of SFC publications.

OPERATING EXPENDITURE

Premises

33. The revised estimate of premises expenses is expected to be about \$33.52 million, about 8.76% (\$2.7 million) higher than the approved estimate. We exercised the lease option to lease the reserved office space (around 11,900 sq. ft.) at 5/F., Chater House in July 2004 at an effective rent of \$22.15/sq. ft., which is comparable to the \$20.23/sq. ft. for the main lease concluded with the landlord last year. We also set up a new backup office (around 2,300 sq. ft.) at Kwun Tong to serve as a first port of call/command centre in case of emergency from October 2004. The effective rental for this new lease is \$4.89 /sq. ft..
34. Premises estimate for 2005/2006 is higher than the revised estimate by 5.01% (\$1.68 million) to reflect the full year effect of the two new leases concluded during 2004/2005.

Personnel Expenses

35. Personnel expenses in the 2004/2005 revised estimates are expected to be higher than the 2004/2005 approved estimates by 9.26% (\$30.28 million) and the 2003/2004 actual expenditure (\$326.17 million) by 9.54% (\$31.11 million). In comparison with the approved 2004/2005 establishment, 12 permanent posts are established mainly to cope with the workload related to dual filing and the regulation of sponsors and independent investment advisors. There has been no general pay increase since April 2001. As approved by the Remuneration Committee, we have, for the first time of the past years, included an additional provision of \$26.3 million for variable pay award in the revised estimates for 2004/2005. Including this provision, the average staff cost will be brought back to the level in 2000/2001 before the market downturn. (The average staff cost actually dropped during the market downturn in 2001/2002 and 2002/2003). The provision for variable pay is necessary to facilitate staff recruitment and retention. The revised establishment at the end of 2004/2005 will be 414 (including 8 temporary established posts).
36. Due to the recovery of the Hong Kong economy and improved market conditions, the overall staff turnover of the whole Commission for the past twelve months ended 30 November 2004 was 11.28%, compared with 6.84% for the same period last year. The turnover in respect of executive staff and non-executive was 11.84% and 10.28% respectively. The turnover rates of Manager and Assistant Manager grades, ranged from 15.48% to 27.72%, caused particular concern.
37. Difficulties have been encountered in the recruitment of professional staff such as lawyers and accountants as the Commission has to compete with professional firms and financial market for talents. Recently, there were cases where the selected candidates declined our offer or new recruits left shortly after joining the Commission mainly due to more attractive package offered by the market. It should be noted that about 60% of our professional staff are lawyers, accountants, Chartered Financial Analysts or Chartered Company Secretaries.

38. According to the comments of the Government Economist released on 26 November 2004, it is anticipated that there will be a shortage of professionals in the finance, accounting and legal fields due to the upturn of economy. At present, there is a shortage of at least 1,000 accountants in Hong Kong. It is believed that the salaries of the above industries will increase. Findings from various surveys conducted by the pay consultants and related organizations such as Hay, McLagan, Hong Kong Institute of Human Resource Management, Hong Kong People Management Association, Hong Kong General Chamber of Commerce all indicate that there will likely be an upward pay trend in 2005. If necessary, the Commission may have to consider fixed pay adjustments in April 2005 to ensure that our salaries are in line with the market. However, in order to contain fixed costs, the Commission has not provided for any general salary increment for 2005/2006 but has instead provided for a variable pay in the 2005/2006 proposed estimates at the same amount of \$26.3 million as in the 2004/2005 revised estimates.
39. The projected personnel expenses for 2005/2006 are higher than the revised estimates by 5.21% (\$18.61 million). The proposed establishment for 2005/2006 is 421 (including 8 temporary established posts), an increase of 7 over the revised establishment of 414 at 31 March 2005. The increase is considered barely sufficient to enable the Commission to discharge its existing and new regulatory functions. Two new posts are proposed in Corporate Finance to cope with the increasing workload arising from prospectuses and policy. One new post is proposed for the discipline team in Enforcement area to direct and supervise the discipline work under Part IX of the SFO. One new post will be created to cope with the expanded work scope of the Intermediaries and Investment Products Division due to the set up of new regulation regime for sponsors. One new post is required in the Intermediaries Supervision Department to lead inspections once the policies issues (such as requiring all investment advisers to take professional indemnity insurance) are settled and expectations on the conduct of the investment advisers have been communicated to the industry. One new post is also proposed in Corporate Communications to cope with the increased need for communications in terms of both front end policies and back end enforcement. One new post will be added to Legal Services to cope with the increase in prosecution work.
40. Even though the figures of the personnel expenses in the 2004/2005 revised estimates and the 2005/2006 proposed estimates indicate an increase when compared to the 2000/2001 actual expenditure, the average staff cost per head is basically back to the level in 2000/2001 before the market downturn. The increase in personnel expenses arising from an increase in headcounts during the period from 2000/2001 to 2005/2006 is to cope with new functions and additional workload related to dual filing, new Securities and Futures Ordinance and an increase in enforcement cases, new investment products, complaints and enquiries, etc. (A 3-year comparison table showing activities in these areas is enclosed as Appendix 1)

Information and Systems Services

41. The revised 2004/2005 estimate is higher than the approved estimate by 1.6% (\$0.28 million). The upward revision is mainly due to the subscription of Blackberry device and service as a wireless e-mail communication solution for senior executives and the purchase of new reference books on investment products, markets development and regulations to enhance research capability.
42. The proposed 2005/2006 information and systems services expenses are 4.03% (\$0.71 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.

General Office and Insurance

43. The revised general office & insurance expenses are lower than the approved estimate by about 7.37% (\$0.55 million). The saving is mainly derived from lower than expected general insurance and professional indemnity insurance premium concluded with the insurer.
44. The estimates of general office and insurance expenses for 2005/2006 are expected to be higher than its revised estimate of 2004/2005 by 6.14% (\$0.42 million) to cover the increase in general office expenses due to increase in headcount and business activities.

Training and Development

45. Training & Development expenses are revised upward by 45.6% (\$1.62 million) in order to provide an adequate level of training activities to meet the needs of various levels of staff both in the technical and management areas. Local in-house training expenses are revised upward by 118% (\$0.59 million) to cover industry-related workshop, management training and language training. Overseas training is re-opened since its suspension in 2002/2003 due to the budget constraints at that time. \$0.1 million is provided to cover overseas training such as ASIC Summer School. A new executive development programme is also added. \$0.25 million is provided for local external training programmes for selected staff and coaching programmes for directorate staff. All the new training programmes were recommended by the Training Committee and endorsed by the Management Committee. We have revised the translation expenses budget upward by \$0.27 million to cope with the pressing demand in translation services. Staff functions budget is also revised upward by \$0.26 million to cover mainly a provision of staff recreation subsidy, which was not included in the approved 2004/2005 estimates.
46. The proposed 2005/2006 estimate is higher than the revised estimate by 28.6% (\$1.48 million). The more intensive training activities expected in 2005/2006 largely explains the increase. An increased training budget is sought to provide an adequate level of training activities to meet the needs of various levels of staff. The increase also takes into account new areas such as corporate regulation, conduct regulation that would call for more training.

Professional & Others

47. Professional & Others expenses are revised downward by about 2.86% (\$0.55 million). The main increases are in external professional services, recruitment and custodian charges in anticipation of more demand of external consultancy, particularly in the areas of intermediaries supervision and more executive search fees. Such increase will be partially washed out by the projected decrease in legal fees.
48. Professional and Others expenses for 2005/2006 are higher than the revised estimate by 3.31% (\$0.61 million). The increase is mainly attributable to the higher executive search fees and legal fees in anticipation of more market manipulation and corporate misconduct cases that will be put to the court.

Corporate Communications

49. The revised 2004/2005 estimate is adjusted downward by 3.99% (\$0.12 million) mainly due to the scale-down of the image building and position survey planned in the approved budget.
50. The proposed 2005/2006 estimate is higher than the 2004/2005 revised estimate by 8.16% (\$0.24 million). The increase is mainly noted in the enhancement of the eIRC website after its revamp in 2004/2005.

External Relations

51. The revised 2004/2005 expenses are adjusted upward by 36.94% (\$1.16 million) to reflect mainly the projected increase in overseas travelling activities and the unbudgeted preparation cost for hosting the 2006 IOSCO Annual Conference.
52. External Relations expenses for 2005/2006 are higher than the revised estimate by 39.53% (\$1.7 million). Major increase is in the preparation costs for the 2006 IOSCO Annual Conference and overseas travelling expenses relating to anticipated increase in the Commission's international work and liaison with overseas regulators.

SCEFI

53. The 2004/2005 estimate of SCEFI is retained to cover the recurring network operation and support expenses plus the purchase of additional client-side equipment for FinNet Fastlink service for the HKMA secure e-mail project in the next 5 months.
54. The estimate of 2005/2006 is \$3.6 million, same as the revised estimate for 2004/2005. 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.

Funding for the Financial Reporting Council (the Audit Investigation Board (AIB) and the Financial Reporting Review Committee(s) (FRRC)

55. The function of the AIB is to investigate suspected irregularities of the auditors of listed corporations and listed collective investment schemes. The ambit of FRRC is to conduct enquiry into the financial reports of such corporations or schemes to ensure that they comply with the relevant legal and accounting requirements. Under the current proposal, a governing board, namely the Financial Reporting Council, will be established to oversee the two bodies and will comprise members from the Government as well as members to be nominated by the relevant parties including the SFC.
56. The annual costs of the operation is preliminarily estimated at \$10 million and will be shared among the HKEx, the accounting profession, the Government and the SFC. Also, a reserve fund of about \$10 million will be set up.
57. As it is expected that the FRC (both the AIB and FRRC) will commence operation in 2005/2006, we have included in our proposed 2005/2006 estimate a provision of \$5 million to cover the SFC's contribution towards the reserve fund and the annual operating costs.

Contingency

58. A contingency of \$0.75 million and \$1.5 million is provided for the rest of the year 2004/2005 and the whole year 2005/2006 to cover unforeseen expenses arising from abrupt changes of environment or unforeseen special requirements.

CAPITAL EXPENDITURE

Revised Estimates

59. The total capital expenditure estimate is reduced slightly from \$13.08 million to \$12.47 million as a result of the reduction of contingency provision from \$1.19 million to \$0.5 million.

Proposed Estimates

60. The total proposed capital expenditure budget for 2005/2006 is expected to be \$16.8 million, \$4.33 million higher than the revised 2004/2005 estimates. The 2005/2006 capital expenditure comprises the following :

- (i) \$1 million is provided for replacement of existing loose furniture due to normal wear and tear;
- (ii) \$3.86 million for office equipment mainly for (a) the final phase of the PC renewal programme; (b) acquisition of office software, network management software and operating systems; and (c) replacement of existing equipment due to obsolescence;
- (iii) \$10.41 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 2005/2006**

	Proposed Estimates Year 2005/2006 HK\$	Revised Estimates Year 2004/2005 HK\$	Approved Estimates Year 2004/2005 HK\$
Annual Grant from Government	-	-	-
Investor Levy - Securities	322,400,000	351,744,000	272,800,000
Investor Levy - Futures / Options Contracts	24,304,000	24,523,000	18,848,000
Fees and Charges	146,016,000	154,800,000	132,350,000
Investment Income	18,400,000	19,700,000	21,500,000
Other Income	<u>1,800,000</u>	<u>4,000,000</u>	<u>1,800,000</u>
Total	<u>512,920,000</u>	<u>554,767,000</u>	<u>447,298,000</u>

**SECURITIES & FUTURES COMMISSION
ESTIMATES OF EXPENDITURE FOR THE YEAR 2005/2006**

OPERATING EXPENDITURE

	Proposed Estimates Year 2005/2006	Revised Estimates Year 2004/2005	Approved Estimates Year 2004/2005
	HK\$	HK\$	HK\$
Premises	35,202,000	33,522,000	30,822,760
Personnel Expenses	375,893,000	357,280,000	327,000,000
Information & Systems Services	18,205,000	17,499,000	17,223,000
General Office & Insurance	7,280,000	6,859,000	7,405,000
Training & Development	6,650,000	5,170,000	3,550,000
Professional & Others	19,156,000	18,543,000	19,088,000
Corporate Communications	3,153,000	2,915,000	3,036,000
External Relations	6,000,000	4,300,000	3,140,000
SCEFI	3,600,000	3,600,000	3,600,000
Funding for the FRC (the AIB and FRRC)	5,000,000	-	-
Sub-total	480,139,000	449,688,000	414,864,760
Contingency	1,500,000	750,000	1,500,000
Total Operating Expenditure	481,639,000	450,438,000	416,364,760

**SECURITIES & FUTURES COMMISSION
ESTIMATES OF EXPENDITURE FOR THE YEAR 2005/2006**

CAPITAL EXPENDITURE

	Proposed Estimates Year 2005/2006	Revised Estimates Year 2004/2005	Approved Estimates Year 2004/2005
	HK\$	HK\$	HK\$
Furniture & Fixtures	1,000,000	1,000,000	1,000,000
Office Equipment	3,860,000	3,630,000	3,630,000
Computer Systems Development	10,410,000	7,340,000	7,260,000
Sub-total	15,270,000	11,970,000	11,890,000
Contingency (Note 1)	1,527,000	500,000	1,189,000
Total Capital Expenditure	16,797,000	12,470,000	13,079,000

Note 1 : Contingency is provided for at 10% of the total 2005/2006 capital expenditure (2004/2005 : 10%)

**SECURITIES & FUTURES COMMISSION
PROJECTED INCOME & EXPENDITURE STATEMENT
FOR THE YEAR 2005/2006**

	Proposed Estimates 2005/2006	Revised Estimates 2004/2005
	HK\$	HK\$
INCOME		
Investor Levy - Securities	322,400,000	351,744,000
Investor Levy - Futures/Options Contracts	24,304,000	24,523,000
Fees & Charges	146,016,000	154,800,000
Investment Income	18,400,000	19,700,000
Other Income	1,800,000	4,000,000
	<hr/>	<hr/>
Total Income	512,920,000	554,767,000
	<hr/>	<hr/>
EXPENDITURE		
Operating Expenditure	481,639,000	450,438,000
Depreciation	26,500,000	26,500,000
	<hr/>	<hr/>
Total Expenditure	508,139,000	476,938,000
	<hr/>	<hr/>
RESULT FOR THE YEAR	<u>4,781,000</u>	<u>77,829,000</u>

**SECURITIES & FUTURES COMMISSION
PROJECTED BALANCE SHEET
FOR THE YEAR 2005/2006**

	Proposed Estimates 2005/2006	Revised Estimates 2004/2005
	HK\$	HK\$
Fixed Assets	<u>28,600,000</u>	<u>35,700,000</u>
Net Current Assets	<u>745,035,508</u>	<u>733,154,508</u>
Net Assets	<u><u>773,635,508</u></u>	<u><u>768,854,508</u></u>
Representing :		
Reserves		
Government Start-up Grant	<u>42,840,429</u>	<u>42,840,429</u>
Income & Expenditure Account		
Beginning Balance	726,014,079	648,185,079
Result for the Year	<u>4,781,000</u>	<u>77,829,000</u>
	<u>730,795,079</u>	<u>726,014,079</u>
	<u><u>773,635,508</u></u>	<u><u>768,854,508</u></u>

Appendix 1**Securities & Futures Commission****Activities Analysis**

	<u>Year 01/02</u>	<u>Year 02/03</u>	<u>Year 03/04</u>	<u>% Change 03/04 over 01/02</u>
LICENSING				
Application for Licence received	3,306	4,555	3,732	12.89%
Application for Regulated Activities received	N/A	N/A	6,410	N/A
Total no. of Licenses at year end (by Licence)	28,395	26,411	20,510	-27.77%
Total no. of Licenses at year end (by Regulated Activities)	N/A	N/A	54,729	N/A
INTERMEDIARIES SUPERVISION				
Routine inspections	215	139	171	-20.47%
Special inspections	41	16	30	-26.83%
Prudential meetings	101	86	76	-24.75%
Breaches noted from completed inspections	553	510	810	46.47%
ENFORCEMENT				
New investigations (cases)	311	391	1,223	293.25%
Successful prosecutions (entities)	50	37	60	20.00%
Disciplinary inquiries conducted	143	163	167	16.78%
Entities disciplined	105	86	78	-25.71%
INVESTMENT PRODUCTS				
No. of authorised collective investment schemes	2,316	2,457	2,414	4.23%
CORPORATE FINANCE				
Total no. of transactions handled (including general and partial offer, privatisations, whitewash waiver, off-market and general offer repurchase and other applications under Takeovers Code and Share	268	341	393	46.64%
Dual filing cases reviewed	N/A	N/A	116	N/A
Structural products approved	19	14	49	157.89%
CONSULTATION AND GUIDELINES				
Consultation papers issued	25	20	6	-76.00%
Consultation conclusions issued	8	37	8	0.00%
Codes and guidelines issued	16	36	5	-68.75%
COMPLAINTS & ENQUIRIES				
No. of complaints	721	959	1,252	73.65%
No. of enquiries	3,073	3,982	5,382	75.14%
Complaints referred to operational divisions	449	576	708	57.68%
Complaints leading to investigations	113	163	161	42.48%

FORECAST OF FINANCIAL POSITION FOR THE YEAR 2004/2005

	Approved	Revised	Variance with		(11 months)	(1 month)	(12 months)	Variance with		Variance with	
	Budget	Budget	Approved Budget 2004/2005		Actual	Forecast for	Forecast Total	Approved Budget 2004/2005		Revised Budget 2004/2005	
	2004/2005	2004/2005 ^{Note}	HK\$'M	%	1.4.04-28.2.05	1.3.05-31.3.05	1.4.04-31.3.05	HK\$'M	%	HK\$'M	%
Revenue	447.30	554.77	107.47	24%	563.27	53.19	616.46	169.16	38%	61.69	11%
Operating Expenditure	416.37	450.44	34.07	8%	388.46	45.59	434.05	17.68	4%	(16.39)	-4%
Depreciation	27.00	26.50	-0.50	-2%	20.24	2.55	22.79	(4.21)	-16%	(3.71)	-14%
Surplus	3.93	77.83	73.90	1880%	154.57	5.05	159.62	155.69	3962%	81.79	105%
Reserves balance brought forward	615.56	691.03	75.47	12%	691.03	845.60	691.03	75.47	12%	0.00	0%
Reserves balance carried forward	619.49	768.86	149.37	24%	845.60	850.65	850.65	231.16	37%	81.79	11%

Note: Based on November 2004 review.

Assumption: The revenue for March 2005 is estimated based on SFC's latest forecast of average daily turnover of \$17.3 billion.