

**For discussion
on 5 February 2018**

Legislative Council Panel on Financial Affairs

**Securities and Futures Commission
Budget for the Financial Year 2018-19**

PURPOSE

This paper highlights the main features of the budget of the Securities and Futures Commission (“SFC”) for 2018-19.

BACKGROUND

2. Section 13(2) of the Securities and Futures Ordinance (Cap. 571) (“SFO”) requires the SFC to submit the estimates of its income and expenditure (“the budget”) for each financial year to the Chief Executive (“CE”) for approval. The CE has delegated the authority to the Financial Secretary (“FS”). In accordance with section 13(3) of the SFO, the FS shall cause the budget to be laid on the table of the Legislative Council (“LegCo”). In line with past practice, the Government has prepared this paper to brief Members on the main features of the SFC’s budget for 2018-19, a copy of which is attached at Annex.

FUNDING OF THE SFC

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

4. Over the years, levies on securities transactions and futures and options contracts have been the main source of income for the SFC. The current rate of levy on securities transactions is 0.0027%, while that on futures and options contracts is \$0.54 or \$0.10 per contract, depending on the type of contracts.

BUDGET FOR 2018-19

5. The SFC has projected a budget deficit of \$127.61 million for 2018-19. As in past years, the SFC does not request any appropriation from LegCo for the 2018-19 budget. The main features of the 2018-19 budget are set out in paragraphs 6 to 14 below.

Income

6. The estimated income for 2018-19 is \$1,870.85 million, which is \$34.99 million (1.9%) above the forecast income for 2017-18 (\$1,835.86 million). The SFC has adopted the following assumptions in projecting the estimated income –

- (a) the average securities market turnover will be \$109 billion per day and the average futures/options market turnover will be 410,000 contracts per day; and
- (b) the annual licence fee waiver will continue for one year in 2018-19.

Expenditure

7. The estimated expenditure for 2018-19 is \$1,998.46 million, which is \$118.05 million (6.3%) above the forecast expenditure for 2017-18 (\$1,880.41 million). The increase is mainly attributable to –

- (a) increase in staff cost by \$99.56 million (7.7%), arising mainly from –
 - (i) a provision of \$25.20 million for 21 new headcount to ensure that the SFC is adequately staffed to discharge its responsibilities in response to market development and the changes in the regulatory environment. Details are set out in paragraph 8 below;
 - (ii) a provision of \$45.05 million budgeted for the annual pay adjustment. This amount is approximately equivalent to an average of 3.8% pay increase; and
 - (iii) a provision of \$7.75 million for the upgrade of 19 positions to reflect the change in the scope of work

and the increase in regulatory responsibilities, and to provide a career path for high performing staff;

- (b) increase in expenses on information and system services by \$8.03 million (12.6%) due to higher maintenance costs for software and hardware to cater for the need of more software subscription and higher backup data centre related charges, and to pay for subscription of more market data and news to support enforcement and supervision activities; and
- (c) increase in funding to external parties such as the Investor Education Centre (by \$6.71 million or 8.7%) for investor education; expenses on internship programme (by \$1.20 million or 24.7%) to build up a pipeline of talent; expenses on regulatory and external engagement activities (by \$1.16 million or 7.0%); and expenses on staff learning and development programmes (by \$0.99 million or 11.6%).

Manpower Plan

8. The SFC proposes 21 new headcount in the budget of 2018-19, bringing its total headcount to 965, with details as follows –

- (a) **Intermediaries Division** (8 posts) – to support the initiative to promote Hong Kong as a booking hub for Asian derivatives, to handle the continued growth in the regulated activities carried out by licensed corporations, and to cope with the workload arising from the SFC's adoption of a front-loaded regulatory approach, the growth in licensees and the introduction of the Manager-In-Charge regime;
- (b) **Enforcement Division** (6 posts) – to handle the growing number of large and serious cases that require urgent regulatory actions, to handle the continued growth in large-scale litigation, and to assist in handling policy-related initiatives that have been increasing both in number and complexity as well as the work related to the International Organization of Securities Commissions and cross-border enforcement co-operation between international regulators;

- (c) **Corporate Finance Division** (4 posts) – to handle the workload related to the Stock Market Listing Rules regulation that has been the SFC’s strategic focus and priority, and to handle the substantial increase in the number of Initial Public Offering applications submitted under the Dual Filing regime and the increase in workload in relation to the takeovers code; and
- (d) **Corporate Affairs Division** (3 posts) – to provide expertise on specific information technology (“IT”) areas, to support and implement various IT systems being rolled out across the SFC, to handle the increased workload in relation to the human resources management, and to provide additional resources for system and analytics related work.

9. The SFC considers that given the highly uncertain environment in which it operates, there is a need to recognise the possibility of urgent unanticipated additional resource requirements in response to new or expanded regulatory mandates. Should any such matters arise, they will be dealt with through a separate interim budget request.

Capital Expenditure

10. The total capital expenditure proposed for 2018-19 is \$56.96 million, which is broadly the same level of the forecast expenditure for 2017-18 (\$56.98 million), comprises the following key items –

- (a) **computer system development** – adoption of front-end technology to streamline the business process; upgrade of market surveillance capabilities; improvement of the access and the exchange of information between stakeholders and the SFC; and enhancement of various IT systems (\$36.35 million);
- (b) **office equipment** – investment in storage technology and data base capacity, as well as software upgrade; replacement of the resources system plus costs relating to the normal replacement of obsolete servers; purchase of computer equipment for the additional headcount; and replacement of obsolete office equipment due to normal wear and tear (\$18.61 million); and

- (c) **office furniture and fixtures** – minor alternation of office configuration and replacement of obsolete furniture due to normal wear and tear (\$2.00 million).

Reserves

11. The SFC estimates that by 31 March 2018, the reserves (after ring-fencing \$3,000 million for possible acquisition of office premises as reported in its 2016-17 budget¹) will be \$3,877.35 million, which is 2.06 times of the forecast expenditure for 2017-18 (\$1,880.41 million).

12. According to section 396 of the SFO, the SFC may, after consultation with the FS, recommend to the CE-in-Council that the rate or amount of levy be reduced if the reserves of the SFC are more than twice its estimated operating expenses for that financial year. The SFC effected a levy reduction of 20% in December 2006, 25% in October 2010 and a further 10% in November 2014. The SFC considers that the levy rate should remain the same in 2018-19, but it will continue to review the situation annually and include its recommendations to the FS in each future budget for any changes that it considers necessary.

13. The SFC will continue to offer an annual licence fee waiver for one year in 2018-19. The SFC will review the situation again next year and depending on the operating environment of the securities industry, it may reinstate the annual licence fee in 2019-20.

14. The SFC estimates that by 31 March 2019, the non-ring-fenced reserves will be reduced to \$3,749.75 million, which is 1.88 times of the projected expenditure for 2018-19 (\$1,998.46 million). The SFC will continue to keep its reserves level under review in accordance with section 396(1) of the SFO, taking into consideration the prevailing market conditions, the SFC's expected resource requirements and its financial projections for the near to medium term.

¹ The SFC's current lease will expire in 2022. The SFC is open to all cost effective accommodation options and is conducting a detailed assessment of the various property strategy options before deciding how to make the best use of the amount ring-fenced.

COMPARISON OF THE 2017-18 ORIGINAL BUDGET WITH THE FORECAST BUDGET

Income

15. The forecast income for 2017-18 is \$1,835.86 million, which is \$417.33 million (29.4%) more than the original budget of \$1,418.53 million. The higher income is mainly due to a higher-than-budgeted market turnover² and a higher net investment income.

Expenditure

16. The forecast expenditure is \$1,880.41 million, which is \$72.65 million (3.7%) below the original budget of \$1,953.06 million. The underspending is mainly due to the time lag experienced in filling vacancies, a lower depreciation cost owing to delays in the implementation of capital projects during the year, lower legal fees, and lower-than-expected costs for system contract services and software maintenance contracts.

Capital Expenditure

17. The forecast capital expenditure is \$56.98 million, which is roughly the same level of the original budget (\$57.41 million).

THE GOVERNMENT'S VIEWS

18. We are studying in detail the SFC's proposed budget for 2018-19. We note that the regulator has not requested appropriation from LegCo despite the fact that it has projected a deficit budget.

19. It is a public commitment of the SFC, as a publicly funded organisation, to deploy its resources and control its expenditures in a prudent manner. The SFC's income is subject to market fluctuation. We therefore agree that the SFC should review its waiver arrangement to

² The revised income for 2017-18 is projected based on the prevailing market performance and the assumption that the average daily turnover of securities transactions and futures/options contracts transactions is \$93 billion and 377,000 contracts respectively for the year. The original budget is made based on assumptions of a turnover of \$81 billion per day and 433,000 contracts per day.

ensure that its resources can be used in a more targeted manner. Meanwhile, the SFC should continue to exercise stringent cost control and make its best effort to cope with extra workload and new regulatory initiatives through redeployment of existing resources.

ADVICE SOUGHT

20. Members are invited to note the proposed budget of the SFC for 2018-19.

**Financial Services Branch
Financial Services and the Treasury Bureau
January 2018**



Securities and Futures Commission
Budget of income and expenditure
for the financial year 2018/2019

18 December 2017



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1. Executive summary

1.1 Each year the budget is prepared based on a policy of tightly controlling all expenditures, as befits a publicly funded organization. Prior year expenditure levels are used as a benchmark except in areas where additional resources have been identified to meet our regulatory obligations and objectives or to support new initiatives and regulatory developments. We will also scrutinise and re-deploy resources from areas that are not expected to recur in the next financial year. Strict controls are applied to ensure that costs stay within budget commitments. As in previous years, we have engaged an independent external consultant to conduct an annual review of financial controls and policies to ensure that they are robust and practical. No material findings were highlighted.

1.2 Set out below is a summary of the Commission's forecast for 2017/18 and proposed budget for 2018/19. For more detailed explanations, reference should be made to sections 3 and 4 of this budget book.

	2018/19	2017/18	Variance	
	Proposed Budget	Forecast	Proposed Budget vs. Forecast	
	(a)	(b)	(c) = (a-b)	(c/b)
	HK\$m	HK\$m	HK\$m	%
Income	1,870.85	1,835.86	34.99	1.9%
Recurrent expenditure				
Staff cost	1,384.92	1,285.37	99.55	7.7%
Premises expenses	253.67	253.67	-	-
Other recurrent expenses	218.53	207.46	11.07	5.3%
Total recurrent expenditure	1,857.12	1,746.50	110.62	6.3%
Legal fees	57.56	56.84	0.72	1.3%
Funding to external parties	83.78	77.07	6.71	8.7%
Total expenditures	1,998.46	1,880.41	118.05	6.3%
Result for the year	(127.61)	(44.55)	(83.06)	

1.3 For 2018/19 we forecast that income will increase by \$34.99 million (1.9%) over the 2017/18 Forecast as a result of the latest securities market turnover and investment return assumptions. We assume that the securities market turnover for 2017/18 and 2018/19 would be around \$93 billion/day and \$109 billion/day respectively. The actual securities market turnover for the first 8 months of 2017/18 was around \$93 billion/day.

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

1.5 The levy rate will remain the same at 0.0027% in 2018/19. We will continue to review the situation annually and include recommendations to the Financial Secretary in each future budget for any changes considered necessary.



- 1.6 The two year annual licence fee waiver that commenced in April 2016 will end by March 2018. After reviewing our fees and charges level and market conditions, we recommend to continue the fee waiver for one year in 2018/19. However, we will review the situation again next year, and depending on the operating environment of the securities industry, we may reinstate the annual licence fee in 2019/20. Estimated annual licence fee income foregone in 2018/19 is around \$200 million.
- 1.7 Total expenditure for 2018/19 is expected to increase by \$118.05 million (6.3%) over the 2017/18 Forecast. The increase is mainly attributable to increases in staff costs (\$99.55 million).
- 1.8 The budget hinges on the need to ensure that the Commission is adequately resourced to effectively and efficiently discharge its responsibilities as the market continues to develop and the regulatory environment changes.
- 1.9 The Commission continually reviews its resourcing needs and organisation structure. Wherever possible, the Commission seeks to re-deploy existing resources to deal with extra workload or new regulatory initiatives anticipated in the next budget year. The Commission has also worked to improve operational and process efficiencies. For initiatives that are currently in a consultative or preliminary stage, existing resources are re-deployed to the extent possible.
- 1.10 Having critically reviewed the manpower needs of the Commission's operating divisions for 2018/19, a net increase of 21 full time posts over the Commission approved headcount of 2017/18 has been included in the budget. This represents a total headcount increase of approximately 2.2% for the next financial year. Please refer to Section 3 for more detailed information about the Commission's 2018/19 manpower plan.
- 1.11 19 position upgrades are requested to reflect the changing scope of work and the increase in regulatory responsibilities, as well as to provide a career path for the Commission's high performing staff.
- 1.12 There is a need to recognize the possibility of urgent unanticipated additional resource requirements in response to new or expanded regulatory mandates. These would be dealt with through a separate interim budget request after a critical review of needs and any resourcing alternatives to that of additional headcount.
- 1.13 A deficit of approximately \$127.61 million is expected in 2018/19 leaving our non-ringfenced reserves at \$3.75 billion at the end of that financial year, which is approximately 1.9 times our annual costs, including funding to various external parties.
- 1.14 We will review our reserves and the levy annually, taking into consideration prevailing market conditions, our expected resource requirements and medium term financial projections.



2. Assumptions

2.1 Investor levy rates

2.1.1 The levy rates will remain unchanged for the year 2018/19, i.e.

- (a) Investor Levy Rate - Securities at 0.0027%; and
- (b) Investor Levy Rate - Future/Options contracts at \$0.54/\$0.1 per contract, depending on the type of contract.

2.2 Market turnover

2.2.1 Equity market

- (a) The average securities market turnover is around \$86 billion/day for the first 6 months of 2017/18. Based on the SFC Research Department's latest statistical analysis result, the average daily securities market turnover is approximately \$93 billion/day for the year 2017/18 (see also para 4.3.2(a)).
- (b) The average securities market turnover is assumed at \$109 billion/day for 2018/19.

2.2.2 Futures and Options market

Based on the transaction volumes for the first half of 2017/18, the futures/options market turnover is assumed to be an average of 377,000 contracts per day for the rest of 2017/18. For budgeting purposes we have assumed that volume will increase in line with estimated increase in the securities market turnover. On this basis, the futures/options market turnover is assumed to be an average of 410,000 contracts per day in 2018/19.

2.3 Fees and charges

2.3.1 Licensing annual fee waiver will continue for one year in 2018/19. The underlying rates of fees and charges, which will continue to apply to all new license applications, are assumed to remain unchanged.

2.4 Rate of return

2.4.1 The average gross return on investment of our reserve funds before investment management fees is assumed to be 2.75% p.a. for the year 2018/19.

2.5 Remuneration adjustment

2.5.1 A provision of 3.8% of personnel costs has been included as salary adjustments for staff (see also 4.4.2 (c)).

2.5.2 In arriving at the provision, the Commission has considered a number of factors including, but not limited to, macro-economic factors (e.g. projected



CPI), relevant industry remuneration trends for 2018/19, the labour market demand for the type of expertise required by the Commission as well as merit adjustments.

2.6 Inflation

2.6.1 Where an estimate of general price level increases is required we have assumed 1.7% when we do not have specific data and/or quotes on which to estimate our future costs.

2.7 Capital expenditure

2.7.1 Capital expenditure is budgeted based on the level of expenditure which will be committed to within a financial year. However, actual expenditure incurred will differ from this and the approved estimates of capital expenditure for different capital projects will, as previously, be carried forward until the completion of the projects.



3. Manpower plan

3.1 Proposed headcount changes 2017/18 vs 2018/19

Division	Headcount						
	Commission Approved 2017/18	Proposed 2018/19	Net Change	Executive Posts	Non-Executive Posts	Upgrades	Para /ref
Centralised Services ^{Note 1}	30	30	-	-	-	4	3.2.1
Corporate Finance	92	96	+4	4	-	-	3.2.2
Enforcement	204	210	+6	5	1	1	3.2.3-3.2.4
Intermediaries	274	282	+8	5	3	6	3.2.5
Legal Services	53	53	-	-	-	1	3.2.6
Investment Products	122	122	-	-	-	2	3.2.7
Supervision of Markets	51	51	-	-	-	1	3.2.8
Corporate Affairs	118	121	+3	1	2	4	3.2.9-3.2.11
TOTAL ^{Note 2}	944	965	21	15	6	19	

Note 1 : Include CEO's Office, International Affairs, Mainland Affairs, Secretariat and Press Office. Following a review of its operational needs the Commission undertook a restructuring exercise in 2017/18 to embed functions previously undertaken by the Risk and Strategy Unit within individual Divisions. This restructuring also resulted in the reduction of one post from Centralised Services.

Note 2 : The Commission has proposed 19 post upgrades for 2018/19

3.1.1 Having made a critical assessment of its manpower needs for 2018/19, a net increase of 21 full time posts has been included in this budget. As can be seen from the table in para 3.1 above, the manpower requests for 2018/19 are centered upon the Corporate Finance, Enforcement and Intermediaries Divisions with other Divisions recording minimal growth or keeping their headcount at the 2017/18 level.

3.1.2 Detailed justifications for additional headcount and upgrades are set out in paragraph 3.2.

3.2 New headcount requests – 2018/19

Centralised Services

3.2.1 No new headcount for 2018/19 is requested. 3 executive and 1 non-executive upgrades are proposed to provide progression for high performing staff.

Corporate Finance Division

3.2.2 The Corporate Finance Division proposes 4 new executive posts for the Takeovers, Pre-IPO and Post-IPO teams. These include:

- (a) 2 new executive posts for the Post-IPO Team due to the Commission's strategic focus and priority in SMLR regulation



following the Commission's adoption of a front loaded regulatory model;

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

Enforcement Division

3.2.3 The Enforcement Division (ENF) proposes 5 new executive and 1 non-executive posts for 2018/19. These requests consist of:

- (a) 2 executive posts and 1 non-executive post for the Corporate Fraud and Corporate Misfeasance Team and the Insider Dealing and Market Manipulation Team in response to the growing number of large and serious cases which require urgent regulatory actions;
- (b) 2 executive posts for the Intermediaries Misconduct Team to handle the continued growth in large scale litigation, including serious misconduct of sponsors; and
- (c) 1 executive post to assist the Enforcement Division in handling the increasing number and complexity of policy-related initiatives as well as IOSCO and international work.

3.2.4 1 executive upgrade is proposed to reflect the increasing complexity and difficulty of the cases encountered by ENF which will require the expertise of more experienced staff.

Intermediaries Division

3.2.5 The Intermediaries Division proposes 8 new posts.

- (a) Intermediaries Supervision Department (ISD), Intermediaries
 - (i) 2 new executive posts are proposed to enable the ISD to acquire new skillsets such as data analytics and model experts in support of the initiative to promote Hong Kong as a booking hub for Asian derivatives.
 - (ii) 1 new executive post and 2 non-executive posts are proposed to handle the continued growth in regulated activities conducted by licensed corporations and to cope with the increase in depth, coverage and complexity of work performed as a result of the Commission's front loaded regulatory approach.
 - (iii) 4 executive and 2 non-executive upgrades are proposed to allow the recruitment of more experienced staff and to provide progression for high performing staff.



(b) Licensing Department, Intermediaries

- (i) 2 executive and 1 non-executive posts are proposed to respond to the increasing workload resulting from the growth in licensees and the introduction of the Manager-In-Charge regime.

Legal Services Division

- 3.2.6 No new headcount for 2018/19 is requested. 1 non-executive upgrade is proposed to provide career progression for high performing staff.

Investment Product Division

- 3.2.7 No new headcount for 2018/19 is requested. 2 executive upgrades are requested to allow recruitment of specialized staff required to address the increase in volume and breadth of policy and other initiatives in market facilitation, policy formulation and application processing and monitoring.

Supervision of Markets Division

- 3.2.8 No new headcount is requested in 2018/19. 1 executive upgrade is proposed to provide career progression for high performing staff.

Corporate Affairs Division

- 3.2.9 The Information Technology Department proposes 2 new non-executive posts to provide expertise in specific technical areas and to support and implement various systems currently being rolled out across the Commission.
- 3.2.10 The Human Resources Department proposes 1 executive post in response to the elevated workload faced by the Department as a result of the growth in the Commission and to provide additional resources for system and analytics related work.
- 3.2.11 A total of 4 upgrades are requested in order to maintain an appropriate Corporate Affairs structure to support the Commission's constituent divisions/departments in discharging their regulatory responsibilities and to provide career progression for high performing staff. The upgrades comprise 2 executive upgrade in External Relations Department, and 2 executive upgrades in Information Technology Department.



4. Financials

4.1 Income and expenditure statement

Para. Ref.	(a) Proposed Budget For Year 2018/19 HK\$'000	(b) Forecast For Year 2017/18 HK\$'000	(c) Approved Budget For Year 2017/18 HK\$'000	Proposed Budget (a) over/(under) Forecast (b)		Forecast (b) over/(under) Approved Budget (c)		
				HK\$'000	%	HK\$'000	%	
Income								
Investor levy								
Securities	4.3.2	1,442,070	1,243,278	1,084,752	198,792	16.0%	158,526	14.6%
Futures/Options contracts		109,000	100,044	114,955	8,956	9.0%	(14,911)	-13.0%
Fees & charges	4.3.3	146,250	146,236	135,262	14	0.0%	10,974	8.1%
Net investment income	4.3.4	166,530	340,574	76,560	(174,044)	-51.1%	264,014	344.8%
Other income	4.3.5	7,000	5,730	7,000	1,270	22.2%	(1,270)	-18.1%
Total		1,870,850	1,835,862	1,418,529	34,988	1.9%	417,333	29.4%
Recurrent expenditures								
Premises	4.4.1	253,666	253,666	256,046	-	0.0%	(2,380)	-0.9%
Staff cost	4.4.2	1,384,922	1,285,365	1,325,793	99,557	7.7%	(40,428)	-3.0%
Information & systems services	4.4.3	71,792	63,762	71,942	8,030	12.6%	(8,180)	-11.4%
General office & insurance	4.4.4	10,400	10,467	10,667	(67)	-0.6%	(200)	-1.9%
Learning & development	4.4.5	9,448	8,463	8,649	985	11.6%	(186)	-2.2%
Professional fees	4.4.6	68,075	68,310	56,130	(235)	-0.3%	12,180	21.7%
Regulatory and external activities	4.4.7	17,738	16,583	18,044	1,155	7.0%	(1,461)	-8.1%
Internship programme	4.4.8	6,084	4,880	5,070	1,204	24.7%	(190)	-3.7%
		1,822,125	1,711,496	1,752,341	110,629	6.5%	(40,845)	-2.3%
Legal fees	4.4.9	57,555	56,840	66,840	715	1.3%	(10,000)	-15.0%
		1,879,680	1,768,336	1,819,181	111,344	6.3%	(50,845)	-2.8%
Depreciation	4.4.10	35,000	35,000	50,000	-	0.0%	(15,000)	-30.0%
Operating expenditure (1)		1,914,680	1,803,336	1,869,181	111,344	6.2%	(65,845)	-3.5%
Funding to external parties								
Funding to the FRC	4.5.1	8,495	8,090	8,090	405	5.0%	-	0.0%
Funding to the IFRS Foundation	4.5.2	392	392	390	-	0.0%	2	0.5%
Funding to IEC	4.5.3-4	74,892	68,590	73,396	6,302	9.2%	(4,806)	-6.5%
Funding to the HKSI and other education initiatives		-	-	2,000	-	N/A	(2,000)	N/A
Total (2)		83,779	77,072	83,876	6,707	8.7%	(6,804)	-8.1%
Total expenditure (1) + (2)		1,998,459	1,880,408	1,953,057	118,051	6.3%	(72,649)	-3.7%
Result for the year		(127,609)	(44,546)	(534,528)	(83,063)	186.5%	489,982	-91.7%
Reserves brought forward		3,877,354	3,921,900	3,770,267	(44,546)	-1.1%	151,633	4.0%
Reserves carried forward		3,749,745	3,877,354	3,235,739	(127,609)	-3.3%	641,615	19.8%



4.2 Capital expenditure statement

Para. Ref	(a)	(b)	(c)	Proposed Budget (a)		Forecast (b)	
	Proposed Budget For Year 2018/19 HK\$'000	Forecast For Year 2017/18 HK\$'000	Approved Budget For Year 2017/18 HK\$'000	over/(under) Forecast (b)	%	over/(under) Approved Budget (c)	%
Capital expenditure							
	4.6						
Furniture & fixtures	2,000	6,355	6,200	(4,355)	-68.5%	155	2.5%
Office equipment	18,610	12,997	13,270	5,613	43.2%	(273)	-2.1%
Vehicles	-	350	350	(350)	N/A	-	-
Computer systems development	36,345	37,278	37,590	(933)	-2.5%	(312)	-0.8%
Total	56,955	56,980	57,410	(25)	0.0%	(430)	-0.7%



4.3 Income

4.3.1 Annual grant from government

S.14 of the Securities and Futures Ordinance provides that: “For each financial year of the Commission, the Government shall pay to the Commission out of the general revenue the moneys appropriated by the Legislative Council for that purpose.” As in previous years, the Commission proposes that the Government does not request any appropriation from the Legislative Council for the financial year 2018/19. The Commission’s decision is made without prejudice to the funding principles established when the Commission was formed, and has no implications for requests for appropriations in future years.

4.3.2 Investor levy

- (a) The following turnover and levy rate assumptions have been used in preparing levy income estimates:

	2017/18		2018/19
	Apr 17-Mar 18 (Budget)	Apr 17-Mar 18 (Forecast)	Apr 18-Mar 19 (Budget)
Securities			
Daily turnover (billion/day)	\$81.0	\$93.0	\$109.0
Levy rate	0.0027%	0.0027%	0.0027%
Futures/Options Contracts			
Daily turnover (contracts)	433,000	377,000	410,000
Levy rate	\$0.54	\$0.54	\$0.54

- (b) The 2017/18 Forecast of Investor Levy – Securities is higher than the Approved Budget by \$158.53 million (14.6%) whereas Investor levy – Futures and Options is lower than the Approved Budget by \$14.91 million (13%). These variances reflect variations in actual securities market turnover for the first eight months of 2017/18 (around \$93 billion/day) when compared to the estimates underlying the Approved Budget.
- (c) We assume that the securities market turnover for 2017/18 and 2018/19 would be around \$93 billion/day and \$109 billion/day respectively.
- (d) For budget purposes, we assume that the volume of future contracts will increase by 9% in 2018/19.



4.3.3 Fees and charges

- (a) The Forecast aggregate fees and charges income for 2017/18 is \$10.97 million (8.1%) higher than the Approved Budget as fees from Corporate Finance are higher than expected.
- (b) The 2018/19 Budget is retained at the 2017/18 Forecast level. We will continue the annual license fee waiver in 2018/19. The annual licence fee foregone, based on Licensing's estimate, is around \$200 million.

4.3.4 Net investment income

- (a) Budgeted investment income was \$76.56 million which comprised of \$52.1 million of fixed income and deposit interest and \$24.46 million gains from equity pooled funds. Due to short term volatility in our pooled equity fund investments, we have recorded a mark-to-market gain of \$178.58 million during the first half of 2017/18. As a result, we have revised our 2017/18 Forecast net investment income to \$340.57 million, after netting investment management fees.
- (b) 2018/19 investment income is budgeted to be \$166.53 million. For budgeting purpose, we assume that the average gross return on investment before investment management fees is 2.75%. The actual rate of return may vary, depending primarily on market performance and the investment strategy to be adopted.

4.3.5 Other income

Other income for 2017/18 and 2018/19 represents license fees and service fees received from the IEC and ICC for providing office space, accountancy, human resources and IT support services, recoveries from enforcement cases and sales of Commission publications.

4.4 Recurrent expenditure

4.4.1 Premises

- (a) Forecast premises expenses for 2017/18 are expected to be close to the Approved Budget.
- (b) Expenses for 2018/19 are retained at 2017/18 Forecast level.

4.4.2 Staff cost

- (a) The overall staff cost for 2017/18 is forecasted to be lower than the 2017/18 Budget by \$40.43 million (3.0%). This is principally due to the time lag experienced in filling vacancies and a number of positions being filled in lower grades.
- (b) The projected headcount at 31 March 2019 is 965, a net increase of 21 (2.2%) over the 2017/18 Commission approved headcount. Please see section 3 for detailed explanations. The projected staff



cost for 2018/19 is \$99.55 million (7.7%) higher than the 2017/18 Forecast.

- (c) The 2018/19 Budget includes provision for an average 3.8% pay increase for Commission staff. This recommendation is based on market information from independent parties including pay consultants and professional associations. In arriving at the proposed increase, additional consideration is given to data relevant to the financial services sector and more specifically, the functional areas from which the Commission is competing for talent from (i.e. compliance, legal and risk). The anticipated supply and demand in the external employment market for the forthcoming year, as well as macroeconomic indicators are also taken into account. Detailed proposals for the actual pay increase will be formulated in Q1, 2018.
- (d) The detailed pay policy will be presented to the Commission's Remuneration Committee for discussion and to the Commission for approval.

4.4.3 Information and systems services

- (a) The information and systems services expenses forecast for 2017/18 is \$8.18 million (11.4%) lower than the Approved Budget due to lower than expected actual costs for systems contract services and software maintenance contracts.
- (b) For 2018/19, we project a \$8.03 million (12.6%) increase due to higher software and hardware maintenance costs to cater for the growth in software subscription and higher backup data centre related charges and increases in subscriptions for market data and news to support enforcement and supervision activities.

4.4.4 General office and insurance

- (a) Forecast general office and insurance for 2017/18 is \$0.2 million (1.9%) lower than the Approved Budget.
- (b) Budgeted expenses for 2018/19 is retained at the 2017/18 Forecast level.

4.4.5 Learning and development

- (a) Forecast learning and development related expenses for 2017/18 are \$0.19 million (2.2%) lower than the Approved Budget.
- (b) The learning and development budget for 2018/19 will be \$0.99 million (11.6%) higher than the 2017/18 Forecast. With the integration of the Hong Kong and China markets and technologies adopted in the financial industry, Mainland China, asset management and FinTech will continue to be our focus in the next fiscal year. More technical and leadership development programmes will be provided to Commission staff to enhance their professional knowledge and leadership and management competencies.



4.4.6 Professional fees

- (a) Forecast professional fee for 2017/18 is \$12.18 million (21.7%) higher than the Approved Budget due to the higher demand in professional services rendered by external forensic accounting firms.
- (b) Budget for 2018/19 will be kept at the Forecast 2017/18 level.
- (c) Key projects in 2018/19 include anti-money laundering, cybersecurity, trading data analytics, remote booking and transfer pricing for licensed corporations, equity capital fund raising process, investor ID model, Central Counterparties resolution and Uncertificated Securities Market.

4.4.7 Regulatory and external activities

- (a) Expenses relating to the Commission's regulatory and international commitments, including hosting regulatory forums and attending international meetings, are included under this heading.
- (b) Forecast regulatory and external activities for 2017/18 are lower than the Approved Budget by \$1.46 million (8.1%) mainly due to lower than expected overseas travelling.
- (c) The 2018/19 budget is \$1.16 million (7%) higher than the 2017/18 Forecast. This is attributable to the combination of lower seminars expenses and an increase in the need for overseas travelling to engage in regulatory reforms and promoting collaboration and public relations programme.

4.4.8 Internship programme

This represents the salary cost of hiring university graduates in support of the Government's internship programme and for the Commission to develop a pipeline of talent for the future. Our proposed expenditure for 2018/19 to recruit these individual represents an increase of \$1.2 million over the 2017/18 Forecast.

4.4.9 Legal fees

- (a) The forecast for 2017/18 is \$10 million (15%) lower than the original budget, taking into account the actual spending level in the first half of the year.
- (b) The budget for 2018/19 is kept at prior year level.



4.4.10 Depreciation

- (a) Forecast depreciation expenses for 2017/18 are expected to be \$15 million (30%) lower than budget owing to the change in timing and delay in carrying out various capital projects during the year.
- (b) The budget for 2018/19 is retained at the 2017/18 Forecast level.

4.5 Funding to external parties

4.5.1 To continue our support for the work of the Financial Reporting Council, the Commission will increase the annual funding from \$8.09 million in 2017/18 to \$8.5 million in 2018/19, with a 5% price adjustment.

4.5.2 To continue our support for the work of the International Financial Reporting Standards Foundation, the Commission will again provide funding of US\$50,000 (or \$392,000) in 2018/19.

4.5.3 Funding to Investor Education Centre (IEC) is revised to \$68.59 million in 2017/18 based on the latest forecast prepared by IEC. In 2018/19, IEC proposed total expenditure of \$74.89 million. Major expenses are summarised below:

	Budget <u>2018/19</u>	Forecast <u>2017/18</u>	Budget <u>2017/18</u>
	\$'m	\$'m	\$'m
Education programmes	39.83	35.18	39.81
Staff costs	26.65	25.72	25.72
Premises costs	3.40	3.40	3.40
Professional & other services	1.80	1.73	1.78
Publicity & external relations	0.58	0.52	0.58
General office & others	2.63	2.04	2.11
Total	<u>74.89</u>	<u>68.59</u>	<u>73.40</u>

4.5.4 IEC projects higher expenditure for 2018/19 based on its experience of the costs of its key operations in 2017/18 as well as proposals for projects in 2018/19 to increase the awareness, effectiveness and reach of education work.

4.6 Capital expenditure

4.6.1 The total capital expenditure for the 2017/18 Forecast is retained at the Approved Budget level.

4.6.2 The total capital expenditure budget for 2018/19 is \$56.96 million. The lower spending in office furniture & fixtures is offset by the higher spending in computer software. The planned capital expenditure for 2018/19 comprises the following:



Capital expenditure	Amount \$'m	Note
Office furniture & fixtures	2.00	(a)
Office equipment	18.61	(b)
Computer systems development	<u>36.35</u>	(c)
Total	<u>56.96</u>	

Notes :-

- (a) \$2 million is provided for minor alternation of office configuration and replacement of obsolete furniture due to normal wear and tear.
- (b) office equipment:
 - (i) \$1 million for replacement of obsolete office equipment due to normal wear and tear; and
 - (ii) \$17.61 million for investment in storage technology and data base capacity, software upgrades, replacement of the resources system plus costs relating to the normal replacement of obsolete servers and computer equipment needed for additional headcount.
- (c) \$36.35 million is provided for front-end technology to streamline the business process, upgrade our market surveillance capabilities, improve access and exchange of information between stakeholders and the Commission and enhance various IT systems.