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**Panel on Financial Affairs**  
**Meeting on 1 February 2021**

**Updated background brief**  
**on the annual budgets of the Securities and Futures Commission**

**Purpose**

This paper sets out background information on the arrangements for funding the Securities and Futures Commission ("SFC") and the scrutiny of SFC's annual estimates. The paper also summarizes the major concerns and views expressed by members when the Panel on Financial Affairs ("FA Panel") discussed SFC's proposed budgets for the five financial years from 2016-2017 to 2020-2021.

**Background**

Establishment, regulatory objectives and organizational structure

2. SFC was established under the then Securities and Futures Commission Ordinance in 1989 as the statutory regulator of the securities and futures market in Hong Kong. In 2002, the Legislative Council ("LegCo") enacted the Securities and Futures Ordinance (Cap. 571) ("SFO") which consolidated and modernized 10 ordinances including Securities and Futures Commission Ordinance regulating the securities and futures market. SFO came into operation on 1 April 2003.

3. The regulatory objectives of SFC as prescribed in section 4 of SFO are to:

(a) maintain and promote the fairness, efficiency, competitiveness, transparency and orderliness of the securities and futures industry;

- (b) promote understanding by the public of financial services including the operation and functioning of the securities and futures industry;
- (c) provide protection for members of the public investing in or holding financial products;
- (d) minimize crime and misconduct in the securities and futures industry;
- (e) reduce systemic risks in the securities and futures industry; and
- (f) assist the Financial Secretary ("FS") in maintaining the financial stability of Hong Kong by taking appropriate steps in relation to the securities and futures industry.

4. Under SFO, the Board of Directors of SFC shall make up of no fewer than eight members and the majority of them must be non-executive directors.<sup>1</sup> All directors of the Board are appointed by the Chief Executive ("CE") or FS with the delegated authority of CE. The Executive Committee performs administrative, financial and management functions as delegated by the Board of Directors. As at 31 March 2020, the actual staff strength of SFC was 921,<sup>2</sup> consisting of 736 professional staff and 185 support staff. The organizational structure of SFC as at March 2020 is shown in **Appendix I**.

#### Financial arrangements

5. Section 14 of SFO provides that the Government shall provide funding to SFC as appropriated by LegCo. In practice, SFC has been self-funded since 1993-1994 through collecting transaction levies from investors and fees and charges from market intermediaries, and thus has not requested for appropriation from LegCo since then.

6. Under section 13(2) of SFO, SFC is required to submit, not later than 31 December of each year, the estimates of its income and expenditure (i.e. budget) for the next financial year to CE for approval.<sup>3</sup> The approval authority was delegated to FS in 1995. Under section 13(3) of SFO, FS shall

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<sup>1</sup> Section 1 of Part 1 of Schedule 2 to the Securities and Futures Ordinance (Cap. 571) ("SFO") provides for the composition of the Board of Directors.

<sup>2</sup> The budgeted headcount in the 2020-2021 budget of the Securities and Futures Commission ("SFC") was 988.

<sup>3</sup> Section 13(1) of SFO specifies that the financial year of SFC commences on 1 April.

cause the budget as approved pursuant to section 13(2) to be laid on the table of LegCo. In addition, under section 15(3) of SFO, SFC shall send a report on its activities conducted during the previous financial year (i.e. the annual report) to FS, who shall cause a copy to be laid on the table of LegCo. In the past five years except 2019, the approved budget and annual report of SFC were tabled at a Council meeting in May and June respectively.<sup>4</sup> It is a practice for SFC and the Government to brief FA Panel in February or March each year on SFC's proposed budget and major initiatives proposed for the next financial year.

7. According to section 396 of SFO, if SFC's reserves, after deducting depreciation and all provisions, are more than twice its estimated operating expenses for a financial year and SFC has no outstanding borrowings, SFC may consult FS with a view to recommending to CE in Council that the rate of a levy be reduced under section 394 of SFO.<sup>5</sup>

### **Major views and concerns expressed by members of the Panel on Financial Affairs**

8. The major views and concerns expressed by members when FA Panel discussed the proposed budgets of SFC for the financial years from 2016-2017 to 2020-2021 at the meetings on 15 February 2016, 6 February 2017, 5 February 2018, 19 February 2019 and 17 March 2020 are summarized in the ensuing paragraphs.

#### Licensing fees

9. During the discussion on SFC's proposed budget for 2019-2020, some members expressed views on the resumption of annual licensing fees by SFC from 2019-2020, and urged SFC to consider waiving or providing a discount on the fees. SFC advised that similar to many financial regulators in Hong Kong, it had been adopting the principle of full cost recovery in the provision of its services. The licence fee waiver was introduced seven years before mainly as

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<sup>4</sup> SFC's approved budgets were tabled at the Council meetings on 4 May 2016, 17 May 2017, 16 May 2018, 16 October 2019 and 20 May 2020. SFC's annual reports were tabled at the Council meetings on 22 June 2016, 14 June 2017, 27 June 2018, 16 October 2019 and 24 June 2020.

<sup>5</sup> Under section 394(1) of SFO, a levy at the rate specified by the Chief Executive ("CE") in Council by order published in the Gazette shall be payable to SFC by the person so specified by CE in Council for the sale and purchase of securities or futures contracts. The order is subject to the negative vetting procedure of the Council.

a temporary measure in response to the then challenges in the market environment and hence the need to provide a financial relief for licensed intermediaries and individuals. In the long run, the norm was for all types of regulated business to pay a reasonable licence or registration fee.

10. When FA Panel discussed SFC's proposed budget for 2020-2021, members noted that SFC had announced in December 2019 that after taking into account the challenging market environment, it would waive the annual licensing fees for one year in 2020-2021 in order to relieve the regulatory cost burden on the securities and futures industry. Some members enquired why the estimated revenue forgone as a result of the waiver (about \$235 million) was not borne by the Government. Some members also urged SFC to consider extending the fee waiver when preparing the budget for 2021-2022 given the significant economic downturn caused by the coronavirus disease-2019 outbreak.

11. SFC advised that it had offered an annual licencing fee waiver in 2009-2010 and from 2012-2013 to end March 2019. Following the resumption of annual licensing fees from 2019-2020 in a phrased approach with a 50% discount in the fees for 2019-2020 and 2020-2021, SFC had expected to fully reinstate the fees from 2021-2022 onwards. However, after reviewing its fees and charges level and the market conditions, SFC announced in December 2019 to fully waive the annual licensing fees for one year in 2020-2021 as a relief measure for brokerage firms. SFC would carefully review the market conditions when considering whether and when to reinstate the collection of annual licensing fees.

#### Measures to address budget deficits

12. When FA Panel discussed SFC's proposed budget for 2018-2019, noting that SFC had projected a deficit budget for the year, some members opined that SFC should strive to achieve fiscal balance and avoid incurring deficits in the long run. SFC advised that its substantial reserves were built up in 2007 with the then extraordinary market situations. However, as the income from levy could no longer meet SFC's operational needs in recent years, SFC had to rely on its reserves to meet the funding gaps while maintaining the levy rate. Given that the market turnover was the key driver of SFC's income, SFC could only achieve a balanced budget in 2018-2019 if the daily average market turnover reached around \$120 billion.

### Human resources issues

13. During the discussions of SFC's proposed budgets for 2016-2017, 2017-2018, 2018-2019 and 2019-2020, members expressed concern about SFC's increasing headcounts. Questions were raised on when SFC expected to reach its optimal staff size and cease expansion in its establishment, and how SFC determined the salaries of its staff and how the salary levels compared with those of the private sector. Some members stressed the need for SFC to consider increase in headcounts carefully to ensure prudent use of its resources.

14. SFC pointed out that the substantial headcount increase over the years was necessary for proper regulation of the growing securities market and dealing with specific projects or challenges ahead (e.g. enhancing efficiency of SFC's enforcement process and the supervision of the Hong Kong Stock Exchange, and its role in regulating listed companies). SFC advised that its Budget Committee and Remuneration Committee, which consisted of independent board members of SFC, would examine the proposed increases in manpower and level of remuneration in a prudent and objective manner. In coping with increase in workload, SFC would first try to meet the shortfall in manpower through internal redeployment before creating new posts as a last resort. Since the global financial crisis, SFC's manpower was considered undersized and hence had constrained its operational capabilities. The considerable growth in SFC's headcounts in subsequent years was a deliberate move. Further growth in headcounts had slowed down since 2016 and the annual increase in headcount was kept under 3%. Headcount increase was expected to level off in the next few years. SFC also pointed out that its establishment size in the proposed 2019-2020 budget (i.e. 988) was largely optimal. The headcount of SFC was frozen in 2020-2021.

15. As regards the determination of staff salary, SFC advised that since SFC primarily recruited talent from the private sector, it was necessary to benchmark staff salaries against the market. Moreover, SFC engaged external consultants to conduct surveys on salary benchmarks in the private sector each year, and would take into account other relevant considerations including staff turnover rates at various levels.

16. Noting the continuous rise in SFC's expenditure on professional and legal fees in the proposed budgets for 2016-2017 and 2017-2018, some members considered that SFC should explore measures to save the relevant costs. SFC explained that the professionals engaged by SFC were mainly legal and financial experts, especially those experienced in market regulation. The size of professional and legal fees reflected the high demand for such professional

services in the market. While SFC had outsourced its legal services to law firms in the past, experience showed that it would be more efficient to have in-house capability than outsourcing.

### Regulatory and enforcement work

#### *Striking a balance between market regulation and development*

17. During the discussion of SFC's proposed budgets for 2016-2017 and 2017-2018, members suggested that SFC should strike a proper balance between market regulation and market development. Some members expressed concern that the substantial increase in SFC's manpower might imply tightening of supervision over intermediaries, thereby increasing the compliance burden on the securities industry. There were also concerns from the industry about the implementation of the Client Agreement Requirements and the application of the Suitability Requirement under the Code of Conduct for Persons Licensed by or Registered with SFC ("the Code") which were unduly burdensome for small brokers.

18. SFC responded that the increase of headcount in the Intermediaries Division was to cope with the increased number of licensed intermediaries, and was not aimed to tighten regulation over small and medium-sized brokers. As regards the Suitability Requirement, SFC pointed out that it had been an existing requirement of the Code for many years and had not been changed as a result of the implementation of the Client Agreement Requirements. SFC was of the view that many existing client agreements were unfair to the clients, and decided to add a new clause in client agreements to the effect that if an intermediary solicited the sale of or recommended any financial product to a client, the financial product must be reasonably suitable for the client. The new clause in the client agreements would enable aggrieved clients to take legal action for breach of contract where there was a suitability failing causing loss. In order to provide more clarity in advance of the coming into force of the new requirement, SFC issued a circular in December 2016 which made clear when the suitability requirements under the Code would be triggered. SFC had also issued a list of frequently asked questions on compliance with the suitability requirements, and would continue to liaise with the brokerage industry on the matter.

#### *Division of work between the Securities and Futures Commission and the Hong Kong Exchanges and Clearing Limited*

19. When FA Panel discussed SFC's proposed budget for 2016-2017, some members expressed concern that the dual role of the Hong Kong Exchanges and

Clearing Limited ("HKEX") as a listed company and the frontline regulator of listing matters might give rise to conflict of interest, and cast doubt on the independence of the Listing Committee. They asked whether SFC would consider taking over HKEX's role as the frontline regulator.

20. SFC responded that the regulatory functions of HKEX over listed companies were related to the enforcement of the Listing Rules, whereas SFC regulated the securities and futures market at large, including listed companies, in accordance with SFO. Under the current regulatory regime, the enforcement of the Listing Rules was overseen by the independent Listing Committee. SFC could have oversight of listing matters through the dual filing arrangements. SFC would make its best endeavours to ensure the independence and effectiveness of the Listing Committee.

*Cyber security and online securities accounts services*

21. When the FA Panel discussed SFC's proposed budgets for 2017-2018 and 2019-2020, some members raised questions about SFC's efforts in ensuring cyber security, in particular the resources and measures deployed in assisting firms to set up an online system (e.g. identity verification process and secured trading) to facilitate Mainland investors in opening securities accounts in Hong Kong.

22. SFC responded that it would increase expenditure on information and system services in 2017-2018 including upgrading software and implementing new measures to enhance system security, and would conduct regular checks on its information technology security systems to mitigate the risks of hacking. In order to improve cyber security in the securities industry, apart from organizing workshops for the industry, SFC was working on a proposal to introduce cyber security baseline requirements in the Code.

23. Regarding online account opening for Mainland investors, SFC advised that the key would be to ensure the process would comply with the requirements of the relevant laws and regulations of the Mainland and that a sufficiently robust client identity verification process was in place. SFC's codes and circulars had clarified that client identity verification could be assisted by a third party such as certification agents or via signing off by professionals. Furthermore, SFC's Intermediaries Division had been in discussion with the Hong Kong Association of Online Brokers in exploring how technological advances could facilitate the development of a new non face-to-face system in opening securities accounts.

*Regulation of virtual assets and collective investment schemes*

24. When FA Panel discussed SFC's proposed budgets for 2018-2019 and 2019-2020, some members expressed concern about the financial risks arising from virtual assets including cryptocurrencies, and enquired about SFC's work in stepping up its regulation on virtual assets.

25. SFC advised that under the existing regulatory regime, a cryptocurrency transaction would fall under SFC's regulatory purview only if it involved securities or collective investment schemes. However, many cryptocurrency transactions nowadays had been structured with the attempt to circumvent SFC's regulatory purview. Such phenomenon was not unique for Hong Kong. Governmental and regulatory bodies worldwide including SFC were exploring measures to enhance protection for investors as existing rules were limited in regulating activities relating to virtual assets. Financial regulators worldwide, including Central Banks, were of the view that due to the relatively small size of virtual assets trading in the market, such trading activities posed limited risk to financial stability at the moment. In November 2018, SFC launched a new regulatory approach for the management or sale of virtual asset funds to protect interests of investors, and for virtual asset trading platform operators to opt in to the regulation by SFC via a Sandbox environment on a voluntary basis. SFC stressed that the new regulatory approach was exploratory and still evolving. SFC would discuss with potential virtual assets trading platform operators with a view to determining whether such platforms were suitable to be regulated by SFC.

26. During the discussion of SFC's proposed budget for 2018-2019, some members conveyed the concern of investors, who had suffered losses from investment in collective investment schemes involving overseas properties, that SFC had not provided responses nor disclosed the results of its investigation regarding their complaints.

27. SFC responded that its investigations of alleged illegal fund-raising on investment in overseas properties depended on whether such activities were related to unauthorized collective investment schemes. Given that the companies involved were often overseas companies, this had limited SFC's ability in obtaining redress for Hong Kong investors who had suffered losses. SFC had been implementing preventive measures such as conducting surveillance on advertisements of overseas properties to identify suspected collective investment schemes. SFC had also liaised with the Estate Agents Authority and conducted investor education work on unauthorized collective investment schemes involving real estate.



### Adoption of technologies in the Securities and Futures Commission's services

28. During the discussion of SFC's proposed budgets for 2019-2020 and 2020-2021, some members opined that SFC should further explore the use of new technology to streamline its work processes and enhance operational efficiency. There were enquiries about SFC's plans to digitalize its services including introducing e-approval in the authorization of financial products and allowing e-submission of documents to SFC.

29. SFC responded that, as a financial regulator, it would make use of and increase investment in advanced and customized technology, in particular the adoption of big data analytics, to enhance its work efficiency and strengthen its market surveillance capabilities. While complete digitalization for SFC's processes would take time, SFC was exploring the feasibility to integrate all its internal systems and was progressing in the use of Cloud services. To prepare for full digitalization of all the interfaces between SFC and its licensees in 2019, SFC was revamping its licensing forms to allow e-filing of documents. Besides setting up the Information and Technology Department, SFC had been employing staff with the knowledge and expertise in various departments for implementing new technology solutions to streamline its business process and upgrade market surveillance capabilities.

### Office premises

30. During the discussion of SFC's proposed budgets from 2016-2017 to 2020-2021, members made various suggestions to SFC on leasing offices or purchasing its own offices. Noting that SFC had ring-fenced \$3,000 million in its reserves for possible acquisition of office premises in the proposed budget for 2016-2017, members expressed concern whether the sum would be adequate for the purchase given the substantial rise in the prices of office premises in recent years, and enquired if LegCo's approval would be required for the purchase.

31. SFC replied that taking into account its development needs, SFC estimated that it would require an office area of some 180 000 square feet which would cost about \$7,000 – \$8,000 million based on the market price in 2018. Although SFC could borrow the shortfall of \$4,000-5,000 million, it would be a huge financial burden for SFC. The lease of SFC office in Central would expire in 2022 (with the option to terminate the lease earlier in 2020). During the discussion of SFC's proposed budget for 2020-2021, SFC indicated that it would move from Central to a new office in Quarry Bay in the second quarter of 2020 with an eight-year lease. Given the possible decline in property prices

amidst an economic downturn, some members enquired if SFC would consider purchasing its office premises before the expiry of the eight-year lease.

32. SFC advised that purchasing its own office premises was all along the long term goal of SFC. It would take time for SFC to identify suitable office premises in an appropriate location and of a considerable size for accommodating its some 900 staff. SFC would move its office from Central to Quarry Bay in the second quarter of 2020 and the relocation could achieve savings of about \$1,000 million in rentals over the eight-year lease. Together with the \$3,000 million which had been ring-fenced for the purchase of its office, SFC would have about \$4,000 million at its disposal for the purchase. SFC would keep in view the availability of suitable office premises in the market and development in the property market, and when appropriate, might consider purchasing its office premises before the expiry of the eight-year lease.

### **Recent development**

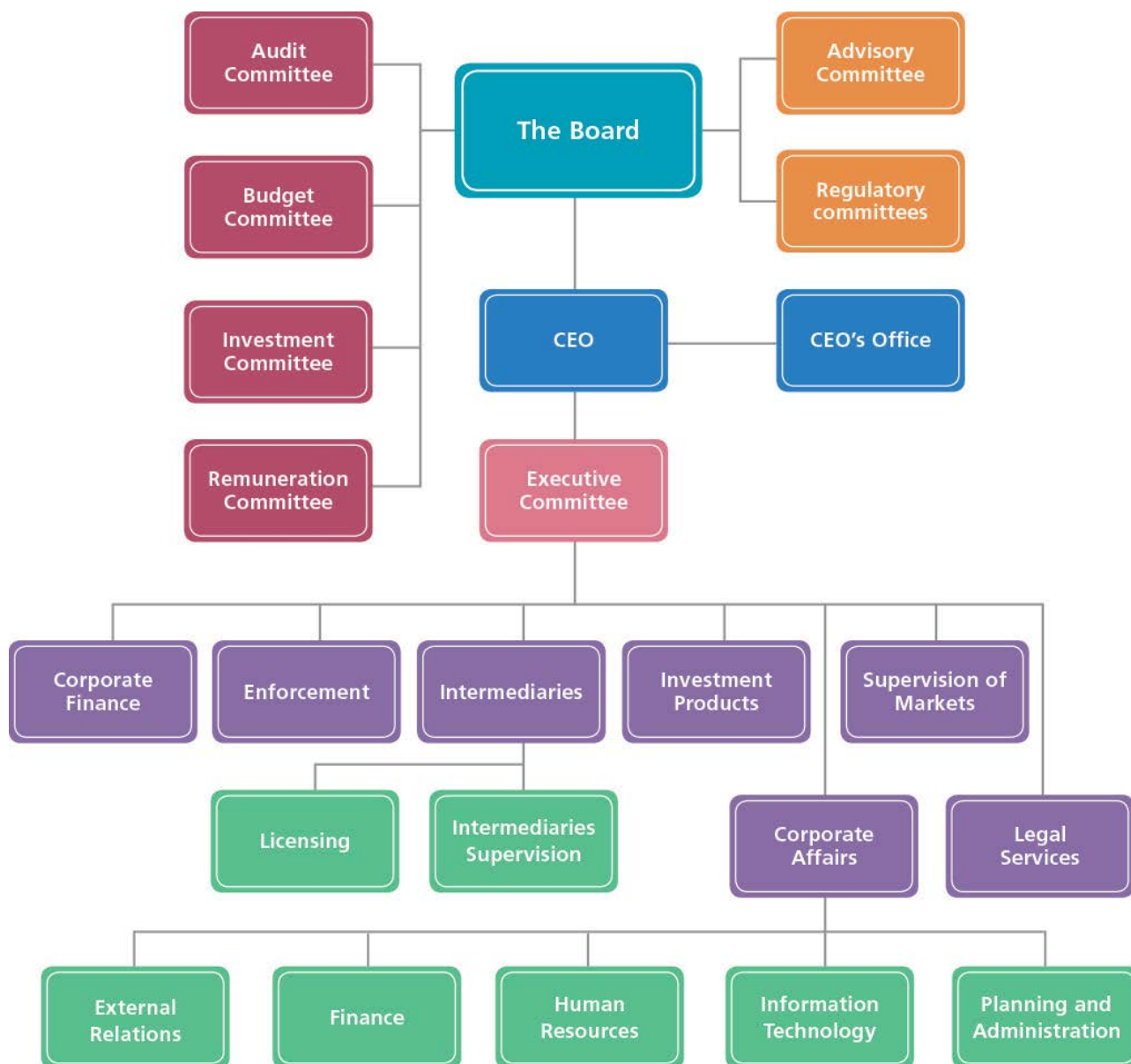
33. SFC and the Government will brief FA Panel on SFC's proposed budget for the financial year 2021-2022 at the meeting on 1 February 2021.

### **Relevant papers**

34. A list of relevant papers is in **Appendix II**.

## Organization structure of the Securities and Futures Commission

### Organizational structure



Note: CEO's Office includes four units, namely the Commission Secretariat, International Affairs and Sustainable Finance, Mainland Affairs and Press Office.

Source: SFC's Annual Report 2019-2020

## List of relevant papers

Date	Event	Papers/Minutes of meeting
15 February 2016	FA Panel discussed the proposed budget of SFC for 2016-2017	<a href="#">Administration's paper</a> (LC Paper No. CB(1)440/15-16(05))  <a href="#">Minutes</a> (LC Paper No. CB(1)803/15-16)
22 June 2016	The Annual Report 2015-2016 of SFC was tabled at the meeting of the Legislative Council	<a href="#">Annual Report 2015-2016</a>
9 November 2016	Hon Mrs Regina IP raised an oral question regarding proposed enhancements to decision-making and governance structure for listing regulation	<a href="#">Hansard</a>
30 November 2016	The Legislative Council passed the motion on "Formulating a comprehensive listing policy"	<a href="#">Hansard</a>  <a href="#">Wording of the motion passed</a>
6 February 2017	FA Panel discussed the proposed budget of SFC for 2017-2018	<a href="#">Administration's paper</a> (LC Paper No. CB(1)502/16-17(06))  <a href="#">Minutes</a> (LC Paper No. CB(1)788/16-17)
14 June 2017	The Annual Report 2016-2017 of SFC was tabled at the meeting of the Legislative Council	<a href="#">Annual Report 2016-2017</a>

<b>Date</b>	<b>Event</b>	<b>Papers/Minutes of meeting</b>
8 November 2017	Hon CHAN Chun-ying raised a written question regarding regulation of the offering and trading of digital tokens	<a href="#">Hansard</a>
29 November 2017	Hon Kenneth LEUNG raised a written question regarding real-time investor identification system for northbound cross-boundary stock trading	<a href="#">Hansard</a>
5 February 2018	FA Panel discussed the proposed budget of SFC for 2018-2019	<a href="#">Administration's paper</a> (LC Paper No. CB(1)530/17-18(03))  <a href="#">Minutes</a> (LC Paper No. CB(1)883/17-18)
27 June 2018	The Annual Report 2017-2018 of SFC was tabled at the meeting of the Legislative Council	<a href="#">Annual Report 2017-2018</a>
19 February 2019	FA Panel discussed the proposed budget of SFC for 2019-2020	<a href="#">Administration's paper</a> (LC Paper No. CB(1)556/18-19(04))  <a href="#">Minutes</a> (LC Paper No. CB(1)951/18-19)
25 March 2019	SFC announced that it would resume the collection of annual licensing fees on 1 April 2019	<a href="#">SFC's circular</a>
16 October 2019	The Annual Report 2018-2019 of SFC was tabled at the meeting of the Legislative Council	<a href="#">Annual Report 2018-2019</a>

<b>Date</b>	<b>Event</b>	<b>Papers/Minutes of meeting</b>
4 December 2019	SFC announced that it would waive the annual licensing fees for 2020-2021	<a href="#">SFC's press release</a>
17 March 2020	FA Panel discussed the proposed budget of SFC for 2020-2021	<a href="#">Administration's paper</a> (LC Paper No. CB(1)365/19-20(06))  <a href="#">Minutes</a> (LC Paper No. CB(1)805/19-20)
24 June 2020	The Annual Report 2019-2020 of SFC was tabled at the meeting of the Legislative Council	<a href="#">Annual Report 2019-2020</a>