

Six-year Comparison of Business Activities Surveys on Investment Advisers, Commodity Trading Advisers and Exempt Investment Advisers under the pre-SFO Regime

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Introduction

With a view to enhancing the understanding of the developments in the securities and futures industry in Hong Kong, the SFC conducted six Business Activities Surveys (BAS) during 1996-2001. The surveys covered all firms registered/licensed under the repealed Securities Ordinance and Commodities Trading Ordinance, which can be categorised into securities dealers, commodity dealers, investment advisers, commodity trading advisers, as well as firms declared as exempt dealers and exempt investment advisers under the repealed Securities Ordinance. Six-year comparisons on the securities dealers and commodity dealers have been discussed in the previous issues of the Quarterly Bulletin (Issue No. 51 and No. 52) and research papers No. 5 and No. 7. This paper will focus on the three types of advisers, namely investment advisers, commodity trading advisers and exempt investment advisers.

Background

Major incidents and developments in the securities and futures markets during 1996-2001 have been discussed in the feature boxes of the previous papers on securities dealers and commodity dealers. Readers may refer to the previous issues of Quarterly Bulletin or our research papers for details.

Response Rate

Investment Advisers

The number of responding investment advisers in 2001 was 588 (Table 1). The response rates to the BAS have been high, with an average level of about 90%. Due to the different response rates in different years, figures reported in later sections may not be strictly comparable.

Commodity Trading Advisers

114 commodity trading advisers responded to the survey in 2001, accounting for 90% of the total questionnaires sent out. Corresponding figures in 1996 were 96 and 79%. The response rate improved over time with a 6-year average close to 90%.

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Exempt Investment Advisers

Exempt investment advisers were first surveyed in 1998. There have been around 30 exempt investment advisers responding to the BAS, and the response rates have ranged from 84% to 100% during 1998-2001 with an average of 92%.

	1996	1997	1998	1999	2000	2001
Number of Respondents						
- Investment Advisers	527	573	560	548	587	588
- Commodity Trading Advisers	96	108	125	117	119	114
- Exempt Investment Advisers	n.a.	n.a.	35	33	30	27
Response Rate						
- Investment Advisers	85%	94%	90%	92%	90%	88%
- Commodity Trading Advisers	79%	84%	93%	96%	94%	90%
- Exempt Investment Advisers	n.a.	n.a.	88%	100%	97%	84%

Note: Exempt Persons were first surveyed in 1998.

Primary Business Activity

Investment Advisers

Around 30% of the responding investment advisers reported fund/portfolio management activities as their primary business (Table 2). The share had been relatively stable during 1996-2001. 17% of the respondents reported that corporate finance advisory activities were their primary business activities in 2001. This compared to 15% in 1996. Meanwhile, those who considered giving investment advice as their primary business dropped 29 percentage points from 43% to 14% during the period. Growth was mainly in the category of “others”, which included financial planning services, marketing of unit trusts, mutual funds and MPF schemes. Its share rose by 31 percentage points from 7% in 1996 to 38% in 2001.

	1996	1997	1998	1999	2000	2001
Investment Advisers						
- Fund/Portfolio Management	32%	33%	36%	33%	31%	29%
- Giving Investment Advice	43%	35%	15%	19%	14%	14%
- Corporate Finance	15%	14%	15%	14%	14%	17%
- Issuing Analyses and Research Reports	3%	3%	3%	2%	2%	2%
- Others (including financial planning services, marketing of unit trusts, mutual funds and MPF schemes)	7%	15%	31%	32%	39%	38%
Commodity Trading Advisers						
- Fund/Portfolio Management	53%	30%	55%	58%	56%	60%
- Giving Investment Advice	44%	50%	22%	24%	26%	23%
- Others (including publication of analyses and research)	3%	20%	23%	18%	18%	17%
Exempt Investment Advisers						
- Fund/Portfolio Management	n.a.	n.a.	24%	33%	33%	35%
- Giving Investment Advice	n.a.	n.a.	21%	22%	27%	28%
- Corporate Finance	n.a.	n.a.	9%	6%	3%	5%
- Investment Holding	n.a.	n.a.	9%	3%	7%	9%
- Banking and Treasury	n.a.	n.a.	15%	9%	3%	9%
- Others (including loan syndication and project finance)	n.a.	n.a.	22%	27%	27%	14%

Note: Exempt Persons were first surveyed in 1998.

Commodity Trading Advisers

Most responding commodity trading advisers considered fund/portfolio management as their primary business. Its share increased from 53% to 60% during 1996-2001. In contrast, those giving investment advice decreased from 44% to 23%. The share of “others” increased by 14 percentage points over the period, and this category included research and the publication of analyses.

Exempt Investment Advisers

Most of the responding firms have been engaged in either fund/portfolio management or providing investment advice.

Gross Operating Income (GOI)

Investment Advisers

In line with the general performance of the stock market, the GOI of investment advisers jumped in 1997 and peaked in 2000. It experienced only a mild drop of 1% in 2001 (Table 3).

Fund advisory and fund management activities contributed the majority share to GOI of investment advisers. It continued to increase throughout the period under study. However, its share fell from 58% in 1996 to 53% in 2001.

The second most important category of income has been corporate finance income. It jumped in 1997 and peaked in 1999. Its share decreased slightly from 20% to 18% during the period.

The category of “others” mainly consisted of interest income, service/management fee income received from group companies and rebate commissions received by the responding firms. Its share rose from 7% in 1996 to 21% in 2001.

Commodity Trading Advisers

The reported amount of GOI was relatively small. This was because a majority of the responding firms considered commodity trading advisory activities as incidental to their core activities, and most of them were unable to distinguish commodity trading advisory business income from their core business results.

Fund/portfolio management activities contributed the majority share of around 81-87% to GOI.

Exempt Investment Advisers

The GOI of exempt investment advisers fell to HK\$203 mn in 2001, even lower than the level of 1998. This was mainly due to the drop of revenue in corporate finance advisory activities from HK\$70 mn in 1998 to HK\$3 mn in 2001 and the share fell from 26% to 1.5%. Income from giving investment advice also declined from HK\$119 mn to HK\$97 mn during 1998-2001, though the share increased from 43% to 48%. In contrast, the income from fund/portfolio management activities increased from HK\$52 mn to HK\$90 mn over the period and the share from 19% to 44%.

	1996		1997		1998		1999		2000		2001	
	HK\$ mn	% to total	HK\$ mn	% to total	HK\$ mn	% to total	HK\$ mn	% to total	HK\$ mn	% to total	HK\$ mn	% to total
Investment Advisers	4,956		9,825		9,468		10,956		11,813		11,680	
- Fund/Portfolio Management	2,873	58.0%	4,903	49.9%	5,210	55.0%	5,645	51.5%	6,105	51.7%	6,171	52.8%
- Corporate Finance Advisory	997	20.1%	2,574	26.2%	2,102	22.2%	3,165	28.9%	3,130	26.5%	2,083	17.8%
- Giving General Investment Advice	523	10.6%	1,752	17.8%	285	3.0%	455	4.2%	570	4.8%	520	4.5%
- Financial Planning	165	3.3%	205	2.1%	110	1.2%	196	1.8%	224	1.9%	397	3.4%
- Publication of Analyses / Research Reports	37	0.7%	56	0.6%	44	0.5%	47	0.4%	46	0.4%	47	0.4%
- Others (including marketing of unit trusts/mutual fund, interest income, service income from group companies and rebate commission)	361	7.3%	335	3.4%	1,717	18.1%	1,448	13.2%	1,738	14.7%	2,462	21.1%
Commodity Trading Advisers	n.a.		n.a.		63		30		26		31	
- Fund/Portfolio Management	n.a.	n.a.	n.a.	n.a.	54	85.7%	26	86.7%	21	80.8%	26	83.9%
- Giving Investment Advice	n.a.	n.a.	n.a.	n.a.	7	11.1%	2	6.7%	2	7.7%	4	12.9%
- Others (including publication of analyses and research)	n.a.	n.a.	n.a.	n.a.	2	3.2%	2	6.7%	3	11.5%	1	3.2%
Exempt Investment Advisers	n.a.		n.a.		274		306		413		203	
- Fund / Portfolio Management	n.a.	n.a.	n.a.	n.a.	52	19.0%	56	18.3%	53	12.8%	90	44.3%
- Giving Investment Advice	n.a.	n.a.	n.a.	n.a.	119	43.4%	173	56.5%	348	84.3%	97	47.8%
- Corporate Finance Advisory	n.a.	n.a.	n.a.	n.a.	70	25.5%	69	22.5%	3	0.7%	3	1.5%
- Others (including publication of analyses and research)	n.a.	n.a.	n.a.	n.a.	33	12.0%	8	2.6%	9	2.2%	13	6.4%

Notes: As categorization is different from Primary Business Activity, this table should not be compared with Table 2. The figures for Commodity Trading Advisers and Exempt Investment Advisers began in 1998.

Profits and Losses

Investment Advisers

In line with stock market activities, the reported total profits of the investment advisers retreated to an aggregate loss of HK\$0.2 bn in 1998 from a profit of HK\$4.7 bn in 1997 (Table 4). Similarly, the total profits of investment advisers dropped to HK\$3.0 bn in 2001, from the peak level of HK\$6.9 bn in 2000.

In 2001, 35% of the responding investment advisers reported losses, compared to 27% in 2000. Nevertheless, the proportion was still lower than the tough year of 1998 when 41% of the respondents reported losses.

	1997	1998	1999	2000	2001
Investment Advisers					
- Total Profits (HK\$ mn)	4,704	-233	4,159	6,891	2,996
- Number of Loss-making Investment Advisers	139	231	145	158	207
- % to Total	24.8%	41.3%	26.5%	26.9%	35.2%
Commodity Trading Advisers					
- Total Profits (HK\$ mn)	1,014	106	304	2,183	636
- Number of Loss-making Investment Advisers	32	52	44	42	46
- % to Total	29.6%	41.6%	37.6%	35.3%	40.4%

Note: The P&L figures began in 1997.

Commodity Trading Advisers

Although the aggregate profits of the responding commodity trading advisers dropped from the peak level of HK\$2.2 bn in 2000 to HK\$0.6 bn in 2001, this was still higher

than the levels of 1998 and 1999. In 2001, 40% of the responding commodity trading advisers reported losses, compared to 35% in 2000. Again, this was still slightly lower than the 42% in 1998.

Exempt Investment Advisers

The BAS did not cover the profit and loss aspect for exempt investment advisers.

Clientele

Investment Advisers

Clientele of investment advisers can be broadly categorised into corporate finance advisory activities and other investment advisory activities.

Corporate finance advisory activities

- Corporate finance advisory activities are analysed in terms of the number of deals, which decreased in 2001 (Table 5). By contribution to GOI, overseas clients represented almost half of the total, despite overseas clients only contributed 15% to the total number of deals (Table 6). The market share of PRC clients increased in the number of deals and in contribution to GOI.

Table 5 - Classifications of Active Clients				
	1998	1999	2000	2001
	(Total Number) % of Total	(Total Number) % of Total	(Total Number) % of Total	(Total Number) % of Total
Investment Advisers				
Corporate Finance Advisory				
<i>Total Number of Deals</i>	(953)	(1,250)	(1,612)	(1,238)
- Local Clients	69%	64%	75%	71%
- PRC Clients	12%	10%	8%	14%
- Overseas Clients	18%	26%	17%	15%
Other Investment Advisory				
<i>Total Number of Clients</i>	(12,000)	(32,698)	(51,744)	(52,712)
Classification A				
- Retail Clients	74%	92%	91%	91%
- Institutional Clients	26%	8%	9%	9%
Classification B				
- Local Clients	57%	73%	71%	81%
- PRC and Overseas Clients	43%	27%	29%	19%
Commodity Trading Advisers				
<i>Total Number of Clients</i>	(476)	(324)	(324)	(366)
Classification A				
- Retail Clients	96%	94%	95%	96%
- Institutional Clients	4%	6%	5%	4%
Classification B				
- Local Clients	96%	96%	99%	94%
- PRC and Overseas Clients	4%	4%	1%	6%
Exempt Investment Advisers				
<i>Total Number of Clients</i>	(254)	(276)	(271)	(179)
- Overseas Professional Clients	26%	54%	73%	83%
- Local Professional Clients	11%	8%	8%	1%
- Overseas Non-professional Clients	12%	11%	4%	14%
- Local Non-professional Clients	51%	27%	15%	2%

Note: The BAS did not cover this aspect in 1996 and 1997.

Other investment advisory activities

- Other investment advisory activities included giving investment advice, financial planning, marketing of unit trust or mutual funds and publication of analyses and research reports. The total number of active clients² served by investment advisers increased from 12,000 in 1998 to 52,712 in 2001. The growth was especially significant in 1999 and 2000 when the Mandatory Provident Funds Scheme was introduced in late 2000.
- By contribution to GOI, institutional clients have been constituting a large share of the advisory markets, though the proportion of institutional clients decreased from 26% in 1998 to 9% in 2001. Whilst the proportion of overseas clients decreased from the peak level of 43% in 1998 to 19% in 2001, the income derived from overseas clients remained relatively stable at 69% in 1998 and 67% in 2001.

Table 6 - Classifications of Active Clients' Income

	1998	1999	2000	2001
	% of Total	% of Total	% of Total	% of Total
Investment Advisers				
Corporate Finance Advisory				
- Local Clients	22%	40%	57%	38%
- PRC Clients	10%	7%	6%	15%
- Overseas Clients	68%	53%	37%	47%
Other Investment Advisory				
Classification A				
- Retail Clients	24%	43%	49%	50%
- Institutional Clients	76%	57%	51%	50%
Classification B				
- Local Clients	31%	48%	45%	33%
- PRC and Overseas Clients	69%	52%	55%	67%
Commodity Trading Advisers				
Classification A				
- Retail Clients	20%	88%	34%	29%
- Institutional Clients	80%	12%	66%	71%
Classification B				
- Local Clients	24%	95%	97%	61%
- PRC and Overseas Clients	76%	5%	3%	39%

Note: The BAS did not cover this aspect in 1996 and 1997.

Commodity Trading Advisers

The number of active clients served by commodity trading advisers was smaller than that by investment advisers. This was because the majority of commodity trading advisers were also registered as commodity dealers or investment advisers. They were unable to differentiate the number of active clients relating solely to the provision of commodity trading advisory service from other services such as commodity dealing or investment advisory.

The reported number of active clients declined from 476 in 1998 to 324 in 1999, but rebounded to 366 in 2001. In 2001, about 96% were retail clients by type (4% being

² The total number of clients recorded in the surveys may not be the actual number of clients in the securities market. This is because some of the clients may have opened several brokerage accounts with different registered firms. And some of the accounts reported as institutional clients are in fact omnibus accounts, which absorb dealing orders directly from the general public.

institutional) and 94% were local clients by origin (6% being PRC and overseas clients).

As advisory income mainly came along with the brokers' primary businesses, the sources of income were highly incidental. For instance, in 2000, a few commodity trading advisers incidentally had advisory income from institutional clients hence causing the proportion of income from institutional clients to increase significantly from 12% to 66%.

Exempt Investment Advisers

The number of active clients served by exempt investment advisers decreased from 254 in 1998 to 179 in 2001, with the proportion of overseas professional clients increasing continuously from 26% in 1998 to 83% in 2001, whilst that of local professional clients declined from 11% to 1%, and that of local non-professional clients declined from 51% to 2% over the same period.

Employment

Investment Advisers

The number of staff employed by investment advisers in 2001 was less than that in 2000 by 3%, but still far higher than the levels during 1996-1999 (Table 7).

The sales and marketing staff increased fivefold in 2000 because investment advisers employed more staff for the Mandatory Provident Funds Scheme, which started operation in Dec 2000. The share of sales and marketing staff increased by 16 percentage points from 12% in 1998 to 28% in 2001, whilst that in giving investment advice advanced by 8 percentage points from 7% to 15%. In contrast, the proportion of fund management staff dropped from 16% to 8% over the period.

In terms of working experience, around 24% of the staff who participated in fund/portfolio management and corporate finance activities in 2001 had more than ten years of relevant experience (Table 8). Another 35% or so had five to ten years of relevant experience, whilst the remainder had less than five years of experience.

Commodity Trading Advisers and Exempt Investment Advisers

The BAS did not have detailed breakdown on employment structure for commodity trading advisers and exempt investment advisers.

Table 7 - Number of Staff Reported by Investment Advisers

	1996		1997		1998		1999		2000		2001	
	% to total		% to total		% to total		% to total		% to total		% to total	
Investment Advisers	7,726		7,730		5,108		4,876		9,921		9,637	
- Front Office	n.a.	n.a.	n.a.	n.a.	3,172	62%	2,965	61%	6,739	68%	7,124	74%
- Sales and Marketing	n.a.	n.a.	n.a.	n.a.	595	12%	525	11%	2,916	29%	2,701	28%
- Giving Investment Advice	n.a.	n.a.	n.a.	n.a.	381	7%	343	7%	1,168	12%	1,448	15%
- Fund / Portfolio Management	n.a.	n.a.	n.a.	n.a.	809	16%	677	14%	895	9%	801	8%
- Corporate Finance	n.a.	n.a.	n.a.	n.a.	779	15%	855	18%	1,107	11%	1,409	15%
- Research	n.a.	n.a.	n.a.	n.a.	608	12%	565	12%	653	7%	659	7%
- Back Office	n.a.	n.a.	n.a.	n.a.	1,936	38%	1,911	39%	3,182	32%	2,513	26%
- Credit Control	n.a.	n.a.	n.a.	n.a.	38	1%	14	0%	37	0%	25	0%
- Risk Management	n.a.	n.a.	n.a.	n.a.	69	1%	56	1%	69	1%	84	1%
- Accounting	n.a.	n.a.	n.a.	n.a.	408	8%	423	9%	476	5%	378	4%
- Compliance	n.a.	n.a.	n.a.	n.a.	163	3%	143	3%	191	2%	198	2%
- Information Technology	n.a.	n.a.	n.a.	n.a.	277	5%	274	6%	367	4%	465	5%
- Others	n.a.	n.a.	n.a.	n.a.	981	19%	1,001	21%	2,042	21%	1,469	15%

Note: The classification of functional group in the questionnaires of 1996 and 1997 was different from those after 1998.

Table 8 - Relevant Experience of Staff Who Participated in Fund or Portfolio Management and Corporate Finance Activities

	1998		1999		2000		2001	
	Number	% to total	Number	% to total	Number	% to total	Number	% to total
Less than Five Years	566	35.6%	609	39.8%	734	36.7%	599	41.3%
Five to Ten Years	574	36.1%	495	32.3%	692	34.6%	502	34.6%
More than Ten Years	448	28.2%	428	27.9%	576	28.8%	350	24.1%
Total	1,588	100.0%	1,532	100.0%	2,002	100.0%	1,451	100.0%

Note: The BAS did not cover this aspect in 1996 and 1997.