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## FINANCIAL REVIEW

Total revenue for the year 1998-99 declined by 54% to \$300.6 million from the previous year due to a sharp drop in stock market turnover and the related reduction in the SFC's share of transaction levy from 0.006% to 0.004% for the financial year. The SFC voluntarily reduced its share of the transaction levy in April 1998 in view of the surplus generated in the previous year.

Through stringent budgetary control, the Commission was able to keep its expenditure for the year to \$373 million, which was 13% lower than the approved budget of \$430 million. Savings were achieved mainly from underspending in personnel expenses (-13%), information and system services (-14%), corporate communications (-25%), general office and insurance (-33%) and training and development (-40%). Excluding depreciation, the actual expenditure of most expense categories were lower than previous year actual expenses, with the exception of personnel and premises expenses. Personnel costs rose 13.2% and premises 7% over actual expenses in the previous year mainly due to an increase in staff hired to cope with the reform programme and additional work and additional office accommodation required respectively.

The substantial decline in revenue resulted in the SFC's first ever-operating deficit of \$72 million, which was \$28 million higher than the original projected deficit of \$44 million.

As at 31 March 1999, the accumulated reserves of the SFC were \$742,810,093, affording the SFC a stable financial situation in its seventh consecutive year without Government grant. These reserves were invested in accordance with guidelines approved by the Financial Secretary, after taking into account a provision of \$150 million for SFC's commitment to contribute to the Unified Exchange Compensation Fund as a result of the CA Pacific default in early 1998.

SFC revenues are derived from three main sources: (a) an annual grant from the Government approximately equal to the net cost to Government

of running the former Office of the Commissioner for Securities and Commodities Trading; (b) a levy (current rate at 0.011% [cf 1997-1998: 0.013%], of which the SFC receives 0.004% [cf 1997-1998: 0.006%], and the SEHK 0.007% [cf 1997-1998: 0.007%]) on transactions recorded on the SEHK; and a levy (current rate at \$1 per contract), on both the buyer and seller, on transactions recorded on the HKFE; and (c) fees and charges for functions performed for specific market participants or users. The SFC did not apply for an annual grant from the Government in 1998-99.

In view of the economic downturn, the SFC decided to freeze its fees and charges at the current level for the financial year. Such fees and charges have remained unchanged since 1994-95. Certain new fees will be introduced in 1999-2000 to recover the costs of administering the applications of a new category of registrants for the Mandatory Provident Fund.

## OPERATIONAL REVIEW

### Policy Co-ordination Across the Commission

Within the Commission, work pertaining to the major legislative and structural reform programmes announced by the Government in March 1999 involved major cross-divisional co-ordination and efforts.

The legislative reform, in the preparation of the composite Securities and Futures Bill, required heavy policy input from all the Executive Directors, as well as the assistance of the Legal Services Division and consultants engaged specifically for this project. The reform in the financial infrastructure area is overseen by the Steering Committee on the Enhancement of Financial Infrastructure chaired by our Chairman, with participation from the Supervision of Markets Division and the Chief Information Officer, together with representatives from the market operators. In the proposed demutualisation and merger of the Exchanges and the Clearing Houses, the Commission assisted the Government in designing and initiating the reform and preparing policy papers, and is heavily involved in the overall

co-ordination and management of this complex project. Support for the overall reform fell heavily on the Corporate Finance Division, with contribution from the Intermediaries Supervision, Enforcement, and Supervision of Markets Divisions.

The overall reform programme, at the strategic, policy and procedural review level, came on top of the normal workload of the Commission during a year of heavy market stress. Despite the decrease in market transactions in the last 12 months, all Divisions of the Commission experienced a heavier-than-normal workload due to major policy reviews, an increase in enforcement and discipline, restructuring of problem intermediaries and new licensing procedures with the pending launch of the Mandatory Provident Fund scheme. The economic slowdown has on the whole increased the complexity of issues for the Commission at all operational levels.

### **Investor Education**

Investor education is key to investor protection. To ensure continuous improvement in this area, an Investor Education Advisory Committee was formed in November 1998 comprising representatives of market organisations, the Legislative Council, the broker community, as well as universities and media.

In view of increasing usage, SFC's Investor Hotline was expanded with new functions and capacity in May 1998. The system now combines operator assistance with pre-recorded audio-text and fax-on-demand retrieval of information. During the year, 3,630 enquiries and 441 complaints were received through the Hotline. About 40% of the complaints required further assessment by the operation divisions of the SFC, with 26 cases passed to the Enforcement Division for investigation.

The SFC launched an Announcement in the Public Interest on television in May 1998 using the theme of "sheep" to educate the public not to follow the crowd when investing. The programme won a Bronze Award in the 1998 Singapore Creative Circle Awards.

In the print medium, a series of investor education articles and question and answer (Q&A) columns

on investors' rights and regulatory policies was published in leading local newspapers during the year. The SFC also sponsored two radio programmes on Radio Television Hong Kong, namely, the "SFC Theatre: The Careless-Lee Family" in Putonghua, and "Be a Smart Investor" in Cantonese.

During the year the SFC Web-site was enhanced with educational stories previously published in Ming Pao and Hong Kong Economic Times, as well as a Q&A section on investor concerns. An interactive module and audio functions will be added in the coming year.

In order to provide maximum reach to investors around the clock, a web-based Investment Resources Centre (IRC) will be developed in the coming year to replace the originally planned IRC at a physical location. The cyberspace IRC is intended to be a one-stop address for Internet surfers to learn about investing and to have direct link to web-sites of regulators and market organisations in Hong Kong.

### **Corporate Communications**

During the past year, the SFC issued 141 press releases [cf 1997-98: 108], and conducted 15 press conferences and media briefings [cf 1997-98: 12]. In addition, 19 luncheons and consultation sessions were held with stakeholder groups, including market practitioners and Legislative Council Members, to explain the Commission's policies and initiatives. Senior SFC staff addressed and participated in over 70 conferences and seminars to convey messages that were important to the regulatory environment.

Two conferences were organised by the SFC in 1998-99. A promotional conference on the Hong Kong securities markets was held in Dalian together with the TDC and SEHK in May 1998. The other was a conference on professional ethics in September 1998, held jointly with the Independent Commission Against Corruption and seven other financial organisations.

## Corporate Resources

### *Human Resources*

The SFC had a total approved headcount of 311 for the year ended 31 March 1999, 7.6% more than the level of 289 last year. As a result of technology upgrades and office automation, six posts of support staff have been redeployed to assist in new initiatives, including the market and legislative reform programmes. The redeployment accounted for 6% of support staff.

Staff turnover continued to decline for the 12 months ended 31 March 1999. The turnover was 3.77% for professional staff (cf 97-98:12.57%), 3.13% for general grade staff (cf 97-98:10.79%), with the overall turnover at 3.48% (cf 97-98:11.76%).

In light of the economic downturn, the Commission froze the salary scale for all grades in April 1998. However, in line with the Commission's merit-based pay policy, variable pay and increases were awarded to staff with good performance.

### *Training & Development*

During the year, courses on professional and technical skills were organised internally for SFC staff. For the coming year, focus in training will be placed on the development and improvement of core competency of staff at all levels.

In 1998-99, two directors were seconded to the Securities and Exchange Commission, Washington D.C. for a period of one month each, while nine other staff members attended various training programmes in the US, Australia and the UK.

### *Information Technology*

The SFC has successfully revamped two major operational systems during the year, including the licensing front-end project and the market surveillance system. The online market surveillance system will be completed by the second quarter of 1999.

With the assistance of the Financial Services Bureau and Information Technology Services Department of the Government, an email linkage was established in December 1998 between the SFC and the Government Communication Network. This

linkage reduces the need for paper-based correspondence with the Government and improves the SFC's overall efficiency.

An external consultant appointed in 1998 to independently assess the Commission's information technology environment had identified four major areas for improvement. These include technology, IT standards, organisation and staffing, and IT process. The Commission will implement the proposed improvements in three stages over a three-year period.

### **Year 2000 Compliance**

While the SFC has been actively monitoring the Year 2000 readiness of intermediaries in Hong Kong, it has also taken steps to ensure that the Commission itself is Year 2000 compliant. All Year 2000 rectification work of in-house systems was completed in December 1998 as scheduled and a Commission-wide contingency plan was completed in the first quarter of 1999.

### **LOOKING FORWARD**

The legislative and market reform programmes, when implemented, will further add to the scope and workload of all the operations divisions of the Commission in the coming year. These reforms, together with the expansion and clarification of the Commission's functions and regulatory objectives under the new Securities and Futures Bill, will require the Commission to re-examine and evaluate its own organisational structure and utilisation of resources, and to redefine and review its focus and approach to regulation. We look forward to meeting these challenges both as a market regulator and as an evolving organisation as we move into the new Millennium.



**Laura M Cha**

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