

**Business Activities Surveys
on Securities / Futures Intermediaries
and Exempt Persons**

Hong Kong
October 2000

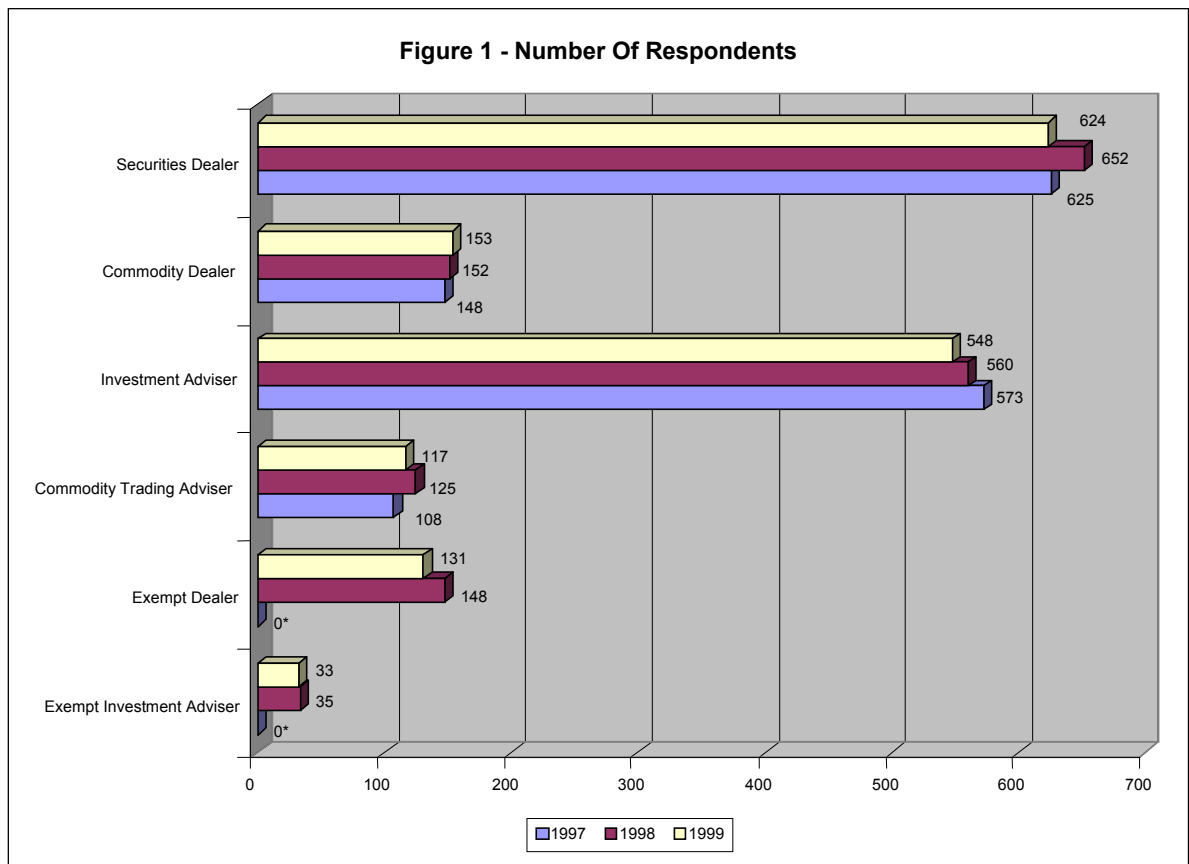
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1. Introduction

- (1) As a continuing exercise to maintain an up to date picture of the business profiles of securities and futures intermediaries in Hong Kong, the Securities and Futures Commission continues to conduct its annual survey on the activities undertaken by registered and exempt firms in the first quarter of 2000. The categories of registered or exempt business entities surveyed are outlined in Figure 1.
- (2) 1,422 questionnaires were issued, covering all registered and exempt firms, ranging from sole-proprietorships and partnerships to corporations. The response rate for 1999 was 92%, as compared to 93% in 1998 and 91% in 1997.

The chart below (figure 1) shows the breakdown of the number of replies by type of registration / exemption status from 1997 to 1999.



*Exempt Persons were first surveyed in 1998.

2. Summary of Major Findings

The major findings of the 1999 survey may be summarised as follows:

- (1) For registered dealers, broking activities constituted their main business function. 81% of the securities dealers cited stockbroking and 87% of the commodity dealer cited futures/options contracts broking as their primary business activities. For exempt dealers, over 50% of them regarded retail and /or commercial banking as their primary business activities.

An overwhelming majority of registered and exempt advisers were either fund managers or plain advisers on securities or commodities. 14% of the securities investment advisers and 6% of the exempt investment advisers primarily engaged in corporate finance advisory activities.

- (2) In 1999, securities and futures intermediaries recorded a 47% growth in total gross operating income which was mainly contributed by the increase in stock broking and proprietary trading income under the recovering market conditions.

Exempt dealers were noted to have increased their share in the securities market in 1999. In particular, their reported share of the securities underwriting business had increased from 27% in 1998 to 40% in 1999.

Registered firms constituting the top 10 gross operating income earners accounted for over 40% of the revenue reported by all respondents in their respective categories in 1999.

United States and European controlled intermediaries altogether attained a 72% share in the market during this year.

- (3) The number of active clients participating in the securities and futures markets increased by 29% in 1999. Most of these new clients were retail clients in the stock and unit trust / mutual funds markets.

Despite the relatively smaller number of institutional clients and overseas clients, they continued to make major contribution to the total gross operating income in the securities and futures markets. A similar client profile was noted in 1997 and 1998.

- (4) Registered securities and futures firms employed about 22,652 (1998: 22,779) persons in 1999. The general economic recovery over 1999 has seen a reversal in the previous trend of reduced headcount.

Probably as a result of the business consolidation, the percentage of the workforce employed by medium sized firms (with staff number range from 51 to 200 for dealers and 31 to 100 for advisers) or large sized firms (with over 200 staff for dealers and 100 staff for advisers) has increased from 47% to 53%.

53% of the total number of staff of registered dealers participated in dealing and marketing activities. Fund management and corporate finance staff accounted for 31% of the workforce of investment advisers.

- (5) In 1999, 13 (1998: 18) dealers and advisers relocated part of their operation outside Hong Kong. 5 of them had relocated part of their trading/advisory functions to countries including Japan and Taiwan while the remaining had relocated their back offices and sales and marketing functions to countries including Singapore and United States.

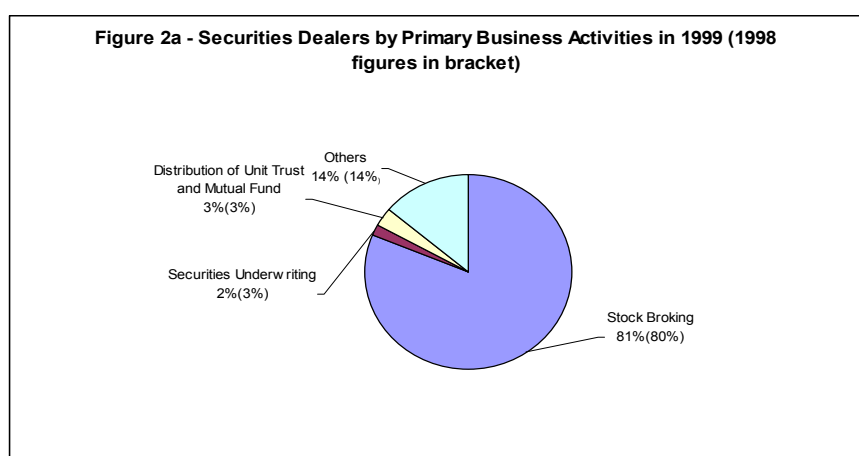
3. Main Findings of Surveys

3.1 Common Parameters

The main findings of the survey on the six types of registered/exempt business entities are presented in accordance with common parameters for easy comparison and reference. The parameters include primary business activity, market share, client profile, custody of client assets by intermediaries, human resources profile, financial performance and business development.

3.2 Primary Business Activity

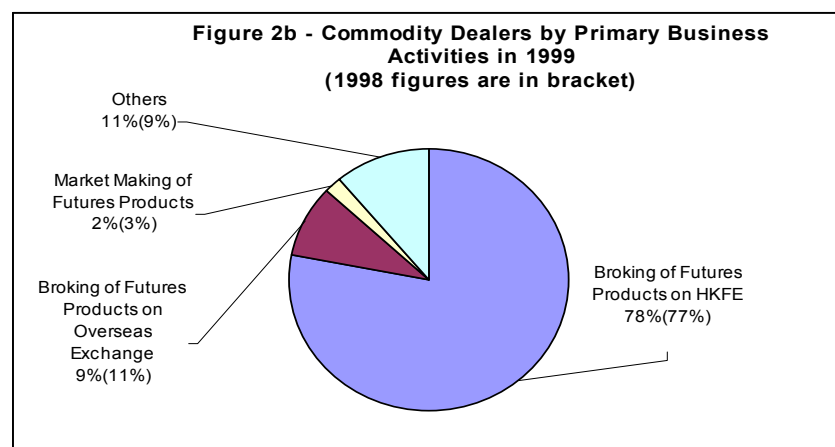
- (1) Broking activities constituted the main business function of securities dealers. 81% (1998: 80%) of securities dealers cited stock broking (figure 2a) as their primary business activity.



- (2) Similarly, a majority of the commodity dealers considered broking activities to be their main business function.

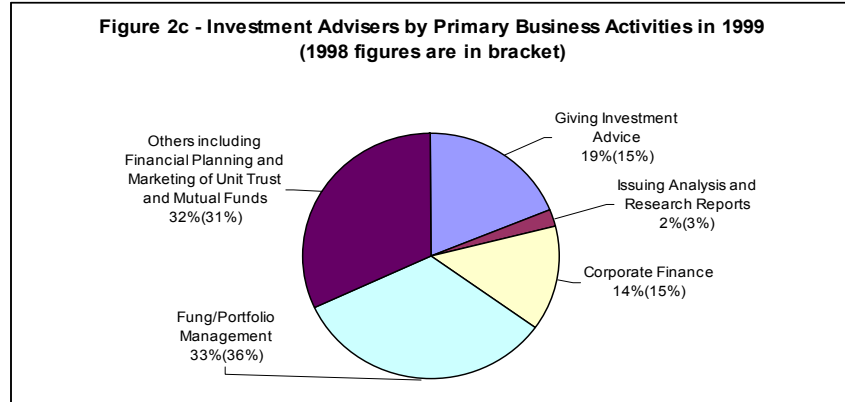
78% (1998: 77%) of the commodity dealers cited broking of futures/options contracts traded on the HKFE (figure 2b) as their primary business activity.

9% (1998: 11%) of the commodity dealers acted as brokers for trading overseas futures/options contracts.



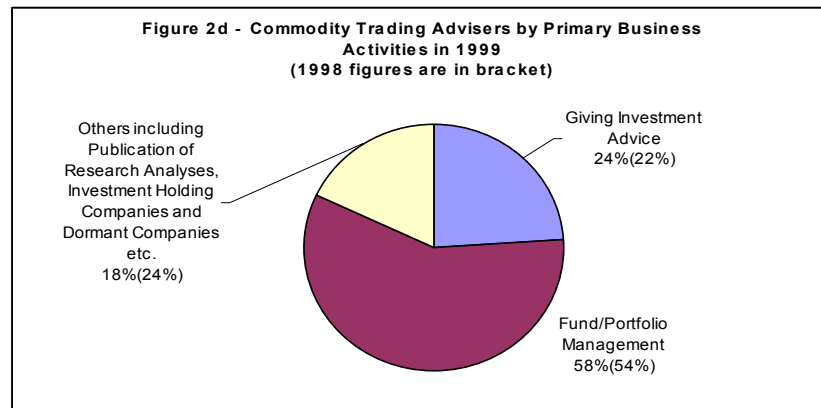
- (3) 33% (1998: 36%) of the investment advisers were either fund managers or advisers to funds whilst 19% (1998: 15%) were advisers to retail clients on securities (figure 2c).

Similar to 1998, 14% of the investment advisers were engaged primarily in corporate finance advisory activities. Only a relatively small number of firms (2%) considered the issue of research analyses and reports as their primary business.



- (4) The majority of the commodity trading advisers considered their commodity trading advisory activities to be incidental to their core businesses such as futures trading or fund management.

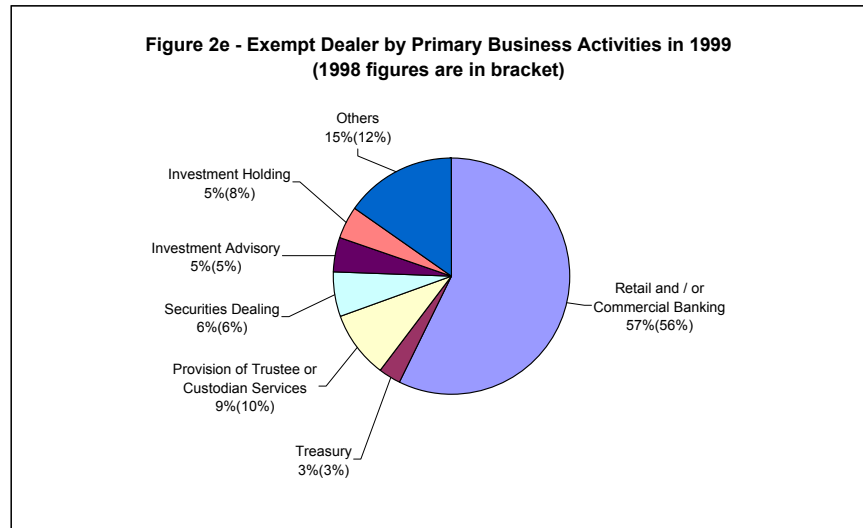
58% (1998: 54%) of the commodity trading advisers were either fund managers or advisers to funds whilst 24% (1998: 22%) were advisers to retail clients on commodities and futures contracts (figure 2d).



- (5) 57% (1998: 56%) of the exempt dealers cited retail and /or commercial banking as their primary business activities. 9% (1998: 10%) of the respondents principally provide trustee or custodian services to clients (figure 2e).

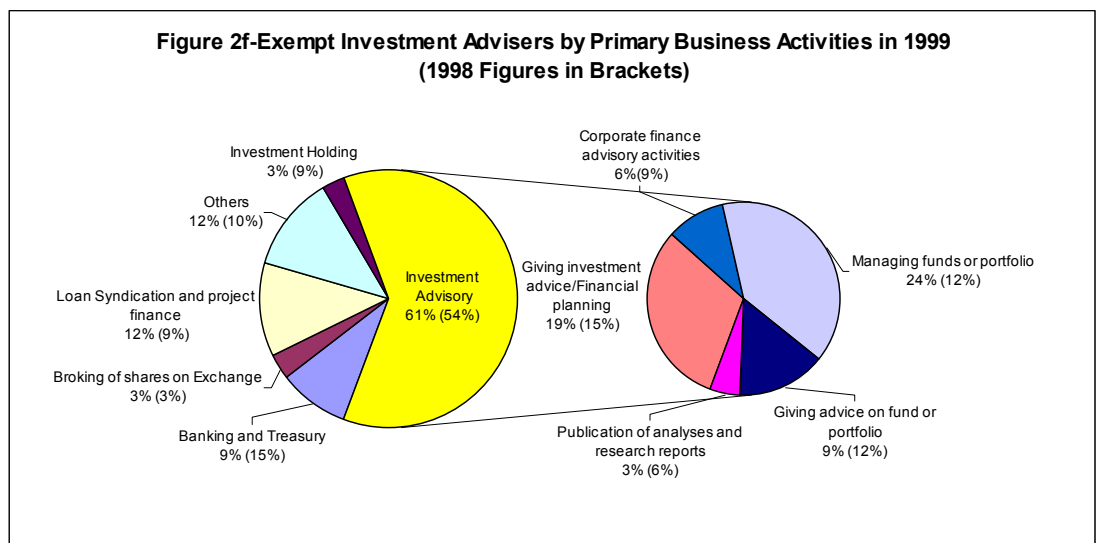
Firms selecting securities dealing as their primary business activities mainly participated in stock broking business.

Firms selecting investment advisory as their primary business activities mainly provided general investment advice.



- (6) 61% (1998: 54%) of the exempt investment advisers considered investment advisory activities as their primary activities. The distribution of the types of advisory activities provided was shown in figure 2f.

All firms not selecting investment advisory activities as their primary business have both exempt dealer and exempt investment adviser status. As such, their principal business is not restricted to the provision of investment advisory services.



3.3 Market Share

- (1) The total gross operating income earned by each type of registered / exempt business entities is as follows:

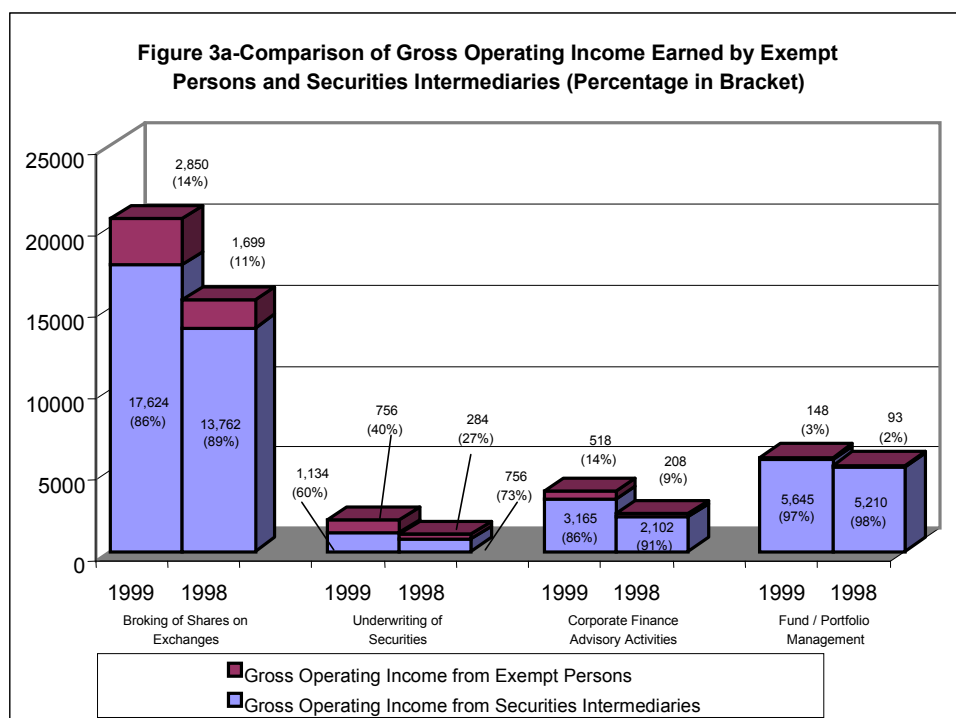
	1999 HK\$ million	1998 HK\$ million	1997 HK\$ million
Securities Dealer	26,802	20,019	34,933
Commodity Dealer	1,638	2,185	2,208
Investment Adviser	10,956	9,468	9,825
Commodity Trading Adviser	30	63	*
Exempt Dealer	12,872	3,675	*
Exempt Investment Adviser	306	274	*
	<u>52,604</u>	<u>35,684</u>	<u>46,966</u>

* the corresponding figures were not available for 1997

On the whole, the securities and futures industry experienced an overall rise of 47% (HK\$17 billion) in gross operating income in 1999 as compared to 1998. The rise is mainly attributable to the increase in commission received from broking of stocks on both local and overseas exchanges (HK\$5 billion) and profit gained from proprietary trading activities (HK\$7 billion). The rises in brokerage income and trading profit are in line with the prevailing strong market sentiment following the gradual recovery of the market in 1999.

The reported figures for total gross operating income of exempt dealers and exempt investment advisers only refer to the income earned from their securities dealing and investment advisory activities carried out under the relevant exemption declarations.

A comparison of the gross operating income earned by securities intermediaries and exempt persons, from broking of shares on exchanges, underwriting of securities, corporate finance advisory activities and fund/portfolio management activities, is shown in figure 3a below.



Exempt dealers are noted to have reported a general increase of their share in the securities market in 1999. Their reported share of the securities underwriting business has increased from 27% in 1998 to 40% in 1999.

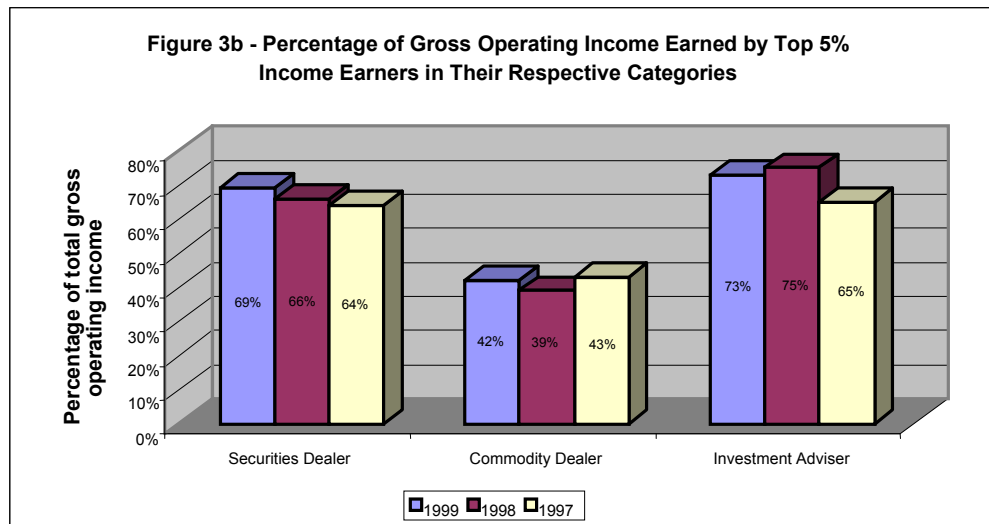
- (2) Contribution to the 1999 total gross operating income by the top 10 and top 5% income earners in their respective categories are as follows:

	Top 10 Income earners	Top 5% Income earners
	% Contribution	% Contribution
Securities Dealer	48%	69%
Commodity Dealer	47%	42%*
Investment Adviser	57%	73%
Commodity Trading Adviser	99%	97%*
Exempt Dealer	83%	81%*
Exempt Investment Adviser	112%#	67%*

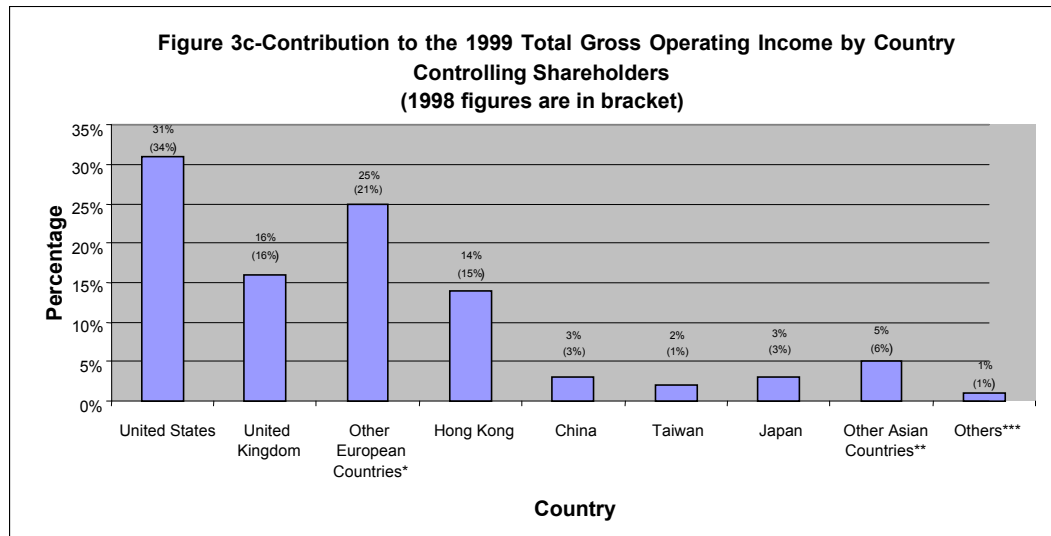
- The % contribution exceeded 100% because some of the responding firms incurred losses from securities dealing / advisory activities in 1999.

* - The % contribution from these top 5% earners was less than that of the top 10 earners because the number of firms making up these top 5% was less than 10.

A comparison on the percentage of gross operating income earned by the top 5% of securities dealers, commodity dealers and investment advisers for the past three years is shown in figure 3b.



- (3) The figure 3c below shows the 1999 total gross operating income generated by the responding intermediaries with reference to the country of domicile of their controlling shareholders.



- * Other European Countries refers to all European countries excluding United Kingdom
- ** Other Asian Countries refers to all Asian countries excluding Japan, Hong Kong, Taiwan and China
- *** Others refers to Canada, South Africa, British Virgin Islands, Bermuda, Belize, Bahamas and Aruba

Intermediaries controlled by firms domiciled in the United States or in European countries together attained a 72% share in the securities and futures markets of Hong Kong. The European intermediaries were mainly controlled by firms domiciled in United Kingdom, Switzerland, France and Netherlands.

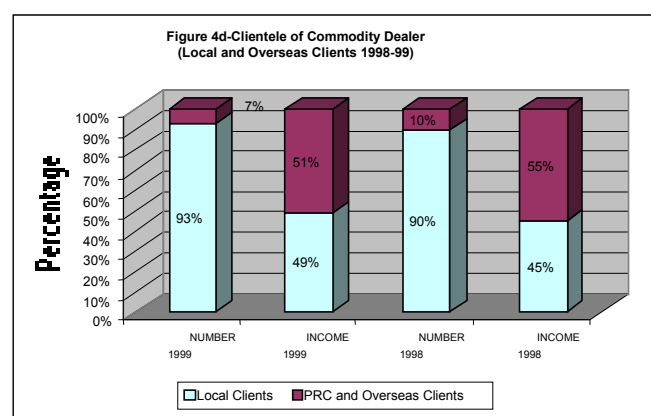
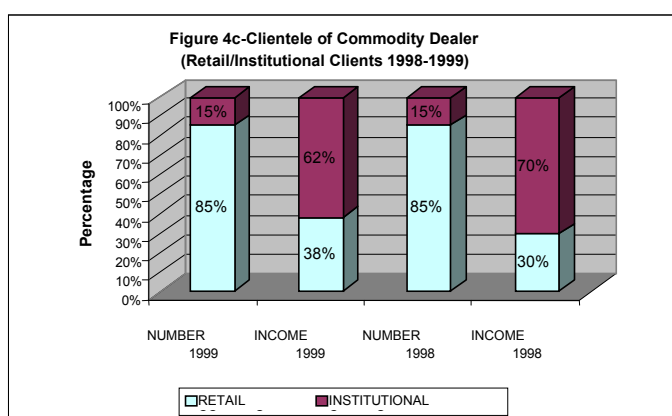
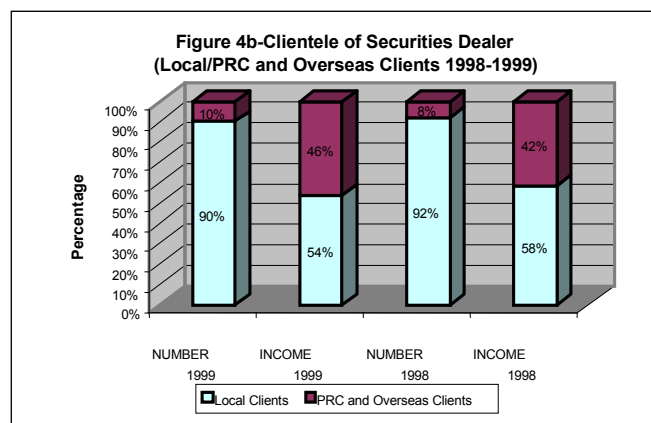
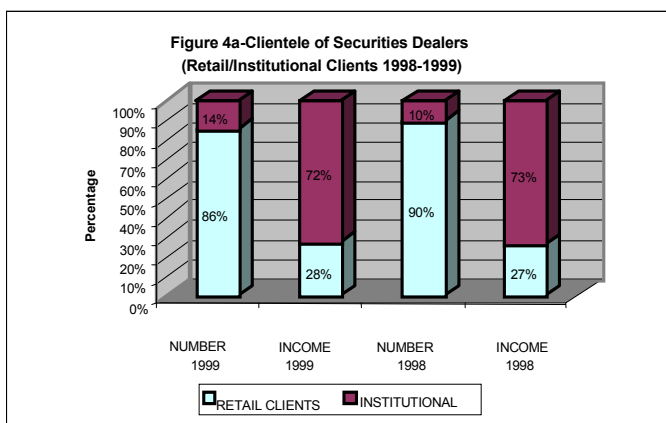
3.4 Client Profile

The reported number of active clients participating in the securities and futures industry as at 1998 and 1999 year ends is as follows:

	1999	% to total	1998	% to total
Securities Dealer	584,176	58	455,127	58
Commodity Dealer	17,982	2	15,471	2
Investment Adviser	32,698	3	12,000	2
Commodity Trading Adviser	324	-	476	-
Exempt Dealer	373,618	37	300,607	38
Exempt Investment Adviser	276	-	254	-
	<u>1,009,074</u>	<u>100</u>	<u>783,935</u>	<u>100</u>

- (1) For dealers, the number of active clients refers mainly to those who participate in trading activities on various exchanges.
- (2) For advisers, the figures above refer only to those who receive investment advice from the adviser firms. They exclude clients of the advisers engaging in corporate finance and fund advisory/fund management activities.
- (3) The number of active clients served by commodity trading advisers was significantly lower than that of the commodity dealers and investment advisers. This is because majority of the commodity trading advisers were also registered as commodity dealers or investment advisers. They were unable to separate out the number of clients relating solely to the provision of commodity trading advisory service as this type of service is generally incidental to their commodity dealing or investment advisory functions.
- (4) The 28% increase in the number of clients served by securities dealers is mainly attributed to the expansion of the retail client base of medium sized local brokers.
- (5) As a result of the increase in the number of investors interested in buying unit trusts and mutual funds, the size of the clientele of investment advisers multiplied more than two fold in 1999.
- (6) Exempt dealers recorded a 24% growth in their client base. The rise was mainly related to the increase in the number of private bank clients served by exempt dealers.
- (7) Analysis of Clientele
 - (a) Dealing Activities

For both securities and futures intermediaries, analysis of their clients by type (retails / institutional clients) and by location (local / overseas clients) in terms of number of active clients and gross operating income earned from the respective clients is depicted at figures 4a & 4b and figures 4c & 4d respectively.



- (i) Institutional clients, despite their lesser number, remain as the major contributors to the income of both securities dealers and commodity dealers.
- (ii) Similarly, although the number of overseas clients is much smaller than that of local clients, they contribute over 40% of the income earned by both securities and commodity dealers.
- (iii) The clients of securities dealers have also been analysed into cash/margin clients, discretionary/non-discretionary clients, and internet/non-internet clients.

Cash clients accounted for about 90% in terms of the number of clients and gross operating income generated.

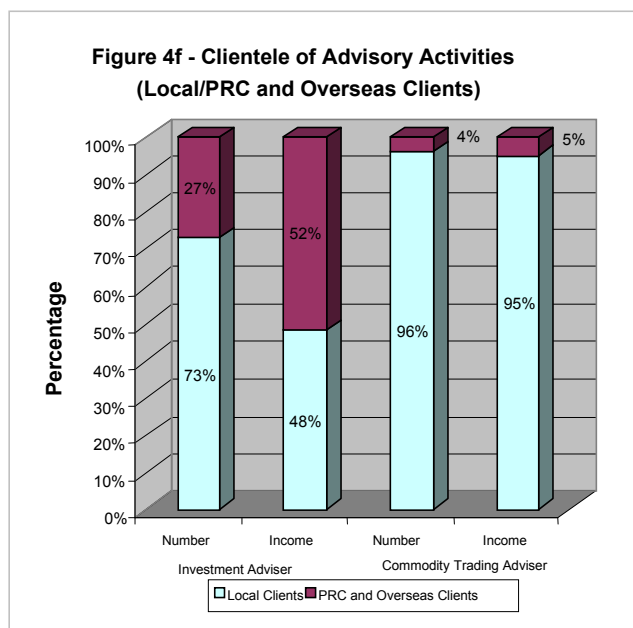
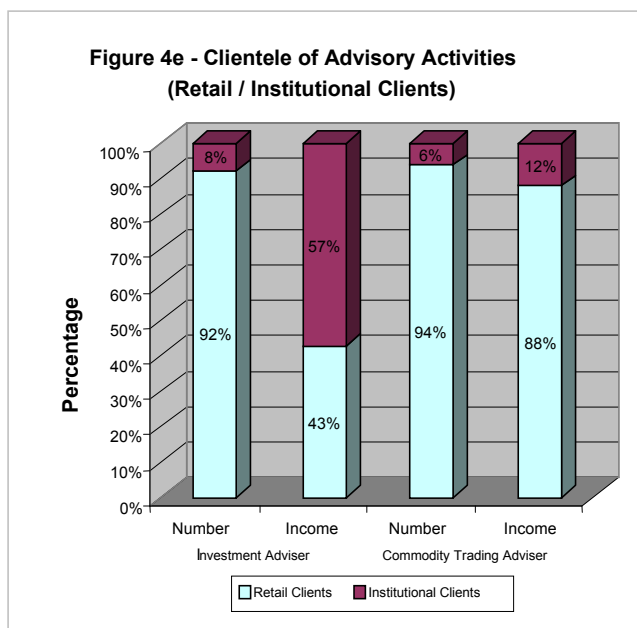
Non-discretionary clients represented over 96% of the total number of clients and gross operating income earned.

Only 2% of the total number of clients have traded through the internet in 1999. The gross operating income derived therefrom amounted to less than 1%.

- (iv) Local and retail clients represented over 90% of the total number of clients of the exempt dealer firms. They were mainly private bank clients served by major banks in Hong Kong.

(b) Advisory Activities

- (i) The classification of clients who receive investment advice from the adviser firms, by type and by location, is depicted at figure 4e and figure 4f below.



As in the case of dealers, institutional clients and overseas clients continue to be the major contributor to the advisory markets in terms of gross operating income.

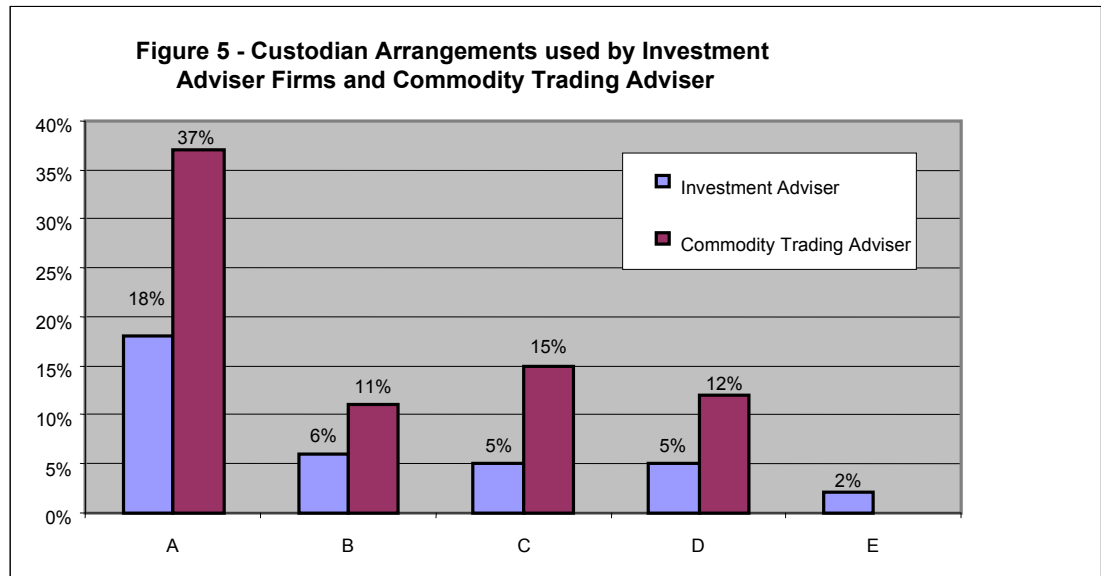
- (ii) The clientele of firms engaging in corporate finance activities is analysed in terms of number of deals effected.

Out of the total number of deals effected, 64% were executed for local clients. The remaining 26% and 10% were transactions executed for overseas and PRC clients respectively.

However, overseas clients are the major contributors to the gross operating income generated from corporate finance activities. They contributed 53% of the income earned, followed by 40% from local clients and 7% from PRC clients.

3.5 Custody of Client Assets by Intermediaries

- (1) A majority of securities dealers (68%) and a significant number of advisers (securities investment advisers: 27%; commodity trading adviser: 50%) held client assets in 1999.
- (2) The use of an independent trustee or custodian was the most common form of custodian arrangement. Figure 5 below shows the profile of custodian arrangements by advisers in 1999, which was similar to that in 1998.



Legend:

- A- Held by independent trustees / custodians
- B- Held by firm's related companies
- C- Kept at clients' own accounts opened with brokers / banks
- D- Kept at the firm's own account opened with brokers / banks and which are designated for holding clients' funds and assets
- E- Others

Please note that some of the responding firms might have used more than one type of custodian arrangement.

3.6 Human Resources Profile

- (1) The number of staff employed by responding firms in 1999 was around 22,652 (1998: 22,779)
- (2) There is no significant change in number of staff employed during 1999 as compared with 1998. The general economic downturn had been recovering over 1999 and headcount reduction effects had been stabilized.
- (3) The distribution of manpower among different types of registered firms was more or less the same in 1998 and 1999.
- (4) Securities Dealers and Commodity Dealers
 - (a) The securities and commodity dealers together employed about 17,683 staff (1998: 17,559) representing 78% (1998: 77%) of the total workforce.
 - (b) In 1999, dealing and marketing staff accounted for 53% (1998: 53%) of the workforce of securities dealers and commodity dealers. Around half of these marketing staff were acting for the firms as agents or by other arrangements.
 - (c) With regard to the working experience of these dealing and marketing staff, only one third of them had over 10 years industry experience. About 39% of the participants had less than five years relevant experience.

- (d) The number of staff employed by the dealers may be analysed as follows:

	1999		1998	
	No of staff	% to total	No of staff	% to total
Small sized firms with less than 50 staff	8,331	47	9,298	53
Medium sized firms with staff number range from 51 to 200	6,421	36	5,752	33
Large sized firms with over 200 staff	2,931	17	2,509	14
	<u>17,683</u>	<u>100</u>	<u>17,559</u>	<u>100</u>

For the year 1999, the percentage of staff employed by medium and large sized firm rose from 47% in 1998 to 53% in 1999. This may be the result of the general business consolidation in the competitive market environment.

(5) Investment Advisers and Commodity Trading Advisers

- (a) The advisory sector together employed about 4,969 (1998: 5,220) staff representing 22% (1998: 23%) of the bulk workforce.

- (b) As in 1998, fund management and corporate finance staff accounted for 31% of the workforce of investment advisers.

39% of these fund management staff had over 10 years industry experience whilst 27% had less than five years relevant experience.

Only 19% of these corporate finance staff had over 10 years industry experience. 50% of these employees had less than five years relevant experience.

- (c) The number of staff employed by investment advisers may be analysed as follows:

	1999		1998	
	No of staff	% to total	No of staff	% to total
Small sized firms with less than 30 staff	2,297	46	2,709	53
Medium sized firms with staff number range from 31 to 100	1,460	29	1,343	26
Large sized firms with over 100 staff	1,212	25	1,056	21
	<u>4,969</u>	<u>100</u>	<u>5,108</u>	<u>100</u>

Similar to dealers, the percentage of staff employed by medium and large sized firms also increased from 47% in 1998 to 54% in 1999.

3.7 *Financial Performance*

The securities and futures intermediaries provided the following financial information for year 1998 and 1999 with reference to their audited or management accounts:

	1999 HK\$ million	1998 HK\$ million
Total Profit / (Loss) after tax :		
Securities Dealer	4,083	(762)
Commodity Dealer	409	545
Investment Adviser	4,159	(233)
Commodity Trading Adviser	304	106

As at 31 December 1999, there were 1,086 (75%) intermediaries reporting a profit which represents a 20% increase over that of last year. A majority of the profit-making firms were either securities dealers or investment advisers.

3.8 *Business Development*

(1) Internet Trading

With the advance of technology, an increasing number of securities and futures intermediaries have been providing or plans to provide dealing or advisory activities over the internet.

Up to 31 December 1999, the number of firms providing the following services over the internet was as follows:

	<u>No. of firms</u>
Order routing	18
Research Data and Market Information	36
General / Company Information	67

There were also 220 firms who reported in the survey that they were planning to provide service on the internet. These firms were mainly securities dealers and investment advisers.

(2) Relocation of Business

In 1999, 13 (1998: 18) dealers and advisers relocated their operation outside Hong Kong. Of the 13 firms, 5 of them had relocated part of their trading/advisory functions to countries including Japan and Taiwan while the remaining had relocated their back offices and sales and marketing functions to countries including Singapore and United States.

Another 19 of the dealers and advisers indicated that they would relocate part of their operations outside Hong Kong in year 2000.