

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

Hong Kong
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1. Introduction

- (1) To maintain an up to date picture of the business profiles of securities and futures intermediaries in Hong Kong, the Securities and Futures Commission conducts an annual survey on the activities undertaken by registered and exempt firms in the first quarter of 2001. The categories of registered or exempt business entities surveyed are outlined in Figure 1.
- (2) This is a summary report of the findings of the survey.
- (3) 1,537 questionnaires were issued, covering all registered and exempt firms, ranging from sole-proprietorships, and partnerships to corporations. The response rate for 2000 was 92%, as compared to 92% in 1999 and 93% in 1998.

The chart below (figure 1) shows the breakdown of the number of replies by type of registration / exemption status from 1998 to 2000.

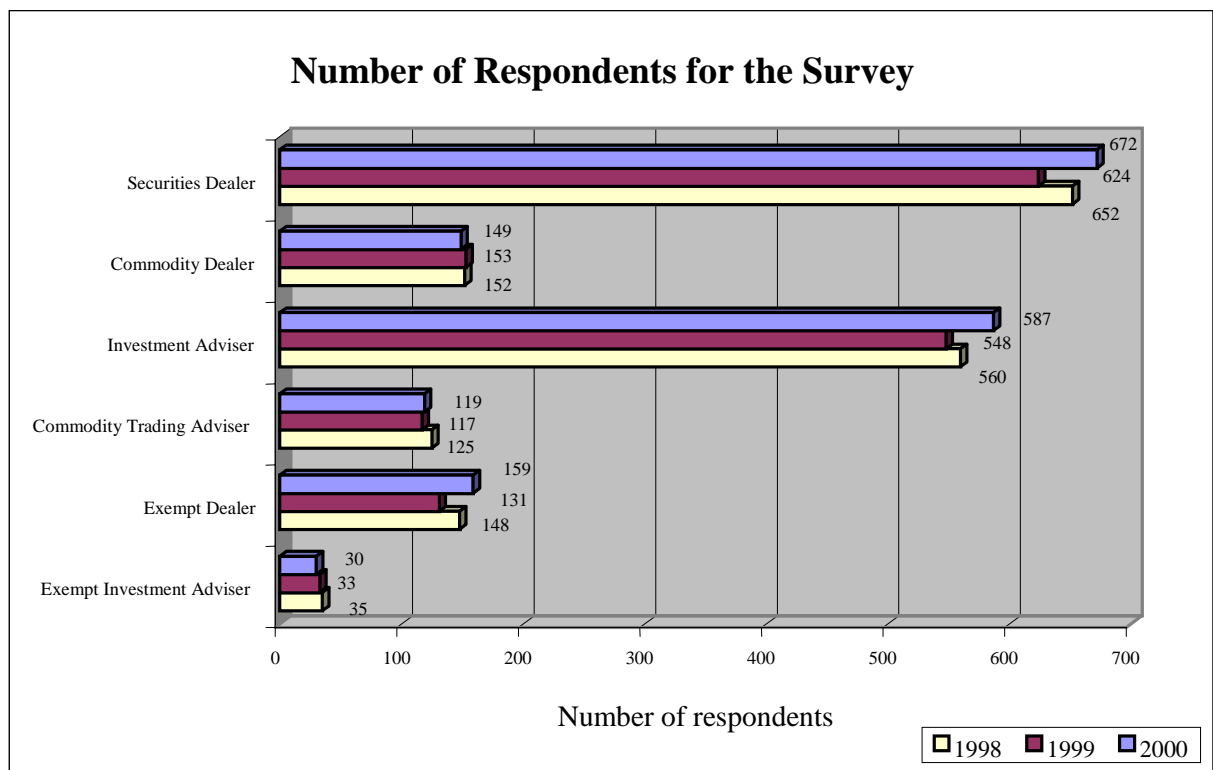


Figure 1

2. Summary of Major Findings

The major findings of the 2000 survey may be summarised as follows:

- (1) For registered dealers, broking activities constituted their main business function. 79% of the securities dealers cited stockbroking and 85% of the commodity dealer cited futures/options contracts broking as their primary business activities. For exempt dealers, around 46% of them regarded retail and /or commercial banking as their primary business activities.

A majority of 45% and 60% of registered investment advisers and exempt investment advisers respectively were either fund managers or advisers on securities. 14% of the securities investment advisers and 3% of the exempt investment advisers primarily engaged in corporate finance advisory activities.

- (2) In 2000, securities and futures intermediaries recorded a 21% growth in total gross operating income which was mainly contributed to by the increase in stock broking. Driven by the technology stock bubble, daily turnover in the stock market reached record levels in the first half of the year 2000. With broking commission being a percentage of the transaction value, commission income from securities dealer increased significantly.

Exempt persons' share of the gross operating income generated from the securities market in 2000 decreased from 26% to 18%. In areas including broking of shares on exchanges, underwriting of securities and fund or portfolio management, exempt dealers have recorded a drop in the share of total gross operating income despite an increase in the amount of gross operating income in most of these areas.

A small number of well capitalised and established firms continued to dominate the securities and futures markets. In all four registered intermediaries categories, the top 10 gross operating income earners accounted for over 40% of the revenue reported by all respondents within their respective categories in 2000. This is comparable to last year's findings.

United States and European controlled intermediaries earned 68% of the total gross operating income in 2000 which is comparable to 72% in 1999.

- (3) The number of active clients participating in the securities market increased by 39% in 2000. Most of these new clients were retail clients in the stock and unit trust / mutual funds markets.

Despite the relatively fewer numbers of institutional clients and overseas clients, constituting only about 10% of total clients, institutional and overseas clients continued to dominate the securities and futures markets contributing about 60% and 40% of total gross operating income respectively. A similar trend was noted in 1998 and 1999.

- (4) Registered securities and futures firms employed about 32,056 (1999: 22,652) persons in 2000. Many investment adviser firms employed more sales and marketing staff in order to position themselves in the Mandatory Provident Fund market. Securities dealer firms also employed more sales and settlement staff in the buoyant and competitive market conditions.

As a result of business consolidation, the percentage of 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) increased from 53% in year 1999 to 62% in year 2000.

54% of the total number of staff of registered dealers participated in dealing and marketing activities. Fund management and corporate finance staff accounted for 20% of the workforce of investment advisers.

- (5) In 2000, 12 (1999: 13) dealers and advisers relocated part of their operation outside Hong Kong. 5 of them had relocated part of their fund management, trading and advisory functions to countries including Japan and Singapore while the remaining had relocated their back offices to countries including Australia and United Kingdom. These relocations were mainly said to arise from a change in business strategy or consolidation of their regional back offices administration.
- (6) There were 90 firms who reported that they were providing online trading in year 2000. These firms were mainly securities dealers. 13% of the total number of clients traded through electronic means and generated about 11% of the gross operating income.

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, gross operating income, 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. 79% (1999: 81%) of securities dealers cited stock broking (figure 2a) as their primary business activity.

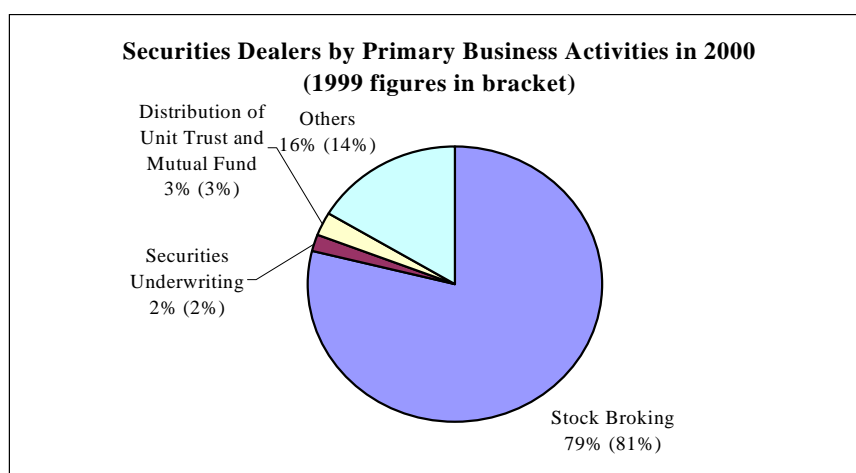


Figure 2a

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

76% (1999: 78%) of the commodity dealers cited broking of futures/options contracts traded on the HKFE (figure 2b) as their primary business activity.

9% (1999: 9%) of the commodity dealers acted as brokers for trading overseas futures/options contracts.

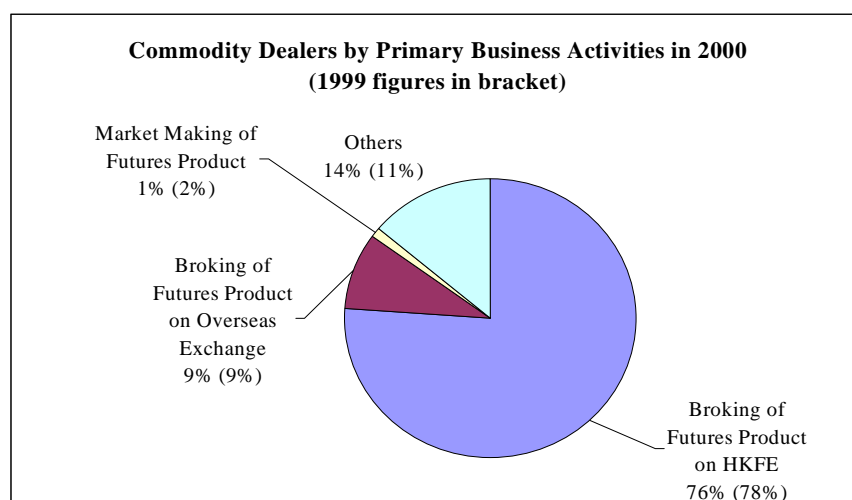


Figure 2b

- (3) 31% (1999: 33%) of the investment advisers were either fund managers or advisers to funds. 14% (1999: 19%) were advisers to retail clients on securities (figure 2c).

As in 1999, 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.

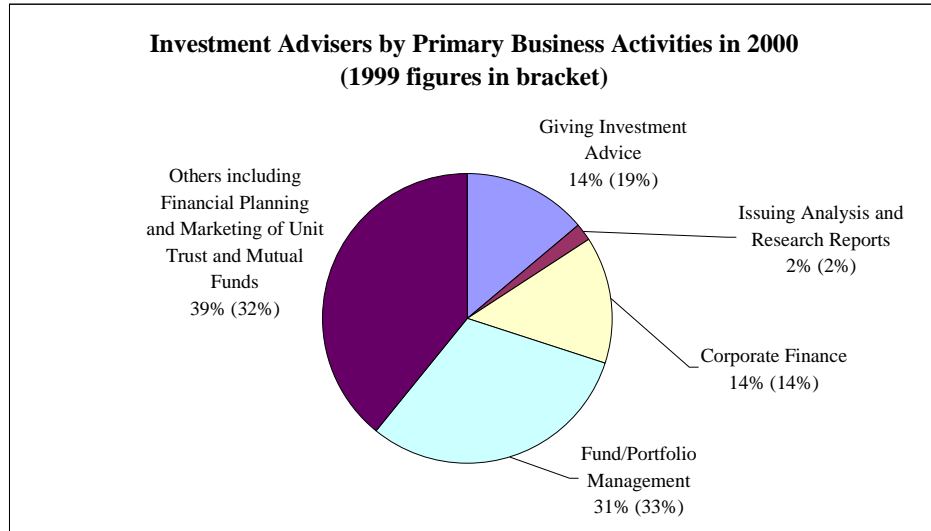


Figure 2c

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

56% (1999: 58%) of the commodity trading advisers were either fund managers or advisers to funds whilst 26% (1999: 24%) were advisers to retail clients on commodities and futures contracts (figure 2d).

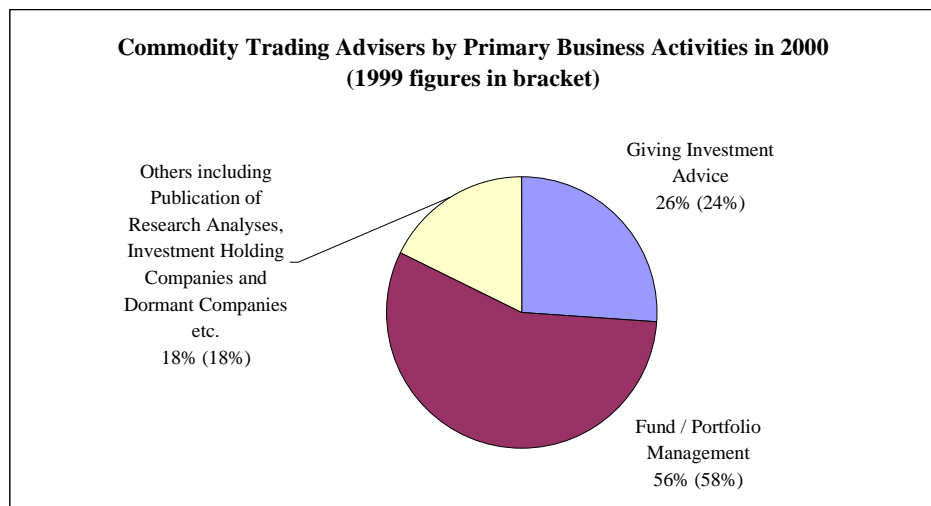
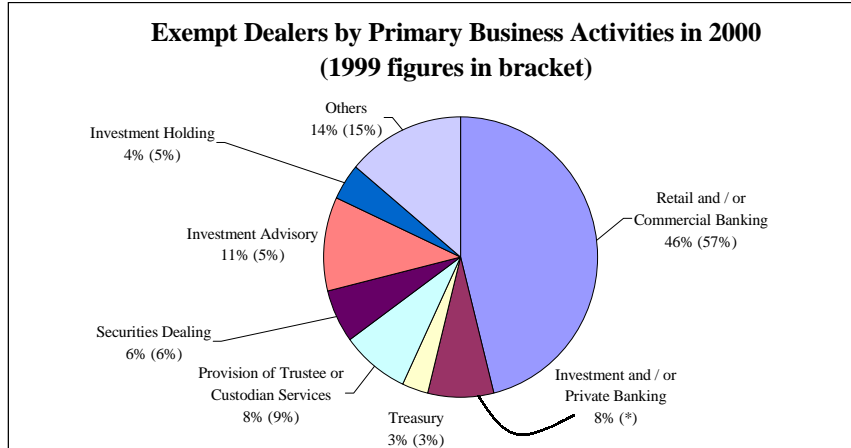


Figure 2d

- (5) 46% (1999: 57%) of the exempt dealers cited retail and /or commercial banking as their primary business activities. 8% of the respondents reported investment and / or private banking as their primary business. 8% (1999: 9%) of the respondents principally provide trustee or custodian services to clients (figure 2e).

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

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



* New business category in the 2000 survey

Figure 2e

- (6) 63% (1999: 61%) of the exempt investment advisers considered investment advisory activities as their primary activity. The distribution of the types of advisory activities provided is shown in figure 2f.

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

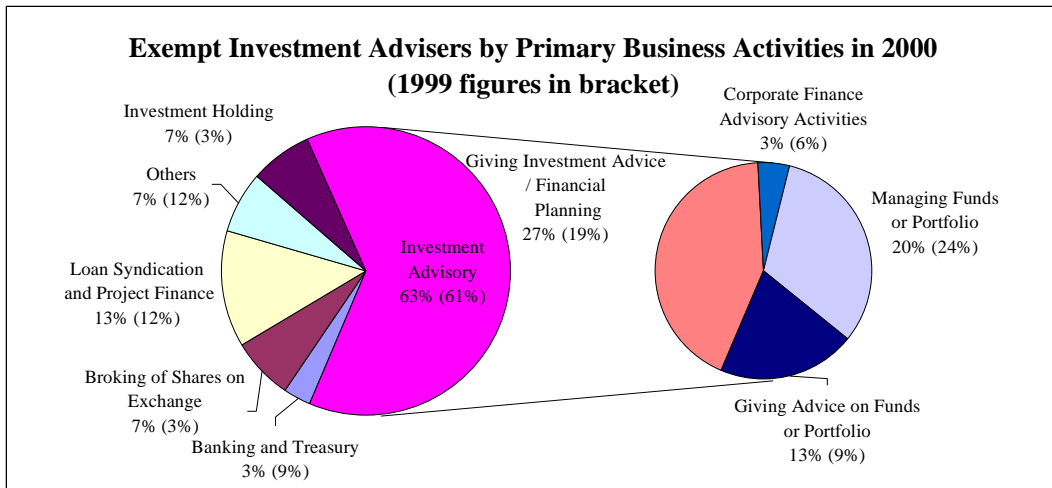


Figure 2f

* 3% reported publication of analyses and research reports as their primary business in 1999.

3.3 Gross Operating Income

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

	2000 HK\$ million	1999 HK\$ million	1998 HK\$ million
Securities Dealer	39,631	26,802	20,019
Commodity Dealer	1,246	1,638	2,185
Investment Adviser	11,813	10,956	9,468
Commodity Trading Adviser	26	30	63
Exempt Dealer	10,629	12,872	3,675
Exempt Investment Adviser	413	306	274
	<u>63,758</u>	<u>52,604</u>	<u>35,684</u>

On the whole, the securities and futures industry experienced an overall rise of 21% (HK\$11 billion) in gross operating income in 2000 as compared to 1999. The rise was mainly attributable to the increase in commission received from broking of stocks on both local and overseas exchanges (an increase of HK\$7 billion). The rise in brokerage income was in line with the prevailing strong market sentiment during the first few months of the year. The futures industry continued to contract with gross operating income declined by 24% compared with the prior year.

The reported figures for total gross operating income of exempt dealers and exempt investment advisers refer only 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 or portfolio management activities, is shown in figure 3a below.

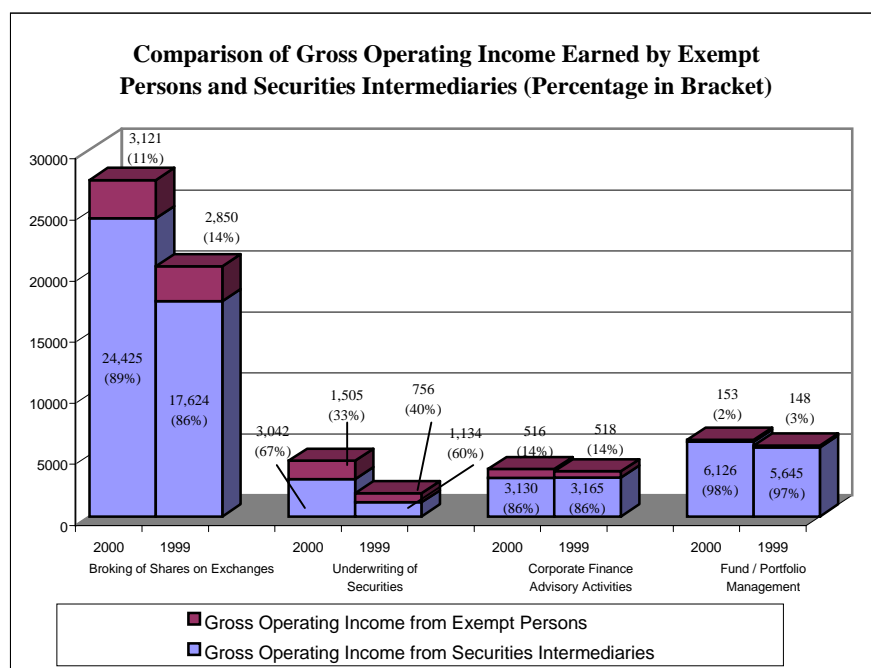


Figure 3a

Exempt persons reported a decrease in their share of gross operating income from the securities market in 2000 in all categories with the exception of corporate finance advisory activities. The proportion of total gross operating income earned by exempt persons from broking of shares on exchanges fell from 14% to 11% in 2000. The corresponding fall in portfolio management and underwriting of securities were from 3% and 40% to 2% and 33% respectively.

- (2) Top 10 and top 5% income earners in their respective categories held the following proportions of total market share:

	Proportion share of top 10 earners' total gross operating income	Proportion share of top 5% earners' total gross operating income
Securities Dealer	42%	65%
Commodity Dealer	42%	35%*
Investment Adviser	44%	71%
Commodity Trading Adviser	100%	95%*
Exempt Dealer	71%	66%*
Exempt Investment Adviser	95%	59%*

* - 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.

There is clearly a high concentration of market share held by a very small number of participants. That concentration has, however, declined slightly when compared to previous years.

A comparison of 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. The table shows a trend in which gross operating income is concentrated in the hands of the large players.

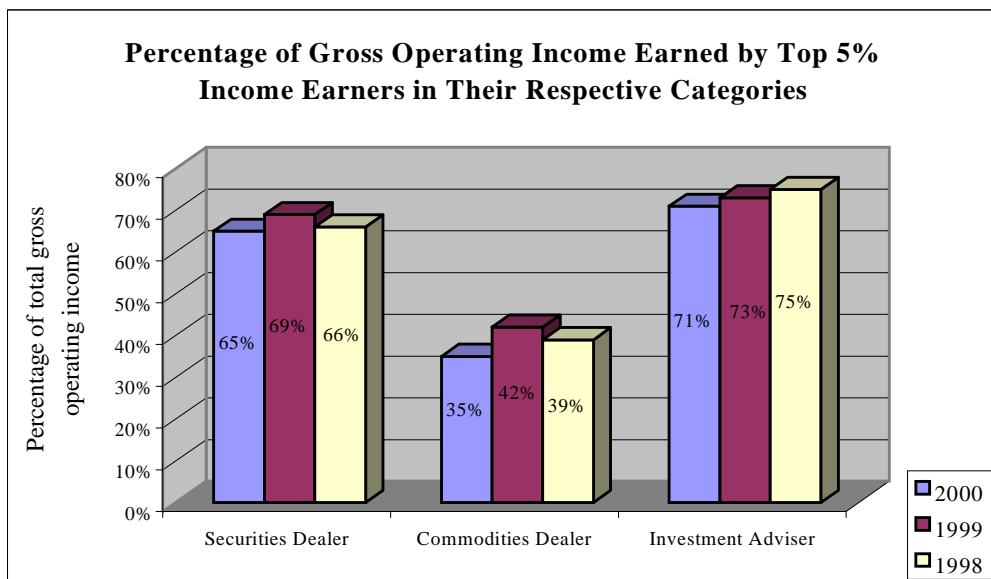


Figure 3b

- (3) The figure 3c below shows the 2000 total gross operating income generated by the responding intermediaries with reference to the country of domicile of their controlling shareholders.

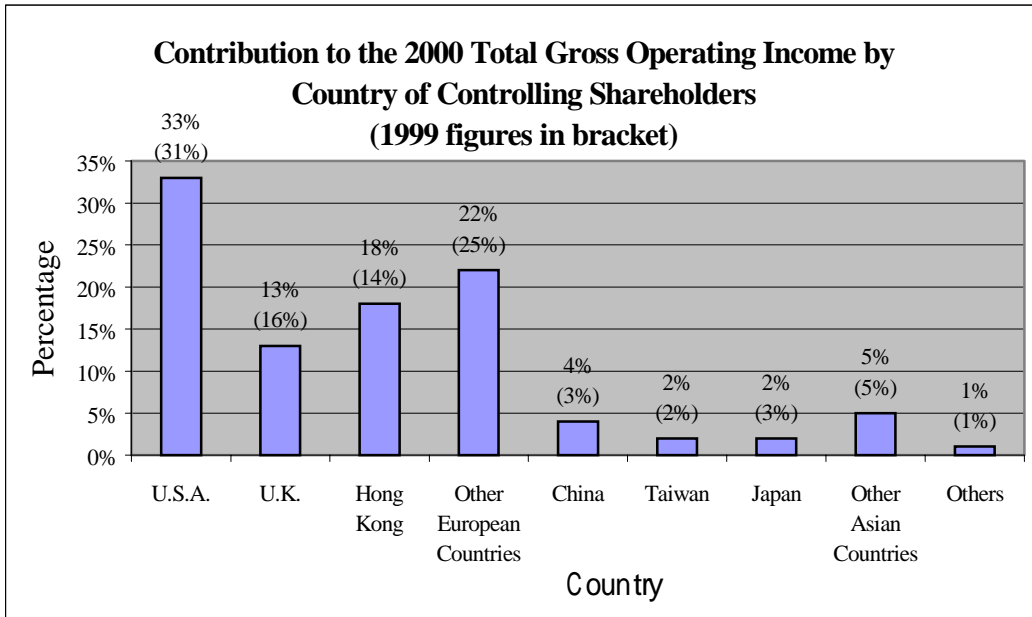


Figure 3c

- * Other Asian Countries refers to all Asian countries excluding Japan, Hong Kong, Taiwan and China
- ** Other European Countries refers to all European countries excluding United Kingdom
- *** Others refer 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 continue to dominate the securities and futures markets. They earned 68% of the gross operating income in the securities and futures markets of Hong Kong with United States firmly on top with 33%. The European intermediaries were mainly controlled by firms domiciled in the United Kingdom, Switzerland, France and the Netherlands.

3.4 Client Profile

The reported number of active clients participating in the securities and futures industry as at 1999 and 2000 year ends is as follows:

	2000	% to total	1999	% to total
Securities Dealer	784,377	56	584,176	58
Commodity Dealer	14,673	1	17,982	2
Investment Adviser	51,744	4	32,698	3
Commodity Trading Adviser	324	-	324	-
Exempt Dealer	555,613	39	373,618	37
Exempt Investment Adviser	271	-	276	-
	<u>1,407,002</u>	<u>100</u>	<u>1,009,074</u>	<u>100</u>

- (1) For dealers, the number of active clients refers mainly to those who have participated in securities trading activities on various exchanges during the year 2000. There will, of course, be an element of double counting of clients who maintain accounts with more than one broker. The double counting may have increased slightly in 2000 because of the more aggressive use of short term promotions (fee discounts, prizes etc) used by brokers to attract new clients.
- (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 or 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 a 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 34% increase in the number of clients served by securities dealers is mainly attributed to the expansion of the retail client base of local brokers as a result of aggressive marketing activities of their internet and retail businesses.
- (5) With the introduction of Mandatory Provident Fund in 2000, there was an increase in the number of investors trading in unit trusts and mutual funds. The size of the clientele of investment advisers increased by 58% in 2000 accordingly.
- (6) Exempt dealers recorded a 49% growth in their client base. The rise was mainly related to the increase in the number of retail clients served by exempt dealers.

(7) Analysis of Clientele

(a) Dealing Activities

For both securities and futures intermediaries, analysis of their clients by type (retail / 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.

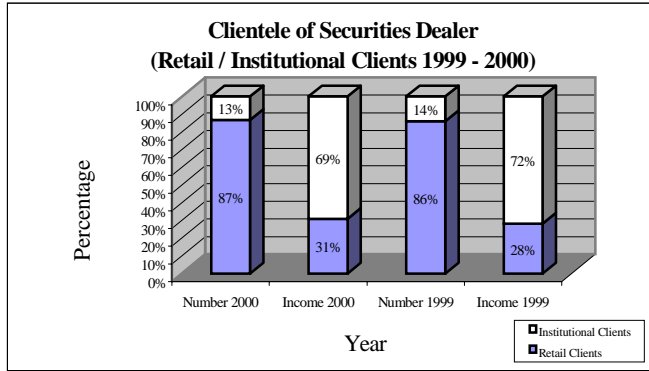


Figure 4a

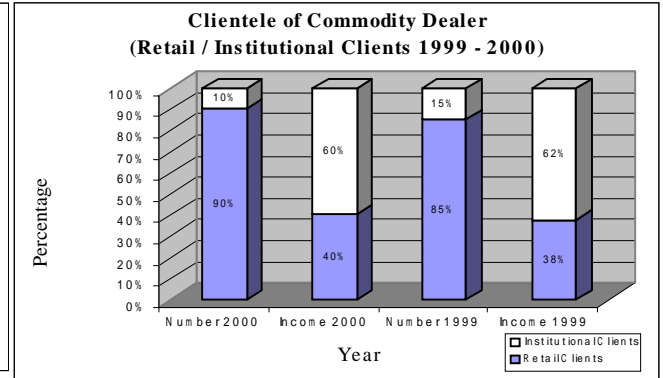


Figure 4b

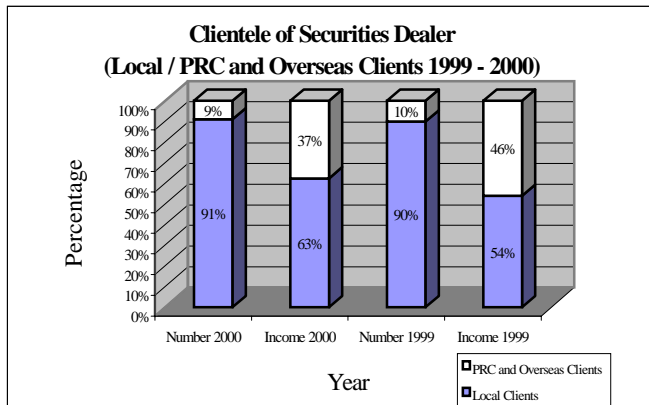


Figure 4c

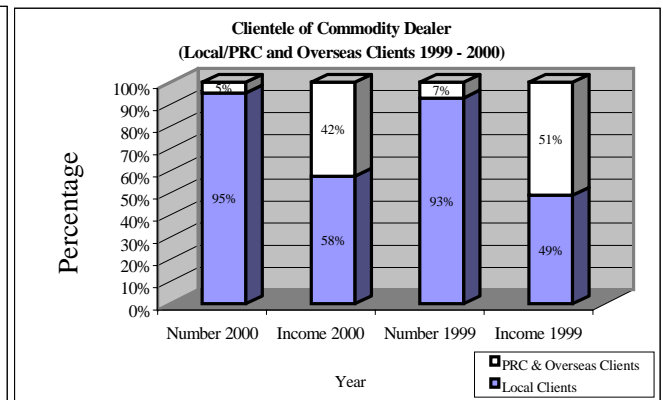


Figure 4d

- (i) Institutional clients, despite their lesser number, remain 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 accounted for 37% and 42% of the income earned by securities dealers and commodity dealers respectively.
- (iii) The clients of securities dealers have also been analysed into cash or margin clients, discretionary or non-discretionary clients, and through electronic means or other media clients.

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

Non-discretionary clients represented about 92% of the total number of clients and gross operating income earned.

13% of the total number of clients traded through electronic means and generated about 11% of the gross operating income.

- (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 of adviser firms, by type and by location, is depicted at figure 4e and figure 4f below.

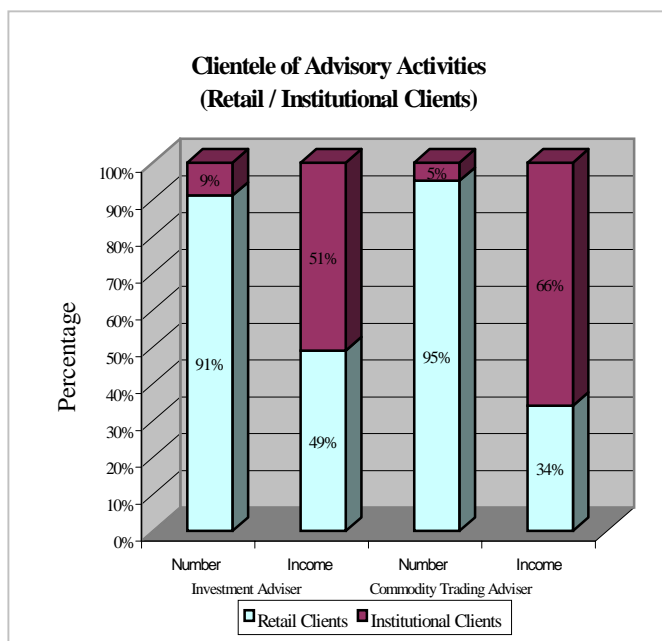


Figure 4e

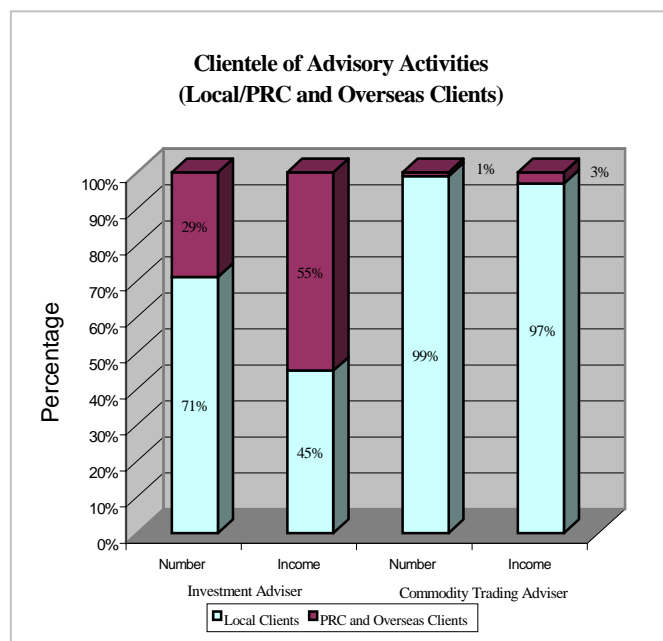


Figure 4f

As in the case of dealers, institutional clients and overseas clients dominate 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, 75% were executed for local clients. The remaining 17% and 8% were transactions executed for overseas and PRC clients respectively. For the year 2000, local clients generated over half of the total gross operating income for investment advisers carrying out corporate finance advisory activities. Overseas clients and PRC clients contributed 37% and 6% of the gross operating income.

3.5 Custody of Client Assets by Intermediaries

- (1) A majority of securities dealers (73%) and a significant number of advisers (securities investment advisers: 26%; commodity trading adviser: 52%) reported that they have custodian arrangements for the purpose of holding clients' funds and assets.
- (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 2000, which was similar to that in 1999.

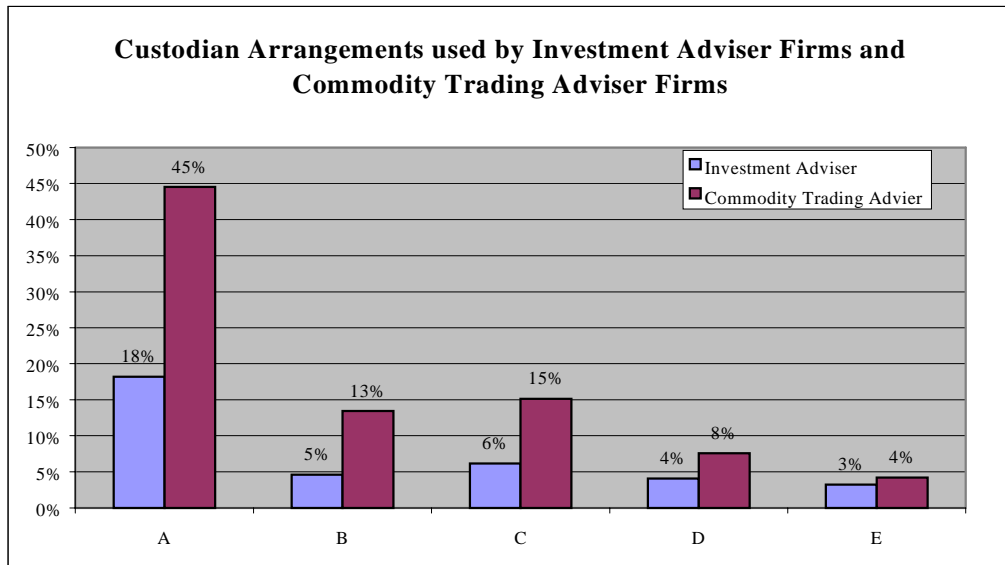


Figure 5

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 2000 was around 32,056 (1999: 22,652)
- (2) The number of staff employed in 2000 increased significantly compared to 1999. Securities dealer firms, which faced keen competition, employed a significant number of new sales and marketing staff. As a result, the corresponding number of back office staff also increased to cope with the increased workload in administrative and other supporting functions. Investment adviser firms also employed more people intending to gain shares in the Mandatory Provident Fund market.
- (3) The distribution of manpower among different types of registered firms was more or less the same in 1999 and 2000.
- (4) Securities Dealers and Commodity Dealers
 - (a) The securities and commodity dealers together employed about 22,054 staff (1999: 17,683) representing 69% (1999: 78%) of the total workforce.
 - (b) In 2000, dealing and marketing staff accounted for 54% (1999: 53%) of the workforce of securities dealers and commodity dealers. Around half of these marketing staff were acting for the firms as agents on a commission basis or by other arrangements.
 - (c) With regard to the working experience of these dealing and marketing staff, only 26% of them had over 10 years industry experience. About 42% of the participants had less than five years relevant experience.
 - (d) The number of staff employed by the dealers may be analysed as follows:

	2000		1999	
	No of staff	% to total	No of staff	% to total
Small sized firms with less than 50 staff	9,436	43	8,331	47
Medium sized firms with staff number range from 51 to 200	7,444	34	6,421	36
Large sized firms with over 201 staff	5,174	23	2,931	17
	22,054	100	17,683	100

The 2000 distribution is comparable to that of 1999, with a general trend to consolidate business away from medium to large sized firms to cope with competition.

(5) Investment Advisers and Commodity Trading Advisers

- (a) The advisory sector together employed about 10,002 (1999: 4,969) staff representing 31% (1999: 22%) of the industry workforce.
- (b) Fund management and corporate finance staff accounted for 20% of the workforce of investment advisers.

36% of these fund management staff had over 10 years industry experience whilst 28% had less than five years relevant experience.

Only 23% of these corporate finance staff had over 10 years industry experience. 44% of these employees had less than five years relevant experience.

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

	2000		1999	
	No of staff	% to total	No of staff	% to total
Small sized firms with less than 30 staff	2,789	28	2,297	46
Medium sized firms with staff number range from 31 to 100	1,649	16	1,460	29
Large sized firms with over 100 staff	5,564	56	1,212	25
	<u>10,002</u>	<u>100</u>	<u>4,969</u>	<u>100</u>

The percentage of staff employed by large sized firm increased from 25% in 1999 to 56% in 2000 mainly due to advisory activities on MPF products carried out by the large insurance companies.

3.7 Financial Performance

The securities and futures intermediaries provided the following financial information for year 1999 and 2000 with reference to their audited or management accounts:

Total Profit / (Loss) After Tax:	2000 HK\$ million	1999 HK\$ million
Securities Dealer	10,088	4,083
Commodity Dealer	1,911	409
Investment Adviser	6,891	4,159
Commodity Trading Adviser	<u>2,183</u>	<u>304</u>

As at 31 December 2000, 81% intermediaries reported a profit which represents a 6% increase over that of last year. A majority of the profit-making firms were either securities dealers or investment advisers.

The graphic representation of profit distribution by licensed category is depicted as follows:

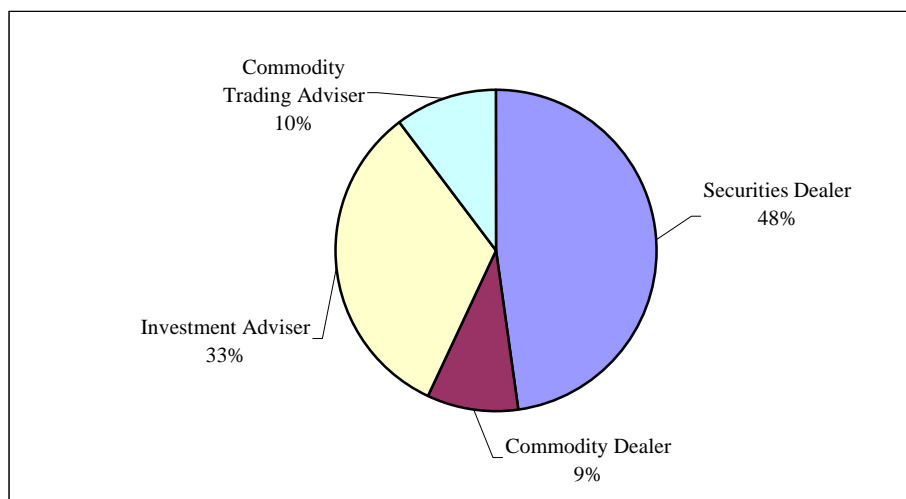


Figure 6

3.8 Business Development

(1) On-line Trading and Advising

With the advance of technology, an increasing number of securities and futures intermediaries have been providing or planning to provide dealing services or advisory activities through electronic means including internet, WAP phone etc.

Up to 31 December 2000, the number of firms providing the following services through electronic means was as follows:

	<u>No. of firms</u>
Online trading	90
Research Data and Market Information	73
General / Company Information	133

There were also 130 firms who reported in the survey that they were planning to provide service through electronic means. These firms were mainly securities dealers.

(2) Relocation of Business

In 2000, 12 (1999: 13) dealers and advisers relocated their operation outside Hong Kong. Of the 12 firms, 5 of them had relocated part of their fund management, trading/advisory functions to countries including Japan and Singapore while the remaining had relocated their back offices to countries including Australia and United Kingdom.

Another 8 of the dealers and advisers indicated that they would relocate part of their operations outside Hong Kong in year 2001.