

LegCo Financial Affairs Panel Meeting

Opening Statement

**By Peter Au-Yang
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6 March 2006

Honourable Chairman Bernard Chan, JP
Honourable Members of the Financial Affairs Panel

1. I am pleased to have the opportunity to brief the Honourable Members on our budget. I shall first explain the main features of the revised and proposed estimates and then discuss our resources requirements. Full details of our budget are set out in the Annex to the Administration's paper, which has already been submitted to the Honourable Members.

Revised Estimates for 2005/06

Estimated Revenue

2. The financial year 2005/06 has been a very good year in terms of market activities. When we prepared the revised estimates, the average daily turnover for the first seven months of the year to 31 October 2005 was about \$19.9 billion, over 50% higher than that assumed in the approved estimates while trading in the futures market was about 29% more active than expected. Higher number of licensing applications and more corporate activities will continue to bring in more fees and charges income. On these bases, we expect our revenue to increase by 42.4% from \$512.9 million to \$730.2 million.

Estimated Operating Expenditure

3. On the expenditure side, the revised estimated operating expenditure for 2005/06 is \$485.9 million, which is slightly above the approved estimates by \$4.2 million (0.9%). The increase is mainly attributable to –
 - (a) pay adjustments (\$5.8 million) granted to 152 staff members in 11 grades following a special pay review for staff retention purpose;
 - (b) an increase in our training and development expenses by 18.8% (\$1.3 million); and
 - (c) an increase in our external professional services, recruitment and custodian charges by about 7.0% (\$1.3 million).

Proposed Estimates for 2006/07

Estimated Revenue

4. On the revenue side, given that the Commission's reserves have exceeded 2 times of our operating expenditure for the current financial year, we have consulted the Financial Secretary and discussed a reduction to the levy rates for securities trading and futures and options contracts. As announced by the Financial Secretary on 22 February 2006, it is proposed that there be a 20% cut in the levy rates. The proposed reduction will be implemented as soon as we have gone through the necessary legislative procedures. For the purposes of our budget for 2006/07, we assume that the levy reduction will take effect from 1 April 2006.
5. The estimated revenue for 2006/07 is \$587.2 million, which is 19.6% (\$143 million) below the revised estimates for 2005/06. The drop is mainly due to a reduction in our levy income as a result of the levy rate reduction to be implemented later in the year and a lower projection of the average daily turnover for 2006/07.
6. It is estimated that there will be a 4.9% (\$9.0 million) increase in our fees and charges income, benefiting from a more active market.

Estimated Operating Expenditure

7. The total estimated operating expenditure for 2006/07 is \$561.9 million (including depreciation), which is 10.3% (\$52.5 million) higher than the revised 2005/06 revised estimates.
8. Members should note two exceptional items for which we have made provisions in 2006/07:
 - (i) \$11.8 million for the 31st Annual Conference of the International Organization of Securities Commissions, an international organisation of securities regulators, which will be hosted by the Commission in Hong Kong in June 2006; and
 - (ii) the \$5 million contribution to fund the Financial Reporting Council which was set up to investigate irregularities of the auditors or reporting accountants as well as to enquire into non-compliance with regulatory requirements in the financial reports of listed corporations.
9. Excluding these two exceptional items, the net increase is 7.4% (\$37.6 million).
10. The increase is mainly attributable to –
 - (a) increase in our Personnel Expenses by about 9.0% (\$34.2 million) arising from:

- (i) creation of six new posts (\$1.9 million) for the regulation of sponsors and authorization of REITs;
 - (ii) upgrading of 22 posts in various divisions (\$3.6 million) to cope with increasing complexities of our work and responsibilities;
 - (iii) additional salary costs (\$13.5 million) arising from filling of vacant posts and full year effect of 19 new posts and 17 upgradings already included in the revised estimates for 2004/05 and the approved budget for 2005/06;
 - (iv) a provision for an average 3% fixed pay adjustment (\$10.7 million) based on findings of three market pay trend surveys which suggested salary increase from 3.3% to 4.5%;
 - (v) an increase in provision (\$3.2 million) for awarding variable pay; and
 - (vi) an increase in other personnel expenses (\$1.1 million) mainly to cater for higher life and medical insurance premium;
- (b) increase in our Training and Development expenses by 16.1% (\$1.3 million) to provide our staff with more training activities; and
- (c) increase in our Professional and Others expenses by 20.1% (\$4.1 million) in anticipation of an increase in litigation and a higher demand for external consultancy.
11. As Members will note, the bulk of our expenditure relates to personnel expenses. We have critically evaluated the required increase and change in our staff establishment when preparing our 2006/2007 budget in light of our existing workload and the requisite number and profile of staff members. We consider that the proposed new posts and upgrading are necessary and the requirements cannot be trimmed down through internal redeployment or administrative means.
12. With regard to staff remuneration, Members will note that there has not been any general salary increase since April 2001, and we did not make any variable pay award to our staff in 2001/02 and 2002/03. Owing to the recovery of the Hong Kong economy from the second half of 2003 onwards and improved market conditions, we have experienced increasing staff turnover since the beginning of 2004. Our overall staff turnover in 2005 was 14.1% which compared with 11.8% for 2004. The turnover rate in 2005 for executive and non-executive staff was 16.2% (12.7% for 2004) and 10.2% (10.3% for 2004) respectively. The problem was most serious at the Manager and Assistant Manager levels, which experienced turnover rates ranging from 13% to 29%. We understand that the majority of our departed staff was attracted to the private sector which offered better pay packages.
13. In order to deal with the staff retention issue, and with reference to pay trend surveys, we have made provisions for an average fixed pay adjustment of 3%

(\$10.7 million) and \$29.5 million for the award of variable pay. The major asset of the Commission is its staff. It is important that our pay levels should be competitive enough to attract, retain and motivate competent staff. On the non-financial front, we plan to, amongst other things, put more resources on staff development and training.

Concluding remarks

14. There will be lots of challenges ahead of us and our workload is expected to increase further as we assume new regulatory functions and continue to enforce the Securities and Futures Ordinance. In particular, Members will note the Government's confirmation of its plan to introduce legislative changes later in the year to give statutory backing to the more important requirements in the Listing Rules. When this exercise is implemented, it will have implications on our staff establishment in future years.
15. In 2006/07, we shall continue to tightly control all our expenditure. However, if required, additional resources will be allocated to areas which are considered necessary to improve the quality of our market or to enhance Hong Kong's status as a preferred fund raising centre in the region.
16. I am pleased to say that we have projected a surplus in our 2006/07 budget even after a 20% reduction in our levy income. Thus it will not be necessary for the Commission to seek an appropriation from the Legislative Council. In fact, we have not requested for any appropriation for 14 years in a row.
17. I shall be happy to answer any questions that the Honourable Members may have. Thank you.