



SECURITIES AND
FUTURES COMMISSION
證券及期貨事務監察委員會

Quarterly Report

October - December 2002



3

2002-2003



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This is the Securities and Futures Commission's third Quarterly Report for the financial year from 1 April 2002 to 31 March 2003. The report aims to enhance the transparency and accountability of the Commission.

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Operations Highlights

1 October to 31 December 2002

1. The SFC recorded a deficit of \$35 million for the three quarters to the end of 2002, 60% below the projected deficit of \$87 million in the approved budget. Reserves at the end of December 2002 stood at \$588.7 million.
2. Revenue for the first three quarters was \$258.3 million, 6% lower than the same period last year. The drop was mainly due to the shrinkage of average daily market turnover from \$8.1 billion to \$7.1 billion.
3. Unaudited expenditure (including depreciation) for the first three quarters was \$293.6 million, 8% lower than the corresponding period of last year. Staff costs were down by 6% while other overheads, including premises expenses, were down by about 16%. The total number of staff at the end of December 2002 was 402 (415 at end of March 2002).
4. The SFC and the Hong Kong Monetary Authority signed a new Memorandum of Understanding on their respective roles and responsibilities in the regulation of Registered Institutions (mostly banks) and their staff in conducting regulated securities activities.
5. By the end of 2002, 37 of the 40 sets of subsidiary legislation required to commence the SFO were gazetted. The remaining items were gazetted in January 2003. At the same time, the SFC continued its SFO related training for intermediaries and market participants to prepare for the target commencement of the Ordinance on 1 April 2003. 40 sessions have been conducted for more than 10,000 attendees.
6. The SFC amended the Financial Resources Rules to raise the haircut ratio on illiquid collateral stocks and warrants, and introduce a borrowing-to-margin loan ratio. The amendments help intermediaries manage their risks.
7. The SFC requested Pacific Pearl Securities Limited to make arrangement to return assets to clients, after the firm failed to meet the minimum liquid capital requirement and ceased business.
8. The SFC announced that it had authorised the first three retail hedge funds. It also published requirements to ensure that hedge fund investors were provided with accurate and relevant information to make informed investment decisions.
9. The SFC published guidelines to make it easier for experienced practitioners and university graduates in designated fields to enter the securities and futures industry.
10. The SFC was finalising the draft guidelines for the authorisation of Real Estate Investment Trusts (REITs) for public consultation in the first quarter of 2003.
11. The Hong Kong Futures Exchange launched the Mini-Hang Seng Index Options, after the SFC had approved the necessary rules changes.
12. The SFC published the Report of the Steering Committee on the Enhancement of Financial Infrastructure II (SCEFI II), outlining recommendations which aim to make Hong Kong the preferred financial centre in the Asian time zone for investors.



13. The SFC directed HKEx to suspend trading in the shares of Styland Holdings Limited due to inadequate information disclosure.
14. The SFC successfully prosecuted 11 entities and disciplined 17 intermediaries for breaches of law and various regulatory requirements.
15. The SFC started publishing a monthly newsletter on its enforcement action, in a bid to increase transparency and strengthen investor confidence.
16. The SFC began a monthly forum with brokers to discuss issues of common interest and involve them in the early stages of policy consultation.
17. In addition to investor education on the impending implementation of the SFO and retail hedge funds, the SFC also organised 11 workshops for about 500 secondary school teachers so that they can share with students the key concepts of investing.
18. The SFC hosted a two-day meeting of the IOSCO Standing Committee 1 in Hong Kong where regulators discussed the latest issues on accounting standards and financial reporting.

(Currency is denominated in Hong Kong dollars unless otherwise stated.)



Review of Operations

1 October to 31 December 2002

This is the Securities and Futures Commission's third Quarterly Report for the financial year starting 1 April 2002.

On 13 December 2002, the Secretary for Financial Services and the Treasury, Mr Frederick Ma, announced that the Securities and Futures Ordinance (SFO) would come into force on 1 April 2003. We welcome the announcement. The SFC and the market continued to gear up for the implementation of the SFO.

During the quarter, initial stock market gains driven by a bigger-than-expected interest rate cut by the US Fed were partially offset by the heightened tension in the Middle East. The Hang Seng Index (HSI) bottomed at 8,859 on 10 October and peaked at 10,227 on 3 December. The HSI closed at 9,321 on 31 December, 2.7% higher than last quarter's close.

Financial Highlights


During the quarter, the SFC continued its tight control over operating expenditure, which totalled \$97 million, about \$2 million below the previous quarter's total. However, as average daily market turnover (including new issue transactions) dropped further to \$6.3 billion from \$6.6 billion in July-September, total income was \$81.5 million, compared with \$85.8 million in the previous quarter.

The SFC therefore registered a quarterly deficit of \$15.5 million, \$2.5 million higher than the previous quarter.

Accumulated deficit for the three quarters to the end of 2002 was \$35 million, which was well below the projected deficit of \$87 million in the approved budget and compared favourably with the \$43.6 million deficit for the same period last year.

Reserves at the end of December 2002 stood at \$588.7 million, equivalent to 1.31 times the approved annual operating expenditure estimate of \$450 million.

Compared with a year ago, revenue for the first three quarters this year was 6% lower, at \$258.3 million. The drop was mainly due to the shrinkage of average daily market turnover to \$7.1 billion from \$8.1 billion. But our stringent cost control measures, including salary and headcount freeze (other than new recruits for the dual filing initiative), paid off by reducing the operating cost by 8% from a year ago to \$293.6 million. Staff cost was down by 6% mainly due to a decrease in staff number and cash compensation for overtime work, and downward adjustment of salaries to reflect the current market trend when filling vacancies. Other overheads, including premises expenses, were down by about 16%. The decrease mainly arose from trimming down external training programmes and less spending on external consultants for market studies.



The total number of staff at the end of December 2002 was 402, comprising 358 regular staff and 44 temporary staff (415 at end of March 2002, comprising 355 regular and 60 temporary staff).

The Securities and Futures Ordinance

On the day the Secretary for Financial Services and the Treasury announced the target commencement date of the SFO, the SFC and the Hong Kong Monetary Authority (HKMA) also announced the signing of a new Memorandum of Understanding (MOU). The MOU sets out our respective roles and responsibilities in the regulation and supervision of Registered Institutions (mostly banks) and their staff in conducting regulated securities activities.

Banks will lose their exempt status and have to register with the SFC under the SFO in order to carry out securities dealing and advisory business. The MOU emphasises a consistent supervisory approach and the establishment of effective communication channels between the two regulators to create a level regulatory field for all industry practitioners.

For effective regulation, the SFO provides flexibility in addressing changing market practices and global conditions by way of subsidiary legislation. In three consecutive weeks since 29 November, 37 of the 40 sets of subsidiary legislation required to commence the SFO were gazetted. The remaining items were gazetted in January 2003. All the gazetted rules, orders, etc. can be found on the SFC website under the special SFO section.

Internally, the SFC has been training its staff and building new systems to ensure the Commission can work hand in hand with the industry to implement the new law. Externally, the SFC has been organising or taking part in training sessions on the SFO for intermediaries and other market participants. By January 2003, we have conducted 40 sessions, with over 10,000 attendees.

Upholding the Standards of Intermediaries

The number of registered and exempt persons fell 1.3% during the quarter and 7.8% during the year amidst the challenging operating environment. However, opportunities remain in the industry. We note a net increase of 25 securities advisory firms in the year. In the futures sector, 11 dealing and 13 advisory firms entered the industry in 2002 - some of which are spin-offs of stockbroking groups.

Number of SFC Registrants under Various Ordinances and Exempt Persons			
	31 Dec 2002	30 Sep 2002	31 Dec 2001
Securities Ordinance (excluding Securities Margin Financiers)	21,112	21,506	23,207
Securities Ordinance (as Securities Margin Financiers)	200	214	219
Commodities Trading Ordinance	4,550	4,592	4,841
Leveraged Foreign Exchange Trading Ordinance	1,063	974	917
Exempt Persons	171	174	196
Total	27,096	27,460	29,380



The number of both cash and margin clients of stockbrokers had also fallen amid the adverse economic conditions, as seen in the table below:

Statistical Information and Financial Position of the Securities Market (note 1)		
	As at 30 Sep 2002	As at 30 Sep 2001
Total number of securities intermediaries (note 2)	703	731
Total number of active cash clients	568,545	629,681
Total number of active margin clients	59,129	62,298
Balance Sheet	(\$ Million)	(\$ Million)
Cash in hand and at bank (note 3)	57,482	58,474
Amounts receivable from margin clients (note 4)	12,564	11,361
Amounts receivable from clients and other dealers arising from dealing in securities	36,527	34,498
Other assets	31,070	26,699
Total assets	137,643	131,032
Amounts payable to clients and other dealers arising from dealing in securities	60,049	54,142
Total borrowings from financial institutions	5,672	4,996
Other liabilities	21,446	21,384
Total shareholders' fund	50,476	50,510
Total liabilities and shareholders' fund	137,643	131,032

Note 1: The data were extracted from the monthly FRR returns submitted by securities dealers and securities margin financiers.

Note 2: Including registered dealers and registered margin financiers.

Note 3: Cash in hand and at bank includes trust monies held on behalf of clients.


Note 4: Average collateral coverage (the number of times the aggregate market value of securities collateral deposited by clients covers the amounts receivable from margin clients on a given date on an industry-wide basis):

<u>As at 30 Sep 2002</u>	<u>As at 30 Sep 2001</u>
3.23	3.55

On 1 October, amendments to the Financial Resources Rules became effective, raising the haircut ratio on illiquid collateral stocks and warrants, and introducing a borrowing-to-margin loan ratio. The amendments help enhance the risk management of intermediaries engaging in margin financing business.

During the quarter, the SFC published guidelines and circulars to clarify regulatory requirements, provide additional guidance and facilitate entry to the securities and futures industry. The more notable ones are:

SFC Guidelines and Circulars Issued between 1 October and 31 December 2002	
	Issue Date
1. Circular to Registered Investment Advisers on Cold Calling	12 November
2. Circular to Registered Persons regarding the Marketing of Hedge Funds	28 November
3. Revised Guidance Note for Short Selling Reporting and Stock Lending Record Keeping Requirements	28 November
4. Guidelines on Hedge Funds Reporting Requirements	28 November
5. Guidelines for Exemptions from the Recognised Industry Qualification and Local Regulatory Framework Paper Requirements	17 December



The revised Guidance Note for Short Selling Reporting and Stock Lending Record Keeping Requirements clarifies the SFC's policies and positions in the application of the short selling provisions in the Securities Ordinance and the Securities (Stock Lending) Rules.

The Guidelines on Hedge Funds Reporting Requirements set out additional guidance regarding hedge funds' on-going reporting obligations (see **Facilitating Market Development** below for details).

The Guidelines for Exemptions from the Recognised Industry Qualification and Local Regulatory Framework Paper Requirements make it easier for people to enter the securities and futures industry. Experienced practitioners and university graduates in designated fields may apply for exemptions from industry qualification. Industry veterans with sound compliance support may apply for exemption from the local regulatory framework examination.

During the quarter, the SFC published a number of consultation and conclusions papers as part of its continuing effort to engage the market in its regulatory work.

SFC Consultation Papers and Conclusions Issued between 1 October and 31 December 2002

	Issue Date
1. Consultation Conclusions on the Draft Securities and Futures (Financial Resources) Rules	11 October
2. Consultation Paper on the Proposed Revisions to the Code of Conduct for Persons Registered with the SFC	21 November
3. Consultation Conclusions on the Hedge Funds Reporting Requirements	28 November


In November, Pacific Pearl Securities Limited voluntarily suspended trading on the Stock Exchange and ceased business, following its failure to meet the minimum liquid capital requirement. To protect investors' interests, the SFC required Pacific Pearl to make arrangements to return assets to clients under the monitoring of the Commission. To date, all assets have been returned to clients in an orderly manner.

Facilitating Market Development

Hong Kong is one of the first jurisdictions in the world to introduce hedge funds to retail investors. On 28 November, the SFC announced that it had authorised the first three hedge funds, following the introduction of the Hedge Funds Guidelines for authorisation in May.

At the same time, the SFC published the Guidelines on Hedge Funds Reporting Requirements and the related consultation conclusions. The aim of these ongoing disclosure requirements is to give hedge fund investors accurate and relevant information so they can make informed decisions.

The SFC issued a Circular to Registered Persons Regarding the Marketing of Hedge Funds to remind financial intermediaries of their obligations to assess whether hedge funds are suitable for their clients. The HKMA also issued a similar circular to those it regulates.



In December, we published on the website a set of Frequently Asked Questions to help the fund industry understand our regulatory requirements. To further facilitate compliance, we also published standardised forms to assist fund managers in reporting ongoing compliance matters.

We have been examining the regulatory issues of Real Estate Investment Trusts (REITs) and conducting research on the rules in Singapore, Australia and the US. Detailed guidelines for the authorisation of REITs are being finalised for public consultation in the first quarter of 2003.

During the quarter, the SFC authorised 119 new unit trusts/mutual funds and 27 other investment products including investment-linked assurance schemes. Of the funds we authorised, a majority are products with guaranteed features. We also authorised four new fund management companies to manage SFC authorised funds. During the same period, 42 funds were deauthorised, with primary reasons being merger and restructuring for better cost efficiency.

Number of Authorized Collective Investment Schemes			
	31 Dec 2002	30 Sep 2002	31 Dec 2001
Unit Trusts and Mutual Funds	1,906	1,823	1,893
Investment-Linked Assurance Schemes	121	112	98
Pooled Retirement Funds	37	39	39
MPF Master Trust / Industry Schemes	47	49	49
MPF Pooled Investment Funds	237	220	217
Other Schemes	34	35	18
Total	2,382	2,278	2,314

The Hong Kong Futures Exchange introduced the Mini-Hang Seng Index (Mini-HSI) Options on 18 November, following the SFC's approval of the rules. Both the contract multiplier and margins for Mini-HSI Options are set at a fraction of those for HSI Options. Mini-HSI Options provide an opportunity for more retail investors to participate in the stock index options market.

In December, the SFC published the Report of the Steering Committee on the Enhancement of Financial Infrastructure II (SCEFI II). The Report outlines recommendations for the enhancement of Hong Kong's financial infrastructure with a view to making Hong Kong the preferred financial centre in the Asian time zone for investors. A High Level Forum was established with participation from the Government, SFC, HKMA, and Hong Kong Exchanges and Clearing Limited (HKEx) to co-ordinate the implementation of SCEFI II recommendations.

The Government's Financial Market Development Task Force submitted its first phase recommendations to the Financial Secretary last June. Since then, the SFC has been working with the Administration and the HKEx to implement the "Quick Win" proposals recommended by the Task Force. These included the facilitation of retail debt issuance by enhancing awareness of offers before and after the registration of a prospectus and streamlining procedures in the prospectus registration and offering processes. The SFC will issue guidelines on new arrangements shortly.

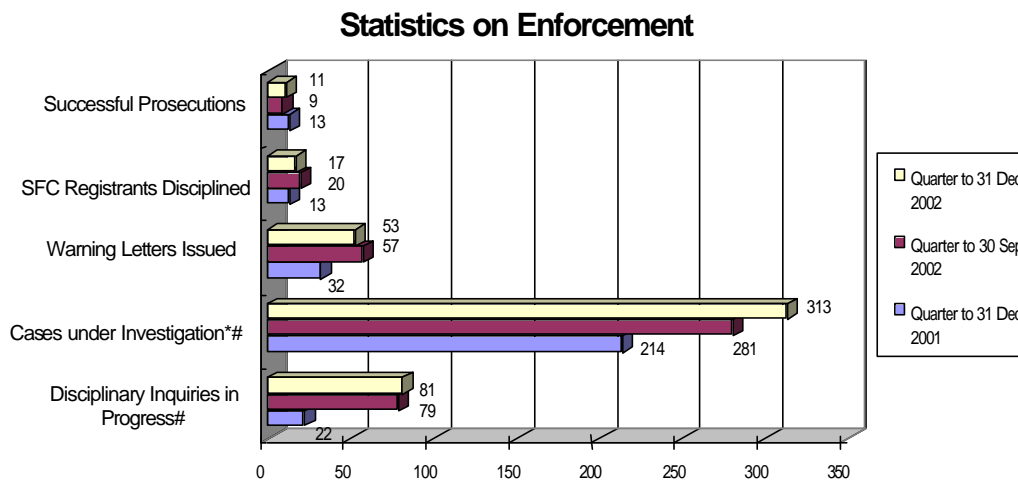
Enforcement

Combating corporate misgovernance remained high on our enforcement agenda. On 23 December, the SFC directed HKEx to suspend trading in the shares of Styland Holdings Limited due to inadequate information disclosure. The stocks had remained suspended in the absence of an announcement that adequately addresses the concerns of the SFC.

In November, the SFC started publishing a monthly newsletter to summarise the SFC's enforcement actions in the previous month, discuss trends of malpractice and provide useful statistics on prosecution and disciplinary actions. Called the *SFC Enforcement Reporter*, the newsletter increases the transparency of the Commission's enforcement work and helps strengthen investor confidence.

During the quarter, the SFC successfully prosecuted 11 firms and persons. Seven were prosecuted for failing to comply with the Securities (Disclosure of Interests) Ordinance, two for breaching the Protection of Investors Ordinance, one each for market manipulation and illegal short selling.

A total of 17 SFC registrants were disciplined for misconduct. Among them, a dealer's representative had her registration revoked. The registrations of four others were suspended while the remaining 12 registrants were reprimanded. There were 81 disciplinary inquiries in progress.



* Some cases are ongoing investigations from the previous quarters.

Number of cases as at end of quarters

Strengthening Communication with Investors and Other Stakeholders

In preparation for the imminent implementation of the SFO, the SFC published on its website and the Electronic Investor Resources Centre (eIRC) educational articles to promote investor awareness and explain how the law will benefit them. We will also publish a booklet and produce a video to familiarise investors with the Ordinance and help them understand the SFC's work.



With the authorisation of retail hedge funds in November, we produced a leaflet entitled *Ten Questions to Ask Before Investing in a Fund* to advise investors the points to note before investing in funds, in particular hedge funds. Two more educational articles were published to explain the regulatory safeguards and help investors find key facts from a prospectus.

Since 2000, the SFC has been organising workshops for secondary school teachers so they can share with students the key concepts of investing. During the quarter, 11 workshops covering the areas of stocks, funds, and options & futures were held for about 500 teachers.

A Personal Financial Management course jointly organised by the SFC and the General Education Unit of the University of Hong Kong ended in November. About 250 university students had attended the popular lectures.

During the quarter, the SFC received 855 investor enquiries and 260 public complaints against registrants, listed companies and market misconduct. These compared with 1,110 enquiries and 282 complaints in the previous quarter, and 755 and 204 cases a year ago.

In the meantime, the SFC continued to publish its newsletter, *SFC Alert*, to bring the latest news about the Commission and its work to intermediaries and investors.

To further promote dialogue with the market, the SFC in November began a monthly forum with brokers to discuss issues of common interest and involve them in the early stages of policy consultation. The regular meetings help deepen understanding between the regulator and the practitioners, and will benefit the Hong Kong market as a whole.

International Co-operation and External Relations


The SFC continued to participate actively in the work of the IOSCO (International Organisation of Securities Commissions). In November, we hosted a two-day meeting of the IOSCO Standing Committee 1 in Hong Kong where regulators discussed the latest issues on accounting standards and financial reporting.

In the area of enforcement co-operation, the SFC received 12 requests from overseas regulators: two seeking assistance, three seeking public information and seven seeking non-public information. The SFC also made seven requests to overseas regulators for investigatory assistance.

During the quarter, the SFC welcomed seven PRC delegations, including representatives of the China Securities Regulatory Commission and Shanghai Stock Exchanges, and three overseas delegations.

Looking Ahead

We are committed to working with the industry in partnership to implement the SFO. We urge market practitioners to ensure that they have in place all the necessary processes and systems to comply with the legislation. If they expect any problems, the SFC stands ready to help where we can.



We understand the public's concerns about corporate governance and quality of the market. We are working closely with the Government, HKEx, market practitioners and professional bodies like Hong Kong Society of Accountants, to consider various options to enhance the quality of listed companies and IPO intermediaries. We are monitoring the developments in major international markets with a view to introducing the most suitable regulatory measures to raise Hong Kong's corporate governance standards.

Market conditions have not shown signs of major revival. Instead, we expect a further decline in revenue. We will use our resources effectively. Despite the additional costs incurred in the recruitment of staff to implement the dual filing regime, by keeping a tight rein on the Commission's expenditure, we expect to keep the deficit for the year below \$79 million, as projected in the latest budget review exercise.

Andrew Sheng
Chairman

14 February 2003

Securities and Futures Commission

Income and Expenditure Account

For the nine months ended 31 December 2002

(Expressed in Hong Kong Dollars)

	Note	Unaudited Three Months Ended		Unaudited Nine Months Ended	
		31 Dec 2002	31 Dec 2001	31 Dec 2002	31 Dec 2001
		\$'000	\$'000	\$'000	\$'000
Income					
Levies		42,487	46,654	143,279	155,088
Fees and charges		30,224	26,174	88,275	85,343
Investment income		8,507	8,956	25,621	32,809
Other income		<u>301</u>	<u>405</u>	<u>1,128</u>	<u>1,060</u>
		<u>81,519</u>	<u>82,189</u>	<u>258,303</u>	<u>274,300</u>
Expenses					
Staff costs		75,464	80,476	227,823	242,152
Premises					
- rent		5,002	5,003	15,007	15,007
- other		2,698	2,798	8,350	8,416
Other expenses		<u>7,810</u>	<u>12,509</u>	<u>25,479</u>	<u>34,447</u>
		90,974	100,786	276,659	300,022
Depreciation		<u>6,014</u>	<u>6,979</u>	<u>16,951</u>	<u>17,891</u>
		96,988	107,765	293,610	317,913
		<u>96,988</u>	<u>107,765</u>	<u>293,610</u>	<u>317,913</u>
Deficit	2	<u>(15,469)</u>	<u>(25,576)</u>	<u>(35,307)</u>	<u>(43,613)</u>

We have not prepared a separate statement of recognised gains and losses as the deficit would be the only component of such a statement.

The notes on pages 14 and 15 form an integral part of the condensed financial statements.

Securities and Futures Commission

Balance Sheet

At 31 December 2002

(Expressed in Hong Kong Dollars)

	<u>Note</u>	<u>Unaudited</u> <u>At 31 Dec 2002</u> \$'000	<u>Audited</u> <u>At 31 Mar 2002</u> \$'000
Non-current assets			
Fixed assets		32,850	39,868
Held-to-maturity debt securities	3	305,124	298,110
Current assets			
Held-to-maturity debt securities	3	226,537	319,113
Bank deposits		57,432	38,815
Debtors, deposits and prepayments		23,861	24,049
Cash at bank and in hand		<u>567</u>	<u>1,076</u>
		<u>308,397</u>	<u>383,053</u>
Current liabilities			
Provision for contribution to the Unified Exchange Compensation Fund		-	30,000
Fees received in advance		35,719	33,301
Creditors and accrued charges		<u>21,966</u>	<u>33,737</u>
		<u>57,685</u>	<u>97,038</u>
Net current assets		<u>250,712</u>	<u>286,015</u>
Net assets		<u>588,686</u>	<u>623,993</u>
Funding and reserves			
Initial funding by Government		42,840	42,840
Accumulated surplus	2	<u>545,846</u>	<u>581,153</u>
		<u>588,686</u>	<u>623,993</u>

The notes on pages 14 and 15 form part of the condensed financial statements.

Securities and Futures Commission

Cash Flow Statement

For the nine months ended 31 December 2002

(Expressed in Hong Kong dollars)

	Unaudited Nine months ended 31 Dec 2002 \$'000	Unaudited Nine months ended 31 Dec 2001 \$'000
Net cash outflow from operating activities	(49,768)	(54,581)
Returns on investments - interest received	25,404	29,630
Payment to the Unified Exchange Compensation Fund	(30,000)	(36,174)
Investing activities		
Held-to-maturity debt securities bought	(33,524)	-
Held-to-maturity debt securities redeemed	118,200	244,000
Fixed assets bought	(12,204)	(19,067)
Fixed assets sold	-	93
Net cash inflow from investing activities	72,472	225,026
Increase in cash and cash equivalents	18,108	163,901
Cash and cash equivalents at beginning of the nine months	39,891	107,093
Cash and cash equivalents at end of the nine months	57,999	270,994
Reconciliation of deficit of income over expenses to net cash outflow from operating activities :		
Deficit	(35,307)	(43,613)
Investment income	(25,621)	(32,809)
Depreciation	16,951	17,891
Loss/(profit) on sale of fixed assets	1	(43)
Decrease in debtors, deposits and prepayments	1,291	10,463
Decrease in creditors and accrued charges	(9,501)	(10,701)
Increase in fees received in advance	2,418	4,231
Net cash outflow from operating activities	(49,768)	(54,581)
Analysis of the balance of cash and cash equivalents :		
	Unaudited At 31 Dec 2002 \$'000	Unaudited At 31 Dec 2001 \$'000
Bank deposits	57,432	270,191
Cash at bank and in hand	567	803
	57,999	270,994

Securities and Futures Commission

Notes to the Condensed Financial Statements
For the nine months ended 31 December 2002
(Expressed in Hong Kong dollars)

1. Basis of preparation

We have prepared the interim financial report in accordance with the requirements of the Main Board Listing Rules of The Stock Exchange of Hong Kong Limited, including compliance with International Accounting Standard 34 "Interim financial reporting" adopted by the International Accounting Standards Board.

The interim financial report is unaudited and the financial information relating to the financial year ended 31 March 2002 included in this report does not constitute the SFC's statutory financial statements for that financial year but is derived from those financial statements.

We have applied the same accounting policies adopted in the financial statements for the year ended 31 March 2002 to the interim financial report.

There were no significant changes in the operation of the SFC for the nine months ended 31 December 2002.

2. Accumulated surplus

Movements of accumulated surplus during the nine months ended 31 December 2002 are as follows :

	<u>Unaudited</u>
	\$'000
Balance at 31 March 2002	581,153
Deficit for the period	(35,307)
	<hr/>
Balance at 31 December 2002	<u>545,846</u>

3. Held-to-maturity debt securities

As of 31 December 2002, the total market value of held-to-maturity debt securities amounted to \$550,444,000 (31 March 2002 : \$632,989,000), which was above the total carrying cost of \$531,661,000 (31 March 2002 : \$617,223,000).



Securities and Futures Commission

Notes to the Condensed Financial Statements
For the nine months ended 31 December 2002
(Expressed in Hong Kong dollars)

4. Ageing analysis of debtors and creditors

There was no material debtor balance and creditor balance included in "debtors, deposits and prepayments" and "creditors and accrued charges" respectively as at 31 December 2002. Therefore we do not provide ageing analysis on debtors and creditors.

5. Exchange fluctuation

All our balance sheet items are denominated in either United States dollars or Hong Kong dollars, and, as a result, we are not exposed to significant exchange rate risk.

6. Investments in subsidiaries

We recognised our investment in FinNet Limited (FinNet) and Investor Compensation Company Limited (ICC) since 31 March 2002.

The SFC formed FinNet on 6 November 2000 with an authorised share capital of \$10,000 and issued share capital of \$2 and ICC on 11 September 2002 with an authorised share capital of \$1,000 and issued share capital of \$0.2.

The objective of FinNet is to operate an electronic network to facilitate payment and delivery transactions and interconnection of all financial institutions and financial entities in Hong Kong.

The objective of ICC is to perform functions relating to the compensation of investors and other functions under Parts III and XII of the Securities and Futures Ordinance.

Both companies are wholly owned subsidiaries of the SFC. However, they were not shown in the balance sheet which was expressed in thousand dollars.

Both companies have not commenced operation. The balance sheets of the companies as at 31 December 2002 and the income and expenditure accounts for the nine months then ended were immaterial. Therefore, we have not prepared consolidated financial statements.



Unified Exchange Compensation Fund (the Fund)

Report of the Securities Compensation Fund Committee (the Committee)

The members of the Committee present their quarterly report and the unaudited condensed financial statements for the nine months ended 31 December 2002.

1. ESTABLISHMENT OF THE FUND

Part X of the Securities Ordinance (Chapter 333) established the Fund.

2. FINANCIAL RESULTS

The Committee presents the financial results which are set out in the condensed financial statements on pages 17 to 23.

3. MEMBERS OF THE COMMITTEE

The members of the Committee during the nine months and up to the date of this report were: -

Mr. Mark Dickens, JP
Mrs. Alexa Lam
Mr. David M. Roberts
Mr. Kwong Ki Chi, GBS
Mr. T. Brian Stevenson, SBS

4. INTERESTS IN CONTRACTS

No contract of significance to which the Fund was a party and in which a Committee Member had a material interest, whether directly or indirectly, subsisted at the balance sheet date or at any time during the nine months ended 31 December 2002.

On behalf of the Committee

Mark Dickens
Chairman

23 January 2003

Unified Exchange Compensation Fund

Income and Expenditure Account

For the nine months ended 31 December 2002

(Expressed in Hong Kong dollars)

	Unaudited Three Months Ended		Unaudited Nine Months Ended	
	<u>31 Dec 2002</u> \$'000	<u>31 Dec 2001</u> \$'000	<u>31 Dec 2002</u> \$'000	<u>31 Dec 2001</u> \$'000
Income				
Investment income	9,717	8,539	32,434	28,512
Net unrealised gain / (loss) on revaluation of debt securities	(3,682)	-	5,726	-
	<u>6,035</u>	<u>8,539</u>	<u>38,160</u>	<u>28,512</u>
Expenses				
Loss on redemption of debt securities	411	-	3,376	-
Auditors' remuneration	10	10	31	31
Bank charges	52	83	203	158
Exchange difference	-	-	11	-
Professional fees	46	633	149	761
Sundry expenses	-	-	1	1
	<u>519</u>	<u>726</u>	<u>3,771</u>	<u>951</u>
Surplus	5,516	7,813	34,389	27,561
Accumulated surplus brought forward	<u>266,651</u>	<u>211,282</u>	<u>237,778</u>	<u>191,534</u>
Accumulated surplus carried forward	<u>272,167</u>	<u>219,095</u>	<u>272,167</u>	<u>219,095</u>

The notes on pages 21 to 23 form part of the condensed financial statements.

Unified Exchange Compensation Fund

Balance Sheet

At 31 December 2002

(Expressed in Hong Kong dollars)

	Note	Unaudited At 31 Dec 2002 \$'000	Audited At 31 Mar 2002 \$'000
Current assets			
Debt securities	6	680,432	728,519
Contributions receivable		-	30,000
Interest receivable		5,771	8,383
Levy receivable		4,171	6,248
Bank fixed and call deposits		207,781	49,723
Cash at bank		32	211
		<u>898,187</u>	<u>823,084</u>
Current liabilities			
Accounts payable and accrued charges		3,000	2,724
Provision for compensation	3	<u>46,998</u>	<u>40,613</u>
		<u>49,998</u>	<u>43,337</u>
Net current assets		<u>848,189</u>	<u>779,747</u>
Net assets		<u>848,189</u>	<u>779,747</u>
Representing:			
Compensation fund			
Contributions from the SEHK		46,450	46,450
less: Compensation paid	2	(83,873)	(80,743)
Provision for compensation	3	(17,902)	(12,343)
add: Recoveries	4	10,002	11,277
Replenishments from the SEHK		<u>16,360</u>	<u>16,360</u>
		<u>(28,963)</u>	<u>(18,999)</u>
Excess transaction levy from the SEHK		353,787	353,787
Special contribution		3,500	3,500
Additional contribution from the SEHK		300,000	300,000
Additional contribution from the SFC		330,000	330,000
Special levy surplus		3,002	3,002
Transaction levy	5	94,173	41,181
Accumulated surplus		<u>272,167</u>	<u>237,778</u>
		1,356,629	1,269,248
less: Compensation paid	2	(450,381)	(442,232)
Provision for compensation	3	<u>(29,096)</u>	<u>(28,270)</u>
		<u>877,152</u>	<u>798,746</u>
		<u>848,189</u>	<u>779,747</u>

The notes on pages 21 to 23 form part of the condensed financial statements.

Unified Exchange Compensation Fund

Statement of Recognised Gains and Losses
For the nine months ended 31 December 2002
(Expressed in Hong Kong dollars)

	<u>Note</u>	Unaudited Nine Months Ended <u>31 Dec 2002</u> \$'000	Unaudited Nine Months Ended <u>31 Dec 2001</u> \$'000
Recoveries received	4	593	2,494
Recoveries re-distributed to claimants	4	(1,868)	(2,482)
(Increase) / decrease in provision for compensation		(6,385)	64,349
Compensation paid out of the Fund	2	(11,279)	(11,998)
Transaction levy	5	52,992	22,993
Net gains not recognised in the income and expenditure account		34,053	75,356
Surplus		34,389	27,561
Total recognised gains		<u>68,442</u>	<u>102,917</u>

The notes on pages 21 to 23 form part of the condensed financial statements.

Unified Exchange Compensation Fund

Cash Flow Statement

For the nine months ended 31 December 2002

(Expressed in Hong Kong dollars)

	Unaudited Nine Months Ended 31 Dec 2002 \$'000	Unaudited Nine Months Ended 31 Dec 2001 \$'000
Net cash (outflow) / inflow from operating activities	(108)	1,191
Returns on investments - interest received	35,046	28,921
Investing activities		
Debt securities redeemed	270,000	123,000
Debt securities bought	(219,575)	(250,562)
Net cash inflow / (outflow) from investing activities	50,425	(127,562)
Financing		
Recoveries received	593	2,494
Recoveries re-distributed to claimants	(1,868)	(2,482)
Transaction levy received	55,070	17,871
Compensation paid	(11,279)	(11,998)
Additional contribution from the SEHK	-	36,174
Additional contribution from the SFC	30,000	36,173
Net cash inflow from financing	72,516	78,232
Increase / (decrease) in cash and cash equivalents	157,879	(19,218)
Cash and cash equivalents at beginning of the nine months	49,934	132,185
Cash and cash equivalents at end of the nine months	207,813	112,967
Reconciliation of surplus for the nine months to net cash (outflow) / inflow from operating activities:		
Surplus	34,389	27,561
Investment income	(32,434)	(28,512)
Unrealised gain on revaluation of debt securities	(5,726)	-
Loss on redemption of debt securities	3,376	-
Exchange loss	11	-
Increase in accounts payable and accrued charges	276	2,142
Net cash (outflow) / inflow from operating activities	(108)	1,191
Analysis of changes in financing:		
	<u>Recoveries</u>	<u>Compensation Paid</u>
Balance at 1 April 2001	9,854	(501,975)
Cash inflow / (outflow) from financing	12	(11,998)
Balance at 31 December 2001	9,866	(513,973)
Balance at 1 April 2002	11,277	(522,975)
Cash outflow from financing	(1,275)	(11,279)
Balance at 31 December 2002	10,002	(534,254)
Analysis of the balance of cash and cash equivalents:		
	<u>Unaudited At 31 Dec 2002 \$'000</u>	<u>Unaudited At 31 Dec 2001 \$'000</u>
Cash at bank	32	99
Bank fixed and call deposits	207,781	112,868
	207,813	112,967

Unified Exchange Compensation Fund
Notes to the Condensed Financial Statements
For the nine months ended 31 December 2002
(Expressed in Hong Kong dollars)



1. ACCOUNTING POLICIES

We have prepared the interim financial report in accordance with the requirements of the Main Board Listing Rules of the Stock Exchange of Hong Kong Limited, including compliance with International Accounting Standard 34 "Interim financial reporting" adopted by the International Accounting Standards Board.

The interim financial report is unaudited and the financial information relating to the financial year ended 31 March 2002 included in this report does not constitute the Fund's statutory financial statements for that financial year but is derived from those financial statements.

We have applied the same accounting policies adopted in the financial statements for the year ended 31 March 2002 to the interim financial report.

2. COMPENSATION PAID

	\$'000
Compensation paid up to the \$8 million limit as set out in Section 109(3) of the Securities Ordinance	
Balance as at 1 April 2001	72,582
Add: compensation paid during the year ended 31 March 2002	<u>8,161</u>
Balance as at 31 March 2002	80,743
Add: compensation paid during the nine months ended 31 December 2002	<u>3,130</u>
Balance as at 31 December 2002	<u>83,873</u>
Compensation paid in excess of the \$8 million limit pursuant to Section 113(5A) of the Securities Ordinance	
Balance as at 1 April 2001	429,393
Add: compensation paid during the year ended 31 March 2002	<u>12,839</u>
Balance as at 31 March 2002	442,232
Add: compensation paid during the nine months ended 31 December 2002	<u>8,149</u>
Balance as at 31 December 2002	<u>450,381</u>
Total compensation paid as at 31 March 2002	<u>522,975</u>
Total compensation paid as at 31 December 2002	<u>534,254</u>

Unified Exchange Compensation Fund

Notes to the Condensed Financial Statements

For the nine months ended 31 December 2002

(Expressed in Hong Kong dollars)

2. COMPENSATION PAID - Cont'd

In eight defaults since 1998, the SEHK proposed and the SFC approved increases in the \$8 million limit via payment of up to \$150,000 per claimant or if higher the claimant's proportional share of the \$8 million limit. The relevant defaults where we made payments during the nine months ended 31 December 2002 were:

Chark Fung Securities Co. Ltd.	\$348,000
Foreground Securities Co. Ltd.	\$4,108,000
Lawsons Securities Company	\$783,000
Win Successful Securities Ltd.	\$6,040,000

3. PROVISION FOR COMPENSATION

	\$'000
Provision for compensation to be paid up to the \$8 million limit	
Balance as at 1 April 2001	10,880
Less: amount paid during the year ended 31 March 2002	(8,161)
unused provision reversed during the year ended 31 March 2002	(372)
Add: additional provision made for the year ended 31 March 2002	<u>9,996</u>
Balance as at 31 March 2002	12,343
Add: additional provision made during the nine months ended 31 December 2002	8,689
Less: amount paid during the nine months ended 31 December 2002	<u>(3,130)</u>
Balance as at 31 December 2002	<u>17,902</u>
Provision for compensation to be paid in excess of the \$8 million limit	
Balance as at 1 April 2001	112,400
Less: amount paid during the year ended 31 March 2002	(12,839)
unused provision reversed during the year ended 31 March 2002	(84,701)
Add: additional provision made during the year ended 31 March 2002	<u>13,410</u>
Balance as at 31 March 2002	28,270
Less: amount paid during the nine months ended 31 December 2002	(8,149)
unused provision reversed during the nine months ended 31 December 2002	(3,206)
Add: additional provision made during the nine months ended 31 December 2002	<u>12,181</u>
Balance as at 31 December 2002	<u>29,096</u>



Unified Exchange Compensation Fund
Notes to the Condensed Financial Statements
For the nine months ended 31 December 2002
(Expressed in Hong Kong dollars)

3. PROVISION FOR COMPENSATION - Cont'd

We made provision for unprocessed claims in respect of seven SEHK exchange participants for which the SEHK has published a notice calling for claims pursuant to Section 112 of the Securities Ordinance. The maximum liabilities of the Fund in respect of six of these default cases can exceed the normal \$8 million limit. In respect of two of these default cases, we revised the provision according to claims being processed.

4. RECOVERIES

In exercising its subrogated rights, the SFC recovered \$593,000 for the Fund in the nine months ended 31 December 2002 (nine months ended 31 December 2001 : \$2,494,000). During the nine months, the Fund re-distributed recoveries of \$1,868,000 to claimants (nine months ended 31 December 2001 : \$2,482,000).

5. TRANSACTION LEVY

With effect from 1 September 2001, the Fund would receive transaction levy at 0.002% chargeable for every leviable transaction in the SEHK. During the nine months ended 31 December 2002, the Fund recognised \$52,992,000 transaction levy (nine months ended 31 December 2001: \$22,993,000).

6. DEBT SECURITIES

As we have prepared the interim financial report on a break-up basis, we stated debt securities at fair value with any resultant unrealised gain or loss recognised in the income and expenditure account.

7. CONTINGENT LIABILITIES

As at the date of this report, the SEHK has received claims against eight exchange participants. They are subject to the normal \$8 million ceiling pursuant to Section 109 of the Securities Ordinance. The validity of these claims is under investigation. We have not made any provision for these claims. The maximum contingent liability of the Fund to these claims is \$64 million (as at 31 March 2002 : \$56 million).



Commodity Exchange Compensation Fund (the Fund)

Report of the Futures Compensation Fund Committee (the Committee)

The members of the Committee present their quarterly report and the unaudited condensed financial statements for the nine months ended 31 December 2002.

1. ESTABLISHMENT OF THE FUND

Part VIII of the Commodities Trading Ordinance (Chapter 250) established the Fund.

2. FINANCIAL RESULTS

The Committee presents the financial results which are set out in the condensed financial statements on pages 25 to 29.

3. MEMBERS OF THE COMMITTEE

The members of the Committee during the nine months and up to the date of this report were:-

Mr. Mark Dickens, JP
Mrs. Alexa Lam
Mr. William D. Grossman
Mr. Mark Ho
Mr. T. Brian Stevenson, SBS

4. INTERESTS IN CONTRACTS

No contract of significance to which the Fund was a party and in which a Committee Member had a material interest, whether directly or indirectly, subsisted at the balance sheet date or at any time during the nine months ended 31 December 2002.

On behalf of the Committee

Mark Dickens
Chairman

23 January 2003

Commodity Exchange Compensation Fund

Income and Expenditure Account

For the nine months ended 31 December 2002

(Expressed in Hong Kong dollars)

	Unaudited		Unaudited	
	Three Months Ended		Nine Months Ended	
	31 Dec 2002	31 Dec 2001	31 Dec 2002	31 Dec 2001
	\$'000	\$'000	\$'000	\$'000
Income				
Investment income	1,640	1,155	5,161	4,383
Net unrealised gain / (loss) on revaluation of debt securities	(823)	-	302	-
	<u>817</u>	<u>1,155</u>	<u>5,463</u>	<u>4,383</u>
	-----	-----	-----	-----
Expenses				
Realised loss on redemption of debt securities	132	-	390	-
Auditors' remuneration	10	10	31	31
Bank charges	11	28	45	54
Professional fees	5	4	23	33
Sundry expenses	-	-	1	1
	<u>158</u>	<u>42</u>	<u>490</u>	<u>119</u>
	-----	-----	-----	-----
Surplus	659	1,113	4,973	4,264
Accumulated surplus brought forward	<u>46,955</u>	<u>38,747</u>	<u>42,641</u>	<u>35,596</u>
	-----	-----	-----	-----
Accumulated surplus carried forward	<u><u>47,614</u></u>	<u><u>39,860</u></u>	<u><u>47,614</u></u>	<u><u>39,860</u></u>

The notes on page 29 form part of the condensed financial statements.

Commodity Exchange Compensation Fund

Balance Sheet

At 31 December 2002

(Expressed in Hong Kong dollars)

	Note	Unaudited At 31 Dec 2002 \$'000	Audited At 31 Mar 2002 \$'000
Current assets			
Debt securities	4	102,103	111,159
Interest receivable		923	1,154
Levy receivable		516	481
Bank fixed and call deposits		22,527	3,677
Cash at bank		227	60
		<u>126,296</u>	<u>116,531</u>
Current liabilities			
Accounts payable and accrued charges		243	253
		<u>243</u>	<u>253</u>
Net current assets		<u>126,053</u>	<u>116,278</u>
Net assets		<u>126,053</u>	<u>116,278</u>
Representing:			
<u>Compensation fund</u>			
Contributions from HKFE	2	21,400	21,600
Contract levy	3	68,645	63,643
Accumulated surplus		47,614	42,641
		<u>137,659</u>	<u>127,884</u>
Deduct: Compensation paid		(24,457)	(24,457)
Add: Recoveries		12,851	12,851
		<u>126,053</u>	<u>116,278</u>

The notes on page 29 form part of the condensed financial statements.

Commodity Exchange Compensation Fund

Statement of Recognised Gains and Losses
For the nine months ended 31 December 2002
(Expressed in Hong Kong dollars)

	<u>Note</u>	Unaudited Nine Months Ended <u>31 Dec 2002</u> \$'000	Unaudited Nine Months Ended <u>31 Dec 2001</u> \$'000
Net contribution from / (refund to) HKFE		(200)	200
Contract levy	3	<u>5,002</u>	<u>4,524</u>
Net gains not recognised in the income and expenditure account		4,802	4,724
Surplus		<u>4,973</u>	<u>4,264</u>
Total recognised gains		<u><u>9,775</u></u>	<u><u>8,988</u></u>

The notes on page 29 form part of the condensed financial statements.

Commodity Exchange Compensation Fund

Cash Flow Statement

For the nine months ended 31 December 2002

(Expressed in Hong Kong dollars)

	Unaudited Nine Months Ended 31 Dec 2002 \$'000	Unaudited Nine Months Ended 31 Dec 2001 \$'000
Net cash outflow from operating activities	(110)	(129)
Returns on investments - interest received	5,392	4,754
Investing activities		
Debt securities redeemed	25,700	39,500
Debt securities bought	(16,732)	(56,750)
Net cash inflow / (outflow) from investing activities	8,968	(17,250)
Financing		
Net contribution (refunded to) / from HKFE	(200)	200
Contract levy received	4,967	4,685
Net cash inflow from financing	4,767	4,885
Increase / (Decrease) in cash and cash equivalents	19,017	(7,740)
Cash and cash equivalents at beginning of the nine months	3,737	19,149
Cash and cash equivalents at end of the nine months	<u>22,754</u>	<u>11,409</u>
Reconciliation of surplus for the nine months to net cash outflow from operating activities:		
Surplus	4,973	4,264
Investment income	(5,161)	(4,383)
Unrealised gain on revaluation of debt securities	(302)	-
Loss on redemption of debt securities	390	-
Decrease in accounts payable and accrued charges	(10)	(10)
Net cash outflow from operating activities	<u>(110)</u>	<u>(129)</u>
Analysis of the balance of cash and cash equivalents:		
	Unaudited At 31 Dec 2002 \$'000	Unaudited At 31 Dec 2001 \$'000
Cash at bank	227	24
Bank fixed and call deposits	22,527	11,385
	<u>22,754</u>	<u>11,409</u>

Commodity Exchange Compensation Fund

Notes to the Condensed Financial Statements

For the nine months ended 31 December 2002

(Expressed in Hong Kong dollars)

1. ACCOUNTING POLICIES

We have prepared the interim financial report in accordance with the requirements of the Main Board Listing Rules of the Stock Exchange of Hong Kong Limited, including compliance with International Accounting Standard 34 "Interim financial reporting" adopted by the International Accounting Standards Board.

The interim financial report is unaudited and the financial information relating to the financial year ended 31 March 2002 included in this report does not constitute the Fund's statutory financial statements for that financial year but is derived from those financial statements.

We have applied the same accounting policies adopted in the financial statements for the year ended 31 March 2002 to the interim financial report.

2. CONTRIBUTIONS FROM HKFE

	\$'000
Balance as at 1 April 2001	21,300
Add: Contributions received during the year ended 31 March 2002	800
Deduct: Refunds to HKFE for outgoing holders of trading rights during the year ended 31 March 2002	<u>(500)</u>
Balance as at 31 March 2002	21,600
Add: Contributions received during the nine months ended 31 December 2002	600
Deduct: Refunds to HKFE for outgoing holders of trading rights during the nine months ended 31 December 2002	<u>(800)</u>
Balance as at 31 December 2002	<u>21,400</u>

3. CONTRACT LEVY

During the nine months ended 31 December 2002, the Fund recognised \$5,002,000 contract levy (nine months ended 31 December 2001: \$4,524,000).

4. DEBT SECURITIES

As we have prepared the interim financial report on a break-up basis, we stated debt securities at fair value with any resultant unrealised gain or loss recognised in the income and expenditure account.