



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

# Quarterly Report

Jul - Sep 2003

A large, stylized, 3D-rendered number '2' in a light orange color, positioned centrally on the cover. The background consists of several overlapping, semi-transparent orange rectangular planes that create a sense of depth and movement. The number '2' is slightly offset from the center, appearing to be part of the layered structure.

2003-2004



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*This is the Securities and Futures Commission's second Quarterly Report for the financial year from 1 April 2003 to 31 March 2004. The report aims to enhance the transparency and accountability of the Commission.*

Office : 8th Floor, Chater House, 8 Connaught Road Central, Hong Kong  
Tel : (852) 2840 9222  
Fax : (852) 2521 7836  
Website : [www.hksfc.org.hk](http://www.hksfc.org.hk)  
Electronic Investor Resources Centre : [www.hkeirc.org](http://www.hkeirc.org)


Enquiries : General : (852) 2840 9222  
Investor Hotline : (852) 2840 9333  
SFC Infoline : (852) 2840 9393  
Media Hotline : (852) 2840 9287  
E-mail : [enquiry@hksfc.org.hk](mailto:enquiry@hksfc.org.hk)



## Operations Highlights

1 July to 30 September 2003

1. The SFC recorded a surplus of \$17 million in the first half of this financial year instead of a projected deficit of \$47 million. Reserves stood at \$583 million on 30 September.
2. The half-year revenue was \$219 million, 24% higher than that of the same period last year, because levy and fees income had exceeded the original estimates. Total expenditure was \$202 million, 3% higher than a year ago. There was underspending in all expenditure categories except for premises expenditure.
3. Migration to the new licensing regime by intermediaries gathered pace. We continued to provide guidance to the industry.
4. Under dual filing, we reviewed 61 new listing applications from April to September and commented on 24 of them.
5. The SFC and HKEx are analysing the responses to the Consultation Paper on the Regulation of Sponsors and Independent Financial Advisers. The conclusions are expected before the end of 2003.
6. The SFC has been working closely with the China Securities Regulatory Commission and the Mainland industry associations in implementing Mainland's commitment under Closer Economic Partnership Arrangement to simplify the procedures for SFC licence holders who are Hong Kong permanent residents applying for securities and futures industry qualifications in the Mainland.
7. The SFC successfully concluded the review of Chapter 20 of the Listing Rules of HKEx for streamlining the listing of SFC-authorized collective investment schemes. The new Chapter 20 became effective on 1 September.
8. The Code on Real Estate Investment Trusts was gazetted and became effective on 15 August.
9. The consultation conclusions for a proposed scripless securities market were published in September. The proposed split register model was broadly accepted by the industry.
10. During the quarter, the SFC had 20 successful prosecutions and disciplined 25 licensees for regulatory breaches.
11. The SFC for the first time produced a Cantonese documentary video drama, "Know the SFC", to explain its work and the improved regulatory framework under the SFO.
12. Australia was gazetted as an Acceptable Inspection Regime under the Code on Unit Trusts and Mutual Funds on 1 August.

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13. The SFC briefed legislators on the risk facing the securities margin financing industry and the need for these risks to be contained. It is working with the industry on appropriate interim measures to manage down the risks of risky practices.
  14. The SFC has participated in the work of the International Organization of Securities Commissions (IOSCO) on securities analysts. In September, the IOSCO published a Statement of Principles and a set of Core Measures to tackle conflicts of interest faced by sell-side securities analysts.
  15. Mr Andrew Sheng was re-appointed as the SFC Chairman while Mr Raymond Kwok was re-appointed as a Non-Executive Director.

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



## Review of Operations

1 July to 30 September 2003

This is the Commission's second Quarterly Report for the financial year starting 1 April 2003.

During the quarter, global equity markets continued their uptrend in active trading on positive economic data and the US Fed's indication to keep for the moment the benchmark interest rate unchanged at a 45-year low. Local market sentiment was bullish on the signing of Closer Economic Partnership Arrangement (CEPA), the implementation of the Mainland individual visit scheme and inflow of capital to the stock market.

The Hang Seng Index (HSI) gained 17.3% during the quarter to close at 11,230, from 9,577 on 30 June. It had risen 30% compared with 31 March and 20.5% compared with the beginning of 2003. The index reached 11,296 on 24 September, a record high since June 2002.

During the quarter, the average daily turnover on the main board rose 48% to \$12 billion. Average daily turnover of Mainland shares - H shares and red chips - jumped 61% and 59% respectively to \$2.1 billion and \$2.2 billion, compared with a 25% increase for HSI constituent stocks.


The average daily turnover on the Growth Enterprise Market (GEM) in the quarter was \$222 million, 74% higher than the previous quarter. The S&P/HKEx GEM Index gained 8.2% to reach 1,185 on 30 September.

### Financial Highlights

As a result of robust market turnover, the SFC recorded a surplus of \$24.4 million for July-September. This has reversed our financial position from a deficit of \$7.4 million in the first quarter to an accumulated surplus of \$17 million for the first six months of this financial year. This compares favourably to a budgeted projection of half-year deficit of \$47 million.

At the end of September, the reserves stood at \$583 million, equivalent to 1.35 times of the approved annual operating expenditure (including depreciation) of \$433 million.

The operating results were better than expected largely because levy and fees incomes had exceeded the original estimates. We also underspent in all expenditure categories except premises. The premises expenditure was higher due to office relocation costs in June.



Total revenue in the first half was \$219 million, 24% higher than that of the same period last year. The average stock market turnover for the first half of this financial year was \$10.5 billion<sup>1</sup>, up 39.3% from \$7.5 billion in the same period last year.

Fees and charges income rose 17.6% to \$68.3 million for the first six months this year, from \$58.1 million in the same period last year, due to the receipt of dual filing fees from the Stock Exchange. The increase in fees income was partially offset by the decrease in investment income because interest rates remained low and investment funds were drawn down to fund the SFC's operations.

Total expenditure (including depreciation) for the six months was \$202 million, 3% higher than the same period last year mainly because of the office relocation expenditure and additional personnel expenses for dual filing functions.

The total number of staff at the end of September was 406, comprising 370 regular staff and 36 temporary staff. The increase from 402 staff a year earlier was due to dual filing and other operational work.

### **The Securities and Futures Ordinance (SFO)**

The SFO has been implemented smoothly for more than six months since it came into effect on 1 April 2003.

During the quarter, we continued to respond to questions from the industry regarding specific aspects or concerns about the application of various provisions of the primary or subsidiary legislation. We revised and published the Outline of Part XV to assist the market to comply with the disclosure of interest requirements.


We participated in public seminars and sharing sessions, attended by more than 700 market participants, and posted frequently asked questions on our website.

We are considering and formulating amendments to some of the items of subsidiary legislation to address market developments. These include amendments to the Securities and Futures (Price Stabilizing) Rules - which prescribe the circumstances in which price stabilizing action will not be regarded as market misconduct - to recognise the UK regime.

Migration of financial intermediaries to the new regime gathered pace. Around 4,600 intermediaries, representing 25% of all those migrating, had either migrated or lodged their migration applications as at 30 September. More than 2,600 have already received their new licences.

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<sup>1</sup> For income purpose, the turnover figure includes the amount of new fund raisings, which also attract transaction levy.



We also announced new performance pledges on handling licensing applications and published a Licensing Information Booklet to facilitate applications under the new licensing regime.

### **Improving Market Quality**

The dual filing regime under the SFO has been operating successfully. In the six months to 30 September, the SFC had reviewed 61 new listing applications and commented on 24 of them.

The consultation period for the Consultation Paper on the Regulation of Sponsors and Independent Financial Advisers jointly issued by the SFC and Hong Kong Exchanges and Clearing Limited (HKEx) ended on 31 July. A total of 129 responses were received, and the SFC and HKEx are analysing these responses. The conclusions are expected before the end of 2003.


Meanwhile, the SFC is looking forward to the views of the market and the public on the Government's Consultation Paper on Proposals to Enhance Regulation of Listing, which was released in early October. The consultation is to follow up the recommendations made in March by the Expert Group to Review the Operation of the Securities and Futures Market Regulatory Structure. We will work closely with the Administration, HKEx and other parties to improve the quality of the Hong Kong market.

### **Partnership with the Industry**

The numbers of licensees and registered institutions have remained relatively stable. As of 30 September, there were 19,915 licensed persons and 98 registered institutions.

In July, the SFC explained to the Legislative Council's Panel on Financial Affairs the risks facing the securities margin financing industry and the need for these risks to be contained. The SFC will continue to work with the Working Group on Review of Financial Regulatory Framework for Intermediaries on appropriate interim measures to manage down the risks of risky practices, such as the revision of the financial resources rules, enhancement of internal control requirements and strengthening investor education. We issued a press release and educational pamphlets on risks arising from pooling and re-pledging client collateral.

The SFC has been working closely with the China Securities Regulatory Commission (CSRC) and the Mainland industry associations in implementing Mainland's commitment under CEPA to simplify the procedures for SFC licence holders who are Hong Kong permanent residents applying for securities and futures industry qualifications in the Mainland.



<b>Statistical Information and Financial Position of the Securities Industry (Note 1)</b>		
	<b>As at 30 Sep 2003</b>	<b>As at 30 Sep 2002</b>
Total number of Securities Dealers and Securities		
Margin Financiers (SMFs)	655	703
Total number of active cash clients (Note 2)	605,944	568,545
Total number of active margin clients (Note 2)	66,175	59,129
<b>Balance Sheet</b>	<b>(\$ Million)</b>	<b>(\$ Million)</b>
Cash in hand and at bank (Note 3)	69,831	57,482
Amounts receivable from margin clients (Note 4)	12,801	12,564
Amounts receivable from SMFs and clients / other dealers arising from dealing in securities	54,723	36,527
Other assets	40,615	31,070
<b>Total assets</b>	<b>177,970</b>	<b>137,643</b>
Amounts payable to SMFs and clients / other dealers arising from dealing in securities	90,497	60,049
Total borrowings from financial institutions	6,616	5,672
Other liabilities	26,677	21,446
Total shareholders' fund	54,180	50,476
<b>Total liabilities and shareholders' fund</b>	<b>177,970</b>	<b>137,643</b>
<p>Note 1: The data were extracted from the monthly Financial Resources Rules Returns submitted by securities dealers and securities margin financiers. These figures are subject to amendments made by the licensed corporations.</p> <p>Note 2: Active clients as at 30.9.03 refer to clients for whom the licensed corporation is required to prepare and deliver monthly statements of account in respect of the relevant reporting month in accordance with the Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules and active clients as at 30.9.02 refer to those who conducted at least one transaction during the past 12 months.</p> <p>Note 3: Cash in hand and at bank includes trust monies held on behalf of clients.</p> <p>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):</p>		
	<u>As at 30 Sept 2003</u>	<u>As at 30 Sept 2002</u>
	4.11	3.23

## Facilitating Market Development

A Bills Committee of the LegCo proposed in September a work plan for the Companies (Amendment) Bill, which, among other proposals, facilitates the offering of shares and debentures. The parts of the bill dealing with reforms to the prospectus regime are being scrutinised in October and November.

To further facilitate securities offering, we invited market practitioners in July to submit suggestions for reform that would work towards achieving a more efficient, competitive and fair environment for issuers and investors. The SFC will reconvene the group as soon as practicable after reviewing their suggestions, to discuss particular proposals further.

The SFC successfully concluded the review of Chapter 20 of the Listing Rules of HKEx for streamlining the listing of SFC-authorized collective investment schemes. HKEx announced the amendments in August and the new Chapter 20 became effective on 1 September.





The Code on Real Estate Investment Trusts (REITs) and its related consultation conclusions were announced on 30 July. Many of the regulatory restrictions in the draft Code were revised, without compromising investor protection, to reflect market practice and to allow for more flexibility in the development of the REITs market. The Code was gazetted and became effective on 15 August.

To enhance investor knowledge, the SFC issued a leaflet to highlight the characteristics of REITs and the potential investment risks involved. We also participated in discussion forums on REITs arranged by various organisations.

The SFC assisted in the formulation of Government policy with respect to funds eligible for inclusion under the Capital Investment Entrant Scheme. The Security Bureau determines that these funds must be SFC-authorized, managed by SFC licensees and invest in permissible investments stipulated by the Scheme. The SFC is responsible for confirming with the Immigration Department regarding the authorisation status and currency denomination of the funds. As at 30 September, the SFC had confirmed the status of 11 funds.


The findings of the Fund Management Activities Survey of 2002 were released in July. They showed that Hong Kong remained a major fund management centre in the Asia-Pacific region for attracting overseas funds for management. The total number of authorised collective investment schemes increased by 7.8% to reach 2,456 compared with a year ago (see table).

As at the end of the quarter, the SFC had authorised seven hedge funds (five single hedge funds and two fund-of-hedge funds). The SFC continued its efforts to educate the industry and the public on hedge funds.

Number of SFC Authorised Collective Investment Schemes			
	30 Sep 2003	30 Jun 2003	30 Sep 2002
Unit trusts and mutual funds	1,947	1,952	1,823
Investment-linked assurance schemes	138	136	112
Pooled retirement funds	37	37	39
MPF master trust / industry schemes	46	46	49
MPF pooled investment funds (Note1)	252	250	220
Other schemes	36	41	35
<b>Total</b>	<b>2,456</b>	<b>2,462</b>	<b>2,278</b>

Note 1: There are 109 funds included in this category that are offered both as retail unit trusts as well as pooled investment funds for MPF purpose.

Last year, the SFC consulted the public on the proposed scripless securities market - where there would be a scripless Central Clearing and Settlement System (CCASS) Register and an Issuer Register which consists of both scripless and certificated holdings. The consultation conclusions were published in September. The proposed split register model was broadly accepted by the industry. The operational details are contained in a separate HKEx consultation paper.



We consulted the public in September to amend the Securities and Futures (Contracts Limits and Reportable Positions) Rules, so that all persons (as opposed to only Exchange Participants at present) holding or controlling futures or options contracts for clients may apply the limits separately to their own accounts and to the positions they hold or control for each of their clients. This would provide a level playing field without affecting the SFC's ability to monitor market activities.

## Enforcement

Combating corporate misgovernance, serious misconduct by intermediaries and market misconduct remain our enforcement priorities.

During the quarter, the SFC had 20 successful prosecutions, compared with nine in the same period last year. The offences involved included market manipulation, breach of Securities (Disclosure of Interests) Ordinance, non-compliance with the financial resources rules, provision of false information, unregistered advising, failure to maintain trust accounts and failure to attend SFC investigation interviews.

We disciplined 25 licensees for regulatory breaches. There were one revocation, four suspensions of licences and 21 public reprimands.

Statistics of Enforcement Actions			
	Jul - Sep 2003	Apr - Jun 2003	Jul - Sep 2002
Successful prosecutions	20	17	9
SFC licensees disciplined	25	17	20
Warning letters issued	35	47	57
Cases under investigation*#	992	788	281
Disciplinary inquiries in progress#	83	75	79

\* Some cases are ongoing investigations from the previous quarter. The rise in the number of cases under investigation as compared to last year was mainly due to late submission cases under the disclosure of interest requirements of the SFO.  
# Number of cases as at end of quarters.

In this quarter, we received 18 complaints in relation to boiler room operations. Liaison work with other domestic and overseas enforcement bodies in this regard is ongoing.

## Strengthening Communication with Investors and Other Stakeholders

The SFC has for the first time produced a Cantonese documentary video drama, "Know the SFC", to explain its work to the public. It also highlights some significant improvements of the regulatory framework under the SFO. An abridged version was aired on Cable TV in July and August, and the full version is now available in VCD format for free distribution to the public.

As noted above, boiler room scams have become active again, targeting Hong Kong investors. A press release was issued in August to alert the public, and urge them to check the SFC's watch list of unlicensed overseas companies in the event of suspicious cold calls. The advice was widely reported in the media.

The Open University, HKEx and the SFC jointly organised five investor education lectures for the public free of charge in August and September. We are also organising a series of investor education workshops for secondary school teachers of Economics, Commerce and related subjects from September to November to facilitate their teaching work.

In light of the increased investors' interest in the market recently, SFC's TV and radio Announcements of Public Interests reminding the investing public of the importance of "When you invest, bank on facts, not rumours" were re-activated in September. They have since been broadcast frequently including at prime viewing slots.

Statistics of Investor Enquiries and Public Complaints			
	Jul - Sep 2003	Apr - Jun 2003	Jul - Sep 2002
Enquiries	1,376	1,007	1,110
Complaints	292	329	282

The rise in enquiries was mainly due to enquiries made by clients of C.A. Pacific Securities Limited which is under liquidation. Following a court order made in June, the liquidators and the SFC notified the compensation claimants about the procedures of returning shares. Up to 30 September, the SFC Investor Hotline had answered about 370 enquiries from these clients.

We continued to publish our bi-monthly newsletter *SFC Alert*, the monthly *SFC Enforcement Reporter*, the first *Quarterly Report* for 2003-04 and the summer issue of *Quarterly Bulletin* to keep the market abreast of our work and enforcement actions. All these publications are available on the SFC website.


### International Co-operation and External Relations

Australia was gazetted as an Acceptable Inspection Regime under the Code on Unit Trusts and Mutual Funds on 1 August. Subject to conditions, Australian fund managers that have been licensed by the Australian Securities and Investments Commission (ASIC) can manage SFC-authorized funds. This followed a co-operation agreement between the SFC and ASIC signed in June.

The SFC continued to participate in different aspects of the work of the International Organization of Securities Commissions (IOSCO), including the work on the regulation of securities analysts and rating agencies. In September, we attended the meeting of the IOSCO Technical Committee, held in Athens, which endorsed a Statement of Principles and a set of Core Measures to tackle conflicts of interest faced by sell-side securities analysts. We welcome the publication of the principles and measures.

The Commission sent a staff member each to the funds department of CSRC and ASIC for four weeks. We received three secondees from CSRC.

In September, one of our staff worked in Mumbai with a World Bank team advising the Indian authorities on their plans to demutualise and rationalise the many stock exchanges in India.



On enforcement co-operation, the SFC received 12 requests from overseas regulators: three requesting assistance, two seeking public information and seven seeking non-public information. We made three requests to overseas regulators for investigatory assistance.

In August, a Deputy Director of the US Securities and Exchange Commission shared her experience in investor education work in a SFC staff seminar, which was also open to the Hong Kong Monetary Authority, Mandatory Provident Fund Schemes Authority, and Hong Kong Securities Institute.

During the quarter, we welcomed four overseas delegations and five Mainland delegations from the private and public sectors.

### Looking Ahead

I am honoured that the HKSAR Chief Executive Mr Tung Chee Hwa has re-appointed me as the Chairman of the SFC for a period of two years from 1 October 2003. I am grateful for the hard work and support of my colleagues, and the advice of our Non-Executive Directors, members of the Advisory Committee and other advisory groups. In this connection, I am pleased that Mr Raymond Kwok has been re-appointed as a Non-Executive Director for one year until 31 July 2004. I warmly welcome his re-appointment.

The key issue we must address in building our reputation as an international financial centre is market quality. I look forward to working with the Government, HKEx and the wider financial community towards that end.

Although market sentiment has improved and in the first six months we recorded a surplus instead of the projected deficit, we will continue to exercise stringent controls on our expenditure. We forecast that our expenditure for the next quarter will be below our budgeted expenditure by \$4 million.

Andrew Sheng  
Chairman

14 November 2003



# **Independent Review Report**

## **To the Securities and Futures Commission (the SFC)**

**(Established in Hong Kong under the Securities and Futures Ordinance)**

### **Introduction**

We have been instructed by the SFC to review the interim financial report for the six months ended 30 September 2003 set out on pages 12 to 16.

### **Respective responsibilities of directors and auditors**

The directors are responsible for preparing an interim financial report of the SFC to comply with International Accounting Standard 34 “Interim financial reporting” adopted by the International Accounting Standards Board. The interim financial report is the responsibility of, and has been approved by, the directors.

It is our responsibility to form an independent conclusion, based on our review, on the interim financial report and to report our conclusion solely to you, as a body, in accordance with our agreed terms of engagement, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

### **Review work performed**

We conducted our review in accordance with Statement of Auditing Standards 700 “Engagements to review interim financial reports” issued by the Hong Kong Society of Accountants. A review consists principally of making enquiries of management and applying analytical procedures to the interim financial report and based thereon, assessing whether the accounting policies and presentation have been consistently applied unless otherwise disclosed. A review excludes audit procedures such as tests of controls and verification of assets, liabilities and transactions. It is substantially less in scope than an audit and therefore provides a lower level of assurance than an audit. Accordingly we do not express an audit opinion on the interim financial report.

### **Review conclusion**

On the basis of our review, which does not constitute an audit, we are not aware of any material modifications that should be made to the interim financial report for the six months ended 30 September 2003.

KPMG  
Certified Public Accountants  
Hong Kong  
11 November 2003

## Securities and Futures Commission

### Income and Expenditure Account

For the six months ended 30 September 2003

(Expressed in Hong Kong Dollars)

	Note	Unaudited Three Months Ended		Unaudited Six Months Ended	
		30 Sep 2003	30 Sep 2002	30 Sep 2003	30 Sep 2002
		\$'000	\$'000	\$'000	\$'000
<b>Income</b>					
Levies		84,592	46,732	139,061	100,793
Fees and charges		35,261	30,350	68,268	58,051
Investment income		5,415	8,510	10,918	17,115
Other income		<u>315</u>	<u>239</u>	<u>803</u>	<u>827</u>
		<u>125,583</u>	<u>85,831</u>	<u>219,050</u>	<u>176,786</u>
<b>Expenses</b>					
Staff costs		78,368	75,785	155,574	152,358
Premises					
- rent		4,467	5,002	9,469	10,005
- other		3,387	2,825	8,467	5,651
Other expenses		<u>8,218</u>	<u>9,315</u>	<u>15,299</u>	<u>17,669</u>
		94,440	92,927	188,809	185,683
Depreciation		<u>6,763</u>	<u>5,752</u>	<u>13,241</u>	<u>10,937</u>
		<u>101,203</u>	<u>98,679</u>	<u>202,050</u>	<u>196,620</u>
<b>Surplus / (Deficit)</b>	2	<u>24,380</u>	<u>(12,848)</u>	<u>17,000</u>	<u>(19,834)</u>

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

The notes on pages 15 and 16 form part of the condensed financial statements.

# Securities and Futures Commission

## Balance Sheet

At 30 September 2003

(Expressed in Hong Kong Dollars)

	<u>Note</u>	Unaudited <u>At 30 Sep 2003</u> \$'000	Audited <u>At 31 Mar 2003</u> \$'000
<b>Non-current assets</b>			
Fixed assets		45,338	30,976
Held-to-maturity debt securities	3	183,799	388,794
<b>Current assets</b>			
Held-to-maturity debt securities	3	324,050	39,036
Bank deposits		91,477	178,371
Debtors, deposits and prepayments		47,113	25,749
Cash at bank and in hand		<u>1,231</u>	<u>421</u>
		<u>463,871</u>	<u>243,577</u>
<b>Current liabilities</b>			
Fees received in advance		31,182	31,557
Creditors and accrued charges		<u>79,213</u>	<u>66,177</u>
		<u>110,395</u>	<u>97,734</u>
<b>Net current assets</b>		<u>353,476</u>	<u>145,843</u>
<b>Net assets</b>		<u>582,613</u>	<u>565,613</u>
<b>Funding and reserves</b>			
<b>Initial funding by Government</b>		42,840	42,840
<b>Accumulated surplus</b>	2	<u>539,773</u>	<u>522,773</u>
		<u>582,613</u>	<u>565,613</u>

The notes on pages 15 and 16 form part of the condensed financial statements.

## Securities and Futures Commission

### Cash Flow Statement

For the six months ended 30 September 2003

(Expressed in Hong Kong dollars)

	Unaudited Six months ended 30 Sep 2003 \$'000	Unaudited Six months ended 30 Sep 2002 \$'000
<b>Cash flows from operating activities</b>		
Surplus / (deficit) for the period	17,000	(19,834)
Adjustments for:		
Depreciation	13,241	10,937
Investment income	(10,918)	(17,115)
Loss on sale of fixed assets	-	1
	<u>19,323</u>	<u>(26,011)</u>
Increase in debtors, deposits and prepayments	(21,508)	(2,537)
Increase / (decrease) in creditors and accrued charges	9,653	(5,661)
(Decrease) / increase in fees received in advance	<u>(375)</u>	<u>97</u>
Cash generated from / (used in) operations	7,093	(34,112)
Payment to the Unified Exchange Compensation Fund	<u>-</u>	<u>(30,000)</u>
<i>Net cash generated from / (used in) operating activities</i>	<u>7,093</u>	<u>(64,112)</u>
<b>Cash flows from investing activities</b>		
Interest received	13,842	16,091
Held-to-maturity debt securities bought	(82,799)	(33,524)
Held-to-maturity debt securities redeemed	-	118,200
Fixed assets bought	<u>(24,220)</u>	<u>(8,132)</u>
<i>Net cash (used in) / generated from investing activities</i>	<u>(93,177)</u>	<u>92,635</u>
<b>Net (decrease) / increase in cash and cash equivalents</b>	(86,084)	28,523
<b>Cash and cash equivalents at beginning of the six months</b>	<u>178,792</u>	<u>39,891</u>
<b>Cash and cash equivalents at end of the six months</b>	<u>92,708</u>	<u>68,414</u>

### Analysis of the balance of cash and cash equivalents :

	Unaudited At 30 Sep 2003 \$'000	Unaudited At 30 Sep 2002 \$'000
Bank deposits	91,477	67,450
Cash at bank and in hand	<u>1,231</u>	<u>964</u>
	<u>92,708</u>	<u>68,414</u>





# Securities and Futures Commission

## Notes to the Condensed Financial Statements

For the six months ended 30 September 2003

(Expressed in Hong Kong dollars)

### 1. Basis of preparation

We have prepared the interim financial report in accordance 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 2003 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 2003 to the interim financial report.

There were no significant changes in the operation of the SFC for the six months ended 30 September 2003.

### 2. Accumulated surplus

Movements of accumulated surplus during the six months ended 30 September 2003 are as follows :

	\$'000
Balance at 31 March 2003	522,773
Surplus	17,000
	<hr/>
Balance at 30 September 2003	<u>539,773</u>

### 3. Held-to-maturity debt securities

As of 30 September 2003, the total market value of held-to-maturity debt securities amounted to \$522,203,000 (31 March 2003 : \$447,562,000), which was above the total carrying cost of \$507,849,000 (31 March 2003 : \$427,830,000).



## Securities and Futures Commission

Notes to the Condensed Financial Statements  
For the six months ended 30 September 2003  
(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 30 September 2003. 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

The SFC formed FinNet Limited (FinNet) on 6 November 2000 with an authorised share capital of \$10,000 and issued share capital of \$2 and Investor Compensation Company Limited (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 subsidiary of the SFC. However, they were not shown in the balance sheet which was expressed in thousand dollars.

The balance sheets of the companies as at 30 September 2003 and the income and expenditure accounts for the six 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 six months ended 30 September 2003.

### 1. ESTABLISHMENT OF THE FUND

Part X of the Securities Ordinance (Chapter 333) established the Fund. However, when the Securities and Futures Ordinance (SFO) and its subsidiary legislation came into effect from 1 April 2003, the Securities and Futures Commission (SFC) formed a new single investor compensation fund (ICF) to ultimately replace the Fund and the Commodity Exchange Compensation Fund. After allowing sufficient money in the Fund to meet claims against it and its other liabilities, the SFC will transfer the remaining balance of the Fund to the ICF after 1 April 2003.

Part X of the Securities Ordinance shall remain effective in respect of the operation of the Fund to the extent described in Section 74 of the Schedule 10 of the SFO.

### 2. FINANCIAL RESULTS

The Committee presents the financial results which are set out in the condensed financial statements on pages 19 to 24.

### 3. MEMBERS OF THE COMMITTEE

The members of the Committee during the six 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 [membership ceased on 16 April 2003]

Mr. Paul Chow Man Yiu [appointed on 19 May 2003]

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 six months ended 30 September 2003.

On behalf of the Committee

Mark Dickens, JP  
Chairman

5 November 2003



# Independent review report to the board of directors of the Securities and Futures Commission (the SFC)

(Established in Hong Kong under the Securities and Futures Ordinance)

## Introduction

We have been instructed by the SFC to review the interim financial report for the six months ended 30 September 2003 of the Unified Exchange Compensation Fund (the Fund) set out on pages 19 to 24.

## Respective responsibilities of directors and auditors

The SFC is responsible for preparing an interim report of the Fund to comply with International Accounting Standard 34 "Interim financial reporting" adopted by the International Accounting Standards Board. The interim financial report is the responsibility of the SFC, and has been approved by the Securities Compensation Fund Committee.

It is our responsibility to form an independent conclusion, based on our review, on the interim financial report and to report our conclusion solely to you, as a body, in accordance with our agreed terms of engagement, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

## Review work performed

We conducted our review in accordance with Statement of Auditing Standards 700 "Engagements to review interim financial reports" issued by the Hong Kong Society of Accountants. A review consists principally of making enquiries of management and applying analytical procedures to the interim financial report and based thereon, assessing whether the accounting policies and presentation have been consistently applied unless otherwise disclosed. A review excludes audit procedures such as tests of controls and verification of assets, liabilities and transactions. It is substantially less in scope than an audit and therefore provides a lower level of assurance than an audit. Accordingly we do not express an audit opinion on the interim financial report.

## Review conclusion

On the basis of our review, which does not constitute an audit, we are not aware of any material modifications that should be made to the interim financial report for the six months ended 30 September 2003.

KPMG  
Certified Public Accountants  
Hong Kong  
5 November 2003

## Unified Exchange Compensation Fund

### Income and Expenditure Account

For the six months ended 30 September 2003

(Expressed in Hong Kong dollars)

	Note	Unaudited Three Months Ended		Unaudited Six Months Ended	
		30 Sep 2003	30 Sep 2002 (Restated)	30 Sep 2003	30 Sep 2002 (Restated)
		\$'000	\$'000	\$'000	\$'000
<b>Income</b>					
Net investment income		1,232	13,133	5,514	29,160
Transaction levy		-	17,284	(4)	37,383
Compensation refund from claimants	2	27,560	-	28,180	-
Recoveries	3	19,585	534	19,585	593
		<u>48,377</u>	<u>30,951</u>	<u>53,275</u>	<u>67,136</u>
<b>Expenses</b>					
Provision for compensation made		-	6,407	-	28,684
Unused provision for compensation reversed		(1,049)	(89)	(2,971)	(428)
Recoveries re-distributed to claimants		-	-	-	1,298
Auditors' remuneration		11	10	21	21
Bank charges		34	82	76	151
Exchange difference		-	11	-	11
Professional fees		44	56	87	103
Sundry expenses		(15)	-	49	1
		<u>(975)</u>	<u>6,477</u>	<u>(2,738)</u>	<u>29,841</u>
<b>Surplus</b>		49,352	24,474	56,013	37,295
<b>Accumulated deficit brought forward</b>		<u>(158,475)</u>	<u>(244,171)</u>	<u>(165,136)</u>	<u>(256,992)</u>
<b>Accumulated deficit carried forward</b>		<u>(109,123)</u>	<u>(219,697)</u>	<u>(109,123)</u>	<u>(219,697)</u>

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

The notes on pages 22 to 24 form part of the condensed financial statements.

## Unified Exchange Compensation Fund

### Balance Sheet

At 30 September 2003

(Expressed in Hong Kong dollars)

	<u>Note</u>	Unaudited At 30 Sep 2003 \$'000	Audited At 31 Mar 2003 \$'000
<b>Current assets</b>			
Debt securities		263,182	555,930
Equity securities	3	22,746	-
Interest receivable		2,451	5,580
Levy receivable		-	5,607
Fixed and call deposits with banks		42,403	339,687
Cash at bank		<u>28,800</u>	<u>17</u>
		359,582	906,821
		-----	-----
<b>Current liabilities</b>			
Accounts payable and accrued charges		4,722	4,590
Provision for compensation	4	<u>15,284</u>	<u>30,628</u>
		20,006	35,218
		-----	-----
<b>Net current assets</b>		<u>339,576</u>	<u>871,603</u>
		-----	-----
<b>Net assets</b>		<u>339,576</u>	<u>871,603</u>
		-----	-----
Representing:			
<b><u>Compensation fund</u></b>			
Contributions from the SEHK		46,450	46,450
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
Accumulated deficit		<u>(109,123)</u>	<u>(165,136)</u>
		927,616	871,603
Contributions to Investor Compensation Fund	5	<u>(588,040)</u>	-
		<u>339,576</u>	<u>871,603</u>
		-----	-----

The notes on pages 22 to 24 form part of the condensed financial statements.

## Unified Exchange Compensation Fund

### Cash Flow Statement

For the six months ended 30 September 2003

(Expressed in Hong Kong dollars)

	Unaudited Six Months Ended 30 Sep 2003 \$'000	Unaudited Six Months Ended 30 Sep 2002 (Restated) \$'000
<b>Cash flows from operating activities</b>		
Surplus for the period	56,013	37,295
Net investment income	(5,514)	(29,160)
Decrease in levy receivable	5,607	1,727
Increase in equity securities received under subrogation	(22,746)	-
(Decrease) / increase in provision for compensation	(15,344)	20,216
Increase in accounts payable and accrued charges	<u>132</u>	<u>298</u>
<b>Net cash from operating activities</b>	<u>18,148</u>	<u>30,376</u>
<b>Cash flows from investing activities</b>		
Debt securities redeemed	120,000	245,000
Debt securities sold	166,824	-
Debt securities bought	-	(219,563)
Interest received	<u>14,567</u>	<u>25,699</u>
<b>Net cash from investing activities</b>	<u>301,391</u>	<u>51,136</u>
<b>Cash flows from financing activities</b>		
Additional contribution from the SFC	-	30,000
Contributions to Investor Compensation Fund	<u>(588,040)</u>	<u>-</u>
<b>Net cash (used in) / from financing activities</b>	<u>(588,040)</u>	<u>30,000</u>
<b>Net (decrease) / increase in cash and cash equivalents</b>	(268,501)	111,512
<b>Cash and cash equivalents at beginning of the six months</b>	<u>339,704</u>	<u>49,934</u>
<b>Cash and cash equivalents at end of the six months</b>	<u>71,203</u>	<u>161,446</u>

#### Analysis of the balance of cash and cash equivalents:

	Unaudited At 30 Sep 2003 \$'000	Unaudited At 30 Sep 2002 \$'000
Cash at bank	28,800	40
Fixed and call deposits with banks	<u>42,403</u>	<u>161,406</u>
	<u>71,203</u>	<u>161,446</u>



**Unified Exchange Compensation Fund**  
**Notes to the Condensed Financial Statements**  
**For the six months ended 30 September 2003**  
*(Expressed in Hong Kong dollars)*

**1. BASIS OF PREPARATION**

The Fund prepares the interim financial report in accordance with International Accounting Standard 34 "Interim financial reporting" adopted by the International Accounting Standards Board. As the Fund will eventually cease operation as a result of the Securities and Futures Ordinance (SFO) which came into effect from 1 April 2003, the Fund prepares the interim financial report on a break-up basis with assets stated at recoverable amounts.

The interim financial report is unaudited and the financial information relating to the financial year ended 31 March 2003 included in this report does not constitute the Fund's statutory accounts for that financial year but is derived from those accounts.

We adopted a new accounting policy for the year ended 31 March 2003 to recognise receipts (including transaction levy, recoveries and replenishments from the SEHK) and distributions (including provision made for compensation payments and re-distribution of recoveries) as income and expenses respectively in the Fund's income and expenditure account. We applied the same accounting policies adopted in the financial statements for the year ended 31 March 2003 to the interim financial report. We have restated the comparative information for the six months ended 30 September 2002 retrospectively to conform to the new policy.

**2. COMPENSATION REFUND FROM CLAIMANTS**

The joint liquidators of C.A. Pacific Securities Ltd. (in Liquidation) and C.A. Pacific Finance Ltd. (in Liquidation) have obtained the court's approval to distribute shares to all clients, starting from 30 June 2003. The clients could either keep the compensation payment paid by the Fund or return the compensation payment to the Fund to get back the shares allotted to them from the liquidators. If a client elects to retain the compensation payment, the liquidators will give that client's allocated shares to the Fund.

During the six months ended 30 September 2003, the Fund received shares from the liquidators as a result of those clients who chose to keep the compensation payment, which is detailed in note 3. The Fund also received repayments of compensation of \$28,180,000 from those clients who chose to take the allocated shares. This amount has been recognised in the Income and Expenditure Account.

An asset has not been recognised for the amounts to be received from the remaining clients or the liquidators, as it is not practical to measure the financial effect as at the date of this report.



## Unified Exchange Compensation Fund

### Notes to the Condensed Financial Statements

For the six months ended 30 September 2003

(Expressed in Hong Kong dollars)

### 3. EQUITY SECURITIES AND RECOVERIES

In relation to the share distribution from C.A. Pacific Securities Ltd. and C.A. Pacific Finance Ltd., the liquidators had advised SFC that shares were allocated to the Fund under its subrogation rights. The Fund recognised as recoveries the allocation at market value of 30 September 2003 after deducting relevant processing fee.

### 4. PROVISION FOR COMPENSATION

	\$'000
Balance as at 1 April 2002	40,613
Less: amount paid during the year ended 31 March 2003	(25,576)
unused provision reversed during the year ended 31 March 2003	(4,443)
additional provision made for the year ended 31 March 2003	20,034
Add: Net provision made for the year ended 31 March 2003	<u>15,591</u>
Balance as at 31 March 2003	30,628
Less: amount paid during the six months ended 30 September 2003	(12,373)
Less: unused provision reversed during the six months ended 30 September 2003	<u>(2,971)</u>
Balance as at 30 September 2003	<u><u>15,284</u></u>

We made provision for claims in respect of four SEHK exchange participants for which the SEHK has published a notice calling for claims. The maximum liabilities of the Fund in respect of three of these default cases can exceed the normal \$8 million limit.

### 5. CONTRIBUTIONS TO INVESTOR COMPENSATION FUND

When the SFO and its subsidiary legislations came into effect from 1 April 2003, the Securities and Futures Commission (SFC) formed a new single investor compensation fund (ICF) to ultimately replace the Fund and the Commodity Exchange Compensation Fund. Under section 75(2) of Schedule 10 of the SFO, the SFC may after 1 April 2003 pay into the ICF, which came into operation after 1 April 2003, such sum of money from the Fund as it considers appropriate. During the six months ended 30 September 2003, the SFC paid \$588,040,000 into the ICF from the Fund.



## Unified Exchange Compensation Fund

Notes to the Condensed Financial Statements

For the six months ended 30 September 2003

*(Expressed in Hong Kong dollars)*

### 6. MATERIAL RELATED PARTY TRANSACTIONS

During the period, the Fund sold debt securities of nominal value HK\$76 million and US\$11.6 million to the ICF at market price. No gain or loss was recognised by the Fund in respect of the disposal of these debt securities.

### 7. CONTINGENT LIABILITIES

As at the date of this report, the SEHK has received claims against nine 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 \$72 million (As at 31 March 2003 : \$72 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 six months ended 30 September 2003.

### 1. ESTABLISHMENT OF THE FUND

Part VIII of the Commodities Trading Ordinance (Chapter 250) established the Fund. However, when the Securities and Futures Ordinance (SFO) and its subsidiary legislation came into effect from 1 April 2003, the Securities and Futures Commission (SFC) formed a new single investor compensation fund (ICF) to ultimately replace the Fund and the Unified Exchange Compensation Fund. After allowing sufficient money in the Fund to meet claims against it and its other liabilities, the SFC will transfer the remaining balance of the Fund to the ICF after 1 April 2003.

Part VIII of the Commodities Trading Ordinance shall remain effective in respect of the operation of the Fund to the extent described in Section 75(1) of the Schedule 10 of the SFO.

### 2. FINANCIAL RESULTS

The Committee presents the financial results which are set out in the condensed financial statements on pages 27 to 31.

### 3. MEMBERS OF THE COMMITTEE

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

Mr. Mark Dickens, JP	
Mrs. Alexa Lam	
Mr. William D. Grossman	[membership ceased on 13 May 2003]
Mr Lobo Lee	[appointed on 19 May 2003 and membership ceased on 3 June 2003]
Mr. Mark Ho	[membership ceased on 3 June 2003]
Mr. Calvin Tai	[appointed on 16 June 2003]
Mr. Lawrence Fok	[appointed on 16 June 2003]
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 six months ended 30 September 2003.

On behalf of the Committee

Mark Dickens, JP  
Chairman

5 November 2003



# **Independent review report to the board of directors of the Securities and Futures Commission (the SFC)**

**(Established in Hong Kong under the Securities and Futures Ordinance)**

## **Introduction**

We have been instructed by the SFC to review the interim financial report for the six months ended 30 September 2003 of the Commodity Exchange Compensation Fund (the Fund) set out on pages 27 to 31.

## **Respective responsibilities of directors and auditors**

The SFC is responsible for preparing an interim report of the Fund to comply with International Accounting Standard 34 "Interim financial reporting" adopted by the International Accounting Standards Board. The interim financial report is the responsibility of SFC, and has been approved by the Futures Compensation Fund Committee.

It is our responsibility to form an independent conclusion, based on our review, on the interim financial report and to report our conclusion solely to you, as a body, in accordance with our agreed terms of engagement, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

## **Review work performed**

We conducted our review in accordance with Statement of Auditing Standards 700 "Engagements to review interim financial reports" issued by the Hong Kong Society of Accountants. A review consists principally of making enquiries of management and applying analytical procedures to the interim financial report and based thereon, assessing whether the accounting policies and presentation have been consistently applied unless otherwise disclosed. A review excludes audit procedures such as tests of controls and verification of assets, liabilities and transactions. It is substantially less in scope than an audit and therefore provides a lower level of assurance than an audit. Accordingly we do not express an audit opinion on the interim financial report.

## **Review conclusion**

On the basis of our review, which does not constitute an audit, we are not aware of any material modifications that should be made to the interim financial report for the six months ended 30 September 2003.

KPMG  
Certified Public Accountants  
Hong Kong  
5 November 2003

# Commodity Exchange Compensation Fund

## Income and Expenditure Account

For the six months ended 30 September 2003

(Expressed in Hong Kong dollars)

	Unaudited Three Months Ended		Unaudited Six Months Ended	
	<u>30 Sep 2003</u>	<u>30 Sep 2002</u> (Restated)	<u>30 Sep 2003</u>	<u>30 Sep 2002</u> (Restated)
	\$'000	\$'000	\$'000	\$'000
<b>Income</b>				
Net investment income	226	2,094	718	4,646
Contract levy	-	1,762	-	3,271
	<u>226</u>	<u>3,856</u>	<u>718</u>	<u>7,917</u>
	-----	-----	-----	-----
<b>Expenses</b>				
Auditors' remuneration	10	11	21	21
Bank charges	10	20	18	34
Professional fees	15	14	19	18
Sundry expenses	-	-	1	1
	<u>35</u>	<u>45</u>	<u>59</u>	<u>74</u>
	-----	-----	-----	-----
<b>Surplus</b>	191	3,811	659	7,843
<b>Accumulated surplus brought forward</b>	<u>108,081</u>	<u>98,710</u>	<u>107,613</u>	<u>94,678</u>
	-----	-----	-----	-----
<b>Accumulated surplus carried forward</b>	<u><u>108,272</u></u>	<u><u>102,521</u></u>	<u><u>108,272</u></u>	<u><u>102,521</u></u>

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

The notes on pages 30 to 31 form part of the condensed financial statements.

## Commodity Exchange Compensation Fund

### Balance Sheet

At 30 September 2003

(Expressed in Hong Kong dollars)

	<u>Note</u>	<u>Unaudited</u> <u>At 30 Sep 2003</u> \$'000	<u>Audited</u> <u>At 31 Mar 2003</u> \$'000
<b>Current assets</b>			
Debt securities		10,022	75,633
Interest receivable		153	957
Levy receivable		-	772
Fixed and call deposits with banks		13,412	51,767
Cash at bank		26	136
		<u>23,613</u>	<u>129,265</u>
<b>Current liabilities</b>			
Accounts payable and accrued charges		231	252
		<u>23,382</u>	<u>129,013</u>
<b>Net current assets</b>			
		<u>23,382</u>	<u>129,013</u>
<b>Net assets</b>			
		<u>23,382</u>	<u>129,013</u>
Representing:			
<b><u>Compensation fund</u></b>			
Contributions from HKFE	2	21,100	21,400
Accumulated surplus		108,272	107,613
		<u>129,372</u>	<u>129,013</u>
Contributions to Investor Compensation Fund	3	(105,990)	-
		<u>23,382</u>	<u>129,013</u>

The notes on pages 30 to 31 form part of the condensed financial statements.

## Commodity Exchange Compensation Fund

### Cash Flow Statement

For the six months ended 30 September 2003

(Expressed in Hong Kong dollars)

	Unaudited Six Months Ended 30 Sep 2003 \$'000	Unaudited Six Months Ended 30 Sep 2002 (Restated) \$'000
<b>Cash flows from operating activities</b>		
Surplus for the period	659	7,843
Net investment income	(718)	(4,646)
Decrease / (increase) in levy receivable	772	(94)
Decrease in accounts payable and accrued charges	<u>(21)</u>	<u>(18)</u>
<b>Net cash from operating activities</b>	<u>692</u>	<u>3,085</u>
<b>Cash flows from investing activities</b>		
Debt securities redeemed	13,000	20,000
Debt securities sold	51,554	-
Debt securities bought	-	(16,732)
Interest received	<u>2,579</u>	<u>3,786</u>
<b>Net cash from investing activities</b>	<u>67,133</u>	<u>7,054</u>
<b>Cash flows from financing activities</b>		
Net contribution refunded to HKFE	(300)	(100)
Contributions to Investor Compensation Fund	<u>(105,990)</u>	<u>-</u>
<b>Net cash used in financing activities</b>	<u>(106,290)</u>	<u>(100)</u>
<b>Net (decrease) / increase in cash and cash equivalents</b>	(38,465)	10,039
<b>Cash and cash equivalents at beginning of the six months</b>	<u>51,903</u>	<u>3,737</u>
<b>Cash and cash equivalents at end of the six months</b>	<u>13,438</u>	<u>13,776</u>
<b>Analysis of the balance of cash and cash equivalents:</b>		
	Unaudited At 30 Sep 2003 \$'000	Unaudited At 30 Sep 2002 \$'000
Cash at bank	26	12
Fixed and call deposits with banks	<u>13,412</u>	<u>13,764</u>
	<u>13,438</u>	<u>13,776</u>

## Commodity Exchange Compensation Fund

### Notes to the Condensed Financial Statements

For the six months ended 30 September 2003

(Expressed in Hong Kong dollars)

#### 1. BASIS OF PREPARATION

The Fund prepares the interim financial report in accordance with International Accounting Standard 34 "Interim financial reporting" adopted by the International Accounting Standards Board. As the Fund will eventually cease operation as a result of the Securities and Futures Ordinance (SFO) which came into effect from 1 April 2003, the Fund prepares the interim financial report on a break-up basis with assets stated at recoverable amounts.

The interim financial report is unaudited and the financial information relating to the financial year ended 31 March 2003 included in this report does not constitute the Fund's statutory accounts for that financial year but is derived from those accounts.

We adopted a new accounting policy for the year ended 31 March 2003 to recognise receipts (including contract levy and recoveries) and distributions (including provision made for compensation payments) as income and expenses respectively in the Fund's income and expenditure account. We applied the same accounting policies adopted in the financial statements for the year ended 31 March 2003 to the interim financial report. We have restated the comparative information for the six months ended 30 September 2002 retrospectively to conform to the new policy.

#### 2. CONTRIBUTIONS FROM HKFE

	\$'000
Balance as at 1 April 2002	21,600
Add: Contributions received during the year ended 31 March 2003	700
Deduct: Refunds to outgoing shareholders during the year ended 31 March 2003	<u>(900)</u>
Balance as at 31 March 2003	21,400
Add: Contributions received during the six months ended 30 September 2003	100
Deduct: Refunds to outgoing shareholders during the six months ended 30 September 2003	<u>(400)</u>
Balance as at 30 September 2003	<u><u>21,100</u></u>





## **Commodity Exchange Compensation Fund**

### **Notes to the Condensed Financial Statements**

**For the six months ended 30 September 2003**

*(Expressed in Hong Kong dollars)*

#### **3. CONTRIBUTIONS TO INVESTOR COMPENSATION FUND**

When the SFO and its subsidiary legislation came into effect from 1 April 2003, the Securities and Futures Commission (SFC) formed a new single investor compensation fund (ICF) to ultimately replace the Fund and the Unified Exchange Compensation Fund. Under section 75(2) of Schedule 10 of the SFO, the SFC may after 1 April 2003 pay into the ICF, which came into operation after 1 April 2003, such sum of money from the Fund as it considers appropriate. During the six months ended 30 September 2003, the SFC paid \$105,990,000 into the ICF from the Fund.

#### **4. MATERIAL RELATED PARTY TRANSACTIONS**

During the period, the Fund sold debt securities of nominal value \$49.5 million to the ICF at market price. No gain or loss was recognised by the Fund in respect of the disposal of these debt securities.



# Investor Compensation Fund (the Fund)

## Report of the Investor Compensation Fund Committee (the Committee)

The members of the Committee present their quarterly report and the unaudited condensed financial statements for the six months ended 30 September 2003.

### 1. ESTABLISHMENT OF THE FUND

Part XII of the Securities and Futures Ordinance (Chapter 571) established the Fund on 1 April 2003.

### 2. FINANCIAL RESULTS

The Committee presents the financial results which are set out in the financial statements on pages 34 to 42.

### 3. MEMBERS OF THE COMMITTEE

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

Mr. Mark Dickens, JP	[appointed on 1 April 2003]
Mr. Paul Chow Man Yiu	[appointed on 30 June 2003]
Mr. Frederick J. Grede	[appointed on 1 April 2003 and resigned on 29 June 2003]
Mrs. Alexa Lam	[appointed on 1 April 2003]
Ms. Anna H. Y. Wu, SBS, JP	[appointed on 1 April 2003]

### 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 six months ended 30 September 2003.

On behalf of the Committee

Mark Dickens, JP  
Chairman

5 November 2003



# Independent review report to the board of directors of the Securities and Futures Commission (the SFC)

(Established in Hong Kong under the Securities and Futures Ordinance)

## Introduction

We have been instructed by the SFC to review the interim financial report for the six months ended 30 September 2003 of the Investor Compensation Fund (the Fund), established under Part XII of the Securities and Futures Ordinance, set out on pages 34 to 42.

## Respective responsibilities of directors and auditors

The SFC is responsible for preparing an interim report of the Fund to comply with International Accounting Standard 34 "Interim financial reporting" adopted by the International Accounting Standards Board. The interim financial report is the responsibility of the SFC, and has been approved by the Investor Compensation Fund Committee.

It is our responsibility to form an independent conclusion, based on our review, on the interim financial report and to report our conclusion solely to you, as a body, in accordance with our agreed terms of engagement, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

## Review work performed

We conducted our review in accordance with Statement of Auditing Standards 700 "Engagements to review interim financial reports" issued by the Hong Kong Society of Accountants. A review consists principally of making enquiries of management and applying analytical procedures to the interim financial report and based thereon, assessing whether the accounting policies and presentation have been consistently applied unless otherwise disclosed. A review excludes audit procedures such as tests of controls and verification of assets, liabilities and transactions. It is substantially less in scope than an audit and therefore provides a lower level of assurance than an audit. Accordingly we do not express an audit opinion on the interim financial report.

## Review conclusion

On the basis of our review, which does not constitute an audit, we are not aware of any material modifications that should be made to the interim financial report for the six months ended 30 September 2003.

KPMG  
Certified Public Accountants  
Hong Kong  
5 November 2003

## Investor Compensation Fund

### Income and Expenditure Account

For the six months from 1 April 2003 (date of establishment) to 30 September 2003

(Expressed in Hong Kong dollars)

	<u>Note</u>	Unaudited Three Months Ended <u>30 Sep 2003</u> \$'000	Unaudited Six Months Ended <u>30 Sep 2003</u> \$'000
<b>Income</b>			
Net investment income	3&5	1,475	2,350
Transaction levy from SEHK	3&6	31,744	51,699
Contract levy from HKFE	3&7	2,615	4,911
		<u>35,834</u>	<u>58,960</u>
<b>Expenses</b>			
ICC expenses	8	1,313	2,699
Professional fees		12	12
Bank charges		5	5
		<u>1,330</u>	<u>2,716</u>
<b>Surplus</b>		34,504	56,244
<b>Accumulated surplus brought forward</b>		<u>21,740</u>	<u>-</u>
<b>Accumulated surplus carried forward</b>		<u>56,244</u>	<u>56,244</u>

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

The notes on pages 37 to 42 form part of the condensed financial statements.

## Investor Compensation Fund

### Balance Sheet

At 30 September 2003

(Expressed in Hong Kong dollars)

	<u>Note</u>	Unaudited <u>At 30 Sep 2003</u> \$'000
<b>Non-current assets</b>		
Held-to-maturity debt securities	9	20,425 -----
<b>Current assets</b>		
Held-to-maturity debt securities	9	197,703
Interest receivable		1,533
Levy receivable from SEHK		12,232
Levy receivable from HKFE		886
Fixed and call deposits with banks		518,799
Cash at bank		26
		<u>731,179</u>
<b>Current liabilities</b>		
Accounts payable and accrued charges		1,330 -----
<b>Net current assets</b>		
		<u>729,849</u> -----
<b>Net assets</b>		
		<u>750,274</u> -----
Representing:		
<b><u>Compensation fund</u></b>		
Contributions from UECF	10	588,040
Contributions from CECF	10	105,990
Accumulated surplus		56,244
		<u>750,274</u> -----

The notes on pages 37 to 42 form part of the condensed financial statements.

## Investor Compensation Fund

### Cash Flow Statement

For the six months from 1 April 2003 (date of establishment) to 30 September 2003  
(Expressed in Hong Kong dollars)

	Unaudited Six Months Ended 30 Sep 2003
	\$'000
<b>Cash flows from operating activities</b>	
Surplus for the period	56,244
Net investment income	(2,350)
Increase in levies receivable	(13,118)
Increase in accounts payable and accrued charges	1,330
	-----
<b>Net cash from operating activities</b>	42,106
	-----
<b>Cash flows from investing activities</b>	
Held-to-maturity debt securities bought	(218,379)
Interest received	1,068
	-----
<b>Net cash used in investing activities</b>	(217,311)
	-----
<b>Cash flows from financing activities</b>	
Contributions received from UECF	588,040
Contributions received from CECF	105,990
	-----
<b>Net cash from financing activities</b>	694,030
	-----
<b>Net increase in cash and cash equivalents</b>	518,825
<b>Cash and cash equivalents at beginning of the six months</b>	-
	-----
<b>Cash and cash equivalents at end of the six months</b>	518,825
	-----

Analysis of the balance of cash and cash equivalents as shown in the balance sheet:

	Unaudited At 30 Sep 2003 \$'000
Cash at bank	26
Fixed and call deposits with banks	518,799
	-----
	518,825
	-----



## Investor Compensation Fund

### Notes to the Condensed Financial Statements

For the six months from 1 April 2003 (date of establishment) to 30 September 2003

(Expressed in Hong Kong dollars)

#### 1. PURPOSE, LIMITATION AND PRINCIPAL ACTIVITY

The Securities and Futures Ordinance (SFO) provides for the establishment of the Investor Compensation Fund (the Fund) to compensate investors who suffer a loss due to the default of an intermediary in relation to trading of products on Hong Kong Exchanges and Clearing Limited. The defaulting intermediary must be licensed or registered with the Securities and Futures Commission (SFC) for dealing in securities, futures contracts or securities margin financing.

The SFC is primarily responsible for the administration and management of the Fund in accordance with section 238 of the SFO, but has also transferred such functions to the Investor Compensation Company Ltd. (ICC) under section 80 of the SFO. ICC is thus responsible for receipt, determination and payment of valid claims against the Fund in respect of defaults of intermediaries occurring on or after 1 April 2003. Upon making payment to a claimant, ICC is subrogated to the claimant's right against the defaulter.

Pursuant to section 244 of the SFO, the Chief Executive has by order set the maximum amount of compensation at \$150,000 per claimant for a single default in relation to securities traded at the Stock Exchange of Hong Kong Limited (SEHK) or futures contracts traded at the Hong Kong Futures Exchange Limited (HKFE).

If amounts owed to claimants against the Fund exceed the Fund's net assets, the SFC would apportion compensation payments to claimants as provided in the Securities & Futures (Investor Compensation-Claims) Rules. The SFC would pay unpaid claim amounts when funds were available in the Fund.

#### 2. MONEY CONSTITUTING THE FUND

The Fund mainly consists of the amounts paid from the two existing compensation funds, the Unified Exchange Compensation Fund (UECF) and the Commodity Exchange Compensation Fund (CECF). The SFC will also pay into the Fund any remaining balance in the Securities Dealers' Deposits Fund and the Commodities Dealers' Deposits Fund after repaying the dealers' deposits and any money due to the registered dealers in accordance with section 76 (11) of Schedule 10 of the SFO.

Other sources of money for the Fund include the levies chargeable on securities traded on the SEHK and futures contract traded on the HKFE, and returns earned on the investment of the Fund.



## Investor Compensation Fund

### Notes to the Condensed Financial Statements

For the six months from 1 April 2003 (date of establishment) to 30 September 2003

(Expressed in Hong Kong dollars)

### 3. SIGNIFICANT ACCOUNTING POLICIES

#### Basis of preparation

The Fund prepares the interim financial report in accordance with International Accounting Standard 34 "Interim financial reporting" adopted by the International Accounting Standards Board. We set out below a summary of our significant accounting policies.

#### Recognition of income

**Investment income** We record Investment income on an accrual basis. It comprises (i) interest earned on bank deposits and held-to-maturity debt securities; (ii) the amortisation of premiums or discounts on purchase of held-to-maturity debt securities on a straight line basis over the periods to redemption; and (iii) the gain or loss on disposal of held-to-maturity debt securities.

**Transaction Levy / Contract levy** We record levy as income at a fixed rate on every leviable SEHK and HKFE transaction on an accrual basis.

#### Translation of foreign currencies

We translate foreign currency transactions during the year into Hong Kong dollars at the exchange rates ruling at the transaction dates. We translate monetary assets and liabilities denominated in foreign currencies into Hong Kong dollars at the exchange rates ruling at the balance sheet date. We record exchange gains and losses as income and expenses when they occur.

#### Investments

We state the investment in debt securities, which we intend to hold to maturity, at cost adjusted for the amortisation of premiums and discounts on purchase over the periods to redemption less any provisions for impairments. We account for purchases and sales of debt securities on the settlement date.

We review the carrying amounts of debt securities as at the balance sheet date and assess whether we expect to recover the carrying amounts. We make provisions for the parts of the carrying amounts that we do not expect to recover. We recognise provisions as an expense when the provisions are made.

We write back provisions against the carrying value of debt securities when the circumstances and events that have led to the write-down or write-off cease to exist and there is persuasive evidence that the new circumstances and events will persist for the foreseeable future.

We recognise profits or losses on sale of debt securities when they arise.





## Investor Compensation Fund

### Notes to the Condensed Financial Statements

For the six months from 1 April 2003 (date of establishment) to 30 September 2003

(Expressed in Hong Kong dollars)

### 3. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

#### Provision for compensation

We make provision for liabilities arising from claims resulting from defaults for which the SFC or ICC has published a notice calling for claims pursuant to section 3 of the Securities & Futures (Investor Compensation-Claims) Rules. The provision covers all such claims received up to the date on which the financial statements are approved by the Committee.

The maximum liability of the Fund to claims for each default case is set at \$150,000 per claimant.

#### Other payables

We state other payables at cost.

#### Contingent liability

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, we disclose the obligation as a contingent liability, unless the probability of outflow of economic benefits is remote. We also disclose possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more future events as contingent liabilities unless the probability of outflow of economic benefits is remote.

#### Related parties

For the purpose of these financial statements, we consider that the following are related parties of the Fund :

- (i) parties that the Fund has the ability, directly or indirectly, to control or significantly influence in making financial and operating decisions;
- (ii) parties that have the ability, directly or indirectly, to control or significantly influence the Fund in making financial and operating decisions; and
- (iii) parties that are subject to common control or common significant influence.

Related parties may be individuals or corporate entities.

## Investor Compensation Fund

### Notes to the Condensed Financial Statements

For the six months from 1 April 2003 (date of establishment) to 30 September 2003

(Expressed in Hong Kong dollars)

#### 4. TAXATION

The interest and profits on investment earned by the Fund are not subject to profits tax under section 14 of the Inland Revenue Ordinance.

#### 5. NET INVESTMENT INCOME

	Three Months Ended 30 Sep 2003 \$'000	Six Months Ended 30 Sep 2003 \$'000
Interest income	1,725	2,600
Premium on held-to-maturity debt securities	(368)	(368)
Discount on held-to-maturity debt securities	<u>118</u>	<u>118</u>
Net investment income	<u>1,475</u>	<u>2,350</u>

#### 6. TRANSACTION LEVY FROM SEHK

From 1 April 2003, the Fund received a transaction levy chargeable at 0.002% of every leviable SEHK transaction.

#### 7. CONTRACT LEVY FROM HKFE

From 1 April 2003, the Fund received a contract levy chargeable at \$0.5 per leviable HKFE transaction except for Mini-Hang Seng Index Futures Contracts, Mini-Hang Seng Index Options Contracts, Stock futures contracts and Options on Stock futures contracts, all of which are chargeable at \$0.1 per transaction.

#### 8. ICC EXPENSES

The SFC formed the Investor Compensation Company Limited (ICC) in September 2002 to perform functions on behalf of the Fund in relation to compensation to investors and other functions under Part III and Part XII of the SFO. The Fund is responsible for funding the establishment and operation of ICC. As at 30 September 2003, \$2,699,000 were incurred for setting up ICC.

## Investor Compensation Fund

### Notes to the Condensed Financial Statements

For the six months from 1 April 2003 (date of establishment) to 30 September 2003

(Expressed in Hong Kong dollars)

#### 9. HELD-TO-MATURITY DEBT SECURITIES

	<u>At 30 Sep 03</u>
	\$'000
Maturing after one year	
In the second to third years - unlisted	<u>20,425</u>
	<u>20,425</u>
Maturing within one year	
- listed outside Hong Kong	97,360
- unlisted	<u>100,343</u>
	<u>197,703</u>
	<u>218,128</u>
Market value of debt securities	
- listed outside Hong Kong	97,579
- unlisted	<u>120,936</u>
	<u>218,515</u>

During the period, the Fund purchased from the UECF and the CECF debt securities of total nominal value of HK\$125.5 million and US\$11.6 million at market prices.

#### 10. CONTRIBUTIONS FROM UECF AND CECF

Under sections 74(2) and 75(2) of Schedule 10 of the SFO, the SFC may pay into the Fund such sum of money from the UECF and the CECF as it considers appropriate after 1 April 2003. During the six months ended 30 September 2003, the SFC paid \$588,040,000 and \$105,990,000 into the Fund from the UECF and the CECF respectively.

#### 11. RELATED PARTY TRANSACTIONS

We have related party relationship with the SFC, the ICC, the SEHK, the HKFE, the UECF and the CECF. During the period, there were no significant related party transactions other than those disclosed in the financial statements (refer to notes 6 to 10).



## Investor Compensation Fund

### Notes to the Condensed Financial Statements

For the six months from 1 April 2003 (date of establishment) to 30 September 2003

(Expressed in Hong Kong dollars)

## 12. FINANCIAL INSTRUMENTS

Financial assets of the Fund comprise debt securities.

(i) Credit risk

The Fund's investment policy only allows the Fund to invest in fixed rate dated securities or in bank deposits. The policy also limits the Fund's exposure to each organisation and each country to not more than 15% and 20% of the total investment respectively. During the period, the Fund complied with the above investment policy and, as a result, was not exposed to significant credit risk.

(ii) Exchange rate risk

The Fund's investment policy allows the Fund have US dollar foreign exchange exposure. As the HK dollar is pegged with the US dollar, the Fund was not exposed to significant foreign exchange risk.

(iii) Market risk

The investment activities of the Fund expose it to various types of market risks which are associated with the markets in which it invests, to the extent of the amount invested in debt securities. Such risk will be reflected in the price and the carrying value of the financial assets concerned.

## 13. CONTINGENT LIABILITIES

As at the date of this report, the Fund has received claims against two intermediaries. 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 \$300,000.