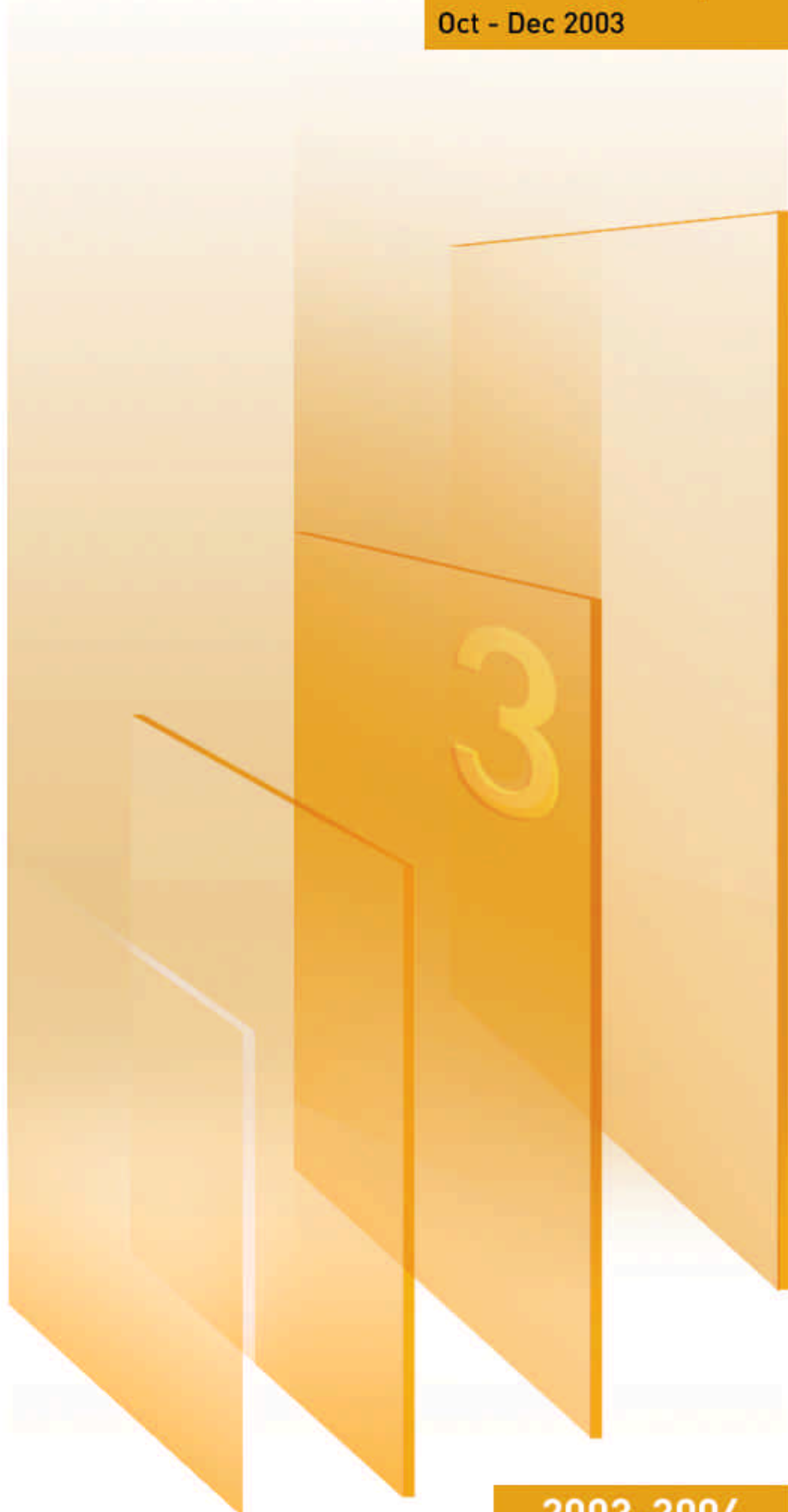




SECURITIES AND  
FUTURES COMMISSION  
證券及期貨事務監察委員會

# Quarterly Report

Oct - Dec 2003



2003-2004



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*This is the Securities and Futures Commission's third 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.*

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## Operations Highlights

1 October to 31 December 2003

1. Accumulated surplus for the three quarters from April to December 2003 was \$65.2 million, compared with the projected deficit of \$70 million in the approved budget. Reserves at the end of December 2003 stood at \$631 million.
2. Total revenue for the three quarters was \$369.4 million, 42.5% higher than that of the same period last year. The operating results were better than expected largely because levy income had benefited from the improvement in market turnover. Total expenditure was 3.3% higher at \$304.2 million mainly because of the office relocation expenditure and additional personnel expenses for dual filing functions.
3. Migration to the new licensing regime by intermediaries continued steadily. As of the end of December, 7,426 licensees or 42% of intermediaries had lodged their migration applications under the new regime.
4. Since 1 April 2003, under dual filing, we had reviewed 82 new listing applications and commented on 33 of them. The SFC indicated to HKEx its intention to object to three listing applications.
5. In December, the SFC and the China Securities Regulatory Commission signed the arrangements in relation to mutual recognition of securities and futures industry qualifications under the Closer Economic Partnership Arrangement.
6. We relaxed our licensing competence requirements in December to facilitate re-entry into the industry by former practitioners.
7. The SFC plans to issue new guidelines setting out the recommended best practice for disclosure of securities services-related fees and charges by intermediaries. In October, we consulted the market. We are studying the eight submissions received.
8. Investors consider that analyst conflicts of interest should be addressed by the SFC, according to an SFC survey. The SFC plans to consult the public on new regulatory proposals based on International Organization of Securities Commissions (IOSCO) principles in the first quarter of 2004.
9. The Working Group on Review of Financial Regulatory Framework for Licensed Corporations completed its discussion in February. We aim to submit a report to the LegCo Panel on Financial Affairs soon.
10. The SFC oversaw the orderly transfer of client positions and return of client monies by Yicko Futures Limited, which is being wound up.
11. We revoked the licence of Tai Wah Securities Limited in December. Tai Wah was declared a defaulter in April following its failure to meet CCASS settlement obligations.

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12. A taskforce on Real Estate Investments Trusts (REITs) held its first meeting in November to discuss issues relating to the development of benchmarks that REITs should consider when investing in overseas properties.
  13. The Guidelines for Regulating Index Tracking Exchange Traded Funds (ETFs) became effective on 24 October. In November, the first ETF was authorised pursuant to the Guidelines and listed under streamlined listing procedures.
  14. In October, the SFC authorised the first group of five Automated Trading Services providers.
  15. During the quarter, the SFC had 14 successful prosecutions and disciplined 22 licensees for misconduct.
  16. The SFC in December launched a monthly on-line column to educate investors on the key principles of investing.
  17. In October, Hong Kong was selected by the IOSCO to host its 31st Annual Conference in 2006. The SFC also signed the IOSCO multilateral agreement on enforcement co-operation.
  18. Amid several popular IPOs, the SFC reminded investors to know their limits when applying for IPO shares. The SFC approved 18 subordinated loans or subordinated loan facilities aggregating \$2.955 billion to assist brokers who lent to investors to meet financial requirements.
  19. Mr Christopher Cheng was appointed as a Non-Executive Director and Hon Jasper Tsang was re-appointed.

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



## Review of Operations

1 October to 31 December 2003

This is the Securities and Futures Commission's third Quarterly Report for the financial year starting 1 April 2003.

Supported by improving GDP growth and several large Initial Public Offerings (IPOs), local market sentiment continued to be bullish. The Hang Seng Index (HSI) rallied 12% during the quarter to close at 12,576, from 11,230 on 30 September. It rose 46% compared with 31 March and 35% compared with the end of 2002. The index closed at the intra-quarter high of 12,594 on 12 December, a record high since June 2002.

Underpinned by active trading in shares of Mainland enterprises, the average daily turnover on the Main Board rose 28% during the quarter to \$15.1 billion. The average daily turnovers of H shares and red chips jumped 79% and 44% respectively to \$3.8 billion and \$3.2 billion. The respective indices rose 56% and 18%.

The average daily turnover on the Growth Enterprise Market (GEM) in the quarter was \$183 million, 17% lower than the previous quarter. The S&P/HKEx GEM Index fell 0.2%.

The quarter was marked by several heavily over-subscribed IPOs. There were 21 IPOs raising a total of \$43.7 billion, which accounted for 74% of the total raised by IPOs in 2003.


Five IPOs (China Life Insurance Company Limited, PICC Property and Casualty Company Limited, AviChina Industry & Technology Company Limited, Great Wall Automobile Holding Company Limited and Fujian Zijin Mining Industry Company Limited) already accounted for 87% of the quarter total or 67% of 2003 total. In particular, China Life Insurance Company Limited, which raised \$26.7 billion, was the largest IPO in the world in 2003 and the third largest in the history of Hong Kong (after China Unicom which raised \$43.6 billion in June 2000 and the then-called China Telecom which raised \$32.7 billion in October 1997).

### Financial Highlights<sup>1</sup>

Good market turnover helped boost revenue in the quarter to \$149 million, 18.7% higher than the previous quarter. Total expenditure (including depreciation) dropped by 0.35% to \$100.8 million. These resulted in a surplus for the quarter of \$48.2 million, nearly doubling the surplus of \$24.4 million in the previous quarter.

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<sup>1</sup> We have consolidated the financial results of Investor Compensation Company Limited in the SFC's nine-month financial report made up to 31 December 2003.



Accumulated surplus for the three quarters from April to December 2003 was \$65.2 million, compared with the projected deficit of \$70 million in the approved budget and the \$35.3 million deficit recorded for the same period last year.

At the end of December, the reserves stood at \$631 million, equivalent to 1.46 times the approved annual operating expenditure (including depreciation) of \$433 million.

The operating results in the three quarters were better than expected largely because levy income had benefited from the improvement in market turnover. The SFC 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 nine months was \$369.4 million, 42.5% higher than that of the same period last year. The average daily stock market turnover for the nine months was \$12.4 billion<sup>2</sup>, up 74.6% from \$7.1 billion in the same period last year.

Fees and charges income rose 19.2% to \$105.2 million in the three quarters, from \$88.3 million in the same period last year. Investment income fell because interest rates remained low.

Total expenditure (including depreciation) from April to December was \$304.2 million, 3.3% higher than the same period last year. This was mainly because of the office relocation expenditure and additional personnel expenses for dual filing functions.

The total number of staff at the end of December was 419, comprising 383 regular staff and 36 temporary staff. The increase from 406 staff three months ago was mainly due to filling of vacancies including those for enforcement and licensing work.

### **Implementation of the Securities and Futures Ordinance (SFO)**


Since the commencement of the SFO on 1 April 2003, there have been enquiries on how Part IV of the Ordinance, which regulates public offering of investment products, applies to new and existing products. The SFC held four industry seminars during the quarter to explain its policy intentions.

The SFC has been considering and formulating amendments to some subsidiary legislation made under the SFO to address market developments. The Securities and Futures (Price Stabilizing) (Amendment) Rules includes the UK as a recognised jurisdiction and became effective on 6 February. The amendment affords a safe harbour for stabilizing action taken in relation to relevant securities on a UK stock market in accordance with the UK Price Stabilizing Rules. The Hong Kong rules have been recognised in the UK since 1 January 2004.

Migration to the new licensing regime by intermediaries continued steadily. As of the end of December,

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<sup>2</sup> For income purpose, the turnover figure includes the amount of new fund raisings, which also attract transaction levy.



7,426 licensees representing 42% of all those migrating had lodged their migration applications under the new regime, up from 25% three months earlier.

### **Improving Market Quality and Shareholders Protection**

Under the dual filing regime, the SFC had reviewed 82 new listing applications and commented on 33 of them in the nine months since 1 April 2003. After consulting the Dual Filing Advisory Group, the SFC indicated to Hong Kong Exchanges and Clearing Limited (HKEx) its intention to object to three listing applications.

The SFC and HKEx have been studying the responses to the Consultation Paper on the Regulation of Sponsors and Independent Financial Advisers. The conclusions will be announced when ready.


In December, the Takeovers and Mergers Panel, in a decision regarding an on-market share repurchase programme of CLP Holdings Limited, confirmed the Takeovers Executive's ruling that Rule 32.1 of the Takeovers Code should not be interpreted so as to permit waiver applications in respect of mandatory offer obligations triggered by on-market share repurchases.

The consultation conclusions on a proposal to empower the SFC to initiate, without Court approval, derivative actions against wrongdoers in relation to listed companies were released in November. As there was limited support, the proposal was put on hold. In the meantime, the SFC will continue its efforts to enhance investors' understanding of their rights as shareholders.

### **Partnership with Industry**

The number of intermediaries increased for the first time since 1 April 2003 as more individuals joined the industry amid the economic rebound and improved market sentiment. As of 31 December 2003, there were 20,103 licensed persons (including 1,318 corporations and 18,785 individuals), compared to 19,915 licensed persons (including 1,343 corporations and 18,572 individuals) as at 30 September. The number of corporations dropped in the quarter because some inactive firms surrendered their licences. The number of registered institutions has remained at 98.

In December, the SFC and the China Securities Regulatory Commission (CSRC) signed the arrangements in relation to mutual recognition of securities and futures industry qualifications under the Closer Economic Partnership Arrangement. It is expected that the arrangements would benefit the development of both markets in facilitating the flow of qualified personnel. SFC staff explained the arrangements to 500 industry participants at a seminar, while answers to frequently asked questions on the subject were posted on the SFC website to enhance the industry's understanding.



It is expected that the first examination on Mainland law and regulations for Hong Kong securities professionals will be held in March 2004 in Shenzhen and the examination for futures professionals in April or May. The Hong Kong Securities Institute has been liaising with its counterparts in the Mainland on the examination arrangements.

In December, the SFC relaxed its licensing competence requirements to facilitate re-entry into the industry by former practitioners. Alternative means are provided to former practitioners who have left the industry for between three and eight years such that they may be exempted from the relevant competence examinations when they re-apply for a licence to practise in the same regulated activity for which they were licensed previously. Under the old requirements, the exemption applied only to those who were licensed within the past three years.

To promote fair competition, price transparency and fees comparability, the SFC plans to issue new guidelines setting out the recommended best practice for disclosure of securities services-related fees and charges by intermediaries. One of the key proposals was to standardise the format of disclosure of more than 70 items of securities services-related fees and charges into six categories. In October, we consulted the market. The SFC is studying the eight submissions received.

Investors found that analyst conflicts of interest was an issue in Hong Kong and should be addressed by the SFC, according to an SFC survey. Following the publication in November of the result of the investor survey and another poll on the industry, we plan to consult the public on new regulatory proposals which would comply with International Organization of Securities Commissions (IOSCO) principles on the regulation of analysts in the first quarter this year.

The Working Group on Review of Financial Regulatory Framework for Licensed Corporations completed its discussion in February 2004. We aim to submit a report to the LegCo Panel on Financial Affairs early this year.

In October, Yicko Futures Limited was suspended as an exchange participant by the Hong Kong Futures Exchange Limited after it failed to meet the margin calls by the HKFE Clearing Corporation Limited (HKCC). It also failed to meet the minimum liquid capital requirement under Financial Resources Rules. These followed the default of a client who was a Registered Trader on payment of margin monies on his open positions on HSI options contracts. Following the suspension of Yicko Futures, the SFC oversaw the process of the firm transferring out client open positions and returning client monies and the process was completed smoothly. In December, HKCC petitioned the High Court to wind up Yicko Futures.

We revoked the licence of Tai Wah Securities Limited in December following a winding-up order of the High Court. The Hong Kong Securities Clearing Company Limited declared Tai Wah a defaulter in April upon its failure to meet settlement obligations, and later petitioned the court to wind up the brokerage.



### Statistical Information and Financial Position of the Securities Industry (Note 1)

	As at 31 Dec 2003	As at 31 Dec 2002
Total number of Securities Dealers and Securities Margin Financiers (SMFs)	673	696
Total number of active cash clients (Note 2)	687,802	565,585
Total number of active margin clients (Note 2)	71,240	56,787
<b>Balance Sheet</b>	<b>(\$ Million)</b>	<b>(\$ Million)</b>
Cash in hand and at bank (Note 3)	88,209	56,998
Amounts receivable from margin clients (Note 4)	15,327	12,242
Amounts receivable from SMFs and clients / other dealers arising from dealing in securities	63,261	24,986
House Investment (Notes 5 and 6)	55,215	6,301
Other assets	49,788	28,210
<b>Total assets</b>	<b>271,800</b>	<b>128,737</b>
Amounts payable to SMFs and clients / other dealers arising from dealing in securities	109,517	50,055
Total borrowings from financial institutions (Note 5)	36,786	5,380
Other liabilities (Note 5)	62,066	21,690
Total shareholders' fund	63,431	51,612
<b>Total liabilities and shareholders' fund</b>	<b>271,800</b>	<b>128,737</b>

Note 1: The data were extracted from the monthly Financial Returns ("FR") submitted in accordance with the Securities and Futures (Financial Resources) Rules by securities dealers and securities margin financiers. These figures are subject to amendments made by the licensed corporations.

Note 2: Active clients as at 31 December 2003 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 31 December 2002 refer to those who have conducted at least one transaction during the past 12 months.

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 31 Dec 2003</u>	<u>As at 31 Dec 2002</u>
4.2	3.4

Note 5: Increase in these items was mainly due to the inclusion of the financial figures of licensed corporations that were exempt dealers before 1 April 2003 and hence were not required to file FR.

Note 6: House investment is separately disclosed from other assets due to the material position held by licensed corporations as at 31 December 2003.

### Facilitating Market Development

A LegCo Bills Committee began to scrutinise the prospectus-related amendments of the Companies (Amendment) Bill during the quarter. The work was completed in January 2004.

The Taskforce on Overseas Real Estate Investments by Real Estate Investment Trusts (REITs) held its first meeting in November to discuss issues relating to the development of benchmarks that REITs should consider when investing in overseas properties. The Taskforce agreed to research the regulatory framework in overseas jurisdictions and conduct case studies to facilitate further discussion.

The Guidelines for Regulating Index Tracking Exchange Traded Funds (ETFs) became effective on 24 October. In November, the first ETF was authorised pursuant to the Guidelines and listed under streamlined listing procedures. The implementation of the procedures has so far been smooth and time-efficient.

As at the end of December, the SFC had nine authorised hedge funds (five single hedge funds and four fund-of-hedge funds). The market for equity-linked deposits continued to expand in the quarter. The growth in the number and variety of these products will likely continue as banks are putting more focus on their wealth management business.

<b>Number of SFC Authorised Collective Investment Schemes</b>			
	<b>31 Dec 2003</b>	<b>30 Sep 2003</b>	<b>31 Dec 2002</b>
Unit trusts and mutual funds	1,862	1,947	1,906
Investment-linked assurance schemes	151	138	121
Pooled retirement funds	37	37	37
MPF master trust / industry schemes	46	46	47
MPF pooled investment funds (*)	252	252	237
Other schemes	41	36	34
<b>Total</b>	<b>2,389</b>	<b>2,456</b>	<b>2,382</b>
* 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.			

In October, the SFC authorised the first group of five Automated Trading Services (ATS) providers, including four overseas exchanges and one local subsidiary of an international information provider. The entities and their respective conditions of authorisation are listed in the Register of ATS on the SFC website.

Also in October, HKEx published a consultation paper which further detailed the operations of a split register model for scripless trading proposed by the SFC earlier. Under the proposal, there would be a scripless Central Clearing and Settlement System Register and an Issuer Register which consists of scripless and certificated holdings. HKEx is studying the market comments.

Towards the year end, there were several very successful IPOs in Hong Kong. To facilitate brokers in offering IPO financing to their clients, the SFC, from early November to the end of December, approved 18 IPO-related subordinated loans or subordinated loan facilities aggregating \$2.955 billion. The SFC took on average less than four business days to approve an application. In straightforward cases where the documentation met all requirements, approval was granted within one to two business days.

## **Enforcement**

During the quarter, the SFC had 14 successful prosecutions - for breaches of disclosure of securities interests law, unlicensed activities, aiding or abetting unlicensed activities, and hawking of futures contracts. There were no unsuccessful prosecutions in all three quarters this year.

From October to December, we disciplined 22 licensees for a variety of misconduct. There were two licence revocations, 10 suspensions (for one week to a year), nine reprimands, and for the first time under the SFO a prohibition order banning a person from re-entry to the industry for life. One of the licensees reprimanded was also fined, which was the first fine under the SFO.

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

<b>Statistics of Enforcement Actions</b>			
	<b>Oct - Dec 2003</b>	<b>Jul - Sep 2003</b>	<b>Oct - Dec 2002</b>
Successful prosecutions	14	20	11
SFC licensees disciplined	22	25	17
Warning letters issued (Note 1)	133	35	53
Cases under investigation (Notes 2, 3 and 4)	781	992	313
Disciplinary inquiries in progress (Note 3)	99	83	81
Note 1: The increase was mainly related to late submission cases under the disclosure of interest requirements of the SFO.			
Note 2: Some cases are ongoing investigations from the previous quarter.			
Note 3: Number of cases as at end of quarters.			
Note 4: The drop was due to the conclusion of some late submission cases under the disclosure of interest requirements of the SFO, and other miscellaneous cases including those relating to market manipulation, unregistered dealing, and other misconduct by brokers. Some of these cases were concluded without any further action due to insufficient evidence.			

### **Strengthening Communication with Investors and Other Stakeholders**


As retail participation in the market increased, the SFC launched more investor education activities on the basics of investment. Among them, a radio drama series *Talk on Wise Investing* on the do's and don'ts of investing, with the participation of popular artistes and commentators, is being aired on Commercial Radio One every Saturday until mid-March 2004.

As a new initiative, the SFC in December started a monthly on-line column, which is hosted by a fictitious character, Dr Wise. Dr Wise represents the institutional wisdom of the SFC and will tell investors the key principles of investing. The column is posted on the SFC website on the last Tuesday of each month.

Amid several heavily over-subscribed IPOs, the SFC reminded investors to know their limits when applying for IPO shares. A leaflet entitled *Questions to Ask Before Investing in a Stock* was also published to urge investors to pause and think carefully so as to make informed investment decisions.

In light of the discovery of several fraudulent copycat websites in the quarter, we published tips on how to detect fake websites and avoid becoming victims.

To enhance investors' knowledge on investment products, we published education materials on index tracking ETFs, commodity futures contracts, structured notes and listed investment companies.



We will run another round of investor education workshops for secondary school teachers in the second quarter of 2004, as the 12 sessions that were held in September to November were well received by more than 500 teachers.

<b>Statistics of Investor Enquiries and Public Complaints</b>			
	<b>Oct - Dec 2003</b>	<b>Jul - Sep 2003</b>	<b>Oct - Dec 2002</b>
Enquiries	1,465	1,376	855
Complaints	306	292	260

The higher number of enquiries was due to increased retail interest in IPO shares and the allotment information error relating to an IPO.

For the first time, the SFC has been given two top annual report awards in Hong Kong. The *Annual Report 2002-03* was the winner of the Diamond Award in the Hong Kong Society of Accountants' Best Corporate Governance Disclosure Awards 2003 (Public Sector/Not-for-Profit Organisations category) and the Gold Prize in the 2003 Hong Kong Management Association's Best Annual Reports Awards (Non-profit Making and Charitable Organisations category). This was the first time the SFC took the Diamond Award and the fourth consecutive year it was awarded the Gold Prize.

In October, the SFC published a summary of its consultation procedures. This aims to enhance the public's understanding of how the SFC conducts its consultations. Public views improve our decision-making process and help ensure that our proposals meet the needs of the market and investors.


We continued to publish our bi-monthly newsletter *SFC Alert*, the monthly *SFC Enforcement Reporter*, the second *Quarterly Report* for 2003-04 and the autumn issue of the *Quarterly Bulletin*. To keep the market fully informed of our enforcement action, in December we also started fortnightly updates on our website of current SFC prosecutions in the Magistrates' Court for breaches of securities and futures legislation.

### **International Co-operation and External Relations**

At its Annual Conference in Seoul in October, IOSCO selected Hong Kong to host the 31st Annual Conference in 2006. The SFC is honoured that Hong Kong was selected. The strong support of the Hong Kong Government was instrumental in securing the bid. We pledge to make the event a success.

Also in Seoul, a Multilateral Memorandum of Understanding Concerning Consultation and Co-operation and the Exchange of Information (MOU) was signed. Hong Kong was amongst the first securities regulators worldwide to sign the MOU. The SFC participated in the IOSCO taskforce that drafted the MOU and sits on a group that reviews applications to join the MOU.

The SFC's active participation in IOSCO was further confirmed with the appointment of SFC Chairman as Interim Chairman of the IOSCO Technical Committee until the end of the Annual Conference this year.



The SFC, the Australian Securities and Investments Commission, the UK Financial Services Authority and the US Securities and Exchange Commission recently concluded a coordinated visit of an international fund manager group by a joint visit to its headquarters in New York. A letter was issued jointly by the four regulators in December, commenting on management and compliance controls, investment and dealing functions, information technology and risk management of the group.

Two staff assisted the World Bank in September and November respectively on a technical assistance programme to India on capital market development.

In mid-November, the SFC conducted a seminar in Bangkok for the Securities and Exchange Commission of Thailand on regulation of derivatives business. SFC staff shared with their Thai counterparts Hong Kong's market structure, regulations and supervisory regime on derivatives markets and intermediaries. The seminar received a very good response.

One staff member was seconded to the CSRC, spending two weeks each at the Enforcement Bureau and Department of Legal Affairs. The SFC's Corporate Finance Division also hosted two CSRC secondees for six months from August 2003 to January 2004.

On enforcement co-operation, the SFC received 11 requests from overseas regulators, all seeking non-public information. We made two requests to overseas regulators for investigatory assistance.

### **Looking Ahead**

While there was strong investor interest in the IPOs in the quarter, the subscription process was not without incidents. In particular, in the China Life Insurance's IPO, there were errors in the announcement of the allotment results. The Commission was finalising a report on the incident at the time of writing. The report would make recommendations to improve the IPO process.

Mr Christopher Cheng was appointed by the Financial Secretary in November as a Non-Executive Director (NED) to succeed Mr Henry Fan, while NED Hon Jasper Tsang was re-appointed. We are honoured to be able to tap their expertise and invaluable advice, which would be vital to the SFC in enhancing the quality of the Hong Kong financial market. I would like to express my deepest gratitude to Mr Fan, who served as an NED longer than anyone else and who helped guide the SFC through some of its most challenging times.

So far this year, we have accumulated a healthy surplus. Barring sudden changes in market conditions, we expect further surplus in the final quarter to 31 March 2004. Nonetheless, we will continue to exercise tight control on our expenditure during the rest of the current financial year.

Andrew Sheng  
Chairman

13 February 2004

# Securities and Futures Commission

## Consolidated Income and Expenditure Account

For the nine months ended 31 December 2003

(Expressed in Hong Kong Dollars)

	Note	Unaudited Three Months Ended		Unaudited Nine Months Ended	
		31 Dec 2003	31 Dec 2002	31 Dec 2003	31 Dec 2002
		\$' 00	\$' 00	\$' 00	\$' 00
<b>Income</b>					
Levies		105,952	42,487	245,013	143,279
Fees and charges		36,965	30,224	105,233	88,275
Investment income		5,054	8,507	15,971	25,621
Recoveries from Investor Compensation Fund		857	1	2,136	834
Other income		<u>209</u>	<u>301</u>	<u>1,011</u>	<u>1,128</u>
		<u>149,037</u>	<u>81,520</u>	<u>369,364</u>	<u>259,137</u>
<b>Expenses</b>					
Staff costs		79,064	75,464	234,966	227,857
Premises					
- rent		4,559	5,002	14,028	15,007
- other		2,836	2,698	11,487	8,350
Other expenses		<u>7,319</u>	<u>7,811</u>	<u>23,384</u>	<u>26,279</u>
		93,778	90,975	283,865	277,493
Depreciation		<u>7,074</u>	<u>6,014</u>	<u>20,315</u>	<u>16,951</u>
		<u>100,852</u>	<u>96,989</u>	<u>304,180</u>	<u>294,444</u>
<b>Surplus / (Deficit)</b>	2	<u>48,185</u>	<u>(15,469)</u>	<u>65,184</u>	<u>(35,307)</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 16 and 17 form part of the condensed consolidated financial statements.

# Securities and Futures Commission

## Consolidated Balance Sheet

At 31 December 2003

(Expressed in Hong Kong Dollars)

	<u>Note</u>	Unaudited <u>At 31 Dec 2003</u> \$'000	Unaudited <u>At 31 Mar 2003</u> \$'000
<b>Non-current assets</b>			
Fixed assets		40,506	30,976
Held-to-maturity debt securities	3	215,859	388,794
<b>Current assets</b>			
Held-to-maturity debt securities	3	375,168	39,036
Bank deposits		59,129	178,371
Debtors, deposits and prepayments		52,454	25,764
Cash at bank and in hand		<u>4,172</u>	<u>421</u>
		<u>490,923</u>	<u>243,592</u>
<b>Current liabilities</b>			
Fees received in advance		32,569	31,557
Creditors and accrued charges		<u>20,697</u>	<u>17,212</u>
		<u>53,266</u>	<u>48,769</u>
		-----	-----
<b>Net current assets</b>		<u>437,657</u>	<u>194,823</u>
		-----	-----
<b>Total assets less current liabilities</b>		694,022	614,593
<b>Non-current liability</b>			
Deferred lease incentives	4	<u>63,225</u>	<u>48,980</u>
<b>Net assets</b>		<u>630,797</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>587,957</u>	<u>522,773</u>
		<u>630,797</u>	<u>565,613</u>

The notes on pages 16 and 17 form part of the condensed consolidated financial statements.

# Securities and Futures Commission

## Balance Sheet

At 31 December 2003

(Expressed in Hong Kong Dollars)

	<u>Note</u>	<u>Unaudited</u> <u>At 31 Dec 2003</u> \$'000	<u>Audited</u> <u>At 31 Mar 2003</u> \$'000
<b>Non-current assets</b>			
Fixed assets		40,210	30,976
Held-to-maturity debt securities	3	215,859	388,794
<b>Current assets</b>			
Held-to-maturity debt securities	3	375,168	39,036
Bank deposits		59,129	178,371
Debtors, deposits and prepayments		54,131	25,749
Cash at bank and in hand		<u>814</u>	<u>421</u>
		<u>489,242</u>	<u>243,577</u>
<b>Current liabilities</b>			
Fees received in advance		32,569	31,557
Creditors and accrued charges		<u>18,782</u>	<u>17,197</u>
		<u>51,351</u>	<u>48,754</u>
		-----	-----
<b>Net current assets</b>		<u>437,891</u>	<u>194,823</u>
		-----	-----
<b>Total assets less current liabilities</b>		693,960	614,593
<b>Non-current liability</b>			
Deferred lease incentives	4	<u>63,163</u>	<u>48,980</u>
<b>Net assets</b>		<u>630,797</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>587,957</u>	<u>522,773</u>
		<u>630,797</u>	<u>565,613</u>
		-----	-----

The notes on pages 16 and 17 form part of the condensed consolidated financial statements.



# Securities and Futures Commission

## Consolidated Cash Flow Statement For the nine months ended 31 December 2003 (Expressed in Hong Kong dollars)

	Unaudited Nine months ended <u>31 Dec 2003</u> \$'000	Unaudited Nine months ended <u>31 Dec 2002</u> \$'000
<b>Cash flows from operating activities</b>		
Surplus / (deficit)	65,184	(35,307)
Adjustments for:		
Depreciation	20,315	16,951
Investment income	(15,971)	(25,621)
(Profit) / loss on sale of fixed assets	<u>(8)</u>	<u>1</u>
	69,520	(43,976)
 (Increase) / decrease in debtors, deposits and prepayments	 (23,389)	 1,291
Increase / (decrease) in creditors and accrued charges	1,487	(5,714)
Increase / (decrease) in deferred lease incentives	14,245	(3,787)
Increase in fees received in advance	<u>1,012</u>	<u>2,418</u>
 Cash generated from / (used in) operating activities	 62,875	 (49,768)
 Payment to the Unified Exchange Compensation Fund	 <u>-</u>	 <u>(30,000)</u>
 <i>Net cash generated from / (used in) operating activities</i>	 <u>62,875</u>	 <u>(79,768)</u>
	-----	-----
<b>Cash flows from investing activities</b>		
Interest received	17,491	25,404
Held-to-maturity debt securities bought	(193,018)	(33,524)
Held-to-maturity debt securities redeemed	25,000	118,200
Fixed assets bought	<u>(27,839)</u>	<u>(12,204)</u>
 <i>Net cash (used in) / generated from investing activities</i>	 <u>(178,366)</u>	 <u>97,876</u>
	-----	-----
<b>Net (decrease) / increase in cash and cash equivalents</b>	<b>(115,491)</b>	<b>18,108</b>
<b>Cash and cash equivalents at beginning of the nine months</b>	<b><u>178,792</u></b>	<b><u>39,891</u></b>
<b>Cash and cash equivalents at end of the nine months</b>	<b><u>63,301</u></b>	<b><u>57,999</u></b>
	-----	-----
<b>Analysis of the balance of cash and cash equivalents :</b>		
	Unaudited <u>At 31 Dec 2003</u> \$'000	Unaudited <u>At 31 Dec 2002</u> \$'000
Bank deposits	59,129	57,432
Cash at bank and in hand	<u>4,172</u>	<u>567</u>
	<u>63,301</u>	<u>57,999</u>
	-----	-----

# Securities and Futures Commission

## Notes to the Condensed Consolidated Financial Statements

For the nine months ended 31 December 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 consolidated the financial results of ICC Limited in the SFC's condensed financial statements made up to 31 December. We have eliminated all material inter-company balances on consolidation. To conform with current period's presentation, we have restated certain comparative figures. 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 nine months ended 31 December 2003.

### 2. Accumulated surplus

Movements of accumulated surplus during the nine months ended 31 December 2003 are as follows :

	\$' 00
Balance at 31 March 2003	522,773
Surplus	65,184
	<hr/>
Balance at 31 December 2003	<u>587,957</u>

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

As of 31 December 2003, the total market value of held-to-maturity debt securities amounted to \$603,312,000 (31 March 2003 : \$447,562,000), which was above the total carrying cost of \$591,027,000 (31 March 2003 : \$427,830,000).



## Securities and Futures Commission

### Notes to the Condensed Consolidated Financial Statements

For the nine months ended 31 December 2003

*(Expressed in Hong Kong dollars)*

#### 4. Deferred lease incentives

Deferred lease incentives consist of incentives granted by our landlord in connection with the lease of our office premises. In accordance with accounting standards we recognise these benefits as an integral part of the lease expense. We will recognise the deferred incentives in our income and expenditure account on a straight line basis from 2004 to 2013.

#### 5. 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 2003. Therefore we do not provide ageing analysis on debtors and creditors.

#### 6. 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.

#### 7. 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. As at 31 December 2003, the investments in subsidiaries amounted to \$2.2. The balance was too small to appear on the balance sheet which was expressed in thousand dollars.

As the balance sheet of FinNet as at 31 December 2003 and the income and expenditure account for the nine months then ended were immaterial, we have not accounted for its result in the condensed 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 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, a new single investor compensation fund (ICF) was formed 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 eventually transfer the remaining balance of the Fund to the ICF.

Part X of the Securities Ordinance remains 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 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 [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 nine months ended 31 December 2003.

On behalf of the Committee

Mark Dickens, JP  
Chairman

2 February 2004

# Unified Exchange Compensation Fund

## Income and Expenditure Account

For the nine months ended 31 December 2003

(Expressed in Hong Kong dollars)

	Note	Unaudited Three Months Ended		Unaudited Nine Months Ended	
		31 Dec 2003	31 Dec 2002 (Restated)	31 Dec 2003	31 Dec 2002 (Restated)
		\$' 00	\$' 00	\$' 00	\$' 00
<b>Income</b>					
Net investment income		1,478	5,624	6,992	34,784
Transaction levy		-	15,609	(4)	52,992
Compensation refund from claimants		3,630	-	31,810	-
Recoveries	3	20,284	-	39,869	593
		<u>25,392</u>	<u>21,233</u>	<u>78,667</u>	<u>88,369</u>
<b>Expenses</b>					
Net provision for compensation (reversed) / made		(812)	(10,592)	(3,783)	17,664
Recoveries re-distributed to claimants		-	570	-	1,868
Auditors' remuneration		10	10	31	31
Bank charges		21	52	97	203
Exchange difference		-	-	-	11
Professional fees		25	46	112	149
Sundry expenses		-	-	49	1
		<u>(756)</u>	<u>(9,914)</u>	<u>(3,494)</u>	<u>19,927</u>
<b>Surplus</b>		26,148	31,147	82,161	68,442
<b>Accumulated deficit brought forward</b>		<u>(109,123)</u>	<u>(219,697)</u>	<u>(165,136)</u>	<u>(256,992)</u>
<b>Accumulated deficit carried forward</b>		<u>(82,975)</u>	<u>(188,550)</u>	<u>(82,975)</u>	<u>(188,550)</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 31 December 2003

(Expressed in Hong Kong dollars)

	<u>Note</u>	Unaudited At 31 Dec 2003 \$' 00	Audited At 31 Mar 2003 \$' 00
<b>Current assets</b>			
Debt securities		176,792	555,930
Equity securities	3	4,936	-
Interest receivable		1,698	5,580
Levy receivable		-	5,607
Fixed and call deposits with banks		199,102	339,687
Cash at bank		<u>594</u>	<u>17</u>
		<u>383,122</u>	<u>906,821</u>
<b>Current liabilities</b>			
Accounts payable and accrued charges		4,667	4,590
Provision for compensation	4	<u>12,731</u>	<u>30,628</u>
		<u>17,398</u>	<u>35,218</u>
<b>Net current assets</b>		<u>365,724</u>	<u>871,603</u>
<b>Net assets</b>		<u>365,724</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>(82,975)</u>	<u>(165,136)</u>
		953,764	871,603
Contributions to Investor Compensation Fund	5	<u>(588,040)</u>	-
		<u>365,724</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 nine months ended 31 December 2003

(Expressed in Hong Kong dollars)

	Unaudited Nine Months Ended 31 Dec 2003	Unaudited Nine Months Ended 31 Dec 2002 (Restated)
	\$' 00	\$' 00
<b>Cash flows from operating activities</b>		
Surplus	82,161	68,442
Net investment income	(6,992)	(34,784)
Decrease in levy receivable	5,607	2,077
Increase in equity securities received under subrogation	(4,936)	-
(Decrease) / increase in provision for compensation	(17,897)	6,385
Increase in accounts payable and accrued charges	<u>77</u>	<u>276</u>
<b>Net cash from operating activities</b>	<u>58,020</u>	<u>42,396</u>
<b>Cash flows from investing activities</b>		
Debt securities redeemed	205,000	270,000
Debt securities sold	166,824	-
Debt securities bought	-	(219,563)
Interest received	<u>18,188</u>	<u>35,046</u>
<b>Net cash from investing activities</b>	<u>390,012</u>	<u>85,483</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>	(140,008)	157,879
<b>Cash and cash equivalents at beginning of the nine months</b>	<u>339,704</u>	<u>49,934</u>
<b>Cash and cash equivalents at end of the nine months</b>	<u>199,696</u>	<u>207,813</u>

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

	Unaudited At 31 Dec 2003	Unaudited At 31 Dec 2002
	\$'000	\$'000
Cash at bank	594	32
Fixed and call deposits with banks	<u>199,102</u>	<u>207,781</u>
	<u>199,696</u>	<u>207,813</u>



**Unified Exchange Compensation Fund**  
**Notes to the Condensed Financial Statements**  
**For the nine months ended 31 December 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 nine months ended 31 December 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 before 29 October 2003 to the Fund to get back the shares allotted to them from the liquidators, subject to paying a processing fee to the liquidators. If a client elects to retain the compensation payment, the liquidators will allocate shares between the client and the Fund proportionally to the client's loss and the amount of the compensation payment as the Fund is subrogated to the client's rights to the extent of the compensation payments.

During the nine months ended 31 December 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. Up to 29 October 2003, the Fund also received repayments of compensation of \$31,810,000 from those clients who chose to take the allocated shares. This amount has been recognised in the Income and Expenditure Account.



## Unified Exchange Compensation Fund

### Notes to the Condensed Financial Statements

For the nine months ended 31 December 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, subject to paying a processing fee to the liquidators. The Fund arranged to pay processing fees and to liquidate the shares as far as possible. The Fund recognised as recoveries the sale proceeds and the remaining shares at market value of 31 December 2003 after deducting relevant processing fees and charges for collecting and selling the securities received.

### 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 nine months ended 31 December 2003	(14,114)
Less: unused provision reversed during the nine months ended 31 December 2003	<u>(3,783)</u>
Balance as at 31 December 2003	<u><u>12,731</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 legislation came into effect from 1 April 2003, a new single investor compensation fund (ICF) was formed 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 nine months ended 31 December 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 nine months ended 31 December 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 nine months ended 31 December 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, a new single investor compensation fund (ICF) was formed 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 eventually transfer the remaining balance of the Fund to the ICF.

Part VIII of the Commodities Trading Ordinance remains 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 26 to 30.

### 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	[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 nine months ended 31 December 2003.

On behalf of the Committee

Mark Dickens, JP  
Chairman

2 February 2004

# Commodity Exchange Compensation Fund

## Income and Expenditure Account

For the nine months ended 31 December 2003

(Expressed in Hong Kong dollars)

	Unaudited Three Months Ended		Unaudited Nine Months Ended	
	31 Dec 2003	31 Dec 2002 (Restated)	31 Dec 2003	31 Dec 2002 (Restated)
	\$'000	\$'000	\$'000	\$'000
<b>Income</b>				
Net investment income	12	427	730	5,073
Contract levy	-	1,731	-	5,002
	<u>12</u>	<u>2,158</u>	<u>730</u>	<u>10,075</u>
	-----	-----	-----	-----
<b>Expenses</b>				
Auditors' remuneration	10	10	31	31
Bank charges	3	11	21	45
Professional fees	3	5	22	23
Sundry expenses	-	-	1	1
	<u>16</u>	<u>26</u>	<u>75</u>	<u>100</u>
	-----	-----	-----	-----
<b>(Deficit) / Surplus</b>	(4)	2,132	655	9,975
<b>Accumulated surplus brought forward</b>	<u>108,272</u>	<u>102,521</u>	<u>107,613</u>	<u>94,678</u>
	-----	-----	-----	-----
<b>Accumulated surplus carried forward</b>	<u><u>108,268</u></u>	<u><u>104,653</u></u>	<u><u>108,268</u></u>	<u><u>104,653</u></u>

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

The notes on pages 29 to 30 form part of the condensed financial statements.

## Commodity Exchange Compensation Fund

### Balance Sheet

At 31 December 2003

(Expressed in Hong Kong dollars)

	<u>Note</u>	<u>Unaudited</u> <u>At 31 Dec 2003</u> \$'000	<u>Audited</u> <u>At 31 Mar 2003</u> \$'000
<b>Current assets</b>			
Debt securities		-	75,633
Interest receivable		-	957
Levy receivable		-	772
Fixed and call deposits with banks		2,496	51,767
Cash at bank		10	136
		<u>2,506</u>	<u>129,265</u>
<b>Current liabilities</b>			
Accounts payable and accrued charges		<u>228</u>	<u>252</u>
<b>Net current assets</b>		<u>2,278</u>	<u>129,013</u>
<b>Net assets</b>		<u>2,278</u>	<u>129,013</u>
Representing:			
<b><u>Compensation fund</u></b>			
Contributions from HKFE	2	-	21,400
Accumulated surplus		<u>108,268</u>	<u>107,613</u>
		108,268	129,013
Contributions to Investor Compensation Fund	3	<u>(105,990)</u>	-
		<u>2,278</u>	<u>129,013</u>

The notes on pages 29 to 30 form part of the condensed financial statements.

## Commodity Exchange Compensation Fund

### Cash Flow Statement

For the nine months ended 31 December 2003

(Expressed in Hong Kong dollars)

<u>Note</u>	Unaudited Nine Months Ended <u>31 Dec 2003</u> \$'000	Unaudited Nine Months Ended <u>31 Dec 2002</u> (Restated) \$'000
<b>Cash flows from operating activities</b>		
Surplus	655	9,975
Net investment income	(730)	(5,073)
Decrease / (increase) in levy receivable	772	(35)
Decrease in accounts payable and accrued charges	<u>(24)</u>	<u>(10)</u>
<b>Net cash from operating activities</b>	<u>673</u>	<u>4,857</u>
<b>Cash flows from investing activities</b>		
Debt securities redeemed	23,000	25,700
Debt securities sold	51,554	-
Debt securities bought	-	(16,732)
Interest received	<u>2,766</u>	<u>5,392</u>
<b>Net cash from investing activities</b>	<u>77,320</u>	<u>14,360</u>
<b>Cash flows from financing activities</b>		
Net contribution refunded to HKFE	-	(200)
Contributions reimbursed to HKFE 2	(21,400)	-
Contributions to Investor Compensation Fund 3	<u>(105,990)</u>	<u>-</u>
<b>Net cash used in financing activities</b>	<u>(127,390)</u>	<u>(200)</u>
<b>Net (decrease) / increase in cash and cash equivalents</b>	(49,397)	19,017
<b>Cash and cash equivalents at beginning of the nine months</b>	<u>51,903</u>	<u>3,737</u>
<b>Cash and cash equivalents at end of the nine months</b>	<u>2,506</u>	<u>22,754</u>
<b>Analysis of the balance of cash and cash equivalents:</b>		
	Unaudited <u>At 31 Dec 2003</u> \$'000	Unaudited <u>At 31 Dec 2002</u> \$'000
Cash at bank	10	227
Fixed and call deposits with banks	<u>2,496</u>	<u>22,527</u>
	<u>2,506</u>	<u>22,754</u>

## Commodity Exchange Compensation Fund

### Notes to the Condensed Financial Statements

For the nine months ended 31 December 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 nine months ended 31 December 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 nine months ended 31 December 2003	400
Deduct: Refunds to outgoing shareholders during the nine months ended 31 December 2003	(400)
Deduct: Contributions reimbursed to HKFE during the nine months ended 31 December 2003	<u>(21,400)</u>
Balance as at 31 December 2003	<u><u>-</u></u>



## **Commodity Exchange Compensation Fund**

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

**For the nine months ended 31 December 2003**

*(Expressed in Hong Kong dollars)*

#### **2. CONTRIBUTIONS FROM HKFE (Con't)**

Under section 75(3) of Schedule 10 of the SFO, the Securities and Futures Commission (SFC) may apply any excess of the Fund over amounts necessary for satisfying claims and outstanding liabilities of the Fund to reimburse the Hong Kong Futures Exchange Ltd. (HKFE) for the amounts which the HKFE has deposited into the Fund as required under section 82 of the Commodities Trading Ordinance. During the period, SFC reimbursed the HKFE \$21.4 million.

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

When the SFO and its subsidiary legislation came into effect from 1 April 2003, a new single investor compensation fund (ICF) was formed 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 period, 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 nine months ended 31 December 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 32 to 40.

### 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	[appointed on 1 April 2003]
Mrs. Alexa Lam	[appointed on 1 April 2003]
Ms. Anna H.Y. Wu, SBS, JP	[appointed on 1 April 2003]
Mr. Frederick J Grede	[appointed on 1 April 2003 and resigned on 29 June 2003]
Mr. Paul Chow Man Yiu	[appointed on 30 June 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 nine months ended 31 December 2003.

On behalf of the Committee

Mark Dickens, JP  
Chairman

2 February 2004

## Investor Compensation Fund

### Income and Expenditure Account

For the nine months from 1 April 2003 (date of establishment) to 31 December 2003

(Expressed in Hong Kong dollars)

	<u>Note</u>	Unaudited Three Months Ended <u>31 Dec 2003</u> \$'000	Unaudited Nine Months Ended <u>31 Dec 2003</u> \$'000
<b>Income</b>			
Net investment income	3&5	1,150	3,500
Transaction levy from SEHK	3&6	40,432	92,131
Contract levy from HKFE	3&7	2,436	7,347
		<u>44,018</u>	<u>102,978</u>
		-----	-----
<b>Expenses</b>			
ICC expenses	8	710	3,409
Professional fees		-	12
Bank charges		24	29
		<u>734</u>	<u>3,450</u>
		-----	-----
<b>Surplus</b>		43,284	99,528
<b>Accumulated surplus brought forward</b>		<u>56,244</u>	-
<b>Accumulated surplus carried forward</b>		<u><u>99,528</u></u>	<u><u>99,528</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 35 to 40 form part of the condensed financial statements.

## Investor Compensation Fund

### Balance Sheet

At 31 December 2003

(Expressed in Hong Kong dollars)

	<u>Note</u>	Unaudited <u>At 31 Dec 2003</u> \$'000
<b>Non-current assets</b>		
Held-to-maturity debt securities	9	20,226 -----
<b>Current assets</b>		
Held-to-maturity debt securities	9	180,192
Interest receivable		1,460
Due from ICC		1,812
Levy receivable from SEHK		13,757
Levy receivable from HKFE		772
Fixed and call deposits with banks		575,326
Cash at bank		17
		<u>773,336</u>
<b>Current liabilities</b>		
Accounts payable and accrued charges		4 -----
<b>Net current assets</b>		
		<u>773,332</u> -----
<b>Net assets</b>		
		<u>793,558</u> =====
Representing:		
<b><u>Compensation fund</u></b>		
Contributions from UECF	10	588,040
Contributions from CECF	10	105,990
Accumulated surplus		99,528
		<u>793,558</u> =====

The notes on pages 35 to 40 form part of the condensed financial statements.

## Investor Compensation Fund

### Cash Flow Statement

For the nine months from 1 April 2003 (date of establishment) to 31 December 2003  
(Expressed in Hong Kong dollars)

	Unaudited Nine Months Ended 31 Dec 2003
	\$'000
<b>Cash flows from operating activities</b>	
Surplus	99,528
Net investment income	(3,500)
Increase in levies receivable	(14,529)
Increase in accounts receivable	(1,812)
Increase in accounts payable and accrued charges	4
	-----
<b>Net cash from operating activities</b>	79,691
	-----
<b>Cash flows from investing activities</b>	
Held-to-maturity debt securities bought	(218,379)
Held-to-maturity debt securities redeemed	17,000
Interest received	3,001
	-----
<b>Net cash used in investing activities</b>	(198,378)
	-----
<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>	575,343
<b>Cash and cash equivalents at beginning of the nine months</b>	-
	-----
<b>Cash and cash equivalents at end of the nine months</b>	<u>575,343</u>

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

	Unaudited At 31 Dec 2003
	\$'000
Cash at bank	17
Fixed and call deposits with banks	575,326
	-----
	<u>575,343</u>



## **Investor Compensation Fund**

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

**For the nine months from 1 April 2003 (date of establishment) to 31 December 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 nine months from 1 April 2003 (date of establishment) to 31 December 2003

(Expressed in Hong Kong dollars)

### 3. SIGNIFICANT ACCOUNTING POLICIES

#### Basis of preparation

The Fund prepares the interim financial report in accordance with the 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 leviabale SEHK and HKFE transaction on an accrual basis.

#### Translation of foreign currencies

We translate foreign currency transactions during the period 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 nine months from 1 April 2003 (date of establishment) to 31 December 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 nine months from 1 April 2003 (date of establishment) to 31 December 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 31 Dec 2003 \$'000	Nine Months Ended 31 Dec 2003 \$'000
Interest income	1,861	4,461
Premium on held-to-maturity debt securities	(1,063)	(1,431)
Discount on held-to-maturity debt securities	<u>352</u>	<u>470</u>
Net investment income	<u>1,150</u>	<u>3,500</u>

#### 6. TRANSACTION LEVY FROM SEHK

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

#### 7. CONTRACT LEVY FROM HKFE

From 1 April 2003, the Fund received a contract levy chargeable under the SFO 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 31 December 2003, ICC incurred \$3,409,000 for its set up and operation.



## Investor Compensation Fund

### Notes to the Condensed Financial Statements

For the nine months from 1 April 2003 (date of establishment) to 31 December 2003

(Expressed in Hong Kong dollars)

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

	<u>At 31 Dec 03</u>
	\$'000
Maturing after one year	
In the second to third years - unlisted	16,704
After three years - unlisted	3,522
	<u>20,226</u>
	-----
Maturing within one year	
- listed outside Hong Kong	97,609
- unlisted	82,583
	<u>180,192</u>
	-----
	200,418
	=====
Market value of debt securities	
- listed outside Hong Kong	97,727
- unlisted	103,185
	<u>200,912</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 nine months ended 31 December 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 nine months from 1 April 2003 (date of establishment) to 31 December 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 three 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 \$450,000.