



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



REVITALISATION

ANNUAL REPORT 2010-11



2010-11 Annual Report theme concept

Water refreshes and revitalises; it nourishes and nurtures. In fact, water is essential to life, just as reforms are necessary to support and strengthen markets as they evolve.



CONTENTS

2	Preface
6	Snapshots of the Year
8	Statistics at a Glance
9	Chairman's Message
12	CEO's Statement
16	Corporate Outlook
20	Corporate Governance
32	Corporate Social Responsibility
38	Regulation
48	Development
56	Education
62	Organisational Matters
66	Statistical Comparisons
68	Activity and Market Data
78	Financial Statements
	<ul style="list-style-type: none">• Securities and Futures Commission• Investor Compensation Fund• Unified Exchange Compensation Fund
130	Supplementary Information
	<ul style="list-style-type: none">• Committees, Panels and Tribunal• Abbreviations and Index

Rapidly evolving investment markets and products and the increasingly intertwined nature of financial markets were among factors leading to the creation of the Securities and Futures Commission (SFC) more than two decades ago. Far from having subsided, the same factors have magnified in proportions as markets became more globalised. As one of the four financial regulators in Hong Kong, the SFC is facing an increasingly complex operating environment. Fortunately, the sound principles behind its inception prevail. The SFC has been rising to the challenge, as evidenced in Hong Kong being free from systemic failure in the latest global financial crisis.

But recognising that even a proven infrastructure requires fine-tuning to meet changing needs, the SFC has made revitalisation its top priority. It is responding to market forces, rectifying deficiencies and in the process, restoring order to the markets, health to the securities and futures industry and confidence among investors.

Established in 1989 two years after a major stock market crash, the SFC is Hong Kong's statutory regulator of the securities and futures industry. Professionals manage the organisation independently, but it is ultimately accountable to the Government and derives its powers from a statute, ie, the Securities and Futures Ordinance (SFO). Jointly with the other financial regulators, the SFC helps develop Hong Kong's stature as an international financial centre.

Mandates

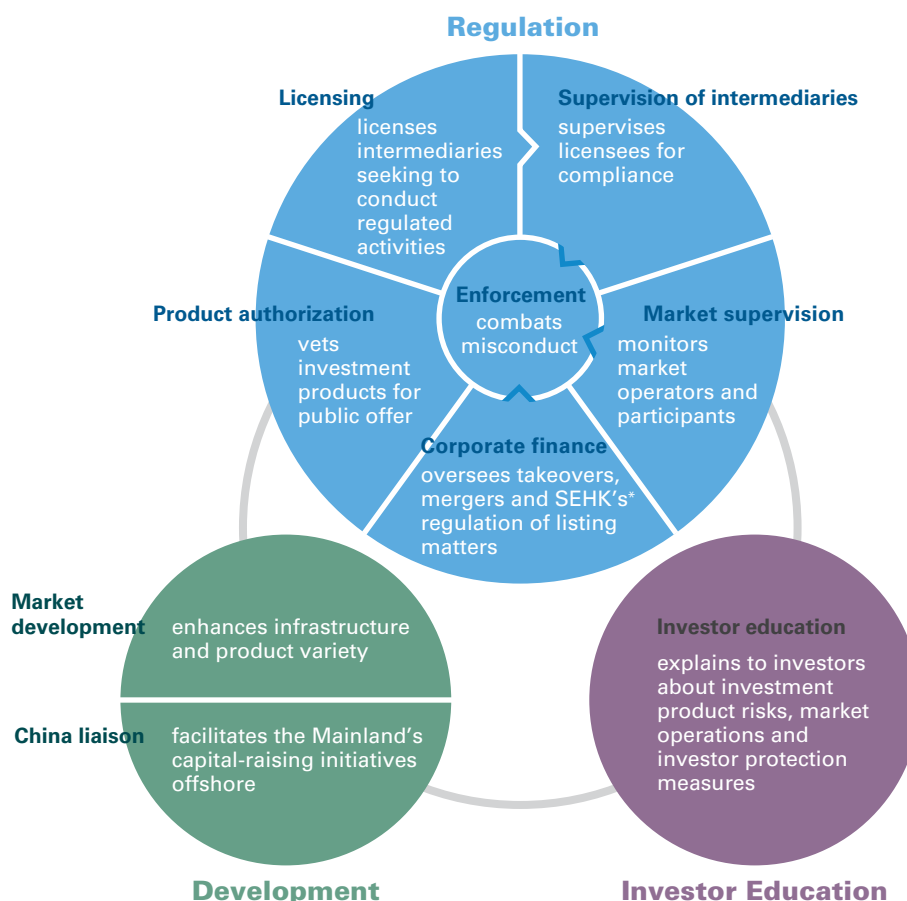
As a statutory body, our work is defined for us according to a scope described in the SFO. Along with the powers come the responsibilities. We are charged with multiple roles as follows:

- Develop and maintain competitive, efficient, fair, orderly and transparent securities and futures markets.
- Help the public understand the workings of the securities and futures industry.
- Provide protection for the investing public.
- Minimise crime and misconduct in the market.
- Reduce systemic risks in the industry.
- Assist the Government in maintaining Hong Kong's financial stability.

Cascading from the mandates described above, our functions are divided into three distinct areas, that of regulation, market development and investor education. As shown in the chart overleaf, we are structured to address our SFO-stipulated operational priorities through sensible division of labour with due checks and balances.

Workings of the SFC

The arrows indicate how one function flows into another. Our regulatory work begins with setting criteria to admit participants into the industry. Then supervision kicks in at various levels to ensure orderly conduct – of intermediaries, market players and market operators. A breach on any front is investigated, and discipline is reinforced by enforcement actions against violators. In addition, investment products must meet pre-determined criteria to be authorized for offer to the general public.



* The Stock Exchange of Hong Kong Ltd

Regulation

Regulatory priority

To maintain a level playing field and a robust operating environment for industry and market participants alike.

How we regulate

Regulation begins with setting standards, proceeds to monitoring for compliance and rounds off with reprimanding or penalising violators to deter misconduct. Standards are set for the full gamut of activities we oversee. Not just licensed intermediaries but market participants of all types must abide by the standards.

Licensing: Our licensing regime stipulates the criteria that must be met by industry practitioners, both corporate and individual, wishing to be and to remain licensed to conduct the 10 types of regulated activities for which the SFC has regulatory responsibility, including dealing in and advising on securities and futures contracts, advising on corporate finance and asset management. From 1 June 2011, the SFC also has assumed regulatory responsibility for a 10th type of regulated activity (providing credit rating services).

Supervision of intermediaries: We issue codes, guidelines and circulars to communicate the standards we expect of industry participants. Through regular reporting and inspections, we monitor the conduct of licensed individuals and the financial soundness of licensed corporations.

Market supervision: To ensure that the markets run smoothly, we supervise the front-line market operators, namely, the exchanges and clearing-houses of Hong Kong Exchanges and Clearing Ltd (HKEx). Through systematic monitoring of market activities, we also keep watch over market participants, ie, all types of investors, industry practitioners, intermediaries and issuers of listed securities. In addition, we oversee the system and technology used in trading platforms in Hong Kong's securities and futures markets.

Corporate finance: We supervise The Stock Exchange of Hong Kong Ltd's (SEHK) performance in its regulation of listing-related matters. We also help to ensure the fair treatment of investors in takeovers and privatisations of public companies by requiring equal treatment of shareholders, mandating disclosure of timely and adequate information and ensuring that there is a fair and informed market.

Enforcement: Core to our regulatory work is the principle of enforcement. We are vested with investigatory and disciplinary powers to call violators to task for infractions or misconduct so as to ensure compliance at every level of Hong Kong's securities and futures markets. In fighting market misconduct, we have recourse to the Market Misconduct Tribunal and the law courts.

Products authorization: For investor protection, certain investment products and/or their offer documents must be authorized by the SFC prior to being distributed to the public. Product-specific codes and guidelines have been issued detailing requirements for authorization of such products and documents.

Development

Developmental priority

To maintain the healthy and sustainable growth of the securities and futures markets by fostering innovation without compromising investor interest.

How we aid development

The vitality of a financial market relies in its ability to anticipate, adapt and improve. As per our mandate to develop the markets, this is also one of our vital tasks. We do so on four fronts – enhancing product variety, assessing alternative trading mechanisms, facilitating business development of intermediaries and building ties outside Hong Kong, notably with the Mainland.

Products: Unlike markets adopting the merit-based regulatory regime, we do not pre-determine the suitability of products. Instead, we require that the offering documents and marketing materials of all products contain adequate and accurate information for investors to make informed decisions. Products are required to meet the applicable structural and issuer eligibility requirements in the product codes. But irrespective of the product type, we bear in mind the international trends to strike a balance between industry innovation and investor protection.

Markets: While monitoring the performance of Hong Kong's front-line market operators on one hand, we also keep abreast of global developments to expand trading channels. Given the growing trend to trade off the bourses, one of our key tasks is to monitor the development of alternative trading platforms, for example, dark pools trading in the Hong Kong market and to provide regulatory responses where necessary.

Cross-border ties: Hong Kong has an indisputable role to play as China's platform to reach out to the world. Through agreements, meetings, seminars, working-level discussions and staff secondment, we maintain close dialogues and collaborative relationships with relevant Mainland authorities to facilitate the Mainland's capital-raising initiatives.

In addition, we are active in the international arena of regulators by participating in international standard setting in various areas. Our senior executives regularly exchange ideas with their counterparts at meetings organised by the International Organization of Securities Commissions. We also participate in the standing committee and are involved in various initiatives of the Financial Stability Board.

Education

Educational priority

To promote investor education with the ultimate aim of safeguarding investor interest and fostering a healthy investing attitude.

How we educate investors

We believe that, in addition to protective measures we prescribe (such as suitability obligations of intermediaries), knowledge of market operations and risks of investment products would prepare investors better to decide what suits them best. As the only regulator with a statutory mandate to educate investors, we champion the cause of knowledge in investing. We reach out to the general public using multiple media, namely, periodical publications, print media, seminars,

television and radio programmes and advertisements, and the InvestEd website (www.InvestEd.hk), etc. Our aim is to nurture a sensible and responsible approach to investing among Hong Kong people. Top of our education agenda is to help the Government set up the Investor Education Council to improve the financial capability of the general public, with a view to assisting them to make more informed financial decisions and manage their money wisely.

How we are funded

The SFC is operationally independent of the Government, and the organisation has been funded by transaction levies and fees from market participants for over 16 years. On 1 October 2010, we reduced for the fourth time our levy for securities and futures trading. At the current level of 0.003%, the levy for securities transactions is significantly lower than the rate of 0.0125% when the mechanism was first set up.

How investor compensation is funded

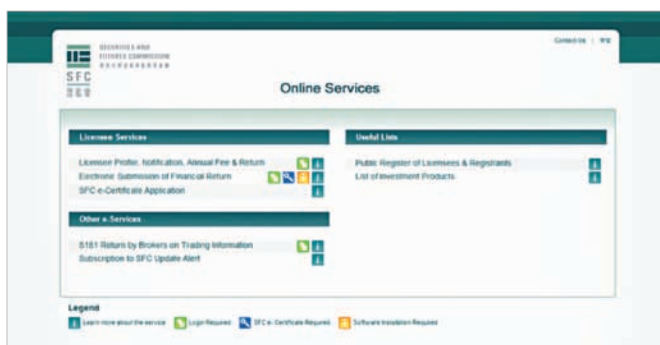
Even with the best of our efforts, risks are inherent in markets and some intermediaries will fail and go out of business from time to time. The Investor Compensation Fund is set up under Part XII of the SFO and managed by the Investor Compensation Co, Ltd (www.hkicc.org.hk), a subsidiary of the SFC. It provides statutory compensation to investors when a licensed brokerage or registered institution goes into default. Each claimant is entitled to a maximum compensation of \$150,000.

SNAPSHOTS OF THE YEAR

2010

April

The online portal for intermediaries has been upgraded to include an electronic annual fee payment function. More new functions will be introduced eventually to allow users to carry out on line all licensing processes and procedures.



We obtain a court order to freeze up to \$997 million in the assets of Hontex International Holdings Co, Ltd for allegedly misleading investors in its prospectus. The amount is equivalent to the proceeds raised by the company in its initial public offering in 2009.

In a landmark move against insider dealing, we seek court orders to ban New York-based Tiger Asia Management LLC from dealing in all listed securities.

May

The six-episode TV drama "SFC in Action" debuts. This is our first-ever TV drama to explain to the public the SFC's regulatory role and work.



Two warrant traders, Patrick Fu Kor Kuen and Francis Lee Shu Yuen, are sentenced to imprisonment, in the first indictable case concerning manipulation of derivative warrants.

CEO Mr Martin Wheatley speaks about global financial reform at the FIX Protocol's Eighth Asia Pacific Trading Summit 2010 held in Hong Kong.



June



The SFC implements a package of protective measures regarding the sale of investment products after consulting the public, including the introduction of an SFC Handbook (as shown on the left). A multimedia campaign with the theme: "Know how the new rules protect you as an investor" is also launched to educate investors on the new measures.

Findings of an Industry Participants Survey released show a majority of respondents expressing satisfaction with the SFC's overall regulatory work.

July

DBS Bank (Hong Kong) Ltd announces a repurchase of Lehman Brothers-related Constellation Notes from eligible customers, involving over 2,100 accounts and a total payment of \$651 million, after reaching an agreement with the SFC and the Hong Kong Monetary Authority (HKMA).



The SFC welcomes a delegation from the Hong Kong and Macao Affairs Office of the State Council, led by its Deputy Head Mr Zhou Bo (middle).

August

The SFC authorizes the first renminbi-denominated fund for sale to retail investors, marking a step forward to help develop Hong Kong into an offshore renminbi centre.

September

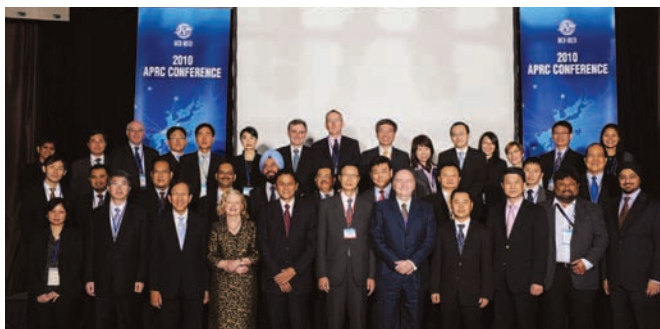


InvestEd Intelligence, a comprehensive bimonthly e-newsletter, makes its debut. Apart from being informative and topical, the e-newsletter also contains interactive elements to make it more fun for the public to learn about their rights and responsibilities of investing.

The plan for Hong Kong's scripless securities market, to be implemented in phases, is announced.

October

The industry indicates support for our proposal to regulate credit rating agencies during a month-long consultation.



Chairman Dr Eddy Fong (third from left, first row) attends the 2010 IOSCO APRC Conference in Taipei, taking part in a panel discussion to share his views on the role of securities market regulators in addressing systemic risk.



January

Dr Fong chairs a panel discussion on the latest regulatory changes and their impact at the Asian Financial Forum, held at the Hong Kong Convention and Exhibition Centre.



Dr Fong welcomes Chairman of the China Securities Regulatory Commission Mr Shang Fulin during the latter's visit to the SFC office.

March

After an agreement with the SFC and HKMA, Standard Chartered Bank makes a repurchase offer of \$1.48 billion to more than 95% of its customers of equity-linked notes issued and guaranteed by Lehman Brothers.

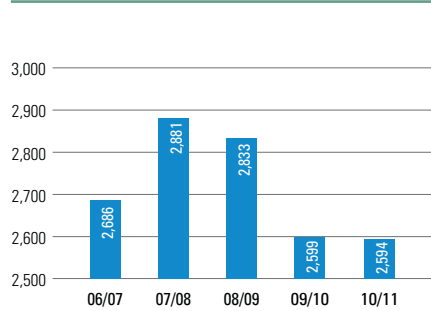


Deputy CEO Mrs Alexa Lam speaks at the Lipper Fund Awards, highlighting the key factors for the growth of the fund industry.

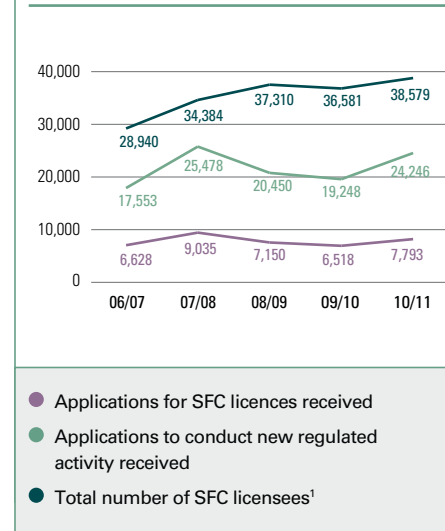
STATISTICS AT A GLANCE

These charts and numbers are intended to provide a glimpse into highlights of the SFC's work in regulation and development. They are also a reflection of market activities. Except noted otherwise, these represent cumulative figures for the reporting years.

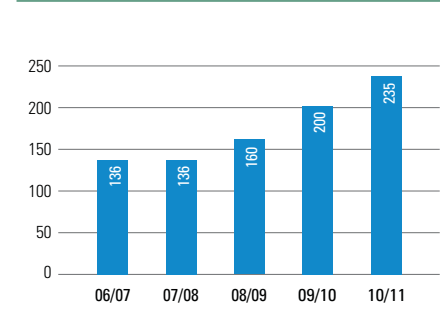
Number of collective investment schemes authorized



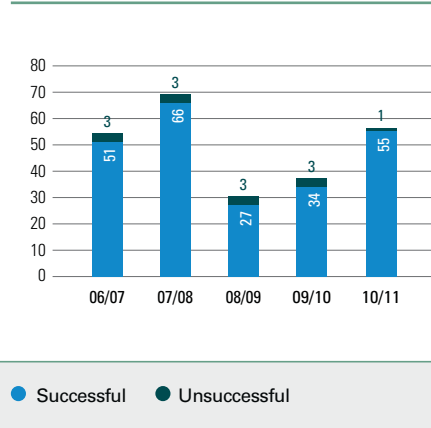
Licensing



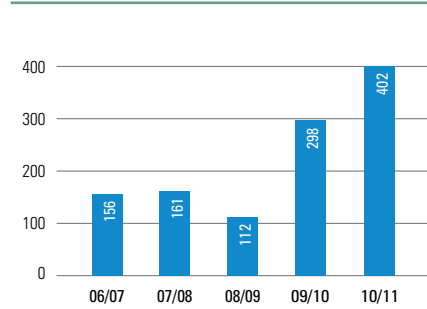
Number of risk-based, on-site inspections conducted



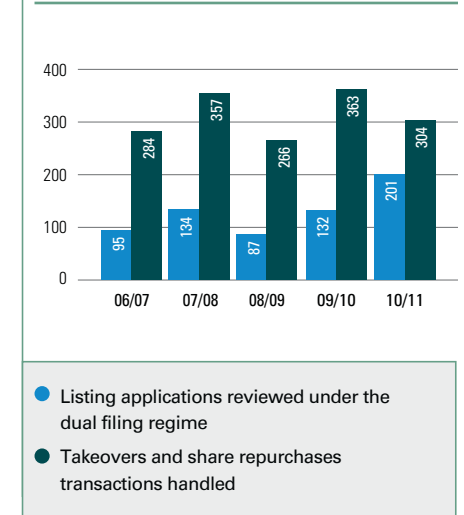
Prosecutions



Enforcement cases handled

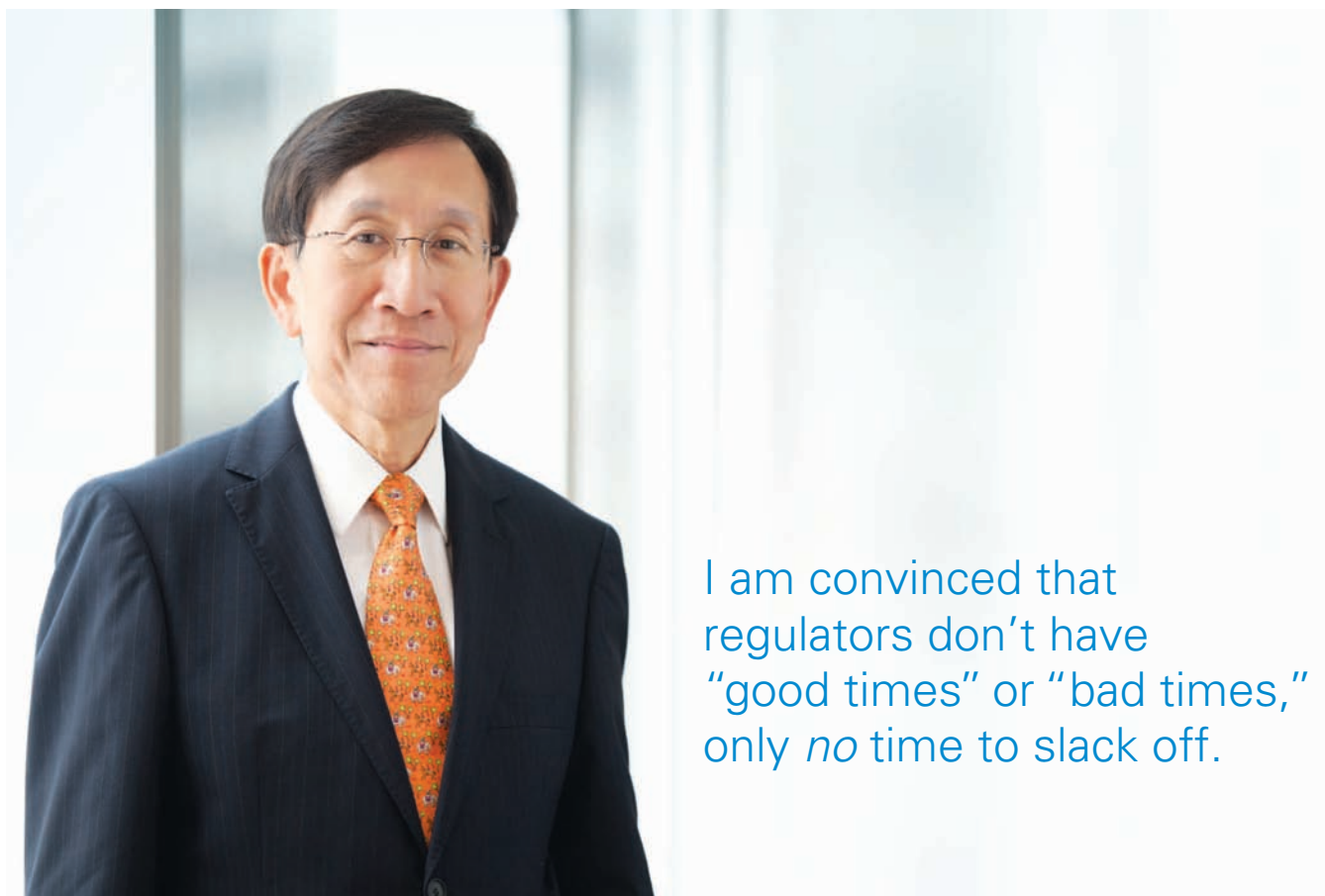


Market-related transactions



¹ This represents a snapshot view as at each financial year-end.

CHAIRMAN'S MESSAGE



I am convinced that regulators don't have "good times" or "bad times," only *no time to slack off*.

In the annual report of 2007-08, I made a remark that my first full year as Chairman of the Securities and Futures Commission (SFC) was "one of stark contrasts" – euphoric markets in the first half and the start of the subprime crisis towards year-end. While the global financial crisis may have abated three years on, uncertainty – and not just on the financial front – continues to pose endless challenges for a financial regulator.

International risks

It has been an eventful spring, marked by political upheavals in the Middle East and North Africa (MENA) and a massive earthquake and tsunami in Japan. While unrest in the MENA region could dent oil output and stoke inflationary pressures globally, the natural disaster in Japan's northeast has damaged some of its nuclear plants, posing a serious threat to public safety and requiring major reconstruction that will further burden its already heavy government debt and potentially undermine economic growth. Nuclear energy is undergoing a rethink globally and this could have a major impact on future energy supply and cost.

These developments complicate the uncertainty that already surrounds the uneven global economic recovery and growth and the assurance of global financial stability, given that balance sheet restructuring after the global financial crisis is incomplete and slow, and leverage remains high.

Moreover, the world is still coping with the sovereign debt crisis in peripheral Euro zone economies and unsustainable sovereign debts and fiscal deficits of larger economies. Concern is growing that these could unravel as interest rates normalise or increase to fight inflation or as investors demand higher yield for the risk of holding sovereign debt. As banks are major holders of sovereign debt, they would be particularly vulnerable to a price adjustment. There is also the risk that prolonging the current low-interest-rate environment in advanced economies would encourage a comeback of higher yielding exotic financial instruments, making faster growing emerging markets more attractive to capital inflows and asset prices in these markets highly vulnerable to major correction once interest rates normalise.

Against this backdrop, regulatory reforms are progressing but face implementation challenges of fatigue and of having to roll out the legislative, rule and procedural changes to give effect to the reforms, which can be quite complex, more so where different national systems are involved. It is in the interest of policymakers, regulators and industry to work together to achieve the desired outcomes without the unintended consequences.

Regional risks

Asia is also not immune to the risks that are playing out internationally. Inflationary pressure is growing as oil prices are likely to remain high in the face of geopolitical tensions, while changing demographics in Asia and the nuclear crisis in Japan are likely to maintain pressure on already increasing food prices in Asia. When monetary easing reverses in advanced economies, the higher interest rates could potentially destabilise financial markets if defaults by borrowers impair bank balance sheets and force banks to rein in lending and disrupt economic activities and growth. The debt servicing burden of governments also could become unsustainable in the face of rising interest rates and growing deficits.

Although Hong Kong has emerged relatively unscathed from the global financial crisis, it faced its own set of challenges. Asia's faster growth had attracted capital inflows and this was given a further boost by the announcement of a second round of quantitative easing by the United States. Hong Kong's stock market comfortably absorbed these inflows without much impact on the price-earnings ratios of companies. Prices in the property markets of Hong Kong and the Mainland increased substantially, prompting policy makers on the Mainland and Hong Kong to introduce prudential measures to cool the property market and to consider policies to increase the supply of affordable housing.

Staying vigilant

Hong Kong is in a relatively fortunate position given its proximity and role in bridging capital flows from and to Mainland China, the world's second largest economy that is continuing on its growth path. But as a major international financial centre, Hong Kong cannot afford to be complacent. Hong Kong is a highly open market and is affected by developments from around the world and also from the Mainland. Hence, the SFC has to remain vigilant to developments both outside and inside Hong Kong in order to assess their implications and consider appropriate action as required to maintain the orderly functioning of our securities market. We need to continue to maintain regular dialogue with the industry, as well as other regulatory agencies and the Government, and to strengthen our regulatory system as required to maintain a robust market infrastructure and the confidence of investors.

Over the past year, we took steps to introduce measures to improve industry practices and strengthen investor confidence. A key measure is enhanced disclosure requirements for investment products and fine-tuning the guidelines governing the sales practices of intermediaries. Other measures are in the pipeline and progress is on track for market consultation in due course. The SFC is mindful of the importance of ensuring that our regulations remain relevant and effective and are in tandem with international standards.

Bigger role as China's world stage

China's growing economic influence offers Hong Kong huge

opportunities. In addition to its traditional role as the world's window to China and the Mainland's international capital-raising platform, Hong Kong is a testing ground to broaden the renminbi's role on the world stage. In fact, the Twelfth Five-Year Plan has a chapter devoted to Hong Kong and Macau for the first time, underlining the potential of the offshore renminbi centre as a future growth sector for Hong Kong.

One indicator of the potential is the rapid growth in renminbi deposits, which have grown more than seven times from the end of 2009 to RMB451.4 billion as at the end of March. The market has responded positively to the opportunities to develop renminbi products. The SFC will keep a watchful eye on any additional risks that may accompany the stream of renminbi products and its related transactions, review the market situation constantly, and closely collaborate with other regulators to pre-empt potential problems.

So once again, vigilance will be our watchword. We will press ahead with educational initiatives, using all mass media channels, to caution investors not to jump on the bandwagon without fully understanding the risks of this asset class.

On the industry front, closer economic ties with the Mainland have attracted more intermediaries from across the border to set up operations in Hong Kong. As a major asset management centre in the region, Hong Kong, indeed, is in a unique position as a springboard for Mainland fund houses to gain experience before venturing overseas.

Hong Kong is committed to healthy competition and will continue to maintain a robust regulatory framework and market infrastructure and diligently enforce our rules so that Hong Kong remains an attractive investment destination for intermediaries and investors alike.

Balancing act

I was asked recently when would be a better time to be a financial regulator. Would it be when the markets are robust or would it be when markets face a downturn, problems crop up, and everyone turns to you for answers?

I have seen ups and downs and I am convinced that regulators don't have "good times" or "bad times," only no time to slack off. As a financial regulator, we are always

trying to balance naturally different self-interests that sometimes diverge. Besides ensuring that the industry infrastructure is sound and that industry participants behave appropriately, the SFC also has a statutory obligation to help develop Hong Kong as a financial centre and to safeguard investor interests. The balancing act gets more demanding as investment products and financial markets get more complicated.

Regulators are not in a popularity contest and we have to maintain a healthy dose of scepticism. We have to remain coolheaded and objective whatever the market situation, keep a keen eye on our objectives and act to achieve the desired outcomes.

We also recognise the importance of ensuring that our organisational design and structure remain effective to meet the SFC's strategic and operational objectives and needs, and have initiated a review to improve our organisational governance and effectiveness.

To achieve our objectives, our efforts alone are not sufficient. We need the market and investors to act with self-discipline and responsibility. Discipline on all our respective parts would be the best assurance of a quality market that would be in the interest of all of us.

The SFC has faced many challenges. The diligence and commitment of our staff are outstanding, while ingenuity in dealing with some complex situations and, above all, good team spirit, have contributed to our success in meeting these challenges. I thank the staff and the Board for their unstinting support, dedication and contribution. I also wish Martin [Wheatley] all the very best for the future, as he leaves Hong Kong after almost six years as CEO of the SFC to take up more exciting regulatory challenges in Britain, his homeland.

Dr Eddy C Fong
Chairman

CEO'S STATEMENT



It is the quality of the implementation that is critical – not the model itself.

This is my sixth and last time penning a message for the annual report of the Securities and Futures Commission (SFC). I do so with mixed feelings – sadness that I am leaving Hong Kong, and in particular, the staff, and satisfaction that looking back, I leave a strong organisation, well placed to support the development of Hong Kong's financial market. I will use this statement, therefore, not just to recap the past year but to reflect on the events of the last six years.

Reform to revitalise

Another year has passed, but regulatory reform following the global financial crisis remains a challenge. Many of the policy issues for Hong Kong have been resolved and I am pleased with the progress of those changes, given that clear timelines were set for implementation. The global agenda,

however, remains at a fluid stage, notwithstanding the passing of the Dodd-Frank Act in the United States and the many reforms in Europe.

In Hong Kong, we have completed some reforms, and are in the process of implementing others. As a major item on our agenda for the reporting year, we launched reforms to two of our key regulatory functions. For retail investment products, we revised the product codes to improve transparency and set enhanced disclosure standards; for intermediaries, we amended the Code of Conduct to raise standards of selling practices.

Our regulatory reform agenda also included other items not stemming directly from the financial fallout, where the key purpose is to better protect investors. For instance, we

introduced enhanced disclosure requirements for synthetic exchange-traded funds (ETFs), as well as a new annotation requirement to make it easier for investors to differentiate between traditional and synthetic ETFs.

In terms of enforcement actions, for the first time, we successfully sought an injunction to pre-empt the misuse of initial public offering (IPO) proceeds. We are seeking court orders to restore the funds raised from the IPO to those who subscribed to shares and to others who purchased the shares since the IPO.

In line with global development to tighten supervision of credit rating agencies (CRAs), we decided to add a new type of regulatory activity to our existing licensing regime. Starting from 1 June 2011, CRAs and their analysts working in Hong Kong are required to be licensed.

On the international scene, uncertainty still hangs over a number of issues unearthed by the financial crisis. As the regulator of securities and futures markets in an international financial centre, we adopt best global practices. We continued to participate actively in discussions at the level of the Group of Twenty (G-20) and the Financial Stability Board to drive regulatory developments in areas such as over-the-counter instruments, dark pools, centralised clearing houses and swap-based execution of trades. Some of these items are new to Hong Kong but need to be addressed as they take up a big part of the global agenda.

Living our values

Over the years, the SFC has progressively established itself as a globally respected regulator and an organisation of professionals responsive to market changes.

To sustain this positive reputation in the financial market, we recognise the need to build on our strengths and most importantly, to revitalise ourselves continuously. We embarked last year on a programme to drive and develop an open and more integrated working culture within the SFC: one that acts with integrity and foresight.

In an organisation-wide effort, we promoted the cause of being proactive, professional and the recognition that people are our greatest asset. A series of "culture workshops" were held to champion these core values as an integral part of

working at the SFC. Even though I shall be leaving, I know that these core values will prevail to guide and inspire our staff in their day-to-day work and to prepare the SFC to face challenges ahead.

Challenges ahead

To sustain our long-term vision of being a globally respected regulator that acts with independence and integrity and is responsive to market changes, we shall implement strategic initiatives to meet identified regulatory risks and challenges.

Items on our near-term agenda include: sponsors' work and quality of listing documents, the disclosure of price-sensitive information and a paperless securities market. Given the rapid emergence of renminbi products and Mainland entities, we also shall strive to grow our market whilst remaining firmly committed to investor protection.

The list goes on. Please see our new "Corporate Outlook" chapter (pages 16-19) as I shall not dwell on details here.

Regulatory thinking

In the aftermath of Lehman Brothers' (LB) collapse and the near meltdown of the global financial system, lots of questions have been asked of regulators. "Why didn't you see it coming? Why didn't you intervene earlier? Are you competent enough to understand the complexities of modern finance?"

There were failures in every market. Some were failures of major financial institutions; some were product failures and some fell just short of total failure but resulted in huge losses. While no market in the world was immune from the effects of the crisis, some fared better than others. Asian markets generally did better – in part because of the structural reforms implemented after the Asian financial crisis.

Within Asia, Hong Kong was more robust than many. We did have some product failures. In particular, credit-linked notes where LB was either the swap counterparty or a defined credit risk saw losses, and a number of other complex products also failed. However, we did not suffer any institutional collapses of brokerages, banks, hedge funds, etc as in other markets.

But the question remains – if this regulatory system has failed us, what is a better system? Regulatory systems around the world vary but most fall into three general categories. The original model, which still prevails in the United States, Hong Kong and Mainland China, is the institutional model. With this model, separate regulators look after banking, securities, insurance, etc. Most other markets have moved beyond this, to variants of either the single integrated regulator largely pioneered by the United Kingdom, or a “twin peaks” model where one organisation takes responsibility for prudential regulation and the other for conduct regulation.

All of these models existed around the world during the crisis and it is not clear that any single model performed particularly better than any other. Why? It is the quality of the implementation that is critical – not the model itself. In particular, the challenge lies in managing the interfaces – either between separate organisations, or between different parts of the same organisation.

In the original report to the Government following LB's collapse and the subsequent product failures in Hong Kong, I proposed that the “twin peaks” model be considered as an alternative to today's structure for Hong Kong. Inevitably, the question is whether the disruption and organisational upheaval of moving to a new structure is justified by the benefits that will accrue.

Two years on, we find ourselves with essentially the same model but some important tweaks to that structure. The SFC has successfully rolled out some improved disclosure requirements for products and Hong Kong is the first regime in the world to develop a regulatory structure specifically for structured products. We have spent some time fine-tuning the conduct requirements of intermediaries to ensure that the existing requirements are better implemented. We have also spent a lot of time improving the interfaces with other regulators.

Financial crises are unfortunately a recurring feature of financial markets. The important thing is to take lessons from this crisis – just as we did with the Asian financial crisis – to ensure that we are in a more robust position when the next crisis emerges.

Coming full circle

I joined the SFC at a time when the local market was on the rebound after the outbreak of the severe acute respiratory syndrome. At the time, Hong Kong was riding very much on the resurgence of the growing Mainland capital markets. Looking back, we have come almost full circle. We went from that to the meltdown of 2007 and 2008, which uncovered problems of product suitability. Since LB's collapse, we have been spending much time rebuilding structures, addressing weaknesses that have become apparent, and rebuilding confidence in the market. The focus of investor protection has also become much clearer as a result of that experience.

Over the past six years, I have seen remarkable changes at the SFC in more aspects than one. As a regulator, we have been taking a firm and pragmatic approach and it paid off. Having in place an effective regime for short selling, for instance, we were able to weather the volatility of 2008 without following other major markets to take up ad hoc measures.

And if successful prosecutions are indicative of esteem, then I am glad to observe that we have been held in high regard by judges. Since March 2007, we managed more than 170 convictions for market manipulation, representing two-thirds of all such convictions since the SFC's inception 22 years ago.

We also made a number of breakthroughs in the courts, by taking on successfully a number of complicated cases, including intervening in a major corporate action, obtaining

a court order to freeze assets of an overseas asset management house and those of its senior officers for suspected insider dealing, and obtaining the maximum jail sentence for insider dealing.

Above all, we took decisive steps to the problems of product-suitability and sales practices, securing from banks and brokers billions of dollars in payment for investors of LB-related products and some other structured products.

As the only regulator with a statutory mandate to educate investors, we have been using multiple channels to reach out to diverse target audiences. The collapse of LB highlighted the issue that investment products were becoming ever more complex and their distribution channels often cut across traditional boundaries of the banking, insurance and securities sectors. Recognising this, we have been working closely with the Government to establish the Investor Education Council, which will take a holistic approach to investor education and address their multi-faceted wealth-management needs.

Traditions in evolution

As a corporate citizen, we formalised a policy to show care for the environment, the community and our staff while maintaining top vigilance in corporate governance.

As a place to work, we have been promoting core values and the one-organisation concept to bring out the more productive, proactive and participative traits of colleagues.

By and large, these changes were made in the context of a changing culture. Culturally, Hong Kong is a diverse mix. While the heritage of the colonial system still lingers, the influence of Mainland China is increasingly evident. When I first came from the UK, I ran a couple of “white board (brainstorming) sessions” but nobody would speak up. In the latest “CEO Sharing Session,” however, I had to answer many well-thought-out questions raised by staff.

Invaluable experience

I take with me a range of experiences that will be invaluable to apply back in the UK. The whole of Europe is undergoing a fairly massive set of regulatory reforms. I am proud of the milestones and directions we managed to set here. Without the support of the Board and the dedication of my colleagues, I am afraid some of the milestones would not have been possible. So let me take this opportunity to thank the Board and all our staff for weathering through challenges and working through the storm.

I am also enormously appreciative of the support we received from the community. Our perception as an organisation has become higher in society than when I first joined. I am pleased that a clear majority of industry participants and industry-related parties polled in a survey last year expressed satisfaction with the work of the SFC. I also would like to thank the media and the legislators for their understanding and feedback.

Forging ahead

While I do not underestimate the challenges and uncertainties ahead, I trust that the SFC, which has established itself as a respected regulator both locally and globally, will continue to strengthen and protect the integrity and soundness of Hong Kong’s securities and futures markets for the benefit of investors and the industry.

Martin Wheatley
Chief Executive Officer

CORPORATE OUTLOOK

The SFC regularly reassesses corporate priorities. Our corporate vision is to be a globally respected regulator, to act with independence and integrity, and to respond to market changes.

Over the past year, external events continued to present risks to the Hong Kong market. To some extent, tightening macroeconomic policies adopted by Mainland China and the sovereign debt crisis in Europe stirred turbulence. But despite the prevailing volatile environment, our financial system continued to demonstrate considerable resilience. Although Hong Kong fared relatively better than many other jurisdictions in surviving the global financial crisis, we have not let down our guard. We continued to refine and reinforce our regulatory model to meet new international standards and market challenges.

Two years after the crisis, while good progress has been made on what needs to be done, incorporating the necessary changes into the existing system seamlessly remains the bigger challenge.

In the aftermath of the financial crisis, the international community has been busy implementing the most radical financial reform proposals since the Great Depression. Hong Kong has been taking part in the discussions of these proposals through the International Organization of Securities Commissions (IOSCO) and the Standing Committee on Standards Implementation of the Financial Stability Board (FSB). Two years after the crisis, while good progress has been made on what needs to be done, incorporating the necessary changes into the existing system seamlessly remains the bigger challenge.

Different jurisdictions have zoomed in on what was perceived as the most pressing and critical issues, resulting in diverse approaches. As a result of thorough discussion and public consultation, locally, we continued to reinforce the integrity

and soundness of the Hong Kong securities and futures markets by building on the existing regulatory regime, instead of spearheading drastic structural changes, for the benefit of both investors and the industry.

While setting new standards for the securities and futures markets and responding to the changing market landscape, we are also mindful that the scope and speed of regulatory changes may cause unintended consequences of a disruptive nature. We believe that the regulatory framework must give rise to high compliance standards backed by strong enforcement while still encouraging the functioning and growth of the industry.

On the other hand, as a free and open economy, Hong Kong's broad and deep markets have offered plenty of opportunities and choices for investors. Having said that, an open economy inevitably introduces more risks. Despite rapid growth as a major market and a pilot offshore centre for renminbi products, our guiding principle remains to encourage market development without compromising investor protection. Keeping a watchful eye on the additional risks that come along with new opportunities, we review and enhance our regulatory regime in response to foreseeable threats.

To meet these longstanding objectives, we have identified the key regulatory risks and challenges facing us and have planned key strategic initiatives to meet such challenges from 2011 to 2013. Nevertheless, risks and challenges are ever-present in the market. We shall review and adjust these initiatives from time to time to respond to the prevailing circumstances.



Dealing with regulatory overload

The financial crisis has brought about unprecedented regulatory reforms on a global scale. These reforms have gone beyond the traditional boundaries of regulation, with new emphasis on systemic risk, macro-prudential regulation along with international co-operation, and more intrusive

micro-prudential and conduct regulation. Similar to other major financial markets, financial reforms in Hong Kong are carried out under extreme timescale pressure.

As part of the post-crisis policy to improve risk transparency in the financial system, to monitor cross-border risk transfer and keep track of systemic risk, we recently took part in an IOSCO initiative to collect systemic risk data on large hedge fund portfolios managed in Hong Kong. Looking ahead, we will continue to participate actively in the work of IOSCO and FSB, to keep pace with the scope and speed of regulatory changes at the global level. Locally, we will pursue cautiously legislative changes based on domestic imperatives and circumstances.

Most relevant to our upcoming work are these items on the international reform agenda: oversight of credit rating agencies (CRAs), over-the-counter (OTC) derivatives and short selling.

- **Regulation of CRAs:** The Group of Twenty (G-20) recommended that CRAs that issue ratings be subject to regulatory oversight, including registration. Locally, we are adding licensing of CRAs as a new type of regulated activity under the existing regime in the first half of 2011 to ensure that credit rating activities are conducted according to the principle of integrity, transparency, responsibility and good governance.
- **Clearing and trade reporting regime for OTC derivatives:** To reduce counterparty risk and improve transparency, the G-20 members have reached a consensus that OTC derivatives should be standardised, traded on exchanges or electronic platforms and cleared through central counterparty clearing houses by the end of 2012.

The SFC is working with the Hong Kong Monetary Authority (HKMA) and Hong Kong Exchanges and Clearing Ltd (HKEx) to establish an appropriate regime for the implementation of mandatory clearing and trade reporting requirements for OTC derivatives.

- **Short-position reporting regime:** Having gathered public comments towards the end of 2009, we shall introduce a short-position reporting regime in Hong Kong to enhance market supervision and risk monitoring, especially at times of high market volatility. As the next step forward, we shall consult the public on the draft subsidiary legislation within 2011.

Task 2 Facilitating renminbi's development

Hong Kong is an offshore centre to pilot the development of renminbi investment products. The rapid emergence of renminbi products and Mainland entities, however, will inevitably introduce to Hong Kong additional product risks and entity risks. While facilitating the development of renminbi business, we are committed to protecting the interests of the investing public.

In view of the increase in the number of Mainland financial institutions in Hong Kong, we will strive to promote best practices and a good compliance culture among the new entities, and seek to provide a fertile ground in Hong Kong for intermediaries to grow in size, strength and competitiveness, in line with international standards.

Furthermore, given the non-convertibility of renminbi and the restricted nature of the Mainland's stock and bond markets, we will work closely with the relevant local regulators and Mainland authorities to ensure that interests of the investing public are protected sufficiently as renminbi products gain popularity. To that end, extensive investor education campaigns will be launched.

To develop Hong Kong as a pilot offshore centre for renminbi products, we will support Government initiatives to augment the relevant infrastructure to facilitate expansion of the universe of renminbi-denominated instruments and financial transactions available to investors. In addition, we will continue to promote co-operation between the securities markets on the Mainland and in Hong Kong and maintain Hong Kong's position as the capital-raising centre for Mainland enterprises.

Task 3

Expanding as a major market

Despite the instability seen in the global markets, the local securities market continues to grow in strength, attracting issuers from new jurisdictions to have their securities listed and traded here. Amidst rapid market development, regulatory oversight on foreign companies and ensuring the quality of listing candidates become key to maintaining Hong Kong's reputation as an international financial centre, upholding market confidence, and safeguarding investor interests.

Since regulatory oversight of listed companies domiciled overseas is likely to be more cumbersome and resource-intensive, we are set to take various measures to enhance the quality of our securities market in terms of compliance, sponsor due diligence, disclosure of price sensitive information, etc.

- **Listing matters:** The SFC will work closely with The Stock Exchange of Hong Kong Ltd (SEHK) to enhance the Listing Rules and attract quality companies from around the world to raise capital here. While supporting market growth on one hand, we are mindful of our regulatory role to maintain high standards.

We conducted a thematic review of listing sponsors and issued a report on the findings in March 2011. We may review shortly the responsibilities relating to a sponsor's work.

- **Disclosure of price-sensitive information:** To raise the quality of our securities market, we will continue to assist

the Government in preparing the relevant legislation to impose on listed corporations a statutory obligation to disclose price-sensitive information. The bill is expected to be gazetted and introduced to the Legislative Council in 2010/11 legislative session.

- **Scriptless securities market:** To achieve paperless securities trading in the long run, we shall work on introducing legislative amendments to implement the scripless regime. We target to do a pilot run in late 2013.

Task 4

Dealing with mis-selling

The collapse of the Lehman Brothers group has brought to light the risks of complex structured investment products. Yet the post-crisis environment of high liquidity and low interest rates continues to fuel demand for higher-yield investment products.

To ensure that intermediaries explain the complexity of investment products, last year, we modernised the disclosure requirements for investment products offered to the public and fine-tuned the conduct requirements of intermediaries regarding the sales process. We continue to work closely with the industry to implement the new measures and to facilitate a smooth transition into the new regime.

One of our major priorities is to enhance the compliance culture of the industry and improve standards, particularly in relation to discharge of suitability obligations. We recently issued a report on the findings specific to the securities

sector based on a mystery shopping exercise conducted simultaneously with HKMA earlier this year. Going forward, we shall continue to raise the compliance standards of the industry and to share information on sale of investment products with HKMA.

We are responsible for authorizing offering documents and marketing materials for the sale of investment-linked assurance schemes (ILASs). To clarify common misunderstanding of ILASs, we shall continue to help investors understand the features of ILASs and the associated risks. As ILASs are essentially a type of insurance, we also will work closely with the Office of the Commissioner of Insurance who oversees the business conduct of insurance companies and agents regarding the sale of ILASs.

Task 5

Anticipating disruptive technology

The emergence of sophisticated trading technology and practices changes the way markets and their participants interact. For instance, investors nowadays have direct access to the markets. While improving trading efficiency, however, new technology also increases the risk of market disruptions due to erroneous trading. Although Hong Kong has not experienced a major failure in this regard, the US flash crash in May 2010 was a stark reminder that inter-connected trading platforms could be vulnerable.

On the other hand, alternative trading avenues outside traditional exchanges, such as dark pools, have enabled niche players to execute trades to their best advantages.

The rapid development of off-exchange transactions worldwide – albeit at an infant stage locally – has captured our attention as to what implications they have on the existing regulatory regime.

At this stage, we continue to monitor closely the growth and evaluate the potential risks and issues arising from technology-driven trading activities and alternative trading avenues, with a view to developing appropriate regulatory policies.

Task 6

Improving organisational effectiveness

To effectively discharge our statutory objectives and stated vision, it remains our priority to attract and retain the best talent.

We will enhance further our performance management framework by linking corporate priorities to individual performance, remuneration and rewards. As part of our corporate culture programme under the theme of “Living our Values” launched last year, we will continue to organise a series of initiatives to promote our core values, cultivate better internal communications, create a good working environment and address needs and concerns of our staff at the SFC.

Apart from fulfilling our statutory obligations to foster orderly growth in the securities and futures markets, we will also strive to adopt policies and practices that benefit the community as a whole and raise our staff’s awareness in terms of our corporate social responsibility.

CORPORATE GOVERNANCE

20	Governance framework
22	Adopting best practices
26	Meeting attendance record
27	Performance pledges
28	Board of Directors

Governance framework



● Internal committees ● External controls

¹ Composed of members from the Board

² Consists of external members and SFC Chairman as ex-officio

Using an established system of good corporate governance and putting the right people in place to guide the organisation, we strive to practise the core values we advocate to be an exemplary corporate citizen and public body.

Board of directors

The Board has the responsibility for setting the overall direction and for providing strategic guidance to the organisation. It meets at least once a month.

The Board comprises a non-executive chairman, a chief executive officer (CEO) and other executive and non-executive directors. All Board members are appointed for a fixed term by the Chief Executive of the Hong Kong Special Administrative Region or by the Financial Secretary (FS) under delegated authority. The majority of Board members are independent non-executive directors (NEDs).

The posts of chairman and CEO have been segregated since the enactment of the Securities and Futures (Amendment) Ordinance 2006.

As at 31 March 2011, the Board consisted of a chairman, six NEDs and five executive directors (EDs) including the CEO. For details of the Board, please see pages 28-31.

Memberships of the Audit Committee and Remuneration Committee comprise only NEDs whereas the Budget Committee comprises both NEDs and non-voting EDs.

Last December, Mr Martin Wheatley announced his impending departure in mid-2011. A global executive search for the CEO is underway.

Earlier in 2011, Mrs Alexa Lam was re-appointed as Executive Director (Policy, China and Investment Products) and Deputy Chief Executive Officer for a three-year term to February 2014.

Mr Anderson Chow Ka-ming, SC, and Professor Leonard Cheng Kwok-hon were each appointed NED for a two-year term to December 2012. Mrs Angelina Lee Wong Pui-ling was re-appointed as NED for two years to July 2012. In addition, Mr Carlson Tong was appointed NED for two years from 1 April 2011 to March 2013.

Last year, 15 Board meetings were held.

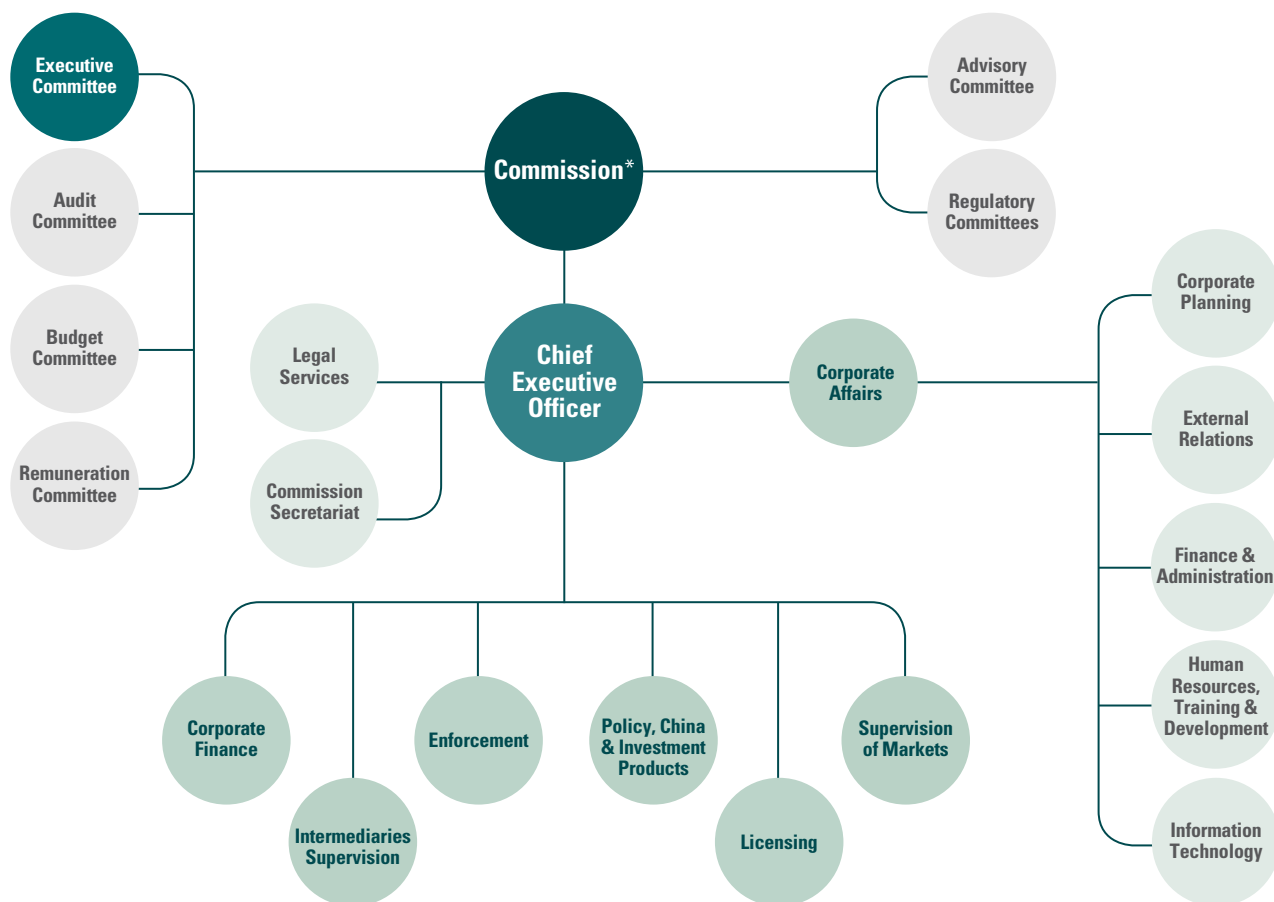
The Executive Committee (ExCo)

The ExCo is responsible for the day-to-day operations of the Commission. Led by the CEO, the ExCo comprises four other EDs, the chief counsel and three senior directors. The ExCo is charged with administrative, financial and management duties delegated to it by the Board.

Checks and controls

In addition to the Board, a number of internal committees and external bodies are involved in the SFC's governance. The internal controls and external checks work in tandem to ensure that we adhere to the policies and procedures to uphold good governance.

Our structure



* The Commission refers to the board of directors.

Adopting best practices




During the year, we continued to work within our governance framework, applying the guiding principles to our work.

Our accountability

We are accountable to the Government and the public as to how we exercise our statutory powers, deploy resources and carry out our regulatory functions. The reviews and examinations carried out under the control framework during the year are set out below.

In addition to yearly financial disclosure in the annual report, we publish our financial statements every quarter. Our budget was submitted to the FS for approval and tabled before the Legislative Council (LegCo).

During the year, we regularly attended meetings at the LegCo to explain to its members issues of public concern and policy initiatives. Apart from attending meetings convened by the Panel on Financial Affairs, we also discussed draft legislation at meetings held by the designated bills committees and a sub-committee.

Internal controls	
 <p>Audit Committee</p>	<p>Membership</p> <ul style="list-style-type: none"> • Chaired by Mrs Angelina Lee <p>Tasks handled</p> <ul style="list-style-type: none"> • Reviewed the SFC’s annual financial statements • Reviewed procedures for oversight of the SFC’s accounting and internal control systems • Made recommendations on the SFC’s appointment of external auditors and determined the scope of the auditors’ work • Analysed the external auditors’ findings and oversaw the SFC’s implementation of improvements agreed following such findings • Considered other matters as required, including complaints against staff
 <p>Remuneration Committee</p>	<p>Membership</p> <ul style="list-style-type: none"> • Chaired by Mr Lawrence Lee <p>Tasks handled</p> <ul style="list-style-type: none"> • Reviewed the SFC’s staff remuneration policy • Advised on market pay trends and recommended periodic adjustments
 <p>Budget Committee</p>	<p>Membership</p> <ul style="list-style-type: none"> • Chaired by Mr Wong Kai-man <p>Tasks handled</p> <ul style="list-style-type: none"> • Approved the basis and proposed parameters for the SFC’s annual budget • Reviewed the SFC’s annual budget for submission to the Board • Conducted half-yearly budget reviews

External checks

Process Review Panel

Membership

- Chaired by Mr Anthony Chow Wing-kin
- Representatives from various community segments
- SFC Chairman and a representative of the Secretary for Justice as ex-officio members

Tasks handled

- Reviewed the internal operation procedures of selected cases involving licensing applications, inspections, product authorization, handling of complaints, investigation, disciplinary actions and processing of listing applications under the Dual Filing regime
- Concluded that the SFC had generally followed its internal procedures and complied with operational guidelines
- Published the ninth report in September 2010

Office of The Ombudsman*

Tasks handled

- Conducted seven preliminary inquiries after receiving public complaints against the SFC including one case brought forward from 2009-10

Courts*

Tasks handled

- Subjected to three applications for judicial review, including one brought forward from 2009-10

* *The Office of The Ombudsman and the courts exercise indirect oversight over the SFC's work.*

Securities and Futures Appeals Tribunal

Membership

- Chaired by High Court judge the Hon Mr Justice Saunders
- 22 panel members took turns to hear cases
- Each case is normally heard by the Chairman and two panel members

Tasks handled

- Received request to review seven cases of SFC regulatory decisions
- Brought forward nine cases from 2009-10
- Issued decisions on six cases, allowed five to be withdrawn and rejected two due to late applications; three cases remain in progress

Transparency

To enhance transparency of our work, we engage the industry and stakeholders, seek their views and advice and conduct consultations.

The Advisory Committee was established under the statute to offer insight into policy matters. We have also established various consultative and regulatory committees to communicate and interact with different stakeholder groups. Such committees allow the SFC to explain policies to external stakeholders and to collect their views. The composition and terms of reference of these committees are set out on pages 130-139. The Products Advisory Committee was formed last year to advise on the revised product code issues.

The process of consultation is a key channel for us to gauge public views on any regulatory changes. Proposed changes, public comments and the subsequent conclusions are published on the SFC website. While required by law to consult on rule changes, we also go beyond the statutory requirement to seek industry input on possible amendments to non-statutory codes and guidelines.

Last year, we conducted six public consultations, some of which sought input on proposed changes to codes including the Codes on Takeovers and Mergers and Share Repurchases, Corporate Finance Adviser Code of Conduct and Guidelines on Competence.

As ongoing dialogue on major market issues and key policy matters, we attended various briefings and meetings with the FS, the Secretary for Financial Services and the Treasury and the Financial Services and the Treasury Bureau (FSTB). In addition, we liaised with lawmakers on legislative amendments and with other regulators and Hong Kong Exchanges and Clearing Ltd on regulatory, supervisory and development issues.

As part of our communication with the industry, we issue technical publications and press releases, participate in conferences and seminars and meet regularly with industry participants.

We held eight media briefings and arranged numerous interviews with key SFC executives. During the year, we issued 161 press releases on different aspects of our work and released two versions of a corporate video online to explain our roles and duties to the general public and the industry respectively. In May 2010, we launched a debut mini

television series entitled “SFC in Action”, which depicted the SFC’s enforcement work in a dramatised manner.

Code of conduct

We adhere to the Code of Conduct which stipulates the standards of behaviour expected of directors and staff and their legal obligations, such as the preservation of secrecy and avoidance of conflicts of interest, as well as matters including personal investments and corrupt practices. Internal financial control processes have been put in place to ensure that financial resources are duly and properly managed.

In terms of business dealings, transparent and fair tendering process and control procedures are in place to cover matters such as the appointment of consultants and the selection of vendors.

Procedures are posted on our website for lodging complaints against our staff and the SFC. Internally, procedures have been established for persons engaged by or work at the SFC to express their grievances or report improprieties.

To foster a professional and ethical culture, the “Living our values” programme was launched during the year to promote the core organisational values of being professional and proactive, and that people count.

Managing risks

For the integrity of our operating environment, contingency plans and resumption measures are put in place.

The operational divisions regularly report to the Board their analysis and recommendations on the management of risks that might affect the industry and the orderly functioning of the markets. Policies and procedures are in place to address readily identifiable risks, including various emergencies and technological glitches.

To be prepared for the handling of emergencies affecting the markets, we continued to review annually business resumption plans covering fires and natural disasters, etc to ensure business continuity or recovery.

Using robust information security controls such as virus detection and preventive tools, we continue to monitor our information technology systems for viral attacks and possible breakdowns, performing regular backup, data and server recovery plans. During the year, we upgraded the computer systems to eliminate any single point of failure. We also refined the “Uninterrupted Power System” to support extended system operation during power outages and strengthened our Internet gateway to ensure secure and uninterrupted communication with our stakeholders.

Meeting attendance record

Attendance of meetings of the Board and functional committees during the year are detailed in the following table:

Meetings attended/held					
	Commission	Audit Committee	Remuneration Committee	Budget Committee	Executive Committee
Chairman					
Eddy C Fong	15/15		1/1		
Executive Directors					
Martin Wheatley	14/15			1/1	16/18
Alexa Lam	13/15			1/1	17/18
Brian Ho	14/15				17/18
Keith Lui	14/15			1/1	15/18
Mark Steward	15/15				15/18
Non-executive Directors					
Chan Kam-lam	12/15		1/1		
Kenneth H W Kwok ¹	10/12	2/2			
Angelina P L Lee	12/15	2/2	1/1	1/1	
Lawrence Lee	14/15		1/1		
Liu Pak Wai ¹	9/12			0/1	
Wong Kai-man	11/15	2/2	1/1	1/1	
Shengman Zhang ¹	11/12	2/2			
Leonard K Cheng ²	3/3		1/1		
Anderson Chow Ka-ming ²	3/3		1/1		
Chief Counsel & Senior Directors					
Stephen Po					15/18
Stephen Tisdall					16/18
Andrew Wan ³					6/6
Andrew Young					15/18

¹ Appointment expired on 31.12.2010
² Appointment started on 1.1.2011
³ Appointment started on 18.1.2011

Performance pledges

In fulfilling our regulatory roles, we pledge to be responsive to the public, market participants and intermediaries under our supervision.

		% of cases meeting the pledge		
		2010/11	2009/10	2008/09
Applications for subordinated loan or modification/ waiver of requirements under SFO				
Commence review of application upon receipt	2 business days	98.3% ¹	96.9%	99.3%
Authorization of investment products				
Commence review of applications upon receipt	2 business days	100%	100%	100%
Preliminary reply to applicants after commencement of application review for investment-linked assurance schemes, Mandatory Provident Fund pooled investment funds, mutual funds, and unit trusts.	7 business days	100%	100%	100%
Preliminary reply to applications after commencement of application review for other schemes	14 business days	100%	100%	100%
Enquiries				
General enquiries:				
Preliminary reply to public enquiries (excluding those from investors)	4 business days	100%	99.8%	99.6%
Investor enquiries:				
Preliminary reply to telephone enquiries	4 business days	100%	100%	100%
Preliminary reply to written enquiries	2 weeks	100%	99.5%	99.6%
Processing of licensing applications²				
Corporations	15 weeks	100%	99%	99%
Representatives (provisional licences)	7 business days	97% ³	88%	89%
Representatives (normal licences)	8 weeks	98% ³	95%	86%
Representatives (responsible officers)	10 weeks	96% ³	97%	95%
Transfer of accreditation	7 business days	94% ³	81%	73%
Public complaints				
Preliminary response to verbal & written complaints	2 weeks	99.2% ⁴	99.3%	99.4%

¹ Two cases failed to meet the pledge by one day due to operational issues.

² Compliance with our performance pledges is measured in relation to applications in respect of which all of the required documentation is supplied by the applicants in a comprehensive and efficient manner and in which delays, for which we have no responsibility, do not occur.

³ Some cases failed to meet the pledges largely due to resource constraints and/or unexpected complications.

⁴ Due to the heavy workload, 15 cases failed to meet the pledge.

Board of Directors



Front row (from left to right):
Dr Eddy C Fong, Martin Wheatley, Angelina P L Lee, The Hon Chan Kam-lam

Back row (from left to right):
Anderson Chow Ka-ming, Alexa Lam, Brian Ho, Wong Kai-man, Keith Lui, Lawrence Lee, Mark Steward, Prof Leonard K Cheng



Dr Eddy C Fong, GBS, JP**Chairman**

(From 20 October 2006. Current appointment expires on 19 October 2011.)

SFC Non-executive Chairman (since October 2006); Certified Public Accountant; Chairman of the Council, Open University of Hong Kong; Non-executive Director, Hong Kong Mortgage Corporation; Member, Banking Advisory Committee of the Hong Kong Monetary Authority; Member, HKEx Listing Nominating Committee.

Formerly, Senior Partner of PricewaterhouseCoopers; Non-executive Director, Mandatory Provident Fund Schemes Authority; Non-executive Director, Exchange Fund Investment Ltd; Member and Chairman, Finance Committee of the Hong Kong Housing Authority.

Chairs Advisory Committee. Member, Remuneration Committee, Nominations Committee, SFC (HKEX Listing) Appeals Committee and Process Review Panel for the SFC.

Martin Wheatley, JP**Chief Executive Officer**

(From 23 June 2006. Current appointment ends on 8 June 2011.)

SFC: Chairman (from 1 October 2005 to 22 June 2006) and Executive Director, Supervision of Markets Division (from 6 June 2005 to 30 September 2005); Member, Financial Stability Board Standing Committee on Standards Implementation; Member, International Organization of Securities Commission (IOSCO) Technical Committee; Chairman, IOSCO Technical Committee Task Force on Short Selling; Member, Council of the Treasury Markets Association and HKEx Listing Nominating Committee. Deputy Chief Executive, London Stock Exchange (LSE) (2001-2004); Board Member, LSE (1998-2004); Chairman, FTSE International Ltd (2000, 2002, 2004); Member, Listing Authority Advisory Committee of the Financial Services Authority of England (2003-2004).

Chairs Executive Committee. Member, Advisory Committee, Budget Committee and SFC (HKEX Listing) Committee.

The Hon Chan Kam-lam, SBS, JP**Non-executive Director**

(From 15 November 2007. Current appointment expires on 14 November 2011.)

Member, National Committee of the Chinese People's Political Consultative Conference; Elected Member (Kowloon East), Legislative Council of the HKSAR; Chairman, LegCo Panel on Financial Affairs; Board Member, Airport Authority; Member, ICAC Advisory Committee on Corruption; Member, Deposit-taking Companies Advisory Committee; Member, Travel Industry Compensation Fund Management Board.

Member, Remuneration Committee and SFC (HKEX Listing) Appeals Committee.

Prof Leonard K Cheng, JP**Non-executive Director**

(From 1 January 2011. Current appointment expires on 31 December 2012.)

Dean of Business and Management, The Hong Kong University of Science and Technology; Director, Hong Kong Institute for Monetary Research; Member, Statistics Advisory Board; Member, Hong Kong Port Development Council; Member, Provisional Minimum Wage Commission (2009-2010); Member, Broadcasting Authority (2003-2009); Member, Manpower Development Committee (2002-2006); Member, Monitoring Group on Trials and Studies for the Harbour Area Treatment Scheme (2001-2003); Member, Investment Promotion Strategy Group (2000-2001); Member, Advisory Committee on New Broad-based Taxes (2000-2001); Member, International Review Panel, Strategic Sewage Disposal Scheme (2000-2001); Member, Hong Kong Committee for Pacific Economic Cooperation (1998-2004); Member, Economic Advisory Committee (1996-2001); Member, Shanghai-Hong Kong Council for the Promotion and Development of Yangtze (1998-2002).

Deputy Chairman, Remuneration Committee and Budget Committee.

Anderson Chow Ka-ming, sc**Non-executive Director**

(From 1 January 2011. Current appointment expires on 31 December 2012.)

Senior Counsel (2004); Recorder, Court of First Instance of the High Court of HKSAR; Deputy High Court Judge, HKSAR (2009); Honorary Lecturer, Department of Professional Legal Education, Faculty of Law, The University of Hong Kong (HKU); Deputy Chairman, Administrative Appeals Board; Chairman, Water Pollution Control Appeal Board; Chairman, Air Pollution Control Appeal Board; Alternate of the Disciplinary Committee Convenor, Hong Kong Institute of Certified Public

Accountants; Member, Disciplinary Panel A of the Hong Kong Institute of Certified Public Accountants; Member, Appeal Board on Public Meetings and Processions; Member, Criminal and Law Enforcement Injuries Compensation Board; Member, Management Committee of the Consumer Legal Action Fund; Chairman, Appeal Tribunal (Buildings) (2000-2007); Member, Disciplinary Chair Committee of the SFC to chair the Takeovers and Mergers Panel in disciplinary proceedings and Takeovers Appeal Committee (2008-2010); Member, Appointment Advisory Board of Hong Kong International Arbitration Centre (2008-2010).

Chairman, Investor Compensation Co, Ltd; Member, Investor Compensation Fund Committee, Securities Compensation Fund Committee and Nominations Committee.

Brian Ho**Executive Director, Corporate Finance Division**

(From 28 August 2006. Current appointment expires on 27 August 2012.)

SFC: 1992-1994 and 1995-present; Senior Director (2000-2006); Solicitor admitted in Hong Kong in 1988; Member, HKEx Listing Nominating Committee; Member, Advisory Committee on Bond Market Development.

Chairs Public Shareholders Group. Member, Nominations Committee and Executive Committee.

Kenneth H W Kwok, BBS, SC, JP**Non-executive Director**

(From 1 January 2005. Appointment expired on 31 December 2010.)

Queen's Counsel (1993); Senior Counsel (1997); Chairman, Board of Review (Inland Revenue Ordinance); Member, Standing Committee on Legal Education and Training (Legal Practitioners Ordinance); Honorary University Fellow, HKU; Member, HKU Law Faculty Board; Member, HKU Academic Board for the Postgraduate Certificate in Laws (PCLL); Governor, HKU Law Alumni Charity Ltd; Member, Advisory Committee on Legal Education (Legal Practitioners Ordinance) (1995-2004); Chairman, Takeovers Appeal Committee (2004); Member, Securities and Futures Appeals Tribunal (2003-2004); Member, Listing Committee, Main Board, The Stock Exchange of Hong Kong Ltd (1997-2003).

Chaired Investor Compensation Co, Ltd. Deputy Chairman, Audit Committee and Remuneration Committee. Member, Nominations Committee, SFC (HKEX Listing) Appeals Committee, Securities Compensation Fund Committee and Investor Compensation Fund Committee.

Note: Except for the Chairman and the CEO, the board members are listed in alphabetical order.

Alexa Lam

Executive Director, Policy, China and Investment Products Division and Deputy Chief Executive Officer

(From 1 December 2001. Current appointment expires on 28 February 2014.)

SFC: Executive Director and Chief Counsel (March -November 2001); Chief Counsel (1999-2001); Senior Adviser-Chairman's Office (1998-1999); Visiting Lecturer, Faculty of Law, HKU (1997-1998); Private law practice in Hong Kong, New York and Chicago (1981-1997); Member, Hong Kong Trade Development Council Financial Services Advisory Committee; Member, Professional Advisory Board – HKU Faculty of Law's Asian Institute of International Financial Law; Member, Finance Management Committee, The Hong Kong Management Association (since 9 September 2009).

Chairs Committee on Unit Trusts, Committee on Investment-Linked Assurance and Pooled Retirement Funds, Committee on Real Estate Investment Trusts and Products Advisory Committee (since August 2010). Member, Advisory Committee, Budget Committee, Executive Committee, Securities Compensation Fund Committee, Investor Compensation Fund Committee and SFC (HKEC Listing) Committee.

Angelina P L Lee, JP

Non-executive Director

(From 1 August 2006. Current appointment expires on 31 July 2012.)

Partner, Woo, Kwan, Lee & Lo; Solicitor; Certified Public Accountant; Independent Non-executive Director, Great Eagle Holdings Ltd; Non-executive Director, Cheung Kong Infrastructure Holdings Ltd; Non-executive Director, Henderson Land Development Co Ltd; Non-executive Director, TOM Group Ltd; Non-executive Director, Mandatory Provident Fund Schemes Authority (2005-2011); Chairman, Takeovers Appeal Committee (2005-2006); Member, Securities and Futures Appeals Tribunal (2003-2006); Member, Listing Committee, The Stock Exchange of Hong Kong Ltd (2000-2006); Member, Standing Committee on Company Law Reform (1991-2003).

Chairs Audit Committee. Member, Budget Committee, Remuneration Committee, Takeovers and Mergers Panel, Takeovers Appeal Committee and SFC (HKEC Listing) Appeals Committee.

Lawrence Lee, JP

Non-executive Director

(From 15 November 2009. Current appointment expires on 14 November 2011.)

Chairman, Hong Kong, PRC and Vietnam offices, Baker & McKenzie; Member, the Hospital Authority; Chairman, the Hospital Governing Committee of Pamela Youde Nethersole Eastern Hospital; Member, Commercial and Securities Group, Baker & McKenzie; Chairman, Asia Pacific Regional Council, Baker & McKenzie (1999-2000); Executive Committee Member, Baker & McKenzie (1997-2000); Member, the Supervisory Board of the Hong Kong Housing Society (2000-2004).

Chairs Remuneration Committee. Member, Audit Committee and SFC (HKEC Listing) Appeals Committee.

Prof Liu Pak Wai, SBS, JP

Non-executive Director

(From 1 January 2005. Appointment expired on 31 December 2010.)

Director, Institute of Global Economics and Finance and Professor of Economics, The Chinese University of Hong Kong; Member, Independent Commission on Remuneration for Members of the Executive Council and the Legislature, and Officials under the Political Appointment System of the HKSAR; Member, Independent Commission on Remuneration for Members of the District Councils of the HKSAR; Member, Provisional Minimum Wage Commission; Director, Hong Kong Institute for Monetary Research; Member, Aviation Development Advisory Committee; Member, Commission on Strategic Development; Member, Sir Edward Youde Memorial Fund Council.

Chaired Remuneration Committee. Deputy Chairman, Budget Committee. Member, SFC (HKEC Listing) Appeals Committee, Committee on Unit Trusts, Committee on Investment-Linked Assurance and Pooled Retirement Funds and Products Advisory Committee.

Keith Lui

Executive Director, Supervision of Markets Division

(From 28 August 2006. Current appointment expires on 27 August 2012.)

SFC: 1991-1994 and 1995-present; Commission Secretary (2001-2004); Senior Director (2002-2006); Member, HKEx Risk Management Committee.

Chairs Securities Compensation Fund Committee and Investor Compensation Fund Committee. Member, SFC (HKEC Listing) Committee, Budget Committee and Executive Committee. Director of the Investor Compensation Co, Ltd.

Mark Steward

Executive Director, Enforcement Division

(From 25 September 2006. Current appointment expires on 24 September 2012.)

Deputy Executive Director, Enforcement, Australian Securities and Investments Commission (ASIC) (2004-2006); Director, Enforcement, ASIC (2003-2004); Solicitor admitted in Australia in 1990.

Member, SFC (HKEC Listing) Committee and Executive Committee.

Wong Kai-man, BBS, JP

Non-executive Director

(From 26 May 2009. Current appointment expires on 25 May 2011.)

Director, Li & Fung (1906) Foundation Ltd; Director, Victor and William Fung Foundation Ltd; Independent Non-executive Director, Shangri-la Asia Ltd; Independent Non-executive Director, SUNeVision Holdings Ltd; Independent Non-executive Director, SCMP Group Ltd; Independent Non-executive Director, China Construction Bank Corporation; Honorary Associate Professor, School of Business, HKU; Member, Listing Committee, Growth Enterprise Market, The Stock Exchange of Hong Kong Ltd (1999-2003); Member, Hospital Governing Committee, Haven of Hope Hospital; Court and Council Member, HKU; Director, School of Professional and Continuing Education, HKU; Court and Council Member, City University of Hong Kong; Director, CityU Enterprises Ltd; Director, Haven of Hope Christian Service; Director, World Vision Hong Kong; Director, Breakthrough Ltd.

Chairs Budget Committee. Deputy Chairman, Audit Committee. Member, Remuneration Committee and SFC (HKEC Listing) Appeals Committee.

Shengman Zhang

Non-executive Director

(From 1 January 2007. Appointment expired on 31 December 2010.)

Chairman, Asia Pacific, Citigroup (from 2009); Vice Chairman of Global Banking, Chief Operating Officer, Citigroup, Markets & Banking, Asia Pacific (2007-2008); Chairman, Public Sector Group, Citigroup (2006-2007); Managing Director, World Bank (1997-2001; 2001-2005); Vice President and Corporate Secretary, World Bank (1995-1997); Executive Director for China, World Bank (1994-1995); Various senior positions, The Ministry of Finance, China (1981-1992).

Member, Audit Committee, Remuneration Committee and SFC (HKEC Listing) Appeals Committee.

CORPORATE SOCIAL RESPONSIBILITY

- 34 Giving back to the community
 - 35 Caring for the environment
 - 36 Promoting staff wellness
 - 37 Enriching our work life
 - 37 Recognising CSR initiatives
-



As a statutory body, we promote a caring attitude towards external stakeholders, the community and our staff. We also aspire to lead and to set an example of best practice for the business community to follow. Into its second year, the Corporate Social Responsibility (CSR) Committee gained momentum and led the organisation to carry out a number of initiatives under the slogan: "Secure a better future for our community."



The splatter of rain is both soothing to the ear and delightful to see. A single droplet may seem insignificant, but when enough comes down to fill a reservoir, it can do wonders for the common good of all.

The CSR Committee is chaired by our Chief Executive Officer. Its members come from throughout the SFC, in addition to the Corporate Affairs Division that hold direct responsibility for key aspects of our social and environmental performance. To ensure that diverse voices are heard, we held an organisation-wide drive to recruit committee members in October 2010.

Under the CSR Committee, three working groups were formed this past year to improve the main areas stipulated in our CSR policy. These are: the Commission Volunteer Group (CVG), the Green Group and the Wellness Group.

We also tracked key indicators of electricity consumption and recycling efforts to monitor our impact on the environment and to promote sustainability. The CSR Quarterly Newsletter launched in January 2011 gives colleagues regular updates of CSR events.



Our slogan reads "Securing a better Future for our Community" as a play on words on the organisation name.

Giving back to the community

The CVG champions community service and volunteer activities. We partnered with the Tung Wah Group of Hospitals and Hong Kong Christian Services to reach out to the needy. A total of 116 colleagues volunteered more than 500 hours to conduct activities for both the old and the young:



Volunteers and the elderly show off their finished scrapbook after an eventful and memorable day.

Activities for the elderly

- At a workshop, we put together for the aged scrapbooks to keep their memories alive.
- We took the aged on an outing to the Mai Po wetland park so they could watch the birds and take note of other ecological phenomena that Nature had to offer.
- We helped some "home-alone" old people with spring cleaning before the Lunar New Year and served them soups.



Our volunteers help an elderly woman put together a scrapbook of fond memories.

Programmes for youth

- We arranged for children in foster care or adoption programmes to visit a music farm in Tai Po, giving them a rare opportunity to spend time with their biological parents and to learn to appreciate Nature.
- In the “Dreams Come True” programme, we partnered with the Hong Kong Family Welfare Society to help teenagers from underprivileged background to fulfil their dreams of learning a new skill, using donations collected from our colleagues to sponsor short courses. The project aimed to provide support, motivation and encouragement to these teenagers.

To encourage colleagues to participate in community or civic services, we revised the Employee Volunteering Leave policy. As a token of appreciation, those who volunteered for a community service would be entitled to corresponding time off of up to one full day per year.

Besides contributing their time, our colleagues donated to a number of charities and supported events such as Operation Smile, the Salvation Army Christmas Kettle Appeal, the Community Chest Dress Special Day, and the Community Chest Skip Lunch Day.



Colleagues spread cheers with carols at the staff Christmas party.

We drew colleagues’ attention to the plight of victims of the 2011 earthquake and tsunami in Japan by posting articles on the CSR Blog and calling for support by different means.

At a corporate level, we continued our “donation in lieu of corporate gift” programme, making nominal donations to charitable causes in the name of guest speakers. Beneficiaries of such corporate donations this year include the Singapore International School Foundation Ltd and St John’s Cathedral.

Volunteer participation

	2010/11	2009/10	Year-on-year % change
Number of staff participating in volunteering activities	116	47	+147%
Number of volunteering hours	583	355.5	+64%

Caring for the environment

We have been striving to adopt best practices to set a good example. Building upon the 2003 guidelines regarding electronic submission of share applications in an initial public offer, we introduced in 2011 a class exemption to the Listing Rules. Under the so-called “mixed media offer,” companies seeking to list shares or debentures on The Stock Exchange of Hong Kong Ltd may now distribute paper application forms without an accompanying printed prospectus, as long as the prospectus is available on line. Targeted at minimising paper wastage, the new rule represents a balanced approach that facilitates market efficiency without undermining investor protection. We hope the mixed media offer will change the long-standing industry practice of printing large quantities of prospectuses that end up being discarded.

As our own initiative to reduce physical filing, we launched the Document Management System (DMS), an electronic document storage programme for the whole organisation. The system facilitated online document sharing. After the first three months, documents filed in the system reached 200,000 copies. We also stopped printing SFC diaries and instead encouraged colleagues to use the digital calendar for appointments.

Paper usage statistics

	2010/11	2009/10	Year-on-year % change
Volume of paper ordered/ person (kg)	63.5	68.4	-7.16%
Volume of paper recycled/ person (kg)	42.6	35.0	+21.71%

On a daily basis, we consciously work to minimise negative environmental impact. To reduce our carbon footprint, we replaced aged office equipment with more environmentally friendly versions and introduced a more energy-efficient hybrid to replace an aged vehicle for executive use. We also adopted a green procurement policy for consumable items, such as paper and light sources. Other green initiatives include reducing the use of disposable utensils and posting new signs and posters to drive awareness of environmental protection.



Colleagues dress in black to show support for Earth Hour and environmental conservation.

March 2011 marked the start of our “Green Campaign.” We invited colleagues to adopt small potted plants so they would be reminded to care for the environment. As an organisation, we also supported World Wildlife Fund’s Earth Hour 2011, a worldwide event, and galvanized staff members to make a personal pledge to cut wastage and support sustainable living. Over a hundred colleagues dressed in black the day prior to Earth Hour in support of environmental conservation.

Promoting staff wellness

Recognising that people are our greatest asset, we are committed to the wellbeing of staff both in and out of the office.

Ahead of the peak flu season in the winter of 2010, we offered flu vaccinations to colleagues and received enthusiastic support. The vaccination was oversubscribed within the first day of registration.



The SFC Chairman Dr Eddy Fong leads by example to accept a flu shot ahead of the flu season.



Along with the fruits comes a small card listing upcoming wellness activities.

To foster a healthy lifestyle among staff, we launched “Wellness Months” in January and March 2011. Colleagues learned tips from healthcare professionals on how to avoid frozen shoulders; others received a free physical check-up; still others received 30-minute neck-and-shoulder massages from therapists-in-training. Everybody in the organisation received free fruits and messages explaining the properties of each type of fruit to encourage a healthy eating habit.



Colleagues prepare fruits for distribution during the Wellness Month.

Apart from physical wellness, we held a series of six sessions on investing featuring a colleague with investment experience who shared key investment concepts and ways to develop a proper attitude towards investing.

Enriching our work life

We formed the Staff Activities Committee (SAC) under the motto “Enriching your Work Life” to organise recreational staff activities to enhance staff’s sense of belonging. The SAC, comprising of volunteers from across the organisation successfully organised events including the staff Christmas and Chinese New Year parties, a movie night, and placed festive candies and treats in all pantries for staff members for the celebration of Chinese New Year.

Recognising CSR initiatives

In recognition of our contribution to community service and protection of the environment, the Hong Kong Council of Social Service has presented the SFC its fifth consecutive Caring Organisation Award. The Award is given to organisations that have met targets in five key assessment areas, namely, volunteer work, monetary donation, employing the vulnerable, caring for employees and caring for the environment. We anticipate that with more active involvement from our colleagues and further development of our CSR strategy, we shall be able to contribute more to the community, the environment and the welfare of our staff.

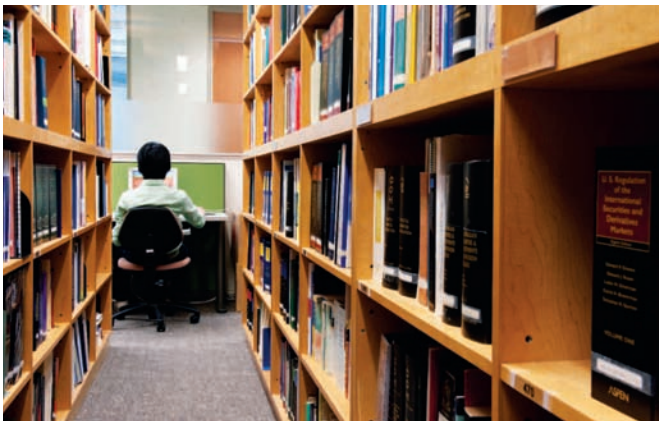
REGULATION

The scope and depth of our regulatory work reflect the increasingly complex market activities we oversee. Not only do we maintain – but we also strive to raise – the standards of financial markets by reviewing our regulatory regime in the context of constant changes. Along this line, we introduced regulatory reform after the global financial crisis to revitalise the markets.

To serve its purpose, water needs to be contained and used. Raindrops won't quench your thirst, but a glass of water on a hot day will be most welcomed.

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- 40 Enhancing investor protection
 - 41 Expanding our licensing regime
 - 41 Raising market standards
 - 42 Supervising intermediaries
 - 43 Enforcing the law
 - 46 Regulating listing matters
 - 47 Enhancing other regulatory areas
 - 47 Handling complaints, compensation
-





A great deal of effort was put into enhancing investor protection and raising industry standards in the past year. As events described below indicate, our regulatory work has gone beyond combating market misconduct. By staying alert and keeping an open mind, we also have been ensuring that our regulation stayed relevant and effective and that we could pre-empt potential risks in the markets.

Enhancing investor protection

During the reporting year, enhancing investor protection was high on our agenda. We conducted a public consultation in late 2009 for this purpose and received positive response from the public, which helped us fine-tune our codes and guidelines governing investment products authorization and the selling process of investment products.

Launching product handbook, key facts statements

- We issued a consolidated product handbook comprising revised codes for unit trusts and mutual funds and for investment-linked assurance schemes, as well as a new code for unlisted structured investment products. We set up the Products Advisory Committee to consult and advise on matters related to the handbook.
- Key facts statements (KFS) for investment products authorized under the above product codes were introduced, requiring issuers to prepare an overview summarising the key features and risks of a retail investment product in plain language for investors' easy reference.
- In promoting a specific investment product to an investor, an intermediary is not allowed to offer any gift other than a discount of fees or charges. The objective is to keep the investor's attention on a product's features and risks so that his/her investment decision is free from the distraction of a gift.
- A post-sale cooling-off period was introduced, allowing investors of unlisted structured investment products with a term of more than one year to opt out of the sales agreement within a given timeframe.

Further conduct requirements will be implemented in phases starting from June 2011. These include, among others, requiring intermediaries to assess a client's knowledge of derivatives and characterise the client accordingly before selling him/her derivative products, and to disclose to clients sales-related information, including benefits received from the product issuer and their affiliation with the product issuer.

We conducted briefing sessions and workshops, published circulars and frequently asked questions to give practical guidance to market practitioners for a smooth transition to the new regulatory environment. In particular, we provided directional comments to over 140 KFS of retail fund products.

Enhancing transparency of synthetic ETFs

To help investors distinguish between synthetic exchange-traded funds (ETFs) and traditional ETFs, we worked together with Hong Kong Exchanges and Clearing Ltd (HKEx) to introduce measures to enhance disclosure related to synthetic ETFs listed on The Stock Exchange of Hong Kong Ltd (SEHK). Managers of synthetic ETFs are required to put an asterisk and an annotation explaining the product is a synthetic ETF right after the name of a synthetic ETF in all public documents, marketing materials and websites. In addition, the alphabet "X" now must appear as a marker on the English and Chinese stock short names of synthetic ETFs, so that investors can easily differentiate them from traditional ETFs. The ETF corner of HKEx's website was also enhanced as part of these measures.

To enhance the transparency of synthetic ETFs, fund managers are required to publish and update on their website the gross and net counterparty exposure of a synthetic ETF on a daily basis and information on collateral/invested assets on a monthly basis. Also, all authorized synthetic ETFs had issued their KFS by the end of March 2011, ahead of schedule for other existing authorized schemes.

Together with HKEx, we issued a circular in November 2010 to provide guidance to the management companies of ETFs on compliance with the on-going disclosure requirements so that investors can be informed as soon as practicable of any

information concerning the relevant ETFs, which investors will need to appraise their ETF positions.

Expanding our licensing regime

In step with global regulatory developments, we formulated proposals to regulate credit rating agencies (CRAs). In July 2010, we conducted a one-month public consultation in relation to our proposals for the creation of a regulatory regime for CRAs operating in Hong Kong. The consultation generated overwhelming public support for such a regime.

Since the licensing regime for CRAs became effective on 1 June 2011, CRAs operating in Hong Kong and their rating analysts are required to be licensed to conduct business under the newly created Type 10 regulated activity (providing credit rating services). We worked closely with the Government to give effect to the required legislative amendments. As the regulation of CRAs is evolving globally, we will maintain a watchful eye on developments in this area in other jurisdictions and will make such adjustments to our regulatory regime as may be necessary from time to time.

Raising market standards

To help Hong Kong stay competitive as a leading international financial centre, we strive to fine-tune our regulatory regime to accommodate market changes and to be on a par with international standards.

We commenced work to build a regulatory regime for the over-the-counter (OTC) derivatives market in Hong Kong to reduce systemic risk, improve transparency and prevent market abuse. The new regulatory regime supports the impending establishment of a trade repository by the Hong Kong Monetary Authority (HKMA) and an OTC derivatives central counterparty clearing house by HKEx. These developments would take a phased approach. The initial phase, currently planned for 2012, would cover mainly interest rate swaps and non deliverable forwards, the major types of derivative products traded in Hong Kong's OTC market. A public consultation will be launched on the subject in 2011.

Last year, Hong Kong saw an increase in the number of alternative liquidity pools, including dark pools. To facilitate our monitoring of the development of these alternative liquidity pools, we supported SEHK in introducing a flagging requirement for reporting trades in Hong Kong-listed securities executed via such alternative liquidity pools. From 1 February 2011, exchange participants have been reporting these trades to SEHK with an "ALP" indicator.

Work to launch a new short-position reporting regime also began during the reporting year. The data on short positions will complement the information the SFC has on short sales. Information collected under this new reporting regime will give us more insight into market dynamics and serve as early warning signs of large short positions, which may require prompt regulatory actions. We are planning to consult the public in 2011 on the draft subsidiary legislation required to implement this new regulation.

Supervising intermediaries

We continued to supervise intermediaries to ensure compliance through on-site inspections and off-site monitoring of their operations. We also engaged in constant dialogue with industry participants to raise awareness of compliance matters.

Reviewing intermediary activities

Last year, we conducted 235 risk-based, on-site inspections of licensed corporations to assess their level of compliance and identified 402 internal control deficiencies, breaches and violations. In addition, 28 cases involving serious breaches by licensed corporations and individuals, such as, misappropriation of client assets, unauthorized trading, serious internal control failure and serious breaches of liquid capital requirement, necessitated further investigation. Upon our request, some of these licensed corporations appointed independent accountants to conduct circularisation of client balances and stock positions and to review in detail their internal control systems.

We also carried out some specialised programmes to look into the activities of intermediaries:

- Concurrently with HKMA, we engaged an external service provider to conduct a mystery shopping programme to look into the selling practices of intermediaries regarding unlisted securities and futures products. The exercise helped to assess licensed corporations' extent of compliance with regulatory requirements, including the "know your client" procedures and explanation of product features and risk disclosure.
- We launched anti-money laundering theme inspections, which will continue into the second half of 2011, to gauge licensed corporations' compliance with key requirements of the new anti-money laundering bill and to raise their awareness and readiness level.

We also continued to monitor closely the financial standing of high-impact and higher risk brokerages by doing stress tests on their liquid capital and analysing their financials. When appropriate, we asked them to tighten risk controls and to improve capital adequacy.

Inspecting sponsors' work

In light of the market conditions and the fact that the Sponsor Guidelines have been effective since 2007, we considered it appropriate to gather more information on the sponsor landscape and to assess the level of compliance of sponsors.

We conducted a survey on all sponsors and collected information about the sponsors' work concerning listing applications on SEHK. In addition, we formed a specialised team and conducted a theme inspection of 17 licensed sponsors. Focusing on the sponsors' work in IPO applications, particularly due diligence, our inspections revealed certain deficiencies in their work and inadequacies in their internal systems and controls. The findings were published in March 2011.

Stressing compliance

- We organised 352 meetings with representatives of licensed corporations and industry bodies to discuss operational and market development issues. For instance, a meeting was held with six industry bodies to discuss daily operational and compliance issues concerning securities and futures trading, eg, various fraud cases identified by our supervision teams.
- In view of several mega-sized rights issues and the increase in market turnover in late 2010, we issued a circular to remind brokerages to monitor their operational capabilities and put in place appropriate contingent arrangements.
- At the seminars co-organised with the Independent Commission Against Corruption, we reminded about 370 participants of the importance of business ethics, highlighted corruption-prone areas in the securities sector, recommended preventive measures, and cautioned them to implement proper policies and procedures.
- We updated about 500 market participants on the latest international and domestic anti-money laundering development in two training seminars jointly offered with the Government and the police.
- Participating in industry forums held by the Institute of Financial Planners of Hong Kong and the Hong Kong Institute of Bankers, we shared with the industry the key concerns in the financial planning and advisory arena, other major regulator's actions to enhance intermediary selling practices, and the latest international regulatory developments.
- We discussed with the industry common control deficiencies and information technology management at a seminar hosted by the Hong Kong Securities Professionals Association.

Enforcing the law

Our enforcement actions over the last 12 months dealt swift blows to misconduct in the securities and futures markets. Through civil proceedings and criminal sanctions, we sent a strong message to would-be rule-breakers. We are determined to fulfil our mandate in all areas, including market misconduct, corporate governance and intermediary misconduct.

Making further progress in LB-related issues

Concerning structured products related to Lehman Brothers (LB), we made yet another breakthrough – this time with DBS Bank (Hong Kong) and Standard Chartered Bank (Hong Kong). Jointly with HKMA, we negotiated two separate agreements so that eligible investors of certain LB-related investment products could recover all or part of their investment.

DBS agreed to pay a total of \$651 million in principal plus interest to its eligible Constellation Note customers. Standard Chartered's repurchase offer of \$1.48 billion covered more than 95% of its customers of equity-linked notes issued and guaranteed by LB. Since it would have been unlikely to achieve the same levels of resolution amounts using disciplinary actions, we believe that the agreements were in the best interest of investors.

We were also pleased with the announcements by the 16 LB Minibond distributing banks and PricewaterhouseCoopers, the receivers of Minibond collateral, concerning the recovery and proposed distributions of the net value of the underlying collateral assets of some Minibond series. This outcome was the result of the Minibond agreement between the SFC, HKMA and the 16 banks on 22 July 2009.

Taking swift and firm actions

In the review period, we deployed a wide range of enforcement actions to penalise violators and to send deterrent messages to market participants.

As a result of our enforcement actions, jail sentences were imposed on 11 individuals. During the year, we successfully prosecuted 12 individuals, two of whom were convicted of 40 counts of market manipulation. We now have civil actions pending before the courts to seek disqualification and compensation orders against a total of 44 individuals and corporations, as well as 120 counts of criminal charges against 24 persons. Below are the highlights of our enforcement actions processed through the courts:

- In the first indictable case against manipulation of derivative warrants, we prosecuted two traders for creating a false and misleading appearance of active trading in 20 derivative warrants. The District Court found that the trading conducted by Patrick Fu Kor Kuen and Francis Lee Shu Yuen falsely inflated the turnover of the warrants by 80% or over \$450 million in value and jailed them for 33 and 36 months respectively. Subsequently, the Court of Appeal (CA) dismissed the appeals by Fu and Lee but reduced the jail sentences to 20 and 21 months respectively. The CA also declined the duo permission to appeal to the Court of Final Appeal (CFA).
- We successfully sought review from the Eastern Magistracy to substitute its original decision to sentence Pablo Chan Pak Hoe to serve 240 hours of community service with a term of four-month imprisonment and a fine of \$120,000. Chan was convicted of insider dealing in the shares of Universe International Holdings Ltd while representing the controlling shareholder in a proposed acquisition. The CA will hear Chan's further appeal in June 2011.
- In light of further insider dealing allegations, we amended our proceedings against Tiger Asia Management LLC (Tiger Asia), a New York-based asset management company, and three of its senior officers to freeze an additional \$8.6 million of Tiger Asia's assets, on top of the \$29.9 million that we applied to freeze in August 2009, and to prohibit it from dealing in all listed securities and derivatives in Hong Kong.
- Our proceedings against Li Han Chun, the former CEO of China Forestry Holdings Co., Ltd (China Forestry) had resulted in interim freezing orders over assets of up to \$398 million held by Li and his company, Top Wisdom Overseas Holdings Ltd (Top Wisdom). We alleged that Li and Top Wisdom disposed of 119 million China Forestry shares before the company's announcement of accounting irregularities. The effect of the interim order is to freeze the proceeds of the sale of those shares by Li and Top Wisdom.
- We obtained an order from the High Court (HC) to freeze assets of up to \$997 million in relation to Hontex International Holdings Company Ltd (Hontex), equivalent to the net proceeds raised by the company in its initial public offering in 2009. Hontex was alleged to have disclosed materially false or misleading information about its financial position in its prospectus. The injunction was obtained to prevent the dissipation of assets and to ensure that there were sufficient assets to satisfy any restoration or compensation orders for Hontex investors.
- The HC also gave an order to disqualify Steven Li Wang Tai, former executive director of Styland Holdings Ltd (Styland), from being a director or being involved in the management of any listed company for six years. Li accepted that he failed to manage the company with the necessary degree of skill and diligence. Our application to the HC to disqualify the other Styland directors and to seek compensation for losses caused was heard in January 2011 and is awaiting court decision. The case represented our first proceeding against former executives of a listed company for payment of compensation to the company they managed.
- We prosecuted Li Jialin, chairman of VST Holdings Ltd (VST), in the District Court, for rigging the price of VST shares and breaching the disclosure of interest requirements. This case, our second indictable prosecution for market manipulation, will be heard in September 2011.

- We sought orders in the High Court to disqualify Andy Wong Shu Wing, a former chairman and executive director of Sunlink International Holdings Ltd (Sunlink) and Lee Chak To, a former chief financial officer of Sunlink, as company directors for alleged misconduct. We alleged that Wong and Lee failed to manage Sunlink with the necessary degree of skill, care, diligence and competence.
- We have commenced civil proceedings against two solicitors Young Bik Fung and Lee Kwok Wa, and Lee's two sisters Patsy Lee Siu Ying and Stella Lee Siu Fan in the High Court for alleged insider dealing in the shares of Hsinchu International Bank Co Ltd and Asia Satellite Telecommunications Holdings Ltd.

During the year, we disciplined 47 licensees for various offences and improper conduct. The value of fines imposed amounted to \$21.4 million. We disciplined 12 licensed corporations and six of their respective responsible officers, and fined them a total of \$18.3 million for internal control deficiencies. Relatively more significant are the following instances:

- Julius Baer (Hong Kong) Ltd was reprimanded and fined \$3 million for failing to take adequate steps to identify clients as professional investors before treating them as such. The status of professional investors would allow certain provisions of the Code of Conduct to be waived.
- Merrill Lynch (Asia Pacific) Ltd and Merrill Lynch Futures (Hong Kong) Ltd (collectively Merrill Lynch) were fined \$3.5 million for systems and controls failings associated with the mis-marking activities in a trading book. Jugurtha Harchaoui, formerly a managing director and senior trader at Merrill Lynch, was banned from re-entering the industry for life for masterminding the mis-marking activities.
- Christfund Securities Ltd, Christfund Futures Ltd and their respective responsible officers were fined a total of \$2.5 million over internal control deficiencies in handling some Mainland clients' accounts.
- Three employees of UBS AG Hong Kong were fined a total of \$1.8 million for carrying out clients' trades that constituted wash sales and may have misled the market.

- Zhang Bijia was banned from re-entering the industry for life for engaging in insider dealing.
- The licence of Chun Peng Fai was revoked and he was banned from re-entering the industry for five years for derivative warrants trading that had the effect of falsely inflating market turnover.

Enforcement activities

Number of trading inquiries issued	4,175
Number of investigations started	262
Number of investigations completed	251
Number of investigations completed within seven months (%)	169 (67%)
Number of persons charged in criminal proceedings	58*
Number of criminal charges laid	361*
Number of Notices of Proposed Disciplinary Actions	29
Number of Notices of Final Decision	49
Number of persons subject to civil proceedings	23
Compliance advice letters issued	185

* We brought a total of 361 criminal charges against 58 persons, with 76 charges laid against nine people for market manipulation.

Enforcement prosecutions affirmed

Disciplinary appeals

Last year, the Securities and Futures Appeal Tribunal (SFAT) upheld five disciplinary appeal actions against five individuals for trading malpractice and insider dealing, but reduced the penalties imposed by the SFC in two cases under certain circumstances.

Separately, the CA allowed our appeal against an SFAT decision and ruled that criminal procedures are not applicable to disciplinary proceedings. The CA affirmed that the Securities and Futures Ordinance (SFO) is a self-sufficient statutory code for dealing with regulatory disciplinary matters. In this case, the CA increased the penalty the SFAT had imposed on the licensee from a licence suspension of 18 months to a prohibition order of three years.

The CA also dismissed appeals by Ng Chiu Mui and Law Kai Yee, two former responsible officers of Hantec International Ltd, against the SFAT's decision to revoke Ng's licence and prohibit her from reapplying for a licence for 10 years and suspend Law for two years and three months for their involvement in unlicensed leveraged foreign exchange trading operation. The CA ruled that their serious misconduct had deprived their clients of the statutory protection and was detrimental to the integrity of the markets.

Criminal appeal

The CFA dismissed appeals by Sammy Ma Hon Kit and his wife Cordelia Tso Kin Wah against their convictions for insider dealing in shares of Egana Jewellery & Pearls Ltd. This followed an earlier ruling by the CA rejecting their appeals and marked the end of the first indictable prosecution since insider dealing was made a criminal offence under the SFO in 2003.

Regulating listing matters

We supervise and oversee SEHK's performance in its regulation of listing-related matters. Our work in this area for the period under review is highlighted as follows:

- We commented on 192 listing applications received via SEHK under the dual filing regime and deferred commenting on nine cases due to serious deficiencies in the initial submissions. Such deficiencies included inaccurate information, misleading or significant errors in the initial listing documents, which necessitated substantial improvements to be made to the draft listing documents.
- In parallel with the Government's proposal to impose a statutory obligation on listed corporations to disclose price-sensitive information, we conducted a public consultation in March 2010 on the draft SFC guidelines regarding the type of information covered and how exemptions could be applied. Guidelines on how to implement the new requirements were released along with the consultation conclusions in February 2011. The

bill prepared by the Government to codify the relevant requirements is expected to be gazetted and introduced to the Legislative Council by July 2011.

- In a consultation paper issued in September 2010, we proposed expanding the scope of the present requirements governing conflicts of interest for analysts to cover research reports on IPOs (including public offers of real estate investment trusts (REITs)), in addition to those on listed securities. We are analysing the responses received and discussing the proposal with market participants and industry representatives. The conclusions will be published in due course.
- The Takeovers Executive¹ publicly criticised Glamour House Ltd and its sole director Xie Xuan for breaching the Takeovers Code in July 2010. Xie failed to make an announcement immediately after the acquisition of voting rights of Asian Capital Resources (Holdings) Ltd, which gave rise to a general offer obligation for the shares in that company.
- The Takeovers Executive publicly censured Templeton Asset Management Ltd (Templeton) for breaches of dealing disclosure over Denway Motors Ltd (Denway) in December 2010. As an associate of Denway holding more than 5%, Templeton failed to disclose its dealings in the shares.
- During the year, we handled 37 takeovers-related cases (including general offers, privatisations and share repurchases), 30 whitewashes and 237 applications under the Codes on Takeovers and Mergers and Share Repurchases. The Takeovers Panel met three times to rule on issues regarding live transactions and/or policy matters.
- We continued to supervise SEHK's performance in its regulation of listing matters. In our annual review of SEHK's regulatory performance in 2009, we noted that the operational procedures and decision-making processes reviewed were appropriate to enable SEHK to discharge its statutory obligation, which is, to maintain an orderly, informed and fair market.

¹ The Takeovers Executive refers to the Executive Director of the Corporate Finance Division of the SFC or any delegate of the Executive Director.

Enhancing other regulatory areas

- In a consultation we conducted last October, we proposed to refine the requirements for proving whether a person qualifies as a high-net-worth professional investor, using a principles-based approach. Such an approach would allow market participants flexibility in establishing whether an investor would qualify as a professional investor. We received 16 written submissions expressing general support of the proposal. The conclusions were published in February 2011 and the amendment will be gazetted in due course.
- To ensure that minority unit holders of REITs would be treated fairly in a takeover, certain changes were made to the REIT Code regarding appointment and removal of REIT managers and the application of the Codes on Takeovers and Mergers and Share Repurchases was extended to REITs. The changes became effective in June 2010 following a two-month consultation. This change was in line with international practice and reflected our commitment to continue developing the Hong Kong REIT market.
- Following our release of the conclusions paper in April 2010 and gazettal of the Securities and Futures and Companies Legislation (Structured Products Amendment) Bill 2010 in July 2010, we have assisted the Government in the process of enacting the Bill. The regulation of structured products, irrespective of their legal form, was brought under the SFO when the relevant Ordinance took effect in May 2011.
- We also provided support to the Government to develop the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Bill, which codifies the customer due diligence and record keeping requirements, in line with the prevailing international standards. We would continue to support the Government by addressing relevant questions from the Legislative Council over the bill and developing uniform generic guidelines with other financial regulators.

Handling complaints, compensation

Last year, we received 203 public complaints related to the collapse of the LB group and 38 of them were referred to HKMA for preliminary review.

We also received 1,734 non-LB related complaints, 324 of which were reviewed by our various operational divisions, including 140 cases investigated by our Enforcement Division. In addition, 158 of non-LB related cases were referred to HKEx, HKMA or other financial regulators, as appropriate.

Public complaints overview

Nature of complaints	2010/11	2009/10	% change
Conduct of licensed intermediaries and registered institutions	429	616	-30%
Listing-related matters and disclosure of interests	483	716	-33%
Market misconduct	415	321	+29%
Products	11	19	-42%
Other financial activities	393	386	+2%
Miscellaneous	3	12	-75%
Subtotal	1,734	2,070	-16%
Complaints related to Lehman Brothers	203	672	-70%
Total	1,937	2,742	-29%

Under our supervision, the Investor Compensation Co, Ltd (ICC) continued to process claims from clients of three brokerages that had defaulted in previous years, as well as claims against four brokerages concerning individual disputes. During the year, the ICC completed the processing of 54 claims and paid out \$5.29 million in compensation to 38 investors.

Water is colourless, but it gives life to flowers, bringing forth blossoms with all the colours of the rainbow.



-
- 50 Riding on renminbi going international
 - 51 Bonding further with the Mainland
 - 52 Supporting market and product development
 - 53 Enhancing process efficiency
 - 54 Joining international efforts
 - 55 Communicating with the market
-

DEVELOPMENT

As the regulator of Hong Kong's securities and futures markets, we are keenly aware of our responsibility to help promote the city's status as an international financial centre and to support its singular position in the Mainland's rapid financial development. Following a series of regulatory reforms to address issues identified in the global financial crisis and to optimise the existing regulatory regime, we are now in a better position to enhance the competitiveness of our markets and meet fresh challenges.



To help foster growth in our securities and futures markets, we paid particular attention to developing their scope and depth, streamlining administrative procedures and enhancing process efficiency for the industry. We also collaborated closely with other regulators elsewhere. Above all, we maintained constructive dialogue with relevant Mainland authorities to offer our market participants opportunities arising from the Mainland's market expansion.

Riding on renminbi going international

The liberalisation of the renminbi remained a hot topic in global quarters during the year. With the market expecting the Mainland Chinese currency to further appreciate, demand for renminbi-denominated investment products also mounted. For nearly two decades, Hong Kong was the major capital-raising centre for Mainland enterprises and its window on the world. It follows that the city has a unique role to play to expand the renminbi's role in the global economy.

A new priority of our work last year was to support the Government's initiative – in tandem with the State's strategic direction – to reinforce Hong Kong as the first renminbi offshore centre. Besides providing input to the Government of a general nature, we promoted the development of renminbi businesses in Hong Kong by exploring renminbi-denominated investment products with local as well as Mainland industry participants.

Authorizing renminbi investment products

Building on the development of the offshore renminbi bond market in Hong Kong, during the year, we authorized the first four retail renminbi-denominated funds investing primarily in renminbi-denominated debt instruments issued outside the Mainland. The funds called for subscription and redemption to be made in renminbi only.

We facilitated the gradual broadening of the spectrum of renminbi investment products by authorizing the first real estate investment trust (REIT) denominated in renminbi for offering to the public in early April 2011. The REIT is the first ever renminbi-denominated product listed and traded outside the Mainland. The REIT is traded on The Stock Exchange of Hong Kong Ltd (SEHK) like a stock but simulates the features of a fixed-income instrument, which is to deliver a source of recurrent income. Initial public offering subscription, trading, clearing and settlement are all denominated in renminbi.

In view of the novelty of the product and to ensure the readiness of the market, its systems and infrastructure, as well as intermediaries and investors, we worked closely with Hong Kong Exchanges and Clearing Ltd (HKEx) and the Hong Kong Monetary Authority (HKMA) and formed a joint working group to look into issues before authorizing this first renminbi REIT.

The launch of these renminbi-denominated investment products marks a significant milestone in Hong Kong's development into an offshore renminbi centre and the process of renminbi normalisation and underscores the capability of Hong Kong's market infrastructure to support renminbi investment products for retail.

Preparing for listing of renminbi securities

Collaborating with market operators, we helped prepare the industry and investors for the listing, trading, clearing and settlement of renminbi-denominated securities. We also liaised with relevant authorities and parties to address potential issues, and assisted brokerages in their preparation:

- We held meetings with various broker associations, HKMA and HKEx in August 2010 and March 2011 to discuss operational issues for trading and settlement of listed renminbi-denominated securities. We asked the associations to urge their members to prepare themselves for the listed renminbi business, including testing their systems and procedures with HKEx, setting up renminbi-designated bank accounts at the Central Clearing and Settlement System for clearing purposes, considering the need for establishing relevant credit lines, resolving issues relating to stamp duty collection on renminbi trades, etc.
- Meetings were held with relevant market practitioners, including the share registrar, sponsors, custodians, receiving banks and potential issuers, to explore operational issues related to the listing of such securities.
- In March 2011, we coordinated with HKEx to organise market-wide end-to-end tests so that market participants could determine if their systems, operations and staff could handle listed renminbi securities properly. Names of market participants that successfully completed these tests and declared their readiness for trading such securities were published on HKEx's website for the public's easy reference. To help prepare brokerages for the tests, we conducted three briefing sessions with HKEx and issued to brokerages circulars, frequently asked questions and checklists.

Bonding further with the Mainland

Besides the renminbi-related issues, we worked closely with the Mainland to develop the market in other areas during the year.

Capitalising on new CEPA initiatives

We provided extensive support to the Government in formulating specific co-operation measures under the securities sector of Supplement VII to the Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA VII), which was entered into in May 2010. We also took part in various discussions with our Mainland counterparts to finalise relevant proposals. Under CEPA VII, exchange-traded funds (ETFs) tracking Hong Kong-listed stocks will be launched on the Mainland at an appropriate time. We also stood ready to support qualified Mainland futures companies to set up subsidiaries in Hong Kong in accordance with the relevant laws.

Other cross-border co-operation

We took part in a number of meetings with senior officials of the Government and relevant Mainland authorities to formulate and push forward Mainland-related policy initiatives that would benefit the Hong Kong market and to secure the support and buy-in from the Central Government. We supported the Government's cross-border co-operation initiatives in ways by:

- furthering Hong Kong's ties with Mainland regions and cities, including Beijing, Shanghai, Guangdong and Shenzhen, such as, by attending the second meeting held by the Expert Group on Hong Kong/Guangdong Financial Co-operation to discuss collaborative initiatives under the Framework Agreement on Hong Kong-Guangdong Cooperation, by attending the Beijing-Hong Kong Financial Services Co-operation Symposium, by meeting with Shenzhen officials to explore opportunities for the Hong Kong-Qianhai development of the financial services sector, and by sharing our views with the Government to further Hong Kong's collaboration with Shanghai and Shenzhen on a broader level;
- participating in or speaking at other meetings, including the First Hong Kong-Shanghai Financial Expert Group Meeting, the Shanghai Expo Finance Forum and the Asian Financial Forum 2011;

- exchanging views with the China Securities Regulatory Commission (CSRC), China Securities Depository and Clearing Corporations as well as stock exchanges on both sides of the border on key market issues and development of cross-border products at the 42nd meeting of the Memorandum of Regulatory Cooperation in Haila'er, Inner Mongolia;
- discussing the development of the Hong Kong and Mainland securities markets and other matters of common interests with the CSRC's Department of Intermediary Supervision in the 18th memorandum of understanding (MOU) meeting held in October 2010; and
- meeting with representatives from the Hong Kong and Macao Affairs Office, the CSRC, the China Insurance Regulatory Commission, the State Administration of Foreign Exchange and the Development Research Center of the State Council to exchange views and seek their support for initiatives that would strengthen the position of Hong Kong as an offshore renminbi centre and a capital raising centre within China.

To keep abreast of latest regulatory developments on the Mainland, we continued to dialogue with the Mainland to bring forward policy initiatives that would further help enhance Hong Kong as an international financial centre and as a testing ground for the financial reform and liberalisation of the Mainland market. In our meetings, we reaffirmed that Hong Kong is ready and able to assist the Mainland as it plays a greater role on the international stage.

Supporting market and product development

Last year, we continued to facilitate market growth and product innovation without compromising investor protection.

Exchange-traded funds

According to market research, Hong Kong is the second largest ETF market in Asia in terms of turnover and market capitalisation. We authorized 11 ETFs during the year, bringing the total number of SFC-authorized ETFs to 72 as at 31 March 2011. Total market capitalisation reached US\$88.6 billion at year end, up 38% from the year-ago level of US\$64.3 billion. The total turnover for Hong Kong-listed ETFs in the year ended 31 March 2011 amounted to US\$83.9 billion, up 29% from the year-ago level of US\$64.8 billion.

China A shares continued to be most popular among investors in Hong Kong. As at 31 March 2011, 24 ETFs in

Hong Kong tracked the performance of A-share indices with their average daily turnover representing about 67% of the total ETF turnover based on market data.

Featured below are the breakthroughs in our ETF market during the year:

- For the first time, we authorized an ETF managed by the Hong Kong asset management subsidiary of a Mainland insurance group and another ETF managed by that of a Mainland fund management company in May 2010 and July 2010 respectively.
- We authorized the first ETF managed by a Hong Kong asset management subsidiary of a Korean investment and securities group in December 2010.
- In December 2010, we authorized the first gold ETF managed by a Hong Kong-based asset management company with the physical gold vault located locally.
- We facilitated the cross-listing of the fourth Hong Kong ETF on the Taiwan Stock Exchange in December 2010.

Other retail investment products

To maintain the competitiveness of our market, we also worked on facilitating the offer of investment products to retail investors. During the year:

- we authorized 209 collective investment schemes (CISs), raising the total number of such schemes to 2,594 as at 31 March 2011;
- we authorized the issue of 84 offering documents and advertisements for unlisted structured products offered to the public; and
- we approved HKEx's proposal to launch dividend point index futures contracts on the Hang Seng Index and Hang Seng China Enterprises Index. Apart from helping investors hedge dividend risks, these products encourage market participants to trade dividend derivatives on the exchange instead of over the counter (OTC), thus enhancing the transparency of those trades. HKEx launched the dividend point index futures contracts on 1 November 2010.

Measures to encourage market growth

Public consultation on the proposed operational model for implementing a scripless securities market was completed and the conclusions were announced in September 2010. The proposal won general support from the market. We are working with HKEx and the Federation of Share Registrars Ltd on details of the operational model, and the Government on necessary legislative amendments.

During the year, HKEx recognised six additional overseas jurisdictions for listings on SEHK, namely, France, Italy, Brazil, Isle of Man, Japan and the State of California in the United States. The additions brought the number of overseas jurisdictions recognised by the Listing Rules to 16 (in addition to Mainland China, Bermuda and Cayman Islands, which were recognised much earlier as acceptable jurisdictions under the Listing Rules). This paved the way for the secondary listing of a Brazilian incorporated company, the first from that jurisdiction and also the first-ever listing by way of Hong Kong Depositary Receipts.

In the meantime, we also proposed legislative amendments to add certain exchanges based in Brazil, India and the Mainland to the lists of specified stock and futures exchanges so as to expand the scope of tax exemptions available to offshore funds engaged in futures trading.

This year saw a number of listings by way of introduction. We worked with HKEx and market participants to enhance liquidity arrangement during the initial listing period and to facilitate dissemination of related information on HKEx's website to avoid significant price fluctuation noted in some previous listings.

We approved HKEx's proposal to extend the trading hours of the securities and derivatives markets in two phases in March 2011 and March 2012 respectively. The new arrangement was meant to improve the price discovery function for Mainland-related securities by increasing the overlap of trading hours with the Mainland exchanges. The changes also would strengthen HKEx's competitiveness by narrowing the gaps between its trading hours and those of its regional competitors. We have been monitoring the market closely for the two-phased implementation.

During the year, we also approved various amendments to the Listing Rules, including:

- launching a framework to allow Mainland issuers to prepare financial statements using Mainland accounting standards, and Mainland audit firms to service these issuers using Mainland auditing standards;
- publishing new rules and guidance on information to be provided to investors and shareholders by listing applicants and listed issuers participating in the natural resources industry; and
- amending rules regarding connected transactions and streamlining requirements for issuers' circulars and listing documents.

We approved four automated trading services (ATS) applications from overseas exchanges, bringing the total number of ATS authorizations to 23 by end of March 2011. Further, we reduced levies payable for trading in securities, futures or options contracts by 25% with effect from 1 October 2010, making it cheaper to trade.

We closely monitor risks associated with the securities and futures markets. To ensure that we are well prepared for contingency events, we have put in place a market contingency plan setting out procedures for dealing with emergency situations that may affect our markets.

Enhancing process efficiency

Other priorities on our task list included streamlining regulatory requirements and removing dispensable constraints or obligations.

SFC Online Portal

We continued to expand the scope, and enhance the functionality, of the SFC Online Portal so that licensees could more effectively communicate with us electronically. During the year, we introduced the functions of making annual fee payments and retrieving payment-related information on line. As at 31 March 2011, about 95% of licensed corporations and registered institutions, and about 90% of licensed individuals, had activated their portal accounts. Further enhancements, which are expected to be launched in the third quarter of 2011, will facilitate the online submission of licensing applications.

Market facilitation

During the year, we processed 101 applications for subordinated loans, and facilitated the operation of certain intermediaries by granting the following modifications relating to the Securities and Futures (Financial Resources) Rules:

- to a licensed corporation of an investment banking group to facilitate its adoption of the third-party clearing model;
- to a licensed corporation in relation to its investment in the Mainland under the Qualified Foreign Institutional Investor Scheme of the Mainland; and
- to three licensed corporations to facilitate market-making activities and/or certain back-to-back arrangement with the holding company.

In addition, to enable the public to more easily identify firms that are permitted to act as sponsors and compliance advisers, we started carrying the List of Sponsors on our website in September 2010.

New post-vetting regime

The post-vetting regime took effect on 25 June 2010 allowing certain routine takeovers-related announcements to be published without being submitted to the SFC for prior comment. It helped reduce the cost and burden of compliance for parties issuing announcements and promoted self-discipline among parties and professionals involved in deals. We also made miscellaneous house-keeping amendments to the Codes on Takeovers and Mergers and Share Repurchases.

Overall, market practitioners have followed our prescriptive guidance and complied with the requirements under the new regime. We will continue to monitor compliance with a view to including additional documents in the Post-Vet List, which names the routine announcements that do not require SFC vetting before publication.

Encouraging fewer hard copies of IPO prospectuses

Starting February 2011, companies seeking to list shares or debentures on SEHK are allowed to distribute paper application forms without accompanying printed prospectuses, as long as the prospectus is available on line. The similar option is also available to issuers of SFC-authorized CISs listed on SEHK. In response of a joint public consultation with SEHK, the market, the public, professionals and an environmental group widely supported the measure, which aimed to enhance market efficiency and environmental protection.

Other streamlining initiatives

We approved rule amendments proposed by HKEx in June 2010 to streamline the designation of market-making facility for securities products, thus simplifying the process to enhance liquidity for new products.

To remove unnecessary burden on applicants and issuers and to enhance the quality of property valuation information provided to investors, we joined SEHK to consult the public on proposals to streamline property valuation disclosure requirements in prospectuses and issuers' circulars. The

consultation ended in February 2011. We are analysing the comments received and target to publish the consultation conclusions in 2011.

Intermediary licensing

We devoted substantial efforts to cope with the significant rebound in new licence applications this year, following previous declines caused by the effects of the global financial crisis. Licence applications from local and overseas intermediaries registered strong growth, bringing the total number of SFC licensees to a record high of 38,579 as at 31 March 2011.

The hedge fund industry also expanded in the year. The number of licensed hedge fund managers/advisers increased 19% and reached an historical high of 326 as at March 2011, underscoring Hong Kong's attraction as an international financial centre and a place that is conducive to conducting this business.

Joining international efforts

To ensure our regulatory approach is in line with international standards, we strengthened regulatory co-operation with overseas counterparts. In particular, we continued to participate in various task forces and committees of international standard setting organisations, including the International Organization of Securities Commissions (IOSCO), the Committee on Payment and Settlement Systems (CPSS), and others:

- the IOSCO Task Force on OTC Derivatives Regulation and the OTC Derivatives Regulators' Forum, which aimed at developing consistent international standards related to OTC derivatives regulation, and allowing regulators to cooperate, exchange views and share information related to OTC derivatives central counterparties and trade repositories respectively;
- the CPSS-IOSCO Steering Committee on Principles for Financial Market Infrastructures, which targeted strengthening core financial infrastructures, including settlement facilities, payment systems and central counterparties through a review of related international standards;
- the IOSCO Task Force on Unregulated Financial Markets and Products, which examined ways to introduce greater transparency and oversight in unregulated financial

markets and products, and improve investor confidence in, and the quality of, these markets, notably in terms of securitisation and credit default swap markets. The Task Force published its recommendations last year, and a report on the survey findings on the level of implementation of the recommendations relating to securitisation was published in March 2011;

- the IOSCO Task Force on Commodity Futures Market, which continued to work on the Group of Twenty's directive relating to enhancing the transparency, regulation and supervision of the commodity derivatives markets, in particular oil derivatives;
- the IOSCO Standing Committee on Secondary Markets, which intensified efforts (including engaging the industry) to identify regulatory issues. Recent studies include those relating to technological developments in the market such as high frequency trading, direct electronic access and dark pools; and
- the IOSCO Standing Committee on Regulation of Market Intermediaries, chaired by the SFC's Senior Director of Intermediaries Supervision, completed a review of international client asset protection and insolvency regimes, and is studying global capital standards for the securities sector and suitability requirements for intermediaries.

The SFC's CEO represented Hong Kong at the Financial Stability Board (FSB) Standing Committee on Standards Implementation. He was invited to lead a review team, comprising experts from FSB member institutions, to conduct a peer review of Italy. The review report was published in February 2011, setting out findings from the assessment of the seven key financial sector standards in Italy, and highlighting issues that could be relevant to other jurisdictions for FSB's consideration.

To maintain continued access by the local hedge fund industry to the European Union's (EU) investor base, we worked with the Government to express our comments to the European Commission on the EU Directive on Alternative Investment Fund Managers.

We discussed the development of the Hong Kong and Taiwan securities markets and other regulatory matters in the second MOU meeting with the Taiwan Financial Supervisory Commission.

Communicating with the market

Through topical publications, we kept the industry informed periodically on latest regulatory developments and compliance concerns. The Enforcement Reporter highlights the more significant enforcement actions to draw the attention of market practitioners and investors. For takeovers-related matters, we continued to publish the Takeovers Bulletin and kept the Practice Notes under review to provide more guidance on the Executive's practices (see footnote on page 46). Separately, the Dual Filing Update helped to remind the market of key aspects in the preparation of listing applications.

Twice a year, we conducted financial review of the Hong Kong securities industry to provide key statistical information on securities dealers and securities margin financiers and give an overview of SEHK participants' financial performance.

We published key findings of an Industry Participants Survey in June 2010. The survey was intended to give us a better understanding of the needs of the industry and related parties and to gain insights for corporate planning. The results were encouraging. Among a random sample of industry participants invited to rate their satisfaction with the SFC, 76% were either "satisfied" or "very satisfied" with our work and 73% expressed satisfaction with our efficiency and staff quality.

In July 2010, we released findings of our annual Fund Management Activities Survey, showing a 45.4% year-on-year growth in Hong Kong's combined fund management business to \$8,607 billion at the end of 2009. This confirms Hong Kong's ability to provide platforms for investors worldwide to invest in the region and for Mainland-related firms to gain exposure to global investment practices.

Our Report of the Survey on Hedge Fund Activities of SFC-licensed Managers/Advisers was released in March 2011 to give an updated account of the hedge fund industry in Hong Kong. As of 30 September 2010, the total hedge fund assets under management in Hong Kong amounted to US\$63.2 billion, seven times the level in 2004. The survey was conducted in conjunction with a data collection exercise coordinated by IOSCO to facilitate identification of possible systemic risks.

EDUCATION

Persistent market volatility continued to pose challenges for investors. During the year, investors also had to deal with the emergence of new investment products and trading methods. To help investors make informed investment decisions and develop a proper attitude towards wealth management, we stepped up our investor education efforts alongside the implementation of opportune rules and regulations.

Just as water is vital to life, education is needed to enlighten the mind. In much the same way, the SFC turns on the fountain of knowledge to provide investors with information and understanding for making suitable investment decisions.

-
- 58 Promoting use of new safeguards
 - 59 Staying abreast of market development
 - 60 Getting external stakeholders to participate
 - 61 Expanding communications channels
 - 61 In support of IEC
-



A package of measures enhancing the sale process of investment products announced in May 2010 reflects the complexity of today’s investment products. Fine-tuning our regulatory regime to enhance investor protection was a major step and part of our strategic planning to rebuild confidence. Our investor education (IE) efforts, therefore, tied in with the regulatory progress to help investors understand their rights on one hand and recognise their responsibility on the other. We launched a series of programmes to inform the public of the finer points of the new measures and explained to them how to make use of their rights in each stage of the investment life-cycle.

Besides explaining the new safeguards, our IE messages closely followed fast-changing market conditions to address the most pressing issues facing investors and to show how popular investment instruments work from a risk perspective. We also reminded investors to steer clear of common mistakes and misconceptions and cautioned them against prevalent investment scams. By involving the external stakeholders in planning and implementing some of these initiatives, we could convey more effectively our IE messages to different segments of the investing public.

We augmented our communications channels to extend our reach and to meet investors’ new needs. In September 2010, we launched *InvestEd Intelligence*, a bi-monthly e-newsletter to replace the former monthly digest *Monthly Focus* while incorporating the *Dr Wise* column to deliver our IE messages in a more comprehensive and effective manner. For better online experience, we upgraded some functions of our InvestEd website, including revamping the homepage and launching applications for mobile devices.



InvestEd homepage revamp

Looking ahead, we will continue to stretch the value and scope of our IE capacity. It remains our near-term priority to help the Government set up the Investor Education Council, a holistic IE body to cover the entire financial services sector.

Promoting use of new safeguards

As the new investor protection measures were launched in phases, we scheduled our IE programmes under the “Know how the new rules protect you” theme accordingly. Over the past year or so, we educated investors on key protection measures that have already taken effect. Under the new rules, product issuers must provide key facts statements (KFS) to explain key features and risks with certain investment products; investors must be given a post-sale “cooling-off” or “unwind” right to change their mind about investing in certain unlisted structured products; and intermediaries are no longer allowed to use gifts, other than a discount of fees or charges, to promote a specific product.



An infographic explaining the difference between bonds and bond funds

In this past spring, we also started a series of mass-media programmes to promote the requirements for intermediaries that will take effect this year, including investor characterisation and disclosure of sales-related information and benefits:

- ‘Ace it!’: A series of one-minute mini dramas with a cast of well-known artistes began airing on TVB Jade in March 2011 to highlight key points of the sales process for investment products. The 10-episode series began with an

explanation of the SFC's regulatory regime, then proceeded to introduce both recently launched and upcoming measures for additional investor protection.

- **'InvestEd Arena':** This three-part quiz on financial knowledge was co-produced by the Hong Kong Economic Times (HKET) and Cable TV. From January to March 2011, contestants were tested on their knowledge of the new investor protection measures and various topics related to financial investment. The first round of the quiz published in HKET attracted a total of 599 entries. Semi-final rounds and the grand finale were aired on Cable TV to let a wider public audience find out about the new investor protection measures in a more interesting way.
- **Infomercials and videos on major broadcasts:** Since September 2010, we have been airing a total of 10 20-second infomercials and two one-minute videos explaining the new measures on major TV stations, namely TVB Jade, Cable TV, Now TV, as well as bus and trains.
- **'Info-wise by Dr Wise':** Our fictitious columnist Dr Wise was dispensing financial advice on Metro Radio from April to June 2010. Besides topical product knowledge, the 45-second messages explained how investor rights were enhanced under the new rules.
- **Brochure and leaflet:** We also published in plain language a booklet entitled "How to Read Product Key Facts Statements" and a leaflet to explain the mechanism of the post-sale cooling off arrangement. Flowcharts were used to help illustrate the salient points of the new measures. The publications were distributed to the general public through multiple channels including intermediaries, newspaper insertions and public libraries.

Staying abreast of market development

Another of our priorities is to raise public awareness of the risks of popular investment products. Responding to market changes, we continued to address topical investment issues and to clarify common misunderstandings through our thematic media programmes and regular IE channels, including our InvestEd website, newsletters and weekly column in Headline Daily.

In March 2011, we launched "SFC Investor Education Advice," a new series of IE infomercials on TVB iNews, Cable TV, Now TV, as well as on buses and trains to explain popular investment products such as renminbi products and synthetic exchange-traded funds (ETFs). The programme also clarified common misunderstanding in the price quoting mechanism of derivative warrants and the relationship between a derivative warrant's implied volatility and its price.

In view of the growing appetite in high-yield investments, we published a brochure on equity-linked investments (ELIs) in March 2011, which explained features such as airbags, daily accrual and early call. It was drafted in plain language and featured scenario analysis to help investors understand downside risks. Over 5,000 copies were distributed through intermediaries to the investing public. We also continued to run the TV commercial (TVC) "Ask Me," featuring a catchy 1970s Canton-pop song with rewritten lyrics to promulgate a questioning attitude towards making investment decisions. Starting February 2011, the TVC has been aired on major business channels including TVB Jade, TVB-HD Jade, ATV Home, Now TV Business Channel and Cable TV Finance Info Channel.

Hong Kong was the largest initial public offering (IPO) centre in the world in 2010. To help individuals invest in IPO shares wisely, we produced "Understanding IPO Prospectus," a series of five one-minute videos in March 2011. Hosted by a famous stock commentator, the programme aimed to show investors how to make use of an IPO prospectus to make informed investment decisions. The videos were aired on various major business channels.



"Understanding IPO Prospectus" one-minuters

Besides, to better prepare investors for a new class of products - listed renminbi securities, we published in March 2011 flowcharts in free newspapers and a business daily explaining key procedures to take before one can invest in a renminbi IPO. In addition, we posted a number of frequently asked questions on our InvestEd website.

In support of the Government's policy to further develop the local bond market, we organised IE programmes to raise public awareness of investing in bonds. Besides giving investors an overview of offerings in the retail bond market, our IE programmes also articulated the risks and features of different bond products, including renminbi bonds and bond funds, as follows:

- **'Invest@Bonds'**, a series of 10 one-minute radio segments, were broadcast on Commercial Radio from February to March 2011. In dialogue format, the programme explained bonds as part of an investment portfolio and the trading mechanism and fees involved. It also pointed out to investors the credit risk, liquidity risk and exchange risk specific to bond investing, and clarified the difference between bonds and bond funds and between bonds and shares issued by a listed company.
- **'Smart on Bonds'** was a series of print and video interviews featuring advice from industry professionals on bond investing. The interviews were published in Ming Pao Daily News, both in print and on line, starting March 2011. The March episode discussed renminbi bond, its trading and associated risks.
- **Financial professionals interview series:** A series of interviews featuring advice provided by industry professionals and academic experts were conducted on Now TV and then published in the Hong Kong Economic Journal. In January and February 2011, seasoned market professionals discussed various aspects of bond investing, including the secondary bond market, liquidity risk, interest-rate movements as a risk and credit risk. The guests also explained bonds in the context of life-cycle investing and clarified the difference between bonds and other investment products, such as stocks and bond funds.

At some interviews, industry professionals and academics also talked about investment issues surrounding popular fund products, including key features and currency risks of renminbi funds, counterparty risks specific to synthetic

ETFs, the fees and charges involved in fund investing, and the SFC's disclosure requirement for performance fees.

Getting external stakeholders to participate

Intermediaries have an important role to play in our efforts to explain new measures guiding the selling process of investment products. The same goes for experts in academic circles. Therefore, we engaged them to help explain the new rules and to dispense IE materials.

Highlighted below are two of the IE initiatives in which industry participants and academic experts made substantial contributions:

- **'Investor Day'**: This annual event we co-organised with The Open University of Hong Kong was held in January 2011. Hosted by academics and market professionals, the full-day education seminars attracted over 500 attendees from the public. Topics featured this year included the economic and market outlook for Hong Kong and China, currency wars and key features and risks of popular investment products.



Investor Day 2011

- **Investor seminar series:** Jointly organised by the SFC and the Hong Kong Society of Financial Analysts, the fourth such full-day event attracted more than 330 participants. At seminars throughout the day, financial analysts shared their views with the audience on a number of issues, eg, market sector analysis, clean energy stocks and ETFs. A presentation on ETFs was posted subsequently on our InvestEd website.

Expanding communications channels

To reach out more efficiently and effectively to investors, we constantly reviewed and adjusted our media strategy and expanded our communications channels.

More encompassing e-newsletter

In September 2010, we launched *InvestEd Intelligence* as a comprehensive bi-monthly e-newsletter. Designed to beef up the former *Monthly Focus*, a digest, the e-newsletter carries articles covering various areas – namely, current market issues, investment products, updates of the SFC’s investor protection work, common misconceptions, and the well-known *Dr Wise* column. Every new issue was advertised in a popular search site, generating a total of over 30,000 page views. To encourage interaction, prizes were given out to the first five readers who answered quizzes correctly in every issue.

Often, *InvestEd Intelligence* came in handy as a channel to communicate messages of current interest. In the March 2011 issue, for instance, the e-newsletter told investors that they would have to get prepared if they wished to trade listed renminbi securities, which were yet to be listed in Hong Kong. Another issue helped investors tell the difference between traditional and synthetic ETFs, not just in terms of the risk exposure of the synthetic class, but also from the markings being introduced to identify them.

Outreach activities

We continued to organise investor outreach programmes in classroom or workshop settings to deliver timely IE message and to inculcate a proper investment attitude. In addition to off-premises seminars, we also arranged for secondary school students to visit the SFC to get a better understanding of our regulatory role and IE initiatives. In the past 12 months, we organised over 80 seminars and visits, involving nearly 10,000 members of the public.

In terms of the targets of our outreach seminars, we added the Trade Development Council, Social Welfare Department and the Police Force to the community groups, university students and secondary school students that we have been serving. Earlier this year, we also leveraged a Government-held event to disseminate IE message. In “Golden Age Delight,” an event organised by the Elderly Commission and

the Labour and Welfare Bureau to prepare someone for retirement, we operated a booth to promote prudent wealth management planning, distributed IE publications and explained the new investor protection safeguards.

Upgrading IE portal

Our IE website had a face lift in the spring of 2011. To help investors access the most useful and popular IE resources, the homepage of the IE website underwent an overhaul, thus improving investors’ surfing experience. The revamp also catered for addition of contents at a later stage. Furthermore, the “SFC InvestEd” app was launched in March 2011, enabling iPhone and iPod Touch users to read our *Dr Wise* column, watch short videos, and keep track of the IE activities calendar.

We continued to add learning tools and to update the existing contents to meet changing investor needs.

- A total of 87 articles and videos were added to the IE portal in the past 12 months, including articles explaining KFS, ETFs, ELLs, Hong Kong depositary receipts, renminbi-denominated products and rights issues, as well as flash videos featuring risk management, corporate actions and structured products.
- To draw traffic to the website – in particular the newly added *InvestEd Intelligence* e-newsletter series, new IE articles and multi-media learning tools – the IE portal carried more than 10 online quizzes and attracted over 1,000 entries.

In support of IEC

We continued to support the plan of the Financial Services and Treasury Bureau (FSTB) to establish an Investor Education Council. At the end of the three-month consultation in May 2010, we had close discussions with FSTB regarding comments received from the public. In December 2010, FSTB published the consultation conclusions confirming its decision to set up the IEC as an entity wholly owned and fully funded by the SFC.

Towards that end, the SFC will provide input for drafting legislative amendments to the Securities and Futures Ordinance in this legislative year so that the SFC’s IE remit can be broadened to cover the entire financial services sector.

ORGANISATIONAL MATTERS

Central to meeting our statutory objectives, we invest substantially in various resources – both tangible and intangible, and introduce enhancements from time to time to improve our organisational effectiveness.

Adding value to work culture

As an organisation, we believe in the values of being professional, proactive and we recognise that people are our greatest asset. To that effect, we devoted time and effort to define and communicate such values and to cultivate such a working environment. In so doing, we hope to attract, motivate, and retain our best talent.

The “Living our Values” culture campaign run last year involved every single member of the SFC workforce. During a series of workshops, we reiterated our core values and demonstrated how such values could be integrated into our daily work. Workshop attendees spoke up and exchanged ideas, thus demonstrating how each and every SFC person could play a part in the organisation.

Reinforcing communication

Every quarter, we hosted “CEO Sharing Sessions” during which our CEO updated staff on the latest market developments, pressing regulatory issues and other organisational matters of immediate interest to employees. The CEO also answered staff questions submitted prior through the Intranet’s “Your Voice” mailbox which was made available to all employees since August 2009.

Bolstering recruitment

Last year, our recruitment efforts addressed our needs as follows:

- Meeting increased challenges to ensure compliance of licensed corporations;
- supporting our work with the International Organization of Securities Commissions; and
- handling increasingly complex issues arising from listed companies’ corporate governance.

Separately, in its second year running, our Graduate Trainee Programme recruited 19 graduates for the 2010 intake and achieved a retention rate of 88%. Our on-campus and overseas recruitment drive also paid off as we saw a 43% year-on-year increase in the number of applications for the 2011 intake.

The three-year graduate programme offers custom-designed classroom training, mentorship and rotational on-the-job experience in different areas of the organisation. By developing our graduate programme, we groom talent from within the organisation to lead and support the SFC’s development.

Developing people

To help staff maintain a high level of technical proficiency and stay abreast of latest market events and trends, we offer practical training, e-learning modules, education sponsorship and a wide range of seminars conducted by local and overseas market experts.

Lectures, seminars, workshops conducted

Topics	Total Training Hours 2010/11	Change from 2009/10
Technical skills and market updates	9,364	+37%
Management skills	5,321	+74%
Language, technology and other skills	6,120	+47%

Overseas secondment and training opportunities are provided to good performers to offer international exposure and to facilitate exchanges between the SFC and our international counterparts.

Last year, we worked with a division to develop a function-specific competency framework and training curriculum. The objective of this project was to identify critical competencies for each job in a division and provide a comprehensive training roadmap to guide personal and professional development. We plan to extend the scope of this project to the rest of the operational divisions in the coming two years.

To further facilitate a self-driven learning culture, we developed our first in-house e-learning module – Applying the Securities and Futures Ordinance. The eSFO, as the tutorial is known, aims to provide a comprehensive overview of the ordinance that defines the SFC's statutory objectives, functions and powers. This comprehensive e-learning module was completed by 21% of professional staff within the first two months of its launch in mid-February 2011.

Acknowledging good performance

Our remuneration strategy is reviewed each year to ensure that we can attract and retain the right talent to deliver our organizational priorities. We also recognise individuals and teams for their outstanding contribution to the organisation through the annual SFC Employee Awards. In 2010/11, four staff members received individual awards and team awards went to six teams for collaborating among different operating units to complete projects successfully.

Enhancing process efficiency

Our information technology specialists have been managing projects to support process-efficiency, collaboration, and better communication. This year, major projects include:

- Setting up an electronic payment gateway in the Licensing Online Portal – since its launch in April 2010, the payment gateway has helped settle more than 1,000 payment transactions of over \$14 million.
- Developing a successful approach to allow our enforcement personnel to cope with the ever-increasing demand on computer forensics.
- Launching the commission-wide Document Management System to improve overall document filing, sharing and storage capabilities.
- Revamping the Intranet to help further facilitate collaboration across divisions.
- Enhancing our corporate website infrastructure to ensure uninterrupted connectivity.

Financial performance explained

Income

Total revenue for the year was \$1.7 billion, down 6.4% from \$1.8 billion a year ago. Income from the securities transaction levy accounted for 81.6%, and fees and charges, 10.2% of our total revenue.

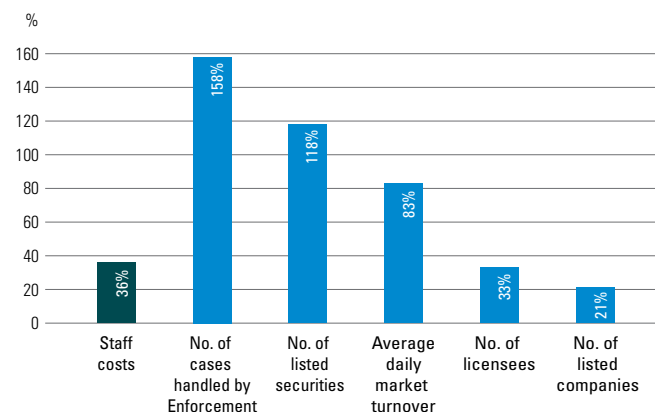
	2010/11	2009/10	2008/09
Levies	81.6%	83.3%	76.9%
Fees and charges	10.2%	8.6%	13.0%
Net Investment Income	7.6%	7.6%	9.6%
Others	0.6%	0.5%	0.5%
	100%	100%	100%

Expenses

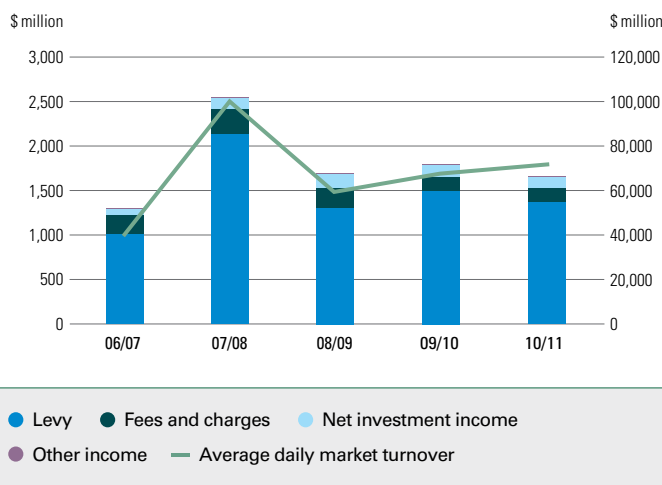
	2010/11	2009/10	2008/09
Staff costs	72.4%	72.5%	72.6%
Premises and related expenses	11.4%	11.3%	10.8%
Other expenses	10.9%	11.6%	12.9%
Depreciation	5.3%	4.6%	3.7%
	100%	100%	100%

We control expenses using the annual budget approved by the Financial Secretary for the operation of the SFC. Adopting stringent controls on spending, our total expenses were \$780 million, about 12.8% below our approved budget. Staff is our most valuable class of assets and accounted for 72.4% of our total expenditures. Our workload increased with a rise in market activities and the number of licensed intermediaries. Over the past five years, our staff costs increased 36% whereas during the same period, the increase in the number of listed companies, listed securities and licensees was 21%, 118%, and 33% respectively.

Changes in staff costs vs level of market activities (2006/07-2010/11)



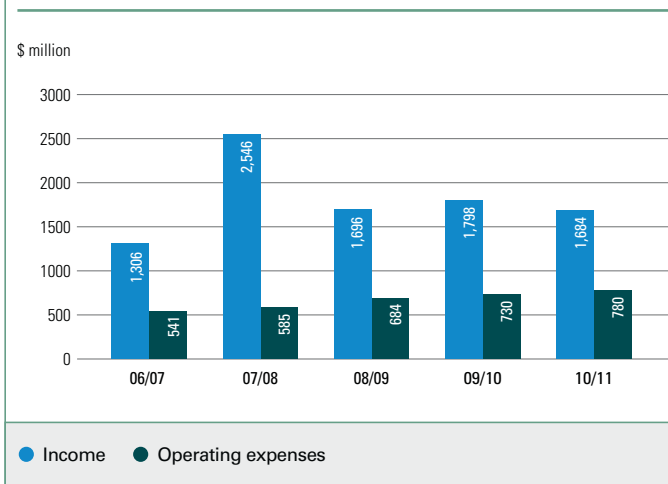
Income vs market turnover (2006/07-2010/11)



Our income is market dependent. In general, our total income is in line with the turnover of the securities market as the securities transaction levy is our main source of income. However, despite an increase in the average daily market turnover in 2010/11, our income decreased 6.4% from the year before due to a 25% levy reduction from October 2010.

The ratio of average expenses to income for the past five years was 36.8% and the average increase on expenses was 9.5% and on income was 22.9%.

Income vs operating expenses (2006/07-2010/11)



	06/07	07/08	08/09	09/10	10/11	5-year average
Expenses to income ratio	41.4%	23.0%	40.3%	40.6%	46.3%	36.8%

Surplus for the year amounted to \$0.9 billion, compared with \$1.1 billion last year.

As at 31 March 2011, our reserves had accumulated to approximately \$6.9 billion, which we managed in strict accordance with investment guidelines approved by the Financial Secretary.

STATISTICAL COMPARISONS

The following table shows certain key market data and statistics related to the work of the SFC in the past three years. Please see corresponding tables starting on page 68.

	2010/11	change	2009/10	change	2008/09
Market activities and transactions					
Listing applications reviewed under the dual filing regime (Table 7)	201	52%	132	52%	87
Takeovers and share repurchases transactions handled (Table 6)	304	-16%	363	37%	266
Licensing					
Applications for SFC licences	7,793	20%	6,518	-9%	7,150
Applications to conduct new regulated activity	24,246	26%	19,248	-6%	20,450
Number of SFC licensees (Table 10)	38,579	5%	36,581	-2%	37,310
Investment products					
Number of SFC-authorized schemes (Table 1)	2,594	-0.2%	2,599	-8%	2,833
NAV of authorized unit trusts and mutual funds (US\$ billion) ¹ (Tables 2 and 3)	1,188.0	28%	926.9	48%	628.3
Inspections of intermediaries					
Risk-based on-site inspections conducted	235	18%	200	25%	160
Enforcement					
Number of cases handled	402	35%	298	166%	112
Successful prosecutions	55	62%	34	26%	27
Unsuccessful prosecutions	1	-67%	3	0%	3
Disciplinary inquiries conducted	73	-11%	82	-17%	99
Actions taken against licensees	47	-16%	56	12%	50

¹ Net asset value (NAV) as at 31 December 2010, 2009 and 2008.

Note: All dollar amounts have been rounded to the nearest decimal, and figures to the nearest digit.

	2010/11	change	2009/10	change	2008/09
Reaching out					
Press releases issued	161	7%	151	-21%	192
Consultation papers issued	6	0%	6	100%	3
Consultation conclusions issued	9	350%	2	-50%	4
Technical publications	9	0%	9	13%	8
Codes and guidelines issued	6	500%	1	-83%	6
Corporate website average daily hit rate	843,145	18%	717,699	46%	492,383
Public enquiries	3,405	7%	3,176	-75%	12,762
Public complaints ²	1,937	-29%	2,742	-73%	10,070

² The figures reflect the number of complainants.

Investor-related

Educational articles	139	-6%	148	12%	132
Talks, seminars and workshops	59	-17%	71	18%	60
Educational segments on radio/TV	109	-15%	128	-1%	129
InvestEd website average daily hit rate	157,909	12%	140,943	-2%	144,285
NAV of all compensation funds (\$ million)	2,113.8	4%	2,023.8	8%	1,873.3
Unified Exchange Compensation Fund	61.6	5%	58.7	2%	57.7
Investor Compensation Fund	2,052.2	4%	1,965.1	8%	1,815.6

Finances and staff

Income (\$ million)	1,683.8	-6%	1,798.4	6%	1,696.1
Expenses including depreciation (\$ million)	780.4	7%	729.7	7%	683.8
Number of staff ³	544	9%	501	5%	478

³ The break down of the figures is as follows:

	31 March 2011		31 March 2010		31 March 2009	
	Actual	Budget	Actual	Budget	Actual	Budget
Professional	402	441	373	401	349	383
Support	142	146	128	135	129*	124
	544	587	501	536	478	507

* A number of junior professional staff headcount vacancies were filled by supporting staff.

ACTIVITY AND MARKET DATA

○ **Table 1** Number of investment products authorized

	2010/11	2009/10	2008/09
Unit trusts and mutual funds	1,944	1,968	2,093
Investment-linked assurance schemes	248	239	235
Pooled retirement funds	35	34	35
Mandatory Provident Fund (MPF) master trust schemes	40	37	36
MPF pooled investment funds ¹	305	296	305
Others ²	22	25	129
Total	2,594	2,599	2,833

¹ 121 funds included in this category were offered both as retail unit trusts as well as pooled investment funds for MPF purposes.

² Other schemes comprised 14 paper gold schemes and eight REITs.

○ **Table 2** Authorized unit trusts and mutual funds – by type

	Number	%	Total NAV ¹ (US\$ million)	%
Bond	327	18.45	360,944	30.38
Equity	1,089	61.46	571,859	48.13
Diversified	78	4.40	43,005	3.62
Money market	44	2.48	86,854	7.31
Fund of funds	80	4.52	7,898	0.66
Index	99	5.59	106,192	8.94
Guaranteed	36	2.03	1,287	0.11
Hedge	11	0.62	920	0.08
Other specialised ²	8	0.45	9,106	0.77
	1,772	100.00	1,188,065	100.00
Umbrella structures	172			
No. of authorized funds	1,944			

¹ NAV as at 31 December 2010.

² Includes Futures and Options Funds and Leveraged Funds.

Table 3 Authorized unit trusts and mutual funds – by origin

	Umbrella funds	Sub-funds	Single funds	Total	%	Total NAV ¹ (US\$ million)	%
Hong Kong	35	104	61	200	10.29	36,821	3.10
Luxembourg	57	1,101	3	1,161	59.72	759,667	63.94
Ireland	34	253	2	289	14.87	259,299	21.83
Guernsey	2	1	0	3	0.16	0	0.00
United Kingdom	5	48	5	58	2.98	50,133	4.22
Other Europe	0	0	15	15	0.77	896	0.08
Bermuda	3	16	3	22	1.13	5,244	0.44
British Virgin Islands	2	4	0	6	0.31	22	0.00
Cayman Islands	34	118	31	183	9.41	11,341	0.95
Others	0	0	7	7	0.36	64,642	5.44
No. of authorized funds	172	1,645	127	1,944	100	1,188,065	100

¹ NAV as at 31 December 2010 (excluding “umbrella funds”).

Table 4 Unlisted retail structured products: authorization of offer and marketing documents

	2010/11	2009/10	2008/09
Authorizations granted under section 105 of the SFO	84	24	61
Authorizations granted to register prospectuses under the Companies Ordinance	0	0	31

Table 5 Renminbi bonds: authorization of offer and marketing documents

	2010/11	2009/10	2008/09
Authorizations granted under section 105 of the SFO	4 ¹	4	4 ²
Authorizations granted to register prospectuses under the Companies Ordinance	2 ³	3 ⁴	3 ⁵

¹ Include one renminbi bond offering with a retail issue size of RMB4.0 billion.

² Include one renminbi bond offering with a retail issue size of RMB1.5 billion.

³ Two renminbi bond offerings with an aggregate retail issue size of RMB3.0 billion.

⁴ Three renminbi bond offerings with an aggregate retail issue size of RMB5.974 billion.

⁵ Three renminbi bond offerings with an aggregate retail issue size of RMB4.5 billion.

Table 6 Takeovers activities

	2010/11	2009/10	2008/09
Codes on Takeovers and Mergers and Share Repurchases			
General and partial offers under the Takeovers Code	29	37	27
Privatisations	6	9	6
Whitewash waiver applications	30	41	34
Other applications under the Takeovers Code	224	254	190
Off-market and general offer repurchases	2	9	7
Other applications under the Share Repurchases Code	13	13	2
Total	304	363	266
Takeovers Bulletins	4	4	4
Executive Statements			
Sanctions imposed with parties' agreement ¹	2	1	0
Takeovers and Mergers Panel			
Meetings for review of the Takeovers and Share Repurchases Codes	1	1	5
Hearings before the Panel (disciplinary and non-disciplinary)	2	3	3
Statements issued by the Panel ²	2	1	3

¹ Pursuant to section 12.3 of the Introduction to the Codes on Takeovers and Mergers and Share Repurchases.

² Pursuant to section 16.1 of the Introduction to the Codes on Takeovers and Mergers and Share Repurchases.

Table 7 New listing applications

	2010/11	2009/10	2008/09
Total listing applications received	201	132	87
Transfer from GEM to Main Board	17	6	15
Listed	117	79	46
Cases lapsed / withdrawn / rejected ¹	11	13	24

¹ As at 31 March.

Table 8 Stock market

	2010/11	Change	2009/10	Change	2008/09
Number of listed companies on the Stock Exchange	1,426	+7%	1,332	+5%	1,266
Main Board	1,258	+9%	1,158	+6%	1,092
Growth Enterprise Market	168	-3%	174	0%	174
Market capitalisation (\$ billion)	21,396.9	+19%	18,055.6	+78%	10,127.7
Main Board	21,259.1	+19%	17,920.9	+78%	10,080.8
Growth Enterprise Market	137.8	+2%	134.7	+187%	47.0
Average daily market turnover (\$ million)	71,862.9	+7%	67,138.1	+14%	58,832.1
Main Board	71,363.8	+7%	66,725.6	+14%	58,689.7
Growth Enterprise Market	499.1	+21%	412.5	+190%	142.4

Table 9 Statistical information and financial position of the Hong Kong securities industry¹

	As at 31.12.2010	As at 31.12.2009	As at 31.12.2008
Total number of securities dealers & securities margin financiers	831	769	741
Total number of active cash clients ²	1,113,657	957,651	918,750
Total number of active margin clients ²	132,101	138,772	113,823
Total number of active clients (+14%)	1,245,758	1,096,423	1,032,573
Balance sheet	(\$ million)	(\$ million)	(\$ million)
Cash in hand and at bank ³	292,827	276,962	251,982
Amounts receivable from margin clients ⁴	58,468	40,160	17,217
Amounts receivable from clients and other dealers arising from dealing in securities	138,422	120,754	86,369
Proprietary positions	173,873	143,467	94,003
Other assets	147,754	137,182	141,203
Total assets (+13%)	811,344	718,525	590,774

Remarks:

¹ Data were extracted from the monthly Financial Returns submitted in accordance with the Securities and Futures (Financial Resources) Rules by licensed corporations licensed for dealing in securities or securities margin financing. Figures reported by an overseas incorporated licensed corporation that carries out its principal business activities outside Hong Kong and operates in Hong Kong as a branch office were excluded from these computations.

² Active clients are 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.

³ Cash in hand and at bank includes trust monies held on behalf of clients totalled \$119,475 million (31.12.2009: \$114,352 million).

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):

As at 31.12.2010	As at 31.12.2009
4.7	5.2

Table 9 Statistical information and financial position of the Hong Kong securities industry (Cont'd)

	As at 31.12.2010	As at 31.12.2009	As at 31.12.2008
Amounts payable to clients and other dealers arising from dealing in securities	287,645	263,372	211,565
Total borrowings from financial institutions	71,558	48,572	37,015
Short positions held for own account ⁵	107,211	36,891	11,186
Other liabilities ⁵	126,899	177,965	156,661
Total shareholders' funds	218,031	191,725	174,347
Total liabilities and shareholders' funds (+13%)	811,344	718,525	590,774
	12 months to 31.12.2010 (\$ million)	12 months to 31.12.2009 (\$ million)	12 months to 31.12.2008 (\$ million)
Profit and loss			
Total value of transactions ⁶	54,372,754	46,347,239	53,923,632
Net securities commission income	31,079	31,676	40,120
Gross interest income	5,280	3,979	9,586
Other income ⁷	82,365	62,841	59,188
Total operating income (+21%)	118,724	98,496	108,894
Total overheads and interest expense	102,224	90,164	87,707
Total operating profit (+98%)	16,500	8,332	21,187
Net profit on proprietary trading	10,606	12,905	5,860
Net profit for the period (+28%)	27,106	21,237	27,047

Remarks:

⁵ The increase of \$70 billion in short positions held for own account from 2009 was mainly due to a reporting reclassification of other liabilities by a securities dealer.

⁶ The total value of transactions includes trading in equities, bonds and other securities in Hong Kong and overseas.

⁷ Other income comprises fund management income, corporate finance income, inter-company management fee income and others.

Table 10 Number of licensees as at 31 March 2011 vs last year

	Corporations		Representatives		Responsible Officers		Total		Change
	2011	2010	2011	2010	2011	2010	2011	2010	
Stock Exchange participants	440	422	11,552	10,736	1,486	1,378	13,478	12,536	+8%
Futures Exchange participants	117	116	931	926	123	120	1,171	1,162	+1%
Stock Exchange and Futures Exchange participants	63	56	3,447	2,852	360	291	3,870	3,199	+21%
Non-participants	1,132	1,037	16,074	16,016	2,854	2,631	20,060	19,684	+2%
Total	1,752	1,631	32,004	30,530	4,823	4,420	38,579	36,581	+5%

Table 11 Breaches by licensed corporations noted during inspections

Nature of Breaches	2010/11	2009/10	2008/09
Failure to comply with Financial Resources Rules	14	12	25
Failure to safekeep client securities	10	7	16
Failure to maintain proper books and records	6	15	13
Failure to safekeep client money	10	21	19
Unlicensed dealing and other registration issues	2	6	0
Breach of licensing condition	2	1	2
Breach of requirements of contract notes / statements of account / receipts	22	30	30
Failure to make filing / notification	1	1	3
Breach of margin requirements	3	5	2
Marketing malpractices	1	0	0
Illegal short selling of securities	0	2	1
Dealing malpractices	1	2	0
Breach of Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission	88	132	154
Breach of Corporate Finance Adviser Code of Conduct	10	16	1
Breach of Fund Manager Code of Conduct	24	12	12
Non-compliance with anti-money laundering guidelines	28	6	23
Breach of other rules and regulations of the Exchanges	20	15	2
Internal control weaknesses	121	107	188
Others	39	51	56
Total	402	441	547

Table 12 Successful prosecution – insider dealing*

Case	Defendants	Date of conviction	Fine (\$) / Penalty	Investigation costs awarded (\$)
1	CHAN Pak Hoe Pablo	5.8.2010	120,000 and 4 months' imprisonment	44,478

* Cases where fines were below \$10,000 are not shown here.

Table 13 Successful prosecutions – market manipulation

Case	Defendants	Date of conviction	Fine (\$) / Penalty	Investigation costs awarded (\$)
1	WONG Chung Shun, Johnson	22.4.2010	27,000	30,273
2	FU Kor Kuen, Patrick	7.5.2010	33 months' imprisonment	694,498
3	LEE Shu Yuen, Francis	7.5.2010	36 months' imprisonment	694,498
4	SZETO Kwok Kwan	13.5.2010	25,000 and 4 weeks' imprisonment suspended for 12 months	31,569
5	NG Kwok Leung	27.5.2010	240 hours' community services	69,268
6	LEUNG Kin Bon	31.5.2010	30,000 and 4 weeks' imprisonment suspended for 12 months	29,700
7	TSUI Hon Wai	10.6.2010	120 hours' community services	60,206
8	CHIU Yat Man	2.12.2010	120 hours' community services	21,988
9	PAN Ming	1.3.2011	immediate 5 months' imprisonment	69,268
10	FONG Ka Lai	24.3.2011	40,000 and 1 month's imprisonment suspended for 12 months	27,444
11	YU Yau Ki, Tony	24.3.2011	4 weeks' imprisonment to run concurrently suspended for 18 months	20,609
Total: 11 entities			122,000	1,749,321

Table 14 Successful prosecution – unlicensed / unauthorized activities*

Case	Defendants	Date of conviction	Fine (\$)	Investigation costs awarded (\$)
1	Unlicensed investment adviser KWOK Sau Ping	6.1.2011	10,000	80,000 ¹

* Cases where fines were below \$10,000 are not shown here.

¹ \$80,000 is the investigation costs awarded for the prosecution of this offence and another unrelated offence. There was no apportionment of costs between them.

Table 15 Successful prosecutions – disclosure of interests*

Case	Defendants	Date of conviction	Fine (\$)	Investigation costs awarded (\$)
1	LEE Jong Dae	22.7.2010	12,000	6,298
2	YEUNG Ka Sing, Carson	22.7.2010	16,000	11,088
3	CHEN Liang	15.9.2010	20,000	10,357
4	LI Chi Keung	11.11.2010	12,000	8,368
5	BEL Trade Investment Holdings Limited	9.12.2010	16,000	13,946
6	Elite Dragon Limited	9.12.2010	16,000	13,946
7	SY Chin Mong, Stephen	9.12.2010	16,000	13,946
8	Ming Yuan Investments Group Limited	17.2.2011	20,000	8,642
9	REN Baogen	24.3.2011	20,000	21,024
10	QI Xiaohong	31.3.2011	18,000	9,581
Total: 10 entities			166,000	117,196

* Cases where fines were below \$10,000 are not shown here.

Table 16 Successful prosecutions – unlawful short selling

Case	Defendants	Date of conviction	Fine (\$)	Investigation costs awarded (\$)
1	CHEUNG Wong Kwan	19.4.2010	30,000	42,144
2	MOK Kee Tong	8.7.2010	54,000	25,711
Total: 2 entities			84,000	67,855

Table 17 Successful prosecutions – provision of false or misleading information*

Case	Defendants	Date of conviction	Fine (\$)	Investigation costs awarded (\$)
1	CHAN Ping Keung	5.11.2010	18,000	4,954
2	LAM Ying Kam	9.11.2010	10,000	10,825
Total: 2 entities			28,000	15,779

* Cases where fines were below \$10,000 are not shown here.

Table 18 Successful prosecutions – failure to submit audited accounts, etc. within the specified period

Case	Defendants	Date of conviction	Fine (\$)	Investigation costs awarded (\$)
1	Able Alliance International Limited	5.11.2010	11,000	4,954
2	CHAN Ping Keung	5.11.2010	11,000	4,954
Total: 2 entities			22,000	9,908

Table 19 Most significant disciplinary actions

Item	Company / Name	Date of action	Conduct	Action / SFAT decision
1	CES Capital International Co Ltd ZHANG Rigang	3.3.2011	Failure to safeguard client monies	Reprimanded and fined \$2 million Reprimanded and fined \$250,000
2	Standard Chartered Bank (HK) Ltd	1.3.2011	Distribution of Lehman Brothers Equity Linked Structured Notes	Standard Chartered Bank repurchased ELNs from eligible customers involving over 2,300 transactions and a total value of about \$1.48 billion
3	ZHANG Xiao Ming	21.2.2011	False trading	Banned for 12 months
4	ZHANG Bijia	31.1.2011	Insider dealing	Banned for life
5	YAM Chin Yui, Peggy	29.12.2010	Forging colleague's signature on banking documents	Banned for 18 months
6	NG Kwok Leung	23.12.2010	Market manipulation	Banned for 3 years
7	Pauline Ellen COUSINS	15.11.2010	Providing false portfolio valuation summaries to mislead customers	Banned for life
8	Noble Apex Advisors Ltd	8.11.2010	Inadequate supervision of staff	Reprimanded and fined \$1 million
9	TAM Sak Man	25.10.2010	Facilitating unlicensed leveraged foreign exchange activities	Reprimanded and fined \$816,220
10	CHUN Peng Fai	20.10.2010	Engaging in derivative warrants trading that falsely inflated market turnover	Revocation and banned for 5 years
11	Jugurtha HARCHAOUI	9.9.2010	Mismarking trading book	Banned for life
12	CHAN Hon Man	31.8.2010	Market manipulation	Banned for 18 months and fined \$134,580
13	IP Chun Chun	19.7.2010	Forgery of clients' signatures	Banned for 5 years
14	DBS Bank (Hong Kong) Ltd	14.7.2010	Distribution of Lehman Brothers- related Constellation Notes	DBS repurchased Constellation Notes from eligible customers involving over 2,100 accounts and a total value of about \$651 million
15	CHU Kwok Shing, Godwin	5.7.2010	Market manipulation	Licence suspended for 18 months
16	KWAN Po Kit	5.7.2010	Operating secret account and conducting conflicts of interest activities	Banned for 5 years and fined \$228,000
17	TAM Man Chuen, Peter	2.7.2010	Misappropriation of clients' assets	Licence suspended for 18 months
18	Julius Baer (Hong Kong) Ltd	28.6.2010	Failure to take adequate steps to identify clients as professional investors before treating them as such	Reprimanded and fined \$3 million
19	Christfund Securities Ltd	17.6.2010	Internal control deficiencies in handling Mainland clients' accounts	Reprimanded and fined \$1.2 million
20	Christfund Futures Ltd	17.6.2010	Internal control deficiencies in handling Mainland clients' accounts	Reprimanded and fined \$700,000
21	HU Frank NG Peony CHANG Pui Chun, Jenny	2.6.2010	Negligence in handling a client's trade orders	Reprimanded and fined \$800,000 Reprimanded and fined \$600,000 Reprimanded and fined \$400,000
22	Merrill Lynch (Asia Pacific) Ltd & Merrill Lynch Futures (HK) Ltd	31.5.2010	Systems and controls failings associated with mis-marking activities in a trading book	Fined \$3.5 million
23	HU Junbo	18.5.2010	Concealing true identities of owners of trading accounts from employer and effecting transactions without obtaining prior written authorizations	Banned for 12 months

○ **Table 20 Requests for regulatory co-operation**

	2010/11		2009/10		2008/09	
	In	Out	In	Out	In	Out
Enforcement-related requests for assistance	93	74	88	89	55	66
Licensing-related requests for assistance	86	1,068	144	847	263	926

'In' represents requests received, while 'out' reflects requests made by the SFC.

○ **Table 21 Comparison with overseas regulatory agencies**

It is difficult to obtain detailed data, in a consistent format, for sensible comparison of key performance measures with other regulators and this is complicated further by the different mandates which each of these regulators have. Nevertheless, we have set out in this table some key data relating to the size of certain other regulators for the interest of readers.

All foreign currency amounts have been translated into Hong Kong dollars with the exchange rate on 31 March of each of the three years.

	2010/11	2009/10	2008/09
SFC (year ended 31 March)¹			
Number of staff	544	501	478
Total expenditure (\$ million)	780	730	684
US Securities and Exchange Commission (SEC) (year ended 30 September)²			
Number of staff	3,848 ⁵	3,748 ⁶	3,656
Total expenditure (\$ million)	8,897 ⁵	8,553 ⁶	7,441
UK Financial Services Authority (FSA) (year ended 31 March)³			
Number of staff (at year-end date)	3,300 ⁷	3,150 ⁸	2,730
Total expenditure (\$ million)	6,424 ⁷	5,014 ⁸	3,999
Australian Securities & Investment Commission (ASIC) (year ended 30 June)⁴			
Number of staff (at year-end date)	Data not available	1,932	1,698
Total expenditure (\$ million)	Data not available	2,756	1,585

¹ The SFC is an independent non-governmental statutory body funded mainly by a market levy and is responsible for regulating the securities and futures markets in Hong Kong.

² The US SEC is an independent, non-partisan, quasi-judicial regulatory government agency with responsibility for administering the federal securities laws.

³ The FSA is an independent non-governmental body funded by the firms it regulates. It has been given statutory powers to regulate the financial services in the UK, including authorization and regulation of deposit taking, insurance, mortgage lending, general insurance advice, mortgage advice and investment business.

⁴ ASIC is an independent Commonwealth government body that enforces and regulates company and financial services laws to protect consumers, investors and creditors.

⁵ Budget figures are extracted from FY2012 Congressional Justification.

⁶ Actual figures are extracted from FY2012 Congressional Justification.

⁷ Budget figures are extracted from FSA Business Plan 2010/2011.

⁸ Actual figures are extracted from FSA Annual Report 2009/2010.

FINANCIAL STATEMENTS: SFC

Independent auditor's report to the Securities and Futures Commission

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

We have audited the consolidated financial statements of the Securities and Futures Commission (the "SFC") and its subsidiaries (together referred to as the "Group") set out on pages 79 to 99, which comprise the consolidated and the SFC statement of financial position as at 31 March 2011 and the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Directors' responsibility for the financial statements

The Hong Kong Securities and Futures Ordinance requires the directors of the SFC to prepare financial statements which give a true and fair view. The directors of the SFC are responsible for the preparation of the financial statements that give a true and fair view in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board and for such internal control as the directors determine necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. This report is made solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the SFC and of the Group's affairs as at 31 March 2011 and of the Group's result and cash flows for the year then ended in accordance with International Financial Reporting Standards.

KPMG

Certified Public Accountants

8th Floor, Prince's Building

10 Chater Road

Central, Hong Kong

20 May 2011

Consolidated statement of comprehensive income

For the year ended 31 March 2011 (Expressed in Hong Kong dollars)

	Note	2011 \$'000	2010 \$'000
Income			
Levies		1,373,404	1,498,659
Fees and charges		171,696	154,583
Investment income	5	131,097	138,351
Less: custody and advisory expenses		(2,613)	(2,230)
Investment income net of third party expenses		128,484	136,121
Recoveries from Investor Compensation Fund		4,157	4,165
Other income	6	6,057	4,879
		1,683,798	1,798,407
Expenses			
Staff costs and directors' emoluments	7	564,876	529,274
Premises			
rent		63,642	58,491
other		25,640	23,632
Other expenses	8	85,162	84,785
Depreciation	10(a)	41,090	33,468
		780,410	729,650
Surplus and total comprehensive income for the year		903,388	1,068,757

The notes on pages 84 to 99 form part of these financial statements.

Consolidated statement of financial position

At 31 March 2011 (Expressed in Hong Kong dollars)

	Note	2011 \$'000	2010 \$'000
Non-current assets			
Fixed assets	10(a)	46,689	49,423
Held-to-maturity debt securities	9	3,827,632	3,769,238
		3,874,321	3,818,661
Current assets			
Held-to-maturity debt securities	9	2,401,449	1,536,402
Debtors, deposits and prepayments	14	207,000	208,198
Bank deposits	11	602,190	566,709
Cash at bank and in hand	11	3,226	2,617
		3,213,865	2,313,926
Current liabilities			
Fees received in advance		68,657	9,260
Creditors and accrued charges		71,504	71,298
		140,161	80,558
Net current assets		3,073,704	2,233,368
Total assets less current liabilities		6,948,025	6,052,029
Non-current liabilities		13	22,397
Net assets		6,925,628	6,022,240
Funding and reserves			
Initial funding by Government		15	42,840
Accumulated surplus		6,882,788	5,979,400
		6,925,628	6,022,240

Approved and authorized for issue by the SFC on 20 May 2011 and signed on its behalf by

Martin Wheatley
Chief Executive Officer

Eddy C Fong
Chairman

The notes on pages 84 to 99 form part of these financial statements.

Statement of financial position

At 31 March 2011 (Expressed in Hong Kong dollars)

	Note	2011 \$'000	2010 \$'000
Non-current assets			
Fixed assets	10(b)	46,677	49,398
Held-to-maturity debt securities	9	3,827,632	3,769,238
		3,874,309	3,818,636
Current assets			
Held-to-maturity debt securities	9	2,401,449	1,536,402
Debtors, deposits and prepayments	14	206,862	208,048
Bank deposits	11	602,190	566,709
Cash at bank and in hand	11	2,909	2,318
		3,213,410	2,313,477
Current liabilities			
Fees received in advance		68,657	9,260
Creditors and accrued charges		71,037	70,824
		139,694	80,084
Net current assets		3,073,716	2,233,393
Total assets less current liabilities		6,948,025	6,052,029
Non-current liabilities		13	22,397
Net assets		6,925,628	6,022,240
Funding and reserves			
Initial funding by Government		15	42,840
Accumulated surplus		6,882,788	5,979,400
		6,925,628	6,022,240

Approved and authorized for issue by the SFC on 20 May 2011 and signed on its behalf by

Martin Wheatley
Chief Executive Officer

Eddy C Fong
Chairman

The notes on pages 84 to 99 form part of these financial statements.

Consolidated statement of changes in equity

For the year ended 31 March 2011 (Expressed in Hong Kong dollars)

	Initial funding by Government \$'000	Accumulated surplus \$'000	Total \$'000
Balance at 1 April 2009	42,840	4,910,643	4,953,483
Total comprehensive income for the year	–	1,068,757	1,068,757
Balance at 31 March 2010 and 1 April 2010	42,840	5,979,400	6,022,240
Total comprehensive income for the year	–	903,388	903,388
Balance at 31 March 2011	42,840	6,882,788	6,925,628

The notes on pages 84 to 99 form part of these financial statements.

Consolidated statement of cash flows

For the year ended 31 March 2011 (Expressed in Hong Kong dollars)

	2011	2010
	\$'000	\$'000
Cash flows from operating activities		
Surplus for the year	903,388	1,068,757
Adjustments for:		
Depreciation	41,090	33,468
Investment income	(131,097)	(138,351)
(Profit)/loss on disposal of fixed assets	(24)	47
	813,357	963,921
Increase in debtors, deposits and prepayments	(8,819)	(27,022)
Increase/(decrease) in fees received in advance	59,397	(56,322)
Increase in creditors and accrued charges	206	594
Decrease in non-current liabilities	(7,392)	(8,177)
Net cash generated from operating activities	856,749	872,994
Cash flows from investing activities		
Interest received	197,228	189,147
Held-to-maturity debt securities purchased	(2,503,382)	(1,765,672)
Held-to-maturity debt securities redeemed at maturity	1,523,827	857,376
Fixed assets purchased	(38,332)	(40,923)
Net cash used in investing activities	(820,659)	(760,072)
Net increase in cash and cash equivalents	36,090	112,922
Cash and cash equivalents at beginning of the year	569,326	456,404
Cash and cash equivalents at end of the year	605,416	569,326

Analysis of the balance of cash and cash equivalents:

	2011	2010
	\$'000	\$'000
Bank deposits	602,190	566,709
Cash at bank and in hand	3,226	2,617
	605,416	569,326

Notes to the consolidated financial statements

For the year ended 31 March 2011 (Expressed in Hong Kong dollars)

1. Status and principal activities

The SFC is governed by Part II of the Hong Kong Securities and Futures Ordinance (the SFO). Under the SFO, the SFC has a duty to ensure an efficient, fair and transparent market and to promote public confidence and investor awareness in Hong Kong's securities, futures and related financial markets. In performing its duty, the SFC is required to act in the interest of the public and ensure that improper and illegal market activities are properly investigated. The registered office and principal place of business of the SFC is 8/F Chater House, 8 Connaught Road, Central, Hong Kong.

2. Income

Details of the funding of the SFC are set out in Section 14 and Sections 394 to 396 of the SFO. Major sources of funding include:

- (a) levies collected by The Stock Exchange of Hong Kong Ltd (SEHK) and Hong Kong Futures Exchange Ltd (HKFE) on transactions recorded on the Exchanges at rates specified by the Chief Executive in Council; and
- (b) fees and charges in relation to its functions and services according to the provision of subsidiary legislation.

3. Significant accounting policies

(a) Statement of compliance

We have prepared the consolidated financial statements, which comprise the SFC and its subsidiaries (together referred to as the "Group"), in accordance with International Financial Reporting Standards ("IFRSs") (including applicable International Accounting Standards and Interpretations) issued by the International Accounting Standards Board ("IASB"). We set out below a summary of our significant accounting policies.

The IASB has issued certain new and revised IFRSs that are first effective or available for early adoption for the current accounting period of the SFC. However, none of these developments are relevant to the SFC's operations.

The SFC has not applied any new standard or interpretation that is not yet effective for the current accounting period (see note 20).

(b) Basis of preparation

We have prepared these financial statements using the historical cost basis as the measurement basis. The accounting policies have been applied consistently by Group entities.

We prepare the financial statements in conformity with IFRSs which requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, income and expenses. We make estimates and associated assumptions based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

We review the estimates and underlying assumptions on an ongoing basis. We recognise the revisions to accounting estimates in the period in which the estimates are revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Notes to the consolidated financial statements (Cont'd)

For the year ended 31 March 2011

3. Significant accounting policies (Cont'd)

(c) Basis of consolidation

Subsidiaries are those entities in which the SFC, directly or indirectly, holds more than half of the issued share capital or controls more than half of the voting power or controls the composition of the board of directors. Control exists when the SFC has the power, directly or indirectly, to govern the financial and operating policies of an entity, so as to obtain benefits from its activities. We include the financial statements of subsidiaries in the consolidated financial statements from the date that control commences until the date that control ceases. We eliminate all material intragroup balances and transactions and any unrealised profits and losses arising from intra-group transactions in preparing the consolidated financial statements.

(d) Recognition of income

We recognise income in the statement of comprehensive income provided it is probable that the economic benefits will flow to the Group and we can measure reliably the revenue and costs. We record our income as follows:

(i) Levies

We record levies from SEHK and HKFE as income on an accrual basis.

(ii) Fees and charges

We record annual fees as income on a straight-line basis over the periods to which they relate. We record other fees and charges as income when they are receivable.

(iii) Investment income

We record investment income as it accrues using the effective interest method. It comprises (a) interest earned on bank deposits and held-to-maturity debt securities; and (b) the amortisation of premiums or discounts on purchases of held-to-maturity debt securities.

(e) Operating leases

We treat the rent payable under operating leases as an expense in equal instalments over the accounting periods covered by the lease term. We recognise lease incentives received in the statement of comprehensive income as an integral part of the aggregate net lease payments made.

(f) Employee benefits

We make accrual for salaries and allowances, annual leave, contributions to defined contribution schemes and the cost of non-monetary benefits in the year in which the associated services are rendered by employees. Where payment or settlement is deferred and the effect would be material, we state these amounts at their present values. Other benefits for services received are accrued when a contractual or constructive obligation arises for the SFC.

(g) Fixed assets and depreciation

We state fixed assets at cost less accumulated depreciation and any impairment losses (see note 3(o)). We charge depreciation to the statement of comprehensive income to write off the costs of fixed assets using the straight-line method over the estimated useful lives as follows:

Leasehold improvements	– 3 years or, if shorter, the life of the respective leases
Furniture and fixtures	– 3 years
Office equipment	– 5 years
Personal computers and software	– 3 years
Computer application systems	– 4 years
Motor vehicles	– 4 years

Notes to the consolidated financial statements (Cont'd)

For the year ended 31 March 2011

3. Significant accounting policies (Cont'd)**(g) Fixed assets and depreciation (Cont'd)**

We capitalise subsequent expenditure only when it increases the future economic benefits embodied in the fixed assets. We recognise all other expenditure in the statement of comprehensive income as an expense as incurred.

We review the carrying amounts of fixed assets for indications of impairment at the end of each reporting period. An impairment loss is recognised to the extent that the carrying amount of an asset, or the cash-generating unit to which it belongs, is more than its recoverable amount. The recoverable amount of an asset, or of the cash-generating unit to which it belongs, is the greater of its net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of time value of money and the risks specific to the assets. An impairment loss is reversed if there has been a favourable change in estimates used to determine the recoverable amount.

We recognise gains or losses arising from the retirement or disposal of an item of fixed assets, being the difference between the net disposal proceeds and the carrying amount of the item, in the statement of comprehensive income on the date of retirement or disposal.

(h) Investments

We state our investments in debt securities, which we have positive intention and ability to hold to maturity, initially at fair value and subsequently at amortised cost using the effective interest method less impairment losses, if any (see note 3(o)). We account for purchases and sales of debt securities on the settlement date.

(i) Related parties

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

- (i) the party has the ability, directly or indirectly through one or more intermediaries, to control the SFC or exercise significant influence over the SFC in making financial and operating decisions or has joint control over the SFC;
- (ii) the SFC and the party are subject to common control;
- (iii) the party is an associate of the SFC or a joint venture in which the SFC is a venturer;
- (iv) the party is a member of key management personnel of the SFC or the SFC's parent, or a close family member of such an individual, or is an entity under the control, joint control or significant influence of such individuals;
- (v) the party is a close family member of a party referred to in (i) or is an entity under the control, joint control or significant influence of such individuals; or
- (vi) the party is a post-employment benefit plan which is for the benefit of employees of the SFC or of any entity that is a related party of the SFC.

Close family members of an individual are those family members who may be expected to influence, or be influenced by, that individual in their dealing with the SFC. As the SFC is an entity controlled by the Government of the Hong Kong Special Administrative Region, any transaction with other government departments and agencies under normal dealings are not necessarily regarded as related parties in the context of International Accounting Standard ("IAS") 24.

(j) 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 end of the reporting period. We recognise exchange gains and losses on translation in the statement of comprehensive income.

Notes to the consolidated financial statements (Cont'd)

For the year ended 31 March 2011

3. Significant accounting policies (Cont'd)

(k) Debtors and other receivables

We state debtors and other receivables initially at their fair value and thereafter at amortised cost less impairment losses. We review the carrying amount of debtors and other receivables at the end of each reporting period to determine whether there is objective evidence of impairment. If any such evidence exists, we reduce the carrying amount to the estimated recoverable amount by means of a charge to the statement of comprehensive income (see note 3(o)).

(l) Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and on hand, demand deposits with banks and other financial institutions, and short-term highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, having been within three months of maturity at acquisition.

(m) Creditors and accrued charges

We state creditors and accrued charges initially at fair values and thereafter at amortised cost unless the effect of discounting would be immaterial, in which case they are stated at cost.

(n) Investment in subsidiaries

We state an investment in a subsidiary at cost less any impairment losses in the statement of financial position.

(o) Impairment

(i) Recognition of impairment loss

We review the carrying amounts of the SFC's assets at the end of each reporting period to determine whether there is any objective evidence of impairment. Objective evidence of impairment includes observable data that comes to the attention of the SFC about events that have an impact on the asset's estimated future cash flows such as significant financial difficulty of the debtor; or significant changes in the technological, market, economic or legal environment that have an adverse effect on the debtor. If any such evidence exists, we estimate the asset's recoverable amount. We recognise in the statement of comprehensive income the difference between the asset's carrying amount and the recoverable amount as an impairment loss whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount.

(ii) Calculation of impairment loss

We calculate the recoverable amount of the SFC's investments in held-to-maturity debt securities and receivables by discounting their expected future cash flows to their present value at the original effective interest rate inherent in the asset. We do not discount receivables with a short duration in the calculation of their recoverable amount. The recoverable amount of other assets is the greater of their net selling price and value in use. In assessing value in use, we discount the estimated future cash flows to their present value at a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, we determine the recoverable amount for the cash-generating unit to which the asset belongs.

(iii) Reversals of impairment loss

We reverse an impairment loss in respect of an asset in a subsequent period if the circumstances and events that are objectively linked 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 reverse an impairment loss only to the extent that the asset's carrying amount does not exceed the carrying amount that we should have determined, net of depreciation or amortisation, if we had not recognised any impairment loss.

Notes to the consolidated financial statements (Cont'd)

For the year ended 31 March 2011

3. Significant accounting policies (Cont'd)**(p) Provisions and contingent liabilities**

We recognise a provision in the statement of financial position when the SFC has a legal or constructive obligation of uncertain timing or amount as a result of a past event, and it is probable that the SFC will require an outflow of economic benefits to settle the obligation and the amount can be estimated reliably. If the effect is material, we determine provisions by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the 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.

4. Taxation

Section 3(3) of the SFO exempts the SFC from Hong Kong taxes.

5. Investment income

	2011	2010
	\$'000	\$'000
Interest income	187,211	188,415
Amortisation of premium on held-to-maturity debt securities	(57,475)	(53,259)
Amortisation of discount on held-to-maturity debt securities	1,361	3,195
	131,097	138,351

Interest income is derived as follows:

	2011	2010
	\$'000	\$'000
Interest income from held-to-maturity debt securities	184,934	187,440
Other interest income	2,277	975
Total interest income on financial assets not at fair value through profit or loss	187,211	188,415

Notes to the consolidated financial statements (Cont'd)

For the year ended 31 March 2011

6. Other income

	2011 \$'000	2010 \$'000
Investigation costs awarded	3,986	2,302
FinNet managed network and support fee	1,561	974
Exchange gain	–	1,022
Sale of SFC publications	433	361
Gain on disposal of fixed assets	24	–
Others	53	220
	6,057	4,879

7. Staff costs and directors' emoluments

	2011 \$'000	2010 \$'000
Salaries and allowances	512,824	479,672
Retirement benefits	31,990	31,087
Medical and life insurance	14,577	16,394
Staff functions	1,323	709
Recruitment	3,447	764
Registration and membership fees	715	648
	564,876	529,274

The total number of staff as at 31 March 2011 was 547 (544 for the SFC and 3 for the Investor Compensation Company Limited) (at 31 March 2010: the total number of staff was 504 comprising 501 for the SFC and 3 for the Investor Compensation Company Limited).

Notes to the consolidated financial statements (Cont'd)

For the year ended 31 March 2011

7. Staff costs and directors' emoluments (Cont'd)

Directors' emoluments included in the above comprised:

	Directors' fee \$'000	Salaries, allowances & benefits in kind \$'000	Discretionary pay \$'000	Retirement scheme contribution \$'000	2011 Total \$'000	2010 Total \$'000
				(Note 1)		
Chief Executive Officer						
Martin Wheatley, JP	–	7,200	1,440	687	9,327	9,090
Executive Directors						
Alexa Lam	–	5,000	1,200	500	6,700	6,625
Brian Ho	–	4,029	1,102	403	5,534	5,405
Keith Lui	–	4,020	1,007	402	5,429	5,188
Mark Steward	–	4,100	1,320	410	5,830	5,580
Paul Kennedy	–	87	17	8	112	5,985
	–	24,436	6,086	2,410	32,932	37,873
Non-executive Chairman						
Dr Eddy C Fong, GBS, JP	702	–	–	–	702	702
Non-executive Directors						
The Hon Chan Kam-lam, SBS, JP	234	–	–	–	234	234
Angelina P L Lee, JP	234	–	–	–	234	234
Christopher Cheng, GBS, JP (retired 14 Nov 2009 (Note 2))	–	–	–	–	–	146
Kenneth H W Kwok, BBS, SC, JP (retired 31 Dec 2010 (Note 2))	176	–	–	–	176	234
Professor Liu Pak Wai, SBS, JP (retired 31 Dec 2010 (Note 2))	176	–	–	–	176	234
Shengman Zhang (retired 31 Dec 2010 (Note 2))	176	–	–	–	176	234
Dr York Liao, SBS, JP (retired 25 May 2009 (Note 2))	–	–	–	–	–	35
Lawrence Lee, JP	234	–	–	–	234	88
Wong Kai-man, BBS, JP	234	–	–	–	234	199
Anderson Chow, SC (appointed 1 January 2011)	58	–	–	–	58	–
Professor Leonard Cheng Kwok-hon, JP (appointed 1 January 2011)	58	–	–	–	58	–
	2,282	–	–	–	2,282	2,340
Total directors' emoluments	2,282	24,436	6,086	2,410	35,214	40,213

Note 1 This represents net contribution expenses accrued during the period ended 31 March 2011 in accordance with the accounting policy set out in note 3(f) on page 85. The future payment of contributions is subject to completion of a vesting period, which is based on total years of service with the SFC. The amount vested at 31 March 2011 was \$1,815,000 (At 31 March 2010: \$1,763,000).

Note 2 Retired having completed appointment period.

Notes to the consolidated financial statements (Cont'd)

For the year ended 31 March 2011

7. Staff costs and directors' emoluments (Cont'd)

The aggregate of the emoluments of the five highest paid individuals in 2010/2011, representing the emoluments of five executive directors, was \$32,820,000 (2009/2010: \$32,685,000 for five executive directors) with the breakdown as follows:

	2011 \$'000	2010 \$'000
Salaries, allowances & benefits in kind	24,349	24,660
Discretionary pay	6,069	5,739
Retirement scheme contribution	2,402	2,286
	32,820	32,685

Their emoluments are within the following bands:

	2011 No. of individuals	2010 No. of individuals
\$5,000,001 to \$5,500,000	1	1
\$5,500,001 to \$6,000,000	2	2
\$6,000,001 to \$6,500,000	0	0
\$6,500,001 to \$7,000,000	1	1
\$7,000,001 to \$7,500,000	0	0
\$7,500,001 to \$8,000,000	0	0
\$8,000,001 to \$8,500,000	0	0
\$8,500,001 to \$9,000,000	0	0
\$9,000,001 to \$9,500,000	1	1

Notes to the consolidated financial statements (Cont'd)

For the year ended 31 March 2011

7. Staff costs and directors' emoluments (Cont'd)**Employee benefits**

We provide retirement benefits to our staff through a defined contribution scheme under the Occupational Retirement Schemes Ordinance (ORSO Scheme) and a Mandatory Provident Fund Scheme (MPF Scheme):

(a) ORSO Scheme**(i) General grade staff**

For general grade staff, we make monthly contributions equal to 12% of the fixed pay, subject to a vesting scale with the benefit fully vested upon completion of 10 years' service. We reinvest forfeited contributions for general grade staff who leave the SFC prior to qualifying for 100% disbursement of the contributions into the total pool of contributions that will be shared by the existing members in the scheme at the end of the scheme year. The amount so reinvested during the year was nil (2010: nil).

(ii) Professional staff

We use forfeited contributions in respect of professional staff who leave the SFC prior to qualifying for 100% disbursement of the contributions to offset the SFC's future contributions. The amount so forfeited during the year was \$2,952,000 (2010: \$1,201,000) and the amount so forfeited available at the end of the reporting period was \$602,000 (2010: \$307,000).

This scheme has obtained an exemption under Section 5 of the MPF Schemes Ordinance.

(b) MPF Scheme

We have participated in a master trust MPF Scheme since December 2000 and made contributions to the MPF Scheme in accordance with the statutory requirements of the MPF Schemes Ordinance.

8. Other expenses

	2011	2010
	\$'000	\$'000
Training and development	5,920	4,989
Legal and professional services	20,714	26,287
Information and systems services	27,755	25,355
Auditor's remuneration	443	409
Funding for the Financial Reporting Council	4,200	4,000
Funding for the International Accounting Standards Committee Foundation	389	388
General office and insurance	5,370	6,124
External relations	18,996	17,186
Exchange loss	1,375	–
Loss on disposal of fixed assets	–	47
	85,162	84,785

Notes to the consolidated financial statements (Cont'd)

For the year ended 31 March 2011

9. Held-to-maturity debt securities

The Group and the SFC

		2011 \$'000	2010 \$'000
Maturing after one year			
In the second to sixth years	– unlisted	1,756,248	367,743
	– listed in Hong Kong	–	96,930
	– listed outside Hong Kong	2,071,384	3,304,565
		3,827,632	3,769,238
Maturing within one year			
	– unlisted	451,746	206,186
	– listed in Hong Kong	95,323	–
	– listed outside Hong Kong	1,854,380	1,330,216
		2,401,449	1,536,402
		6,229,081	5,305,640
Amortised cost at 31 March			
	– unlisted	2,207,994	573,929
	– listed in Hong Kong	95,323	96,930
	– listed outside Hong Kong	3,925,764	4,634,781
		6,229,081	5,305,640
Market value at 31 March			
	– unlisted	2,205,710	583,473
	– listed in Hong Kong	95,836	99,853
	– listed outside Hong Kong	3,982,773	4,714,668
		6,284,319	5,397,994

The average yield to maturity of the debt securities was 1.5% at 31 March 2011 (2010: 1.6%).

Notes to the consolidated financial statements (Cont'd)

For the year ended 31 March 2011

10. Fixed assets
(a) The Group

	Furniture, fixtures and leasehold improvements \$'000	Office equipment \$'000	Computer application systems \$'000	Personal computers and software \$'000	Motor vehicles \$'000	Total \$'000
Cost						
At 1 April 2010	61,147	7,528	161,641	48,300	1,967	280,583
Additions	8,012	1,156	19,850	8,727	611	38,356
Disposals	(460)	(772)	(975)	(1,324)	(979)	(4,510)
At 31 March 2011	68,699	7,912	180,516	55,703	1,599	314,429
Accumulated depreciation						
At 1 April 2010	51,344	5,024	138,382	34,443	1,967	231,160
Charge for the year	12,643	942	16,067	11,285	153	41,090
Written back on disposals	(460)	(772)	(975)	(1,324)	(979)	(4,510)
At 31 March 2011	63,527	5,194	153,474	44,404	1,141	267,740
Net book value						
At 31 March 2011	5,172	2,718	27,042	11,299	458	46,689
Cost						
At 1 April 2009	61,263	11,147	138,838	32,091	1,967	245,306
Additions	360	1,223	22,803	16,537	–	40,923
Disposals	(476)	(4,842)	–	(328)	–	(5,646)
At 31 March 2010	61,147	7,528	161,641	48,300	1,967	280,583
Accumulated depreciation						
At 1 April 2009	43,045	9,102	123,629	25,795	1,720	203,291
Charge for the year	8,775	717	14,753	8,976	247	33,468
Written back on disposals	(476)	(4,795)	–	(328)	–	(5,599)
At 31 March 2010	51,344	5,024	138,382	34,443	1,967	231,160
Net book value						
At 31 March 2010	9,803	2,504	23,259	13,857	–	49,423

Notes to the consolidated financial statements (Cont'd)

For the year ended 31 March 2011

10. Fixed assets (Cont'd)

(b) The SFC

	Furniture, fixtures and leasehold improvements \$'000	Office equipment \$'000	Computer application systems \$'000	Personal computers and software \$'000	Motor vehicles \$'000	Total \$'000
Cost						
At 1 April 2010	61,132	7,472	161,641	48,059	1,967	280,271
Additions	8,012	1,156	19,850	8,727	611	38,356
Disposals	(460)	(772)	(975)	(1,324)	(979)	(4,510)
At 31 March 2011	68,684	7,856	180,516	55,462	1,599	314,117
Accumulated depreciation						
At 1 April 2010	51,328	4,987	138,382	34,209	1,967	230,873
Charge for the year	12,643	936	16,067	11,278	153	41,077
Written back on disposals	(460)	(772)	(975)	(1,324)	(979)	(4,510)
At 31 March 2011	63,511	5,151	153,474	44,163	1,141	267,440
Net book value						
At 31 March 2011	5,173	2,705	27,042	11,299	458	46,677
Cost						
At 1 April 2009	61,248	11,091	138,838	31,850	1,967	244,994
Additions	360	1,223	22,803	16,537	–	40,923
Disposals	(476)	(4,842)	–	(328)	–	(5,646)
At 31 March 2010	61,132	7,472	161,641	48,059	1,967	280,271
Accumulated depreciation						
At 1 April 2009	43,029	9,071	123,629	25,568	1,720	203,017
Charge for the year	8,775	711	14,753	8,969	247	33,455
Written back on disposals	(476)	(4,795)	–	(328)	–	(5,599)
At 31 March 2010	51,328	4,987	138,382	34,209	1,967	230,873
Net book value						
At 31 March 2010	9,804	2,485	23,259	13,850	–	49,398

Notes to the consolidated financial statements (Cont'd)

For the year ended 31 March 2011

11. Bank deposits and cash at bank

The effective interest rate on bank deposits and cash at bank at 31 March 2011 ranged from 0.04% to 1.34% (2010: 0.01% to 0.33%). These balances mature within one year at both 31 March 2011 and 31 March 2010.

12. Investments in subsidiaries

The SFC formed FinNet Limited (FinNet) on 6 November 2000 with an authorized share capital of \$10,000 and issued share capital of \$2 and Investor Compensation Company Limited (ICC) on 11 September 2002 with an authorized share capital of \$1,000 and issued share capital of \$0.2. Both FinNet and ICC are incorporated in Hong Kong.

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 facilitate the administration and management of the Investor Compensation Fund established under the SFO.

Both companies are wholly owned subsidiaries of the SFC. As at 31 March 2011, the investments in subsidiaries, which are stated at cost less any impairment losses, amounted to \$2.2 (2010: \$2.2). The balance is too small to appear on the statement of financial position which is expressed in thousands of dollars.

The statement of financial position of FinNet as at 31 March 2011 was immaterial and its expenses have been paid by the SFC. We have not therefore consolidated FinNet in the Group's financial statements.

The financial statements of ICC are included in the consolidated financial statements.

13. Non-current liabilities

Non-current liabilities represent deferred lease incentives and provision for premises reinstatement cost. Deferred lease incentives consist of incentives granted by our landlord in connection with the lease of our office premises. We recognise the deferred lease incentives in our statement of comprehensive income on a straight line basis over the lease period from 2004 to 2013 as an integral part of the lease expense.

14. Debtors, deposits and prepayments

Debtors, deposits and prepayments include \$196,758,000 receivables classified as loans and receivables in accordance with the determination of IAS 39 (2010: \$198,321,000). Receivables are usually due within 30 days.

We do not provide an ageing analysis of debtors as there was no material overdue debtor balance included in "debtors, deposits and prepayments" as at 31 March 2010 and 2011.

Notes to the consolidated financial statements (Cont'd)

For the year ended 31 March 2011

15. Initial funding by Government

The Government provided funds to pay for the SFC's initial non-recurrent and capital expenditure. These funds are not repayable to the Government. The SFC is eligible to receive an appropriation from the Government in each financial year. Since the financial year ended 31 March 1994, the SFC has requested the Government not to make an appropriation to it. The SFC manages its funding requirements from its income and accumulated surplus.

16. Capital commitments

Capital commitments outstanding at 31 March 2011 not provided for in the financial statements were as follows:

	2011 \$'000	2010 \$'000
Authorized and contracted for	29,158	35,072
Authorized but not contracted for	32,046	23,026

17. Commitment to pay rents for offices

At 31 March 2011, the minimum amount we are committed to pay in rent for our office up to the expiry dates of the leases are as follows:

	The Group and the SFC	
	2011 \$'000	2010 \$'000
Payable next year	72,473	74,765
Payable in one to five years	76,265	148,738
Payable in more than five years	–	–
	148,738	223,503

During the year ended 31 March 2011, \$63,642,000, net of lease incentives, was recognised as an expense in the statement of comprehensive income in respect of operating leases (2010: \$58,491,000).

Notes to the consolidated financial statements (Cont'd)

For the year ended 31 March 2011

18. Related party transactions

We have related party relationships with the Unified Exchange Compensation Fund (UECF), the Investor Compensation Fund (ICF), Securities Ordinance (Chapter 333) – Dealers' Deposits Fund, Commodities Trading Ordinance (Chapter 250) – Dealers' Deposits Fund and Securities Ordinance (Chapter 333) – Securities Margin Financiers' Security Fund. In addition to the transactions and balances disclosed elsewhere in these financial statements, we have the following significant related party transactions.

(a) Reimbursement from the ICF for all the ICC's expenses, in accordance with Section 242(1) of the SFO

During the year, \$4,157,000 was recovered from ICF for ICC's expenses (2010: \$4,165,000). As at 31 March 2011, the amount due to ICF from ICC was \$128,000 (at 31 March 2010: \$260,000).

(b) Remuneration of key management personnel

We consider that the directors' emoluments as disclosed in note 7 are the only remuneration for key management personnel of the Group.

(c) Operating expenses of FinNet

During the year, all operating expenses incurred by FinNet were absorbed by the SFC. The amount absorbed for the year was \$20,000 (2010: \$19,000) including the provision for audit fee of \$10,500 (2010: \$10,000).

(d) Legal services provided by a non-executive director

Prior to his appointment, the Group engaged a non-executive director to provide legal services in respect of a number of matters. He continued to provide services in respect of matters commenced prior to his appointment. Fees payable to him for such services after his appointment amounted to \$489,000 under normal commercial terms and conditions.

19. Financial instruments

Financial instruments of the SFC comprise held-to-maturity debt securities, bank deposits, cash at bank and debtors. These are classified into different categories at inception in accordance with IAS 39, depending on the purpose for which the assets were acquired or the liabilities were incurred. The categories are: held to maturity and other financial liabilities.

The main financial risks of the SFC arise from its investments in held-to-maturity debt securities. The SFC confers upon its Executive Directors the power to act upon the advice received from an external investment adviser and to ensure that the portfolio's investments comply with the investment policy approved by the Financial Secretary which sets control limits on credit risk, market risk, interest rate risk, liquidity risk and foreign exchange risk. The Executive Directors report thereon to the SFC on a regular basis.

(a) Credit risk

The SFC's credit risk is primarily attributable to debt security investments. The Financial Secretary has approved our investment policy which, subject to other control limits, only allows the SFC to invest in high-quality dated securities, rated AA or above. The policy also limits the exposure to each organisation and each country, except for the US Treasury. During the year, the SFC complied with the above investment policy in order to manage its credit risk, and as a result, was not exposed to significant credit risk. The maximum exposure to credit risk is represented by the carrying amount of each financial asset in the statement of financial position after deducting any impairment allowance.

Notes to the consolidated financial statements (Cont'd)

For the year ended 31 March 2011

19. Financial instruments (Cont'd)

(b) Interest rate risk

The SFC's interest bearing assets mainly comprise fixed interest rate bearing debt securities and bank balances. The SFC is subject to the risk that future cash flows from re-investments will fluctuate because of changes in market interest rates (re-pricing risk). The SFC manages re-pricing risk of its fixed rate debt securities by imposing different levels of concentration and maturity limits. The effective interest rates and maturity profile of the SFC's interest bearing assets are disclosed in the respective notes to the financial statements. At 31 March 2011, it is estimated that a general increase of 100 basis points, with all other variables held constant, would increase the SFC's surplus and accumulated surplus by approximately \$17,011,000 (2010: \$13,606,000). The extent of any decrease in interest rates is expected to be minimal which would decrease the SFC's surplus by an insignificant amount. As at 31 March 2011 the average duration of the SFC's investment portfolio was 1.66 years (31 March 2010: 1.06 years).

The sensitivity analysis above is estimated as an annualised impact on interest income assuming the change in interest rates had occurred at the end of the reporting period. The analysis is performed on the same basis for 2010.

(c) Exchange rate risk

The only foreign currency investment allowed under the SFC's investment policy is US dollar dated securities. As the HK dollar is pegged to the US dollar, and since there were no other exchange rate exposures other than in US dollars and HK dollars, the SFC was not exposed to significant foreign exchange risk at the end of the reporting period.

(d) Fair values

All financial instruments are carried at amounts not materially different from their fair values as at 31 March 2011 and 2010 except for held-to-maturity debt securities as disclosed in note 9. The following summarises the major methods and assumptions used in estimating the fair values of these financial instruments.

- The fair value of listed held-to-maturity debt securities is based on quoted market prices at the end of the reporting period using current bid prices without any deduction for transaction costs. Fair values for unlisted debt investments are based on third party quotes.

20. Possible impact of amendments, new standards and interpretations issued but not yet effective for the year ended 31 March 2011

Up to the date of issue of these financial statements, the IASB has issued a number of amendments and Interpretations and one new standard which are not yet effective for the year ended 31 March 2011 and which have not been adopted in these financial statements.

Effective for accounting periods beginning on or after

Revised IAS 24, *Related party disclosures*
IFRS 9, *Financial instruments*

1 January 2011
1 January 2013

The SFC is in the process of making an assessment of what the impact of these amendments is expected to be in the period of initial application. So far it has concluded that the adoption of them is unlikely to result in a restatement of SFC's results of operations and financial position.

FINANCIAL STATEMENTS: ICF

Report of the Investor Compensation Fund Committee (the Committee)

The members of the Committee present their annual report together with the audited financial statements for the year ended 31 March 2011.

Establishment of the Investor Compensation Fund (the Fund)

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

Financial statements

The surplus of the Fund for the financial year ended 31 March 2011 and the state of the Fund's affairs as at that date are set out in the financial statements on pages 102 to 115.

Members of the Committee

The members of the Committee during the year ended 31 March 2011 and up to the date of this report were:

Mr Keith Lui (Chairman)

Mr Gerald Greiner (retired on 1 April 2010)

Mr Kenneth H W Kwok, BBS, SC (retired on 31 December 2010)

Mrs Alexa Lam

Mr Eric Yip (appointed on 1 April 2010 and retired on 31 March 2011)

Mr Chow Ka Ming, Anderson, SC (appointed on 15 February 2011)

Mr Tai Chi Kin (appointed on 1 April 2011)

Interests in contracts

No contract of significance to which the Fund was a party and in which a Committee member of the Fund had a material interest, subsisted at the end of the financial year or at any time during the financial year.

Auditors

KPMG retire and, being eligible, offer themselves for re-appointment. A resolution for the re-appointment of KPMG as auditors of the Fund is to be proposed at the forthcoming Investor Compensation Fund Committee meeting.

By order of the Committee

Keith Lui

Chairman

20 May 2011

Independent auditor's report to the Securities & Futures Commission (the SFC)

We have audited the financial statements of Investor Compensation Fund (the Fund) established under Part XII of the Securities and Futures Ordinance set out on pages 102 to 115, which comprise the statement of financial position as at 31 March 2011 and the statement of comprehensive income, the statement of changes in equity and the statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

The SFC's responsibility for the financial statements

The Securities and Futures Ordinance requires the directors of the SFC to prepare financial statements which give a true and fair view. The directors of the SFC are responsible for the preparation of the financial statements that give a true and fair view in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board and for such internal control as the directors determine necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. This report is made solely to you and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements give a true and fair view of the state of the Fund's affairs as at 31 March 2011 and of its surplus and cash flows for the year then ended in accordance with International Financial Reporting Standards.

KPMG

Certified Public Accountants

8th Floor, Prince's Building

10 Chater Road

Central, Hong Kong

20 May 2011

Statement of comprehensive income

For the year ended 31 March 2011 (Expressed in Hong Kong dollars)

	Note	2011 \$'000	2010 \$'000
Income			
Net investment income	5	88,837	154,796
Exchange difference		1,695	1,733
Recoveries		4,569	1,345
		95,101	157,874
Expenses			
Investor Compensation Company expenses	7	4,157	4,165
Compensation (write-backs)/expenses	8	(218)	363
Auditor's remuneration		95	86
Bank charges		770	755
Professional fees		3,239	2,975
		8,043	8,344
Surplus and total comprehensive income for the year		87,058	149,530

The notes on pages 106 to 115 form part of these financial statements.

Statement of financial position

At 31 March 2011 (Expressed in Hong Kong dollars)

	Note	2011 \$'000	2010 \$'000
Current assets			
Financial assets designated at fair value through profit or loss			
– Debt securities	9	1,608,583	1,517,803
– Pooled fund	9	224,824	184,523
Fair value adjustment on unsettled trades		15	–
Interest receivable		17,823	16,371
Due from Investor Compensation Company		128	261
Fixed and call deposits with banks	10	189,486	150,452
Cash at bank	10	12,467	102,283
		2,053,326	1,971,693
Current liabilities			
Provision for compensation	8	150	5,656
Creditors and accrued charges		983	895
Fair value adjustment on unsettled trades		–	7
		1,133	6,558
Net current assets		2,052,193	1,965,135
Net assets		2,052,193	1,965,135
Representing:			
Compensation fund			
Contributions from Unified Exchange Compensation Fund	11	994,718	994,718
Contributions from Commodity Exchange Compensation Fund	11	108,923	108,923
Accumulated surplus		948,552	861,494
		2,052,193	1,965,135

Approved and authorized for issue by the Securities and Futures Commission (the SFC) on 20 May 2011 and signed on its behalf by

Eddy C Fong
Chairman of the SFC

Martin Wheatley
Chief Executive Officer of the SFC

The notes on pages 106 to 115 form part of these financial statements.

Statement of changes in equity

For the year ended 31 March 2011 (Expressed in Hong Kong dollars)

	Contributions from Unified Exchange Compensation Fund \$'000	Contributions from Commodity Exchange Compensation Fund \$'000	Accumulated surplus \$'000	Total \$'000
Balance at 1 April 2009	994,718	108,923	711,964	1,815,605
Total comprehensive income for the year	–	–	149,530	149,530
Balance at 31 March 2010 and 1 April 2010	994,718	108,923	861,494	1,965,135
Total comprehensive income for the year	–	–	87,058	87,058
Balance at 31 March 2011	994,718	108,923	948,552	2,052,193

The notes on pages 106 to 115 form part of these financial statements.

Statement of cash flows

For the year ended 31 March 2011 (Expressed in Hong Kong dollars)

	2011 \$'000	2010 \$'000
Cash flows from operating activities		
Surplus for the year	87,058	149,530
Net investment income	(88,837)	(154,796)
Exchange difference	(1,695)	(1,733)
Decrease in amount due from Investor Compensation Company	133	216
Decrease in provision for compensation	(5,506)	(2,376)
Increase in accounts payable and accrued charges	88	94
Net cash used in operating activities	(8,759)	(9,065)
Cash flows from investing activities		
Purchase of debt securities	(509,650)	(1,158,241)
Sale or maturity of debt securities	409,036	1,220,937
Sale of equity securities	968	733
Interest received	57,623	62,260
Net cash (used in)/generated from investing activities	(42,023)	125,689
Net (decrease)/increase in cash and cash equivalents	(50,782)	116,624
Cash and cash equivalents at beginning of the year	252,735	136,111
Cash and cash equivalents at end of the year	201,953	252,735

Analysis of the balance of cash and cash equivalents:

	2011 \$'000	2010 \$'000
Fixed and call deposits with banks	189,486	150,452
Cash at bank	12,467	102,283
	201,953	252,735

Notes to the financial statements

For the year ended 31 March 2011 (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 transferred some functions to the Investor Compensation Company Limited (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, the SFC is subrogated to the claimant's right against the defaulter.

Pursuant to Section 244 of the SFO, the Chief Executive in Council 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 Ltd (SEHK) or futures contracts traded at Hong Kong Futures Exchange Ltd (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 become available in the Fund.

2. Money constituting the Fund

The Fund mainly consists of the amounts paid from the two compensation funds, the Unified Exchange Compensation Fund (UECF) and the Commodity Exchange Compensation Fund (CECF) (wound up on 26 May 2006). 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 though it is not likely that these payments will be made within the coming year.

Other sources of money for the Fund include the levies chargeable on securities traded on SEHK and futures contracts traded on HKFE, and returns earned on the investment of the Fund (see also note 5).

3. Significant accounting policies

(a) Statement of compliance

The Fund prepares its financial statements in accordance with International Financial Reporting Standards (IFRSs) (including applicable International Accounting Standards and Interpretations) issued by the International Accounting Standards Board (IASB). A summary of the significant accounting policies adopted by the Fund is set out below.

The IASB has issued certain new and revised IFRSs that are first effective or available for early adoption for the current accounting period of the Fund. However, none of these developments are relevant to the Fund's operations.

The Fund has not applied any new standard or interpretation that is not yet effective for the current accounting period (see note 15).

Notes to the financial statements (Cont'd)

For the year ended 31 March 2011

3. Significant accounting policies (Cont'd)

(b) Basis of preparation

We have prepared these financial statements using the historical cost basis as the measurement basis, except that we state financial instruments classified as designated at fair value through profit or loss at their fair value (see note 3(e)).

We prepare the financial statements in conformity with IFRSs which requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, income and expenses. We make estimates and associated assumptions based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

We review estimates and underlying assumptions on an ongoing basis. We recognise revisions to accounting estimates in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

(c) Recognition of income

We recognise income in the statement of comprehensive income provided it is probable that the economic benefits will flow to the Fund and we can measure reliably the revenue and costs. We record interest income as it accrues using the effective interest method.

(d) Translation of foreign currencies

We translate foreign currency transactions during the year into Hong Kong dollars at the foreign exchange rates ruling at the transaction dates. We translate monetary assets and liabilities denominated in foreign currencies that are stated in fair value into Hong Kong dollars at the foreign exchange rates ruling at the end of the reporting period. We record exchange gains and losses on translation in the statement of comprehensive income.

(e) Financial instruments

(i) Initial recognition

We classify the financial instruments into different categories at inception, depending on the purpose for which the assets were acquired or the liabilities were incurred. The categories are: fair value through profit or loss, loans and receivables and other financial liabilities.

We initially measure financial instruments at fair value, which normally will be equal to the transaction price, plus, in case of a financial asset or financial liability not held at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability. We charge transaction costs on financial assets and financial liabilities at fair value through profit or loss to expense immediately.

We account for financial assets and financial liabilities on the date the Fund becomes a party to the contractual provisions of the instrument. We use settlement date accounting to record regular purchase or sale of financial assets. From this date, we record in our books any gains and losses arising from changes in fair value of the financial assets or financial liabilities.

The Fund's financial instruments mainly consist of debt and equity securities designated at fair value through profit or loss. We state financial assets and liabilities under this category at fair value and recognise changes in the fair value in the statement of comprehensive income in the period in which they arise. Upon disposal or repurchase, the difference between the net sale proceeds or the net payment and the carrying value is included in the statement of comprehensive income.

Notes to the financial statements (Cont'd)

For the year ended 31 March 2011

3. Significant accounting policies (Cont'd)

(e) Financial instruments (Cont'd)

(ii) Fair value measurement principles

We determine the fair value of financial instruments based on their quoted market prices on a recognised stock exchange or a price from a broker/dealer for non-exchange-traded financial instruments at the end of the reporting period without any deduction for estimated future selling costs. Financial assets are priced at current bid prices, while financial liabilities are priced at current asking prices. Unlisted equity investments are shares in pooled funds. The fair value is determined based on the Fund's share in the net assets of the pooled funds as determined by the custodian.

(iii) Derecognition

We derecognise a financial asset when the contractual rights to receive the cash flows from the financial asset expire, or where the financial asset together with substantially all the risks and rewards of ownership, have been transferred.

We derecognise a financial liability when the obligation specified in the contract is discharged, cancelled or expired.

(iv) Offsetting

We offset the financial assets and financial liabilities and report the net amount in the statement of financial position where there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

(f) Impairment

(i) Recognition of impairment loss

We review the carrying amounts of the Fund's assets at the end of each reporting period to determine whether there is any objective evidence of impairment. If any such evidence exists, we estimate the asset's recoverable amount. We recognise in the statement of comprehensive income the difference between the asset's carrying amount and the recoverable amount as an impairment loss whenever the carrying amount of an asset exceeds its recoverable amount.

(ii) Calculation of impairment loss

We calculate the recoverable amount of the Fund's receivables by discounting their expected future cash flows to their present value at the original effective interest rate inherent in the asset. We do not discount receivables with a short duration in the calculation of their recoverable amount.

(iii) Reversals of impairment loss

We reverse an impairment loss in respect of an asset in a subsequent period if the circumstances and events that are objectively linked 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 reverse an impairment loss only to the extent that the asset's carrying amount does not exceed the carrying amount that we would have determined if we had not recognised any impairment loss.

(g) Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and on hand, demand deposits with banks and other financial institutions, and short term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, having been within three months of maturity at acquisition.

(h) Other receivables

We state other receivables initially at fair value and thereafter at amortised cost less impairment losses (see note 3(f)), unless the effect of discounting would be immaterial, in which case we state them at cost less impairment losses.

Notes to the financial statements (Cont'd)

For the year ended 31 March 2011

3. Significant accounting policies (Cont'd)

(i) Provision for compensation

We make provision for liabilities arising from claims resulting from defaults for which it is probable that the Fund will require an outflow of economic benefits to settle the obligation and the amount can be estimated reliably, independent of whether a notice calling for claims pursuant to Section 3 of the Securities & Futures (Investor Compensation-Claims) Rules has been published. The provision covers all such claims received up to the date on which the financial statements are approved by the SFC. If the effect is material, we determine provisions by discounting the expected future cash flows that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

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

As the Fund is continually updating information in respect of claims received, it is possible that the recent claim experience is not indicative of future payments that will be required for claims received as at the end of the reporting period. Any increase or decrease in the provision would affect profit and loss in future years.

(j) Creditors and accrued charges

We state creditors and accrued charges initially at fair value and thereafter at amortised cost unless the effect of discounting would be immaterial, in which case we state them at cost.

(k) Contingent liabilities

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

(l) Related parties

For the purpose of these financial statements, a party is considered to be related to the Fund if:

- (i) the party has the ability, directly or indirectly through one or more intermediaries, to control the Fund or exercise significant influence over the Fund in making financial and operating decisions or has joint control over the Fund;
- (ii) the Fund and the party are subject to common control;
- (iii) the party is an associate of the Fund or a joint venture in which the Fund is a venturer;
- (iv) the party is a member of key management personnel of the Fund or the Fund's parent, or a close family member of such an individual, or is an entity under the control, joint control or significant influence of such individuals;
- (v) the party is a close family member of a party referred to in (i) or is an entity under the control, joint control or significant influence of such individuals; or
- (vi) the party is a post-employment benefit plan which is for the benefit of employees of the Fund or of any entity that is a related party of the Fund.

Close family members of an individual are those family members who may be expected to influence, or be influenced by, that individual in their dealings with the Fund.

Notes to the financial statements (Cont'd)

For the year ended 31 March 2011

4. Taxation

The interest and profits on investments earned by the Fund are not subject to Hong Kong Profits Tax under Section 14 of the Inland Revenue Ordinance.

5. Net investment income

	2011	2010
	\$'000	\$'000
Interest income from bank deposits	248	129
Interest income on financial assets designated at fair value through profit or loss	48,807	52,853
Realised (loss)/gain on disposal of equity securities	(10)	5
Realised (loss)/gain on redemption/disposal of debt securities	(2,443)	4,043
Gain on revaluation of equity securities	40,979	71,812
Gain on revaluation of debt securities	1,256	25,954
Net investment income	88,837	154,796

6. Levy from SEHK/HKFE

From 1 April 2003, the Fund received a levy chargeable on leviable SEHK transactions and leviable HKFE contracts pursuant to Part 2 and Part 3 of the Securities and Futures (Investor Compensation – Levy) Rules.

After the Securities and Futures (Investor Compensation – Levy) (Amendment) Rules 2005 came into effect on 28 October 2005, a levy suspension and re-instatement mechanism was established whereby the investor compensation levies can be suspended when the net asset value of the Fund exceeds \$1.4 billion, and subsequently reinstated when the net asset value of the Fund falls below \$1 billion. Pursuant to the Securities and Futures (Investor Compensation – Levy) (Amendment) Rules 2005 and the Gazette on 11 November 2005, no person is required to pay any levy to the Fund in respect of a sale and purchase of securities and futures contract with effect from 19 December 2005.

7. ICC expenses

The SFC formed the ICC in September 2002 to perform functions on behalf of the Fund in relation to the 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. For the year ended 31 March 2011, ICC incurred costs of \$4,157,000 for its operations (2010: \$4,165,000).

Notes to the financial statements (Cont'd)

For the year ended 31 March 2011

8. Provision for compensation

	\$'000
Balance as at 1 April 2009	8,032
Add: compensation expenses during the year ended 31 March 2010	363
Less: compensation paid during the year ended 31 March 2010	(2,739)
Balance as at 31 March 2010 and 1 April 2010	5,656
Less: compensation write-backs during the year ended 31 March 2011	(218)
Less: compensation paid during the year ended 31 March 2011	(5,288)
Balance as at 31 March 2011	150

We maintained provision for liabilities arising from claims received resulting from one default case for which ICC has published a notice calling for claims pursuant to Section 3 of the Securities & Futures (Investor Compensation-Claims) Rules. The maximum liability of the Fund to claims for this case is set at \$150,000 per claimant. As at 31 March 2011 all provisions were expected to be paid within one year.

9. Financial assets designated at fair value through profit or loss

	2011 \$'000	2010 \$'000
(a) Debt securities		
(i) Listing status		
Listed – outside Hong Kong at quoted market prices	535,919	345,199
Listed – outside Hong Kong based on valuation techniques	109,436	63,001
Listed – in Hong Kong	143,605	51,608
Unlisted	819,623	1,057,995
	1,608,583	1,517,803
(ii) Maturity profile		
Within one year	552,995	317,118
After one year but within two years	443,101	406,937
After two years but within five years	484,958	629,833
After five years	127,529	163,915
	1,608,583	1,517,803
(iii) The weighted average effective interest rate of debt securities on 31 March 2011 was 1.7% (2010: 2.0%).		
(b) Pooled fund		
Unlisted	224,824	184,523

The pooled fund comprises mainly listed equity securities.

Notes to the financial statements (Cont'd)

For the year ended 31 March 2011

10. Deposits with banks and cash at bank

The effective interest rate on deposits with banks and cash at bank at 31 March 2011 ranged from 0.1% to 0.3% (2010: 0.04% to 0.2%). The balances mature within one year at both 31 March 2011 and 31 March 2010.

11. 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. Up to 31 March 2011, the SFC had \$994,718,000 (2010: \$994,718,000) and \$108,923,000 (2010: \$108,923,000) paid into the Fund from the UECF and the CECF respectively.

The Fund defines "capital" as including contributions from the UECF and the CECF and the accumulated surplus.

12. Material related party transactions

We have related party relationships with the SFC, the ICC and the UECF. During the year, there were no significant related party transactions other than those disclosed in the financial statements (refer to notes 7 & 11).

13. Financial risk management and fair values

The financial assets of the Fund mainly comprise debt securities and units in a pooled fund. The underlying investments of the pooled fund mainly comprise equity securities.

The main financial risks of the Fund arise from its investments in debt securities and units in the pooled fund. The SFC appoints external investment managers to manage the Fund's investments and to ensure that the portfolio's investments comply with the Fund's investment policy approved by the SFC which sets control limits on credit risk, market risk, interest rate risk, liquidity risk and foreign currency risk. The external investment managers report thereon to the SFC on a regular basis.

The Fund's exposure to these risks and the financial risk management policies and practices used by the Fund to manage these risks are described below.

(a) Credit risk

The Fund's Investment Policy and Administrative Guidelines (the Policy) only allows the Fund to invest in pooled funds, fixed rate dated securities rated A or above or in bank deposits. The Policy further limits the Fund's exposure to each issuer and each country, except for holdings of US Treasuries, any issuances by Hong Kong Government and specified multilateral agencies rated AAA by Moody's or S&P's and approved pooled funds. The Fund's investment managers are responsible for managing the portfolio and ensuring the portfolio's investments meet the Policy and restrictions and reports thereon on a monthly basis. During the year, the Fund complied with the above Policy and, as a result, was not exposed to significant credit risk. The maximum exposure to credit risk is the carrying value of the assets in the statement of financial position.

(b) Liquidity risk

The Fund's policy is to regularly monitor its liquidity requirement to ensure that it maintains sufficient reserves of cash and readily realisable marketable securities to meet its liquidity requirements in the short and longer term.

Notes to the financial statements (Cont'd)

For the year ended 31 March 2011

13. Financial risk management and fair values (Cont'd)

(c) Interest rate risk

The Fund's interest bearing assets mainly comprise fixed interest rate bearing debt securities and bank deposits. The Fund's bank deposits are exposed to short term bank deposit interest re-pricing risk.

The Fund is subject to the risk that future cash flows of a debt security will fluctuate because of changes in market interest rates. In order to manage the re-pricing risk, the Fund adopts a policy of maintaining duration at no more than 2.5 years within its debt securities portfolio. As at 31 March 2011 the duration was 1.82 years (31 March 2010: 2.11 years).

At 31 March 2011, it is estimated that a general increase/decrease of 100 basis points in interest rates, with all other variables held constant, would decrease/increase the Fund's gains on revaluation of debt securities and the accumulated surplus by approximately \$32,492,000 (2010: \$35,039,000). Further, at 31 March 2011, it is estimated that a general increase of 100 basis points in interest rates, with all other variables held constant, would increase the Fund's interest income and the accumulated surplus by approximately \$4,398,000 (2010: \$3,217,000). The extent of any decrease in interest rate is expected to be minimal which would decrease the Fund's surplus by an insignificant amount. Other components of the accumulated surplus would not be affected (2010: Nil) by the changes in interest rates.

The sensitivity analysis above indicates the instantaneous change in the Fund's accumulated surplus that would arise assuming that the change in interest rates had occurred at the end of the reporting period and had been applied to re-measure those financial instruments held by the Fund which expose the Fund to fair value interest rate risk at the end of the reporting period. The analysis is performed on the same basis for the year ended 31 March 2010.

(d) Foreign currency risk

The Fund's investment policy allows the Fund to 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.

(e) 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 and equity securities. Such risk will be reflected in the price and the carrying value of the financial assets concerned.

The Fund invests in units of a pooled fund, which mainly comprises listed equity securities, the performance of which is measured against the benchmark index MSCI AC Pacific ex Japan. It is estimated that a general increase/decrease of 24.9% in the benchmark index would increase/decrease the Fund's surplus and the accumulated surplus by approximately \$48,337,000 (2010: a general increase/decrease of 24.2% in the benchmark index would increase/decrease the Fund's surplus and the accumulated surplus by approximately \$35,982,000).

The sensitivity analysis above indicates the instantaneous change in the Fund's accumulated surplus that would arise assuming that the changes in the benchmark index had occurred at the end of the reporting period and had been applied to re-measure those financial instruments held by the Fund which expose the Fund to equity price risk at the end of the reporting period. It is also assumed that the fair values of the Fund's investment in pooled fund would change in accordance with the historical correlation with the relevant benchmark index since the portfolio is diversified in terms of industry distribution and that all other variables remain constant. The analysis is performed on the same basis for 2010.

Notes to the financial statements (Cont'd)

For the year ended 31 March 2011

13. Financial risk management and fair values (Cont'd)**(f) Fair values of financial instruments**

The following table presents the carrying value of financial instruments measured at fair value at the end of the reporting period across the three levels of the fair value hierarchy defined in IFRS 7, *Financial Instruments: Disclosures*, with the fair value of each financial instrument categorised in its entirety based on the lowest level of input that is significant to that fair value measurement. The levels are defined as follows:

- Level 1 (highest level): fair values measured using quoted prices (unadjusted) in active markets for identical financial instruments
- Level 2: fair values measured using quoted prices in active markets for similar financial instruments, or using valuation techniques in which all significant inputs are directly or indirectly based on observable market data
- Level 3: (lowest level): fair values measured using valuation techniques in which any significant input is not based on observable market data

All financial instruments are carried at amounts not materially different from their fair values as at 31 March 2011 and 2010.

Where available, the fair value of the debt securities is the quoted market price. The fair value of unlisted debt securities is determined based on quotes from bond market-makers.

The fair value of the investment in the unlisted pooled fund is determined based on the Fund's share in the net assets of the pooled fund as determined by the custodian. The majority of the underlying assets of the pooled fund are listed securities.

Changes in the market conditions could materially affect fair value estimates. Any increase or decrease in the fair values of financial instruments would affect profit or loss in future years.

	2011			
	Level 1 \$'000	Level 2 \$'000	Level 3 \$'000	Total \$'000
Assets				
Trading securities				
– Listed	663,537	125,423	–	788,960
– Unlisted	72,133	747,490	–	819,623
Pooled fund				
– Unlisted	224,824	–	–	224,824
	960,494	872,913	–	1,833,407

Notes to the financial statements (Cont'd)

For the year ended 31 March 2011

13. Financial risk management and fair values (Cont'd)

(f) Fair values of financial instruments (Cont'd)

	Level 1 \$'000	Level 2 \$'000	2010 Level 3 \$'000	Total \$'000
Assets				
Trading securities				
– Listed	396,807	63,001	–	459,808
– Unlisted	277,500	780,495	–	1,057,995
Pooled fund				
– Unlisted	184,523	–	–	184,523
	858,830	843,496	–	1,702,326

During the year there were no significant transfers between financial instruments in Level 1 and Level 2.

14. Contingent liabilities

As at the date of this report, in addition to the provision made, as described in note 8, there are other claims received for which currently there is insufficient information to determine the likely level of payment. The maximum liability in respect of these claims is \$600,000 (2010: \$450,000). This is determined based on the lower of the maximum compensation limit of \$150,000 per claimant or the amount claimed.

15. Possible impact of amendments, new standards and interpretations issued but not yet effective for the year ended 31 March 2011

Up to the date of issue of these financial statements, the IASB has issued a number of amendments and Interpretations and one new standard which are not yet effective for the year ended 31 March 2011 and which have not been adopted in these financial statements.

Effective for accounting periods beginning on or after

Revised IAS 24, <i>Related party disclosures</i>	1 January 2011
IFRS 9, <i>Financial instruments</i>	1 January 2013

The Fund is in the process of making an assessment of what the impact of these amendments is expected to be in the period of initial application. So far it has concluded that the adoption of them is unlikely to have a significant impact on the Fund's results of operations and financial position.

FINANCIAL STATEMENTS: UECF

Report of the Securities Compensation Fund Committee (the Committee)

The members of the Committee present their annual report together with the audited financial statements for the year ended 31 March 2011.

Establishment of the Unified Exchange Compensation Fund (the Fund)

Part X of the repealed 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 settlement of all claims against the Fund and its other liabilities, the SFC will eventually transfer the remaining balance of the Fund to the ICF.

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

Financial statements

The surplus of the Fund for the financial year ended 31 March 2011 and the state of the Fund's affairs as at that date are set out in the financial statements on pages 118 to 129.

Members of the Committee

The members of the Committee during the year ended 31 March 2011 and up to the date of this report were:

Mr Keith Lui (Chairman)
Mr Gerald Greiner (retired on 31 March 2011)
Mrs Alexa Lam
Mr Kenneth H W Kwok, BBS, SC (retired on 31 December 2010)
Mr Eric Yip (retired on 31 March 2011)
Mr Chow Ka Ming, Anderson, SC (appointed on 15 February 2011)
Mr Lo Wai Keung, David (appointed on 1 April 2011)
Mr Tai Chi Kin (appointed on 1 April 2011)

Interests in contracts

No contract of significance to which the Fund was a party and in which a Committee member of the Fund had a material interest, subsisted at the end of the financial year or at any time during the financial year.

Auditors

KPMG retire and, being eligible, offer themselves for re-appointment. A resolution for the re-appointment of KPMG as auditors of the Fund is to be proposed at the forthcoming Securities Compensation Fund Committee meeting.

By order of the Committee

Keith Lui
Chairman

11 May 2011

Independent auditor's report to the Securities & Futures Commission (the SFC)

We have audited the financial statements of the Unified Exchange Compensation Fund (the Fund) established under Section 99 of the repealed Hong Kong Securities Ordinance set out on pages 118 to 129, which comprise the statement of financial position as at 31 March 2011 and the statement of comprehensive income, the statement of changes in equity and the statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

The SFC's responsibility for the financial statements

The repealed Hong Kong Securities Ordinance (Chapter 333) requires the directors of the SFC to prepare financial statements which give a true and fair view. The directors of the SFC are responsible for the preparation of the financial statements that give a true and fair view in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board and for such internal control as the directors determine necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. This report is made solely to you and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements give a true and fair view of the state of the Fund's affairs as at 31 March 2011 and of its surplus and cash flows for the year then ended in accordance with International Financial Reporting Standards.

KPMG

Certified Public Accountants

8th Floor, Prince's Building

10 Chater Road

Central, Hong Kong

11 May 2011

Statement of comprehensive income

For the year ended 31 March 2011 (Expressed in Hong Kong dollars)

	Note	2011 \$'000	2010 \$'000
Income			
Interest income		173	149
Recoveries	5	1,666	310
		1,839	459
Expenses			
Auditor's remuneration		40	38
Professional fees		13	13
Sundry expenses		1	1
		54	52
Surplus and total comprehensive income for the year		1,785	407

The notes on pages 122 to 129 form part of these financial statements.

Statement of financial position

At 31 March 2011 (Expressed in Hong Kong dollars)

	Note	2011 \$'000	2010 \$'000
Current assets			
Equity securities received under subrogation		1	2
Interest receivable		20	4
Fixed and call deposits with banks		71,565	68,958
Cash at bank		274	22
		71,860	68,986
Current liabilities			
Creditors and accrued charges	6	10,294	10,305
		10,294	10,305
Net current assets			
		61,566	58,681
Net assets			
Representing:			
Compensation fund			
Contributions from SEHK	7	48,700	47,600
Excess transaction levy from SEHK	9	353,787	353,787
Special contribution		3,500	3,500
Additional contribution from SEHK		300,000	300,000
Additional contribution from the SFC		330,000	330,000
Special levy surplus	10	3,002	3,002
Accumulated surplus		17,295	15,510
		1,056,284	1,053,399
Contributions to Investor Compensation Fund	11	(994,718)	(994,718)
		61,566	58,681

Approved and authorized for issue by the Securities Compensation Fund Committee on behalf of the Securities and Futures Commission on 11 May 2011 and signed on its behalf by

Keith Lui
Chairman

Tai Chi Kin
Committee Member

The notes on pages 122 to 129 form part of these financial statements.

Statement of changes in equity

For the year ended 31 March 2011 (Expressed in Hong Kong dollars)

	2011	2010
	\$'000	\$'000
Compensation Fund balance as at 1 April	58,681	57,674
Net contribution from SEHK	1,100	600
Total comprehensive income for the year	1,785	407
Compensation Fund balance as at 31 March	61,566	58,681

The notes on pages 122 to 129 form part of these financial statements.

Statement of cash flows

For the year ended 31 March 2011 (Expressed in Hong Kong dollars)

	2011	2010
	\$'000	\$'000
Cash flows from operating activities		
Surplus for the year	1,785	407
Interest income	(173)	(149)
Decrease in equity securities received under subrogation	1	305
(Decrease)/increase in creditors and accrued charges	(11)	24
Net cash generated from operating activities	1,602	587
Cash flows from investing activities		
Interest received	157	189
Net cash generated from investing activities	157	189
Cash flows from financing activities		
Contributions from SEHK	1,100	600
Net cash generated from financing activities	1,100	600
Net increase in cash and cash equivalents	2,859	1,376
Cash and cash equivalents at beginning of the year	68,980	67,604
Cash and cash equivalents at end of the year	71,839	68,980

Analysis of the balance of cash and cash equivalents:

	2011	2010
	\$'000	\$'000
Fixed and call deposits with banks	71,565	68,958
Cash at bank	274	22
	71,839	68,980

Notes to the financial statements

For the year ended 31 March 2011 (Expressed in Hong Kong dollars)

1. Purpose, limitation and principal activity

The Fund provides compensation to investors who suffer a loss due to the default of an exchange participant of The Stock Exchange of Hong Kong Ltd (SEHK). Part X of the repealed Securities Ordinance governs its operation.

SEHK receives and determines claims against the Fund. The Securities and Futures Commission (SFC) maintains and invests the money of the Fund and makes payments to claimants. Upon making payment to a claimant, the SFC is subrogated to the claimant's rights against the defaulter.

The repealed Securities Ordinance limits the total compensation amount that may be paid per exchange participant default to \$8 million. If allowed claims exceed the limit, payments are made proportionally to claimants. SEHK, with the approval of the SFC, can decide to exceed the limit if it considers, among other things, that the assets of the Fund so permit. For eight defaults since 1998, SEHK proposed and the SFC approved exceeding the limit via payment of up to \$150,000 per claimant or, if higher, the claimant's proportional share of the \$8 million limit.

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 repealed Securities Ordinance. Unpaid claim amounts would be charged against future receipts by the Fund and paid when funds are available.

After 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 settlement of all claims against the Fund and its other liabilities, the SFC will eventually transfer the remaining balance of the Fund into the ICF. Claims for any defaults occurring after 31 March 2003 should be made against the ICF. If the sum of money in the Fund is not sufficient to meet its liabilities, the SFC shall pay into the Fund from the ICF the appropriate sum of money according to Section 242 of the SFO.

Apart from the above change and Section 112 of the repealed Securities Ordinance, under Section 74 of Schedule 10 of the SFO, Part X of the repealed Securities Ordinance remains effective in respect of the operation of the Fund.

2. Money constituting the Fund

Before 1 April 2003, SEHK was required to keep deposited with the SFC \$50,000 for each SEHK trading right under the repealed Securities Ordinance. When the SFC makes compensation payments out of the deposits, the SFC may require SEHK to replenish the net amount paid after the SFC has exhausted its subrogated rights against the defaulter. The SFC pays to SEHK the investment return earned on any remaining deposits net of Fund expenses. During the year, the SFC did not make such payment as the total of the compensation payments exceeded the deposits received from SEHK (2010: nil).

SEHK and the SFC have made contributions of their own money to the Fund. The SFC determines to retain investment returns earned on these contributions in the Fund.

Other sources of money for the Fund include: recoveries; SEHK replenishments detailed in note 14; special levy surplus detailed in note 10; and transaction levy received before the SFO became effective from 1 April 2003.

The Fund defines "capital" as including all elements of the Fund less contributions to the ICF and less contributions from SEHK (deposits for transferred trading rights) as disclosed on the face of the statement of financial position.

Notes to the financial statements (Cont'd)

For the year ended 31 March 2011

3. Significant accounting policies

(a) Statement of compliance

The Fund prepares its financial statements in accordance with International Financial Reporting Standards (IFRSs) (including applicable International Accounting Standards and Interpretations) issued by the International Accounting Standards Board (IASB). A summary of the significant accounting policies adopted by the Fund is set out below.

The IASB has issued certain new and revised IFRSs that are first effective or available for early adoption for the current accounting period of the Fund. However, none of these developments are relevant to the Fund's operations.

The Fund has not applied any new standard or interpretation that is not yet effective for the current accounting period (see note 15).

(b) Basis of preparation

Under the SFO, the Fund will continue in operation until all claims against it and all its liabilities have been settled. As the Fund will eventually cease operation, we have prepared these financial statements on a break-up basis with assets stated at recoverable amounts. We have not provided for potential future claims and recoveries as these cannot be reliably estimated. We have also not provided in the financial statements for all expenses expected to be incurred subsequent to the end of the reporting period and up to the date operations will cease as these are estimated to be immaterial.

We prepare the financial statements in conformity with IFRSs which requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, income and expenses. We make estimates and associated assumptions based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

We review estimates and underlying assumptions on an ongoing basis. We recognise revisions to accounting estimates in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

(c) Recognition of income

(i) Interest income

We record interest income as it accrues using the effective interest method.

(ii) Recoveries

We recognise recoveries pursuant to Section 118 of the repealed Securities Ordinance as income to the Fund and recoveries re-distributed to claimants as expenses. We record recoveries received and re-distributed when and only when we can be virtually certain that the recoveries will be received and paid.

(iii) Replenishments by SEHK

We record replenishments from SEHK pursuant to Section 107 of the repealed Securities Ordinance as income of the Fund on a receipt basis. For the purpose of calculating the amount to be replenished by SEHK, we deem compensation payments up to the amount of \$8 million for each default to be charged to the contribution from SEHK.

Notes to the financial statements (Cont'd)

For the year ended 31 March 2011

3. Significant accounting policies (Cont'd)

(d) Impairment

(i) Recognition of impairment loss

We review the carrying amounts of the Fund's assets at the end of each reporting period to determine whether there is any objective evidence of impairment. If any such evidence exists, we estimate the asset's recoverable amount. We recognise in the statement of comprehensive income the difference between the asset's carrying amount and the recoverable amount as an impairment loss whenever the carrying amount of an asset exceeds its recoverable amount.

(ii) Calculation of impairment loss

We calculate the recoverable amount of the Fund's receivables by discounting their expected future cash flows to their present value at the original effective interest rate inherent in the asset. We do not discount receivables with a short duration in the calculation of their recoverable amount.

(iii) Reversals of impairment loss

We reverse an impairment loss in respect of an asset in a subsequent period if the circumstances and events that are objectively linked 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 reverse an impairment loss only to the extent that the asset's carrying amount does not exceed the carrying amount that we would have determined if we had not recognised any impairment loss.

(e) Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and on hand, demand deposits with banks and other financial institutions, and short term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, having been within three months of maturity at acquisition.

(f) Creditors and accrued charges

We state creditors and accrued charges initially at fair value and thereafter at amortised cost unless the effect of discounting would be immaterial, in which case they are stated at cost.

Notes to the financial statements (Cont'd)

For the year ended 31 March 2011

3. Significant accounting policies (Cont'd)

(g) Contingent liabilities

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

(h) Related parties

For the purpose of these financial statements, a party is considered to be related to the Fund if:

- (i) the party has the ability, directly or indirectly through one or more intermediaries, to control the Fund or exercise significant influence over the Fund in making financial and operating decisions or has joint control over the Fund;
- (ii) the Fund and the party are subject to common control;
- (iii) the party is an associate of the Fund or a joint venture in which the Fund is a venturer;
- (iv) the party is a member of key management personnel of the Fund or the Fund's parent, or a close family member of such an individual, or is an entity under the control, joint control or significant influence of such individuals;
- (v) the party is a close family member of a party referred to in (i) or is an entity under the control, joint control or significant influence of such individuals; or
- (vi) the party is a post-employment benefit plan which is for the benefit of employees of the Fund or of any entity that is a related party of the Fund.

Close family members of an individual are those family members who may be expected to influence, or be influenced by, that individual in their dealings with the Fund.

Notes to the financial statements (Cont'd)

For the year ended 31 March 2011

4. Taxation

Section 87 of the Hong Kong Inland Revenue Ordinance exempts the Fund from Hong Kong Profits Tax.

5. Recoveries

During the year, the Fund recognised as recoveries the payments from liquidator of Lawsons Securities Company.

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 recognised as recoveries the sale proceeds of shares allocated and the remaining shares at market value as of 31 March 2011 after deducting relevant processing fees and charges for collecting and selling the shares received.

The shares allocated to the Fund under its subrogation rights are classified as designated at fair value through profit and loss securities in accordance with the determination in IAS 39, *Financial instruments: Recognition and measurement*. According to IFRS 7, *Financial instruments: Disclosures*, these subrogated shares should be classified as level 1 financial instruments as they all have quoted market price (unadjusted) in an active market for an identical instrument. At the end of each reporting period the fair value is remeasured, with any resultant gain or loss being recognised in "Recoveries". Dividend income, if any, is also recognised in "Recoveries".

6. Creditors and accrued charges

Creditors and accrued charges comprised mainly compensation payments re-established for those cheque payments that were not cleared over six months from the cheque issuing date and accrued auditor's remuneration.

These liabilities classified as financial liabilities measured at amortised costs in accordance with the determination in IAS 39 unless the effect of discounting would be immaterial, in which case they are stated at cost, are due on demand or within one year and are unsecured.

Notes to the financial statements (Cont'd)

For the year ended 31 March 2011

7. Set-off of SEHK deposits and refunds/contributions from SEHK

According to Section 104 of the repealed Securities Ordinance, SEHK contributes to the Fund in respect of each trading right at the rate of \$50,000 per trading right. In the absence of claims or other provisions as set out in Section 106 of the repealed Securities Ordinance, the SFC must refund to SEHK the deposit within six months after the relinquishment. During the year, deposits of \$1,700,000 in respect of 34 new trading rights were received from SEHK.

During the year, the SFC had refunded to SEHK of \$600,000 in respect of the deposit of 12 relinquished trading rights. As at 31 March 2011, there are 9 trading rights in total that have been relinquished but not yet refunded.

The movement of contributions from SEHK during the year was as follows:

	2011 \$'000	2010 \$'000
Balance brought forward	47,600	47,000
Add: 34 new trading rights issued (2010: 26)	1,700	1,300
Less: 12 relinquished trading rights refunded (2010: 14)	(600)	(700)
Balance carried forward	48,700	47,600

8. Contingent liabilities

As at the date of this report, there is no outstanding claim against the Fund.

In relation to the default cases, any excess of recovered amounts (refer to note 5), if any, will be re-distributed to claimants. As the timing of re-distribution and amount of these potential excess amounts are uncertain at the date of this report, we disclose this as a contingent liability.

9. Excess transaction levy from SEHK

SEHK paid these amounts to the Fund from 1992 to 1994 under an agreement with the SFC and the Financial Secretary concerning SEHK's budget and its receipt of transaction levy.

Notes to the financial statements (Cont'd)

For the year ended 31 March 2011

10. Special levy surplus

In November 2000, the former Financial Services Bureau of the HKSAR Government transferred to the Fund \$3,002,000 under the provisions of the Exchanges (Special Levy) Ordinance.

11. 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 74(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. Total contributions paid into the ICF upto 31 March 2011 amounted to \$994,718,000 (2010: \$994,718,000).

12. Material related party transactions

We have related party relationships with the ICF and the SFC. During the year, there were no significant related party transactions other than those disclosed in the financial statements (refer to note 11).

13. Financial risk management

The Fund's interest bearing assets mainly comprise deposits at banks which mature or re-price in the short term, as a result of which the Fund is subject to a limited exposure to interest rate risk due to fluctuations in the prevailing market rates. At 31 March 2011, it is estimated that a general increase/decrease of 100 basis points in the interest rates, with all other variables held constant, would increase/decrease the Fund's surplus and accumulated surplus by approximately \$716,000 (2010: \$690,000). Other components of accumulated surplus would not be affected (2010: Nil) by the changes in interest rates. The exposure to credit and liquidity risks arises in the normal course of the Fund's operation. The Fund is not exposed to any foreign exchange risk as all transactions and balances are denominated in HK dollars.

The Fund's credit risk is primarily attributable to amounts at bank. Management's policy is that bank balances are placed only with licensed banks rated P-1 or A-1 by Moody's or S&P respectively.

The Fund's policy is to regularly monitor its liquidity requirements to ensure that it maintains sufficient reserves of cash to meet its liquidity requirements in the short and longer term.

Notes to the financial statements (Cont'd)

For the year ended 31 March 2011

14. Replenishments from SEHK

Under Section 107 of the repealed Securities Ordinance, the SFC may require SEHK to replenish the Fund with an amount that is equal to that paid in connection with the satisfaction of the claim (limited to \$8,000,000 per each defaulted case) after the SFC has exhausted all relevant rights of action and other legal remedies against the defaulter.

Up to 31 March 2011, SEHK has replenished \$16,361,000 to the Fund. In compliance with Section 107 of the repealed Securities Ordinance, if no further recoveries were to be collected, the SFC may require SEHK to further replenish \$70,816,000 to the Fund as follows:

	2011 \$'000	2010 \$'000
Compensation paid up to the \$8 million limit as set out in Section 109(3) of the repealed Securities Ordinance	100,738	100,738
Less: Recoveries received for compensation paid up to \$8 million	(29,946)	(29,946)
Add: Recoveries re-distributed to claimants	16,385	16,385
Less: Replenishments from SEHK	(16,361)	(16,361)
Net amount the SFC may request SEHK for replenishment	70,816	70,816

Under Section 74(3) of Schedule 10 of the SFO, the SFC having allowed sufficient funds to meet claims, may reimburse SEHK for the deposits paid by SEHK into the Fund for each trading right. The reimbursement of these SEHK deposits may be set off against further replenishments required from SEHK.

Replenishment from SEHK are not recognised in the statement of financial position given that the Fund is not aware of any need for requesting SEHK for replenishment in the near future.

15. Possible impact of amendments, new standards and interpretations issued but not yet effective for the year ended 31 March 2011

Up to the date of issue of these financial statements, the IASB has issued a number of amendments and Interpretations and one new standard which are not yet effective for the year ended 31 March 2011 and which have not been adopted in these financial statements.

Effective for accounting periods beginning on or after

Revised IAS 24, *Related party disclosures*
IFRS 9, *Financial instruments*

1 January 2011

1 January 2013

The Fund is in the process of making an assessment of what the impact of these amendments is expected to be in the period of initial application. So far it has concluded that the adoption of them is unlikely to have a significant impact on the Fund's results of operations and financial position.

COMMITTEES, PANELS AND TRIBUNAL

A number of committees and panels have been set up to advise the SFC on various matters and perform other functions as set out in their terms of reference. This section outlines the work of these committees and panels and provides a membership list by type in alphabetical order. For information on the **Audit Committee**, **Remuneration Committee**, **Budget Committee** and **Executive Committee**, please see our discussion in the Corporate Governance chapter.

SFC Committees

Academic and Accreditation Advisory Committee

Approves industry-based courses and examinations for the purpose of meeting the licensing competence requirements, endorses applications from professional bodies and tertiary institutions as recognised institutions for providing continuous professional training, advises the SFC on areas to study in the context of enhancing Hong Kong's position as an international financial centre and provides input for the development of industry-related courses and training programmes.

During the year, the Committee met once to review the examination concerning the newly created regulated activity for credit rating agencies and considered an application as recognised institution for providing continuous professional training.

Chairman

TISDALL Stephen Clifford (from 1.4.2010)

Members

Prof CHAN Chi Fai, Andrew, SBS, JP (from 1.4.2010)	PICKERELL Blair Chilton (from 1.4.2010)
Prof CHAN Kalok	SHEK Chi Fai, Derek
Prof CHAN Man Man, Johannes, SC	SO Yuk Sing, Christine
Prof CHENG Yu Shek, Joseph, JP	VAS Judy
ESPINA Anthony	

No of meetings: 1

Average attendance rate: 90%

Advisory Committee

Advises the SFC on any matter of policy regarding the performance of its functions.

Chairman

Dr FONG Ching, Eddy, GBS, JP

Members

CHAN Henry	LAM Cheung, Alexa
CHEONG Ying Chew, Henry	LEUNG Margaret
CHEW Fook-aun	Dr LIN Yong
DICKENS Mark Francis, JP	WHEATLEY Martin, JP
EU Andrew Douglas	WONG Kwai-lam
FU Yu Ning	WONG Shou Yeh, David
Dr HU Zulu, Fred	WU Thomas Jefferson
KENNEDY Paul Michael (to 7.4.2010)	

No of meetings: 4

Average attendance rate: 83.3%

Committee on Investment-Linked Assurance and Pooled Retirement Funds

Considers new policies for the regulation of collective investment schemes commonly regarded as investment-linked assurance schemes (ILAS) and pooled retirement funds, considers the acceptability of new management groups, authorizes schemes with novel product features, and imposes conditions and/or grants waivers on such schemes.

During the year, the Committee met once to discuss the proposed revisions to the ILAS Code as proposed under the Consultation Paper on Proposals to Enhance Protection for the Investing Public issued on 25 September 2009. The Products Advisory Committee (page 134) was set up to replace this Committee. As such, this Committee was dissolved on 10 August 2010.

Chairman

LAM Cheung, Alexa (to 10.8.2010)

Members

Prof CHAN Kalok (to 10.8.2010)

CHOI Fung Yee, Christina (to 10.8.2010)

CHU Wing Yiu (to 10.8.2010)

HON Wai Ming, Angel (to 10.8.2010)

LAU Ka Shi (to 10.8.2010)

Prof LIU Pak Wai, SBS, JP (to 10.8.2010)

LUK Kin Yu, Peter (to 10.8.2010)

MAK Tat Cheung (to 10.8.2010)

McSHANE Darren Mark (to 10.8.2010)

YIP Chi Leung (to 10.8.2010)

No of meetings: 1

Average attendance rate: 81.8%

Committee on Real Estate Investment Trusts

Advises the SFC on general policy matters or regulatory issues that are related to the Code on Real Estate Investment Trusts (REITs), the overall market development of REITs, the property or securities market or investment management in Hong Kong or elsewhere, professional practices or guidelines that are involved in the operation of REITs, and fund investment or management in general.

During the year, the Committee met twice to discuss policy issues in relation to REITs.

Chairman

LAM Cheung, Alexa

Members

AU Fun Kuen (to 31.3.2011)

CHENG Wai Meng, Milton

Prof CHENG Yu Shek, Joseph, JP

CHOI Fung Yee, Christina

CHOW, Susan Mo Fong (to 31.3.2011)

FOK Glenn

HUI Chiu Chung, JP (to 31.3.2011)

LAW Shing Mui, Alice

LEUNG Kar Cheung, Catherine

MURRAY Alastair Elliot (to 31.3.2011)

Prof PANG Tsan Wing, SBS

PO Wai Kwong (to 31.3.2011)

STEVENSON Thomas Brian, SBS (to 31.3.2011)

WESTLEY Kevin Anthony (to 31.3.2011)

No of meetings: 2

Average attendance rate: 70%

Committee on Unit Trusts

Considers new policies for the regulation of collective investment schemes commonly regarded as mutual funds and unit trusts, considers the acceptability of new management groups, authorizes schemes with novel product features, and imposes conditions and/or grants waivers on such schemes.

During the year, there were no circumstances that called for the convening of a meeting of the Committee. The Products Advisory Committee (page 134) was set up to replace this Committee. As such, this Committee was dissolved on 10 August 2010.

Chairman

LAM Cheung, Alexa (to 10.8.2010)

Full Members

Dr AU King Lun, MH (to 10.8.2010)

Prof CHAN Kalok (to 10.8.2010)

CHOI Fung Yee, Christina (to 10.8.2010)

HEUNG Shu Fai (to 10.8.2010)

HSU Li Ching (to 10.8.2010)

LEE Kevin (to 10.8.2010)

Prof LIU Pak Wai, SBS, JP (to 10.8.2010)

McSHANE Darren Mark (to 10.8.2010)

MURRAY Alastair Elliot (to 10.8.2010)

NG Ka Yiu, Desmond (to 10.8.2010)

PICKERELL Blair Chilton (to 10.8.2010)

Alternate Members

KWAN Sau Ha (to 10.8.2010)

MAK Tat Cheung (to 10.8.2010)

MASSEY LI Susan Hong (to 10.8.2010)

No of meetings: 0

Average attendance rate: N/A

Disciplinary Chair Committee

Members are nominated by the Nominations Committee on the basis that they are duly experienced and legally qualified persons. Their role is to act as Chairman of the Takeovers and Mergers Panel in disciplinary proceedings under the Codes on Takeovers and Mergers and Share Repurchases or of the Takeovers Appeal Committee on a case-by-case basis.

During the year, there were no disciplinary proceedings under the Takeovers Code nor meetings of the Takeovers Appeal Committee involving members of this Committee.

Members

CHAN Kin Keung, Anthony, SC

CHAN King Sang, Edward, SC

CHOW Ka-ming, Anderson, SC (to 31.12.2010)

HO Ambrose, SC

LI Gladys Veronica, SC

NG Kar Fai, Peter, SC

WONG Yuk Lun, Horace, SC

No of meetings: 0

Average attendance rate: N/A

Investor Compensation Fund Committee

Administers the Investor Compensation Fund and regulates its procedures in accordance with Part XII of the Securities and Futures Ordinance (SFO).

During the year, the Committee met once to consider the financial statements of the Fund and dealt with other administrative matters.

Chairman

LUI Kei Kwong, Keith

Members

CHOW Ka-ming, Anderson, SC (from 15.2.2011)

LAM Cheung, Alexa

KWOK Hing Wai, Kenneth, BBS, SC (to 31.12.2010)

YIP Chee Hang, Eric (from 1.4.2010 to 31.3.2011)

No of meetings: 1

Average attendance rate: 75%

Investor Education Advisory Committee

Provides ideas and support to the SFC in setting its investor education targets.

In the past year, the Committee held two meetings at which members discussed the investor education focus for fiscal 2010 and key issues investors should take note of when participating in initial public offering and trading of listed renminbi securities.

Chairman

LAM CHEUNG, Alexa

Full Members

CHAN King Cheung

LECKIE Stuart Hamilton, OBE, JP

SIN Tak Wah

CHIU Lai Kuen, Susanna

LEE Kam Wing, Bruno

TAI Chi Kin

CHOW Ka Leung, Louis

LEE Yiu Wing

WONG Wan Ming, Rosa

LAI, Ivy Wan Ying

Dr MAK Sui Choi, Billy

LAM Po Yee (to 28.10.2010)

PAN San Kong, Terry (from 29.10.2010)

Alternate Members

CHEUNG Marn-kay

TAM Sau Ngor, Vera

YIP Chee Hang, Eric (to 31.3.2011)

No of meetings: 2

Average attendance rate: 84.6%

Nominations Committee

Nominates members of the Takeovers and Mergers Panel, the Takeovers Appeal Committee and the Disciplinary Chair Committee.

During the year, the Nominations Committee met once to consider the appointment and reappointment of members of the Takeovers and Mergers Panel and the Takeovers Appeal Committee.

Ex-officio Members

WHEATLEY Martin, JP (Chairman)	CLARK Stephen Edward	HO Yin Tung, Brian
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Members

Dr FONG Ching, Eddy, GBS, JP	KWOK Hing Wai, Kenneth, BBS, SC (to 31.12.2010)
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Alternate members to CLARK Stephen Edward

GRAHAM David	LIU Chee Ming
KO, Teresa Yuk Yin, JP	MAGUIRE John Martin

No of meetings: 1

Average attendance rate: 100%

Products Advisory Committee

The Committee may be consulted by the SFC on a wide range of matters relating to the SFC Handbook for Unit Trusts and Mutual Funds, Investment-Linked Assurance Schemes and Unlisted Structured Investment Products, the SFC Code on MPF Products and the Code on Pooled Retirement Funds, overall market environment, industry practices and novel product features. Members' term of appointment is from the Committee's establishment on 10 August 2010 to 31 March 2012.

During the year, the Committee met once to discuss the prospects and opportunities for the development of renminbi business in Hong Kong.

Chairman

LAM Cheung, Alexa

Members

Dr AU King Lun, MH	HSU Li Ching	MURRAY Alastair Elliot
Prof CHAN Kalok	KWAN Sau Ha	NG Ka Yiu, Desmond
CHAN King Cheung	LAU Ka Shi	NORONHA Virginia
CHOI Fung Yee, Christina	LAW Shing Mui, Alice	NOYES Keith Samuel
CHOW Ka Leung, Louis	LEE Kevin	PICKERELL Blair Chilton
CHU Wing Yiu	Prof LIU Pak Wai, SBS, JP	RICHARDSON David Alexander
FUNG Hau Chung, Andrew	LUK Kin Yu, Peter	SHIU Barbara
FUNG Ka Shing, Bernard	MAHOMED Ferheen	TSANG, Jacob Chung
GOOD Nicholas Michael Whateley	MAK Tat Cheung	WONG Wan Ming, Rosa
HEUNG Shu Fai	MASSEY LI Susan Hong	YANG Ning Kwan, Peggy
HON Wai Ming, Angel	McSHANE Darren Mark	YIP Chi Leung

No of meetings: 1

Average attendance rate: 76%

Public Shareholders Group

Advises on issues relating to shareholders' rights and interests.

During the year, the Group met three times and discussed a number of issues, including the initial listing eligibility, the proposed property valuation requirements for listing applicants and listed issuers, the listing of overseas companies, the use of structure contracts and the new framework for reporting accountants' report.

Chairman

HO Yin Tung, Brian

Members

BROWN Melissa	LUNG Hak Kau (to 31.3.2011)
CHAN Chi Keung, Raymond	KWOK Lam Kwong, Larry, BBS, JP
CHAN Chun Hung, Vincent (to 31.3.2011)	MUH Anthony Yi Tong
KERR William Walter Raleigh (to 31.3.2011)	NGAN Wai Wah
LECKIE Stuart Hamilton, OBE, JP (to 31.3.2011)	PULLING Edward

No of meetings: 3

Average attendance rate: 67%

Securities Compensation Fund Committee

Administers the Unified Exchange Compensation Fund and regulates its procedures in accordance with Part X of the repealed Securities Ordinance which, under section 74 of Schedule 10 to the SFO, continues to apply to and in relation to any claim for compensation from the Fund made before 1 April 2003.

During the year, the Committee met once to consider the financial statements of the Fund and dealt with other administrative matters.

Chairman

LUI Kei Kwong, Keith

Members

CHOW Ka Ming, Anderson, SC (from 15.2.2011)	LAM Cheung, Alexa
GREINER Gerald Dale (to 31.3.2011)	YIP Chee Hang, Eric (to 31.3.2011)
KWOK Hing Wai, Kenneth, BBS, SC (to 31.12.2010)	

No of meetings: 1

Average attendance rate: 80%

SFC Dual Filing Advisory Group

Advises on treatment of cases and policy issues under the dual filing regime.

During the year, there were no circumstances that called for the convening of a meeting of the Group.

Members

BROWN Stephen James (from 1.4.2010)	IP Koon Wing, Ernest
CHAN Yuk Sing, Freeman (from 1.4.2010)	KERR William Walter Raleigh (from 1.4.2010)
CHOW Siu Lui	LEE Ka Sze, Carmelo (from 1.4.2010)
CLARK Stephen John	LEE Raymond
FONG Chi Wai, Alex	NESBITT Gavin Paul
HOWE Christopher John	YEUNG Eirene

No of meetings: 0

Average attendance rate : N/A

SFC (HKEC Listing) Committee

Exercises powers and functions equivalent to those of the Main Board and GEM Listing Committees of The Stock Exchange of Hong Kong Ltd (SEHK) when actual or potential conflicts arise between the interests of Hong Kong Exchanges and Clearing Ltd (HKEx) and those of the proper performance of the SEHK's listing functions. In such cases, the relevant SEHK functions may be exercised by the SFC.

During the year, there were no circumstances that called for the convening of a meeting of the Committee.

Chairman

Members present in each Committee meeting will elect a Chairman among themselves at the beginning of that meeting

Members

BEST, Roger Thomas, JP (to 31.3.2011)	STEWART Mark Robert
KEYES Terence Francois	TISDALL Stephen Clifford (from 1.4.2010)
KO, Teresa Yuk Yin, JP	TSOI Tong Hoo, Tony
LAM Cheung, Alexa	WHEATLEY Martin, JP
LUI Kei Kwong, Keith	WONG Tin Yau, Kelvin, DBA, FHKIoD

No of meetings: 0

Average attendance rate: N/A

SFC (HKEC Listing) Appeals Committee

Exercises powers and functions equivalent to those of the SEHK's Listing Appeals Committee when actual or potential conflicts arise between the interests of HKEx and those of the proper performance of the SEHK's listing functions. In such cases, the relevant powers and functions may be exercised by the SFC.

During the year, there were no circumstances that called for the convening of a meeting of the Committee.

Chairman

Members present in each Committee meeting will elect a Chairman among themselves at the beginning of that meeting

Members

The Hon CHAN Kam-lam, SBS, JP	LEE Lawrence, JP
Prof Leonard K CHENG, JP (from 1.1.2011)	LEE Pui Ling, Angelina, JP
CHOW Ka-ming, Anderson, SC (from 1.1.2011)	Prof LIU Pak Wai, SBS, JP (to 31.12.2010)
Dr FONG Ching, Eddy, GBS, JP	WONG Kai-man, BBS, JP
KWOK Hing Wai Kenneth, BBS, SC (to 31.12.2010)	ZHANG Shengman (to 31.12.2010)

No of meetings: 0

Average attendance rate: N/A

Share Registrars' Disciplinary Committee

Hears and determines disciplinary matters relating to share registrars in the first instance.

During the year, there were no circumstances that called for the convening of a meeting of the Committee.

Chairman

LIU Swee Long, Michael

Deputy Chairman

CHARLTON Julia Frances

Members

CHIONG Chung Seng, Desmond	NG Wai Sum, Sam	TANG Yuen Shun, Cynthia
FONG Loong Choon, Julian	NORRIS Nicholas Andrew	WONG Shiu Hoi, Peter
NESBITT Gavin Paul	RICHARDSON David Alexander	
NG Chi Keung, Victor (to 31.3.2011)	SHAFTESLEY Colin	

No of meetings: 0

Average attendance rate: N/A

Share Registrars' Disciplinary Appeals Committee

Hears and determines appeals from the Share Registrars' Disciplinary Committee. Members of the Share Registrars' Disciplinary Appeals Committee for the hearing of each appeal case brought before it consists of members of the Share Registrars' Disciplinary Committee who did not preside or participate in the disciplinary hearing of that case.

During the year, there were no circumstances that called for the convening of a meeting of the Committee.

Takeovers and Mergers Panel

Hears disciplinary matters in the first instance and reviews rulings by the Executive at the request of any party dissatisfied with such a ruling. Considers novel, important or difficult cases referred to it by the Executive. Reviews, upon request by the SFC, the provisions of the Codes on Takeovers and Mergers and Share Repurchases (Codes) and the Rules of Procedure (Rules) for hearings under the Codes and recommends appropriate amendments to the Codes and Rules to the SFC.

During the year, the Panel met once to consider policy issues under the Takeovers Code and twice to rule on matters relating to the application of the Takeovers Code.

Chairman

CLARK Stephen Edward

Deputy Chairmen

GRAHAM David	LIU Chee Ming
KO, Teresa Yuk Yin, JP	MAGUIRE John Martin

Members

CHAN Yuk Sing, Freeman	LIU Swee Long, Michael	TORTOISHELL Andrew
CHARLTON Julia Frances	LIU Yun Bonn	WEBB David Michael
DENNY Roger Michael	LUNG Hak Kau	WINTER Richard David
DESAI Kalpana	NESBITT Gavin Paul	WONG Oi Ming, Christine (to 10.6.2010)
IP Koon Wing, Ernest	NORRIS Nicholas Andrew	YEH V-Nee
KWOK Tun Ho, Chester	RODGERS Daniel James	YU Ka Po, Benita
LEE Pui Ling, Angelina, JP	SABINE Martin Neville	
LIU Che Ning	TAN Siew Boi, May	

No of policy meetings: 1 **Average attendance rate: 41%**

No. of transaction-related meetings: 2 **Average attendance rate: N/A**

Takeovers Appeal Committee

Reviews disciplinary rulings of the Takeovers and Mergers Panel at the request of an aggrieved party for the sole purpose of determining whether any sanction imposed by the Panel is unfair or excessive.

During the year, there were no circumstances that called for the convening of a meeting of the Committee.

Members

CHAN Yuk Sing, Freeman	LEE Pui Ling, Angelina, JP	RODGERS Daniel James
CHARLTON Julia Frances	LIU Che Ning	SABINE Martin Neville
CLARK Stephen Edward	LIU Chee Ming	TAN Siew Boi, May
DENNY Roger Michael	LIU Swee Long, Michael	TORTOISHELL Andrew
DESAI Kalpana	LIU Yun Bonn	WEBB David Michael
GRAHAM David	LUNG Hak Kau	WINTER Richard David
IP Koon Wing, Ernest	MAGUIRE John Martin	WONG Oi Ming, Christine (to 10.6.2010)
KO, Teresa Yuk Yin, JP	NESBITT Gavin Paul	YEH V-Nee
KWOK Tun Ho, Chester	NORRIS Nicholas Andrew	YU Ka Po, Benita

No of meetings: 0 **Average attendance rate: N/A**

Independent Panels and Tribunal

Arbitration Panel under Securities and Futures (Leveraged Foreign Exchange Trading) (Arbitration) Rules

Resolves disputes in accordance with the Securities and Futures (Leveraged Foreign Exchange Trading) (Arbitration) Rules.

During the year, no new cases were received and there was no outstanding case as at 31 March 2011.

Chairman

CHAN Siu-chung, Justin

Deputy Chairman

TAN Cheng Soo, Eddie

Members

FUNG Hau Chung, Andrew

LAM Yuk Kun, Lawrence

LAU Cheuk Hang, Philip

Process Review Panel for the Securities and Futures Commission

Reviews and advises the SFC upon the adequacy of the SFC's internal procedures and operational guidelines governing the action taken and operational decisions made by the SFC and its staff in the performance of its regulatory functions, including the receipt and handling of complaints, licensing and inspection of intermediaries, and disciplinary action.

Chairman

CHOW Wing Kin, Anthony, SBS, JP

Members

Prof CHAN Yuk Shee, BBS, JP (to 30.10.2010)

CHIU Chi Cheong, Clifton

CHOW Yuen-ye (from 1.11.2010)

Dr FONG Ching, Eddy, GBS, JP

FUNG Hau Chung, Andrew

Prof HO Yan-ki, Richard (from 1.11.2010)

LAI Ying Sie, Benedict, JP

Dr LAM Kit-lan, Cynthia (from 1.11.2010)

LEE Jor Hung, Dannis, BBS

Dr Hon LEUNG Mei-fun, Priscilla

LIU Che Ning

SUN Tak Kei, David, BBS, JP

Securities and Futures Appeals Tribunal

Hears appeals against a range of regulatory decisions made under the SFO by the SFC and determines any question or issue arising out of or in connection with any appeal.

Chairman

The Hon Mr Justice SAUNDERS, Judge of the Court of First Instance of the High Court

Members

CHAN Kam Wing, Clement

CHAN Yuen Fan, Florence

CHEONG Ying Chew, Henry

CHIU Lai Kuen, Susanna

CHUI Yik Chiu, Vincent

Prof HO Shun Man, Simon

Prof HO Yan Ki, Richard

KWAN Pak Chung, Edward

KWOK Lam Kwong, Larry, BBS, JP

KUNG Yiu Fai, Ronald

Dr LAM Kit-lan, Cynthia

LEUNG Kar Cheung, Catherine

MURRAY Alastair Elliot

PANG Yuk Wing, Joseph, JP

SZE Tsai Ping, Michael

TANG Yuen Shun, Cynthia

THORNHILL Richard John

Rev TONG Hin Sum, Paul

TSAI Wing Chung, Philip

TSANG Sui Cheong, Frederick

WONG Yuen Fai, Stanley, JP

WU King Cheong, Henry, BBS, JP

ABBREVIATIONS AND INDEX

Abbreviations

Australian Securities and Investments Commission	ASIC
China Securities Regulatory Commission	CSRC
Closer Economic Partnership Arrangement	CEPA
Committee on Payment and Settlement Systems	CPSS
Corporate social responsibility	CSR
Court of Appeal	CA
Court of Final Appeal	CFA
Credit rating agencies	CRAs
Equity-linked investments	ELIs
Exchange-traded funds	ETFs
Executive Directors, SFC	EDs
Financial Resources Rules	FRR
Financial Services and the Treasury Bureau	FSTB
Financial Services Authority, UK	FSA
Financial Stability Board	FSB
Group of Twenty	G-20
High Court	HC
Hong Kong Exchanges and Clearing Ltd	HKEx
Hong Kong Monetary Authority	HKMA
Hong Kong Special Administrative Region	HKSAR
Initial public offering	IPO
International Organization of Securities Commissions	IOSCO
Investor Education Council	IEC
Investment-linked assurance scheme	ILAS
Key facts statements	KFS
Legislative Council	LegCo
Lehman Brothers	LB
Mandatory Provident Fund	MPF
Memorandum of Understanding	MOU
Non-executive Director, SFC	NED
Process Review Panel	PRP
Real Estate Investment Trusts	REITs
Securities and Exchange Commission, US	SEC
Securities and Futures Appeals Tribunal	SFAT
Securities and Futures Commission	SFC
Securities and Futures Ordinance	SFO
Standing Committee on Standards Implementation	SCSI
The Stock Exchange of Hong Kong Ltd	SEHK

Index

The index does not include references in the financial statements.

A

Advisory Committee, SFC

pp. 21, 24, 30, 31, 130, 131, 132

Asian financial crisis

pp. 13, 14

Audit Committee, SFC

pp. 20, 21, 22, 30, 31, 130

Australian Securities and Investments Commission (ASIC)

pp. 31, 77

C

Chief Executive, HKSAR

p. 20

China Insurance Regulatory Commission

p. 52

China Securities Regulatory Commission (CSRC)

This refers to Mainland China's regulator of the securities and futures markets. An enterprise unit under the State Council mandated to regulate, maintain and promote the securities and futures markets of China.

pp. 7, 52

Closer Economic Partnership Arrangement VII (CEPA VII)

This is China's free trade agreement with Hong Kong, which grants easier access to China markets for Hong Kong-made products and Hong Kong-based service companies. The first of a series of CEPA agreements was signed in June 2003. CEPA covers three broad areas: tariff agreements for the trade of goods, preferential treatment for service suppliers and mutual recognition of professional qualifications, and an agreement to enhance co-operation in various trade and investment facilities to improve the overall business environment.

p. 51

Codes on Takeovers and Mergers and Share Repurchases

pp. 24, 46, 47, 54, 70, 132, 138

Committee on Payment and Settlement Systems (CPSS)

p. 54

Companies Ordinance

p. 69

Corporate social responsibility (CSR)

pp. 32, 33, 34, 35, 37

Court of Appeal (CA)

p. 44

Court of Final Appeal (CFA)

pp. 44, 46

Court of First Instance

pp. 30, 139

Credit-linked notes

p. 13

Credit rating agencies (CRAs)

pp. 7, 13, 17, 41, 55, 130

D

Dark pool

Also known as alternative trading venues, these are facilities that allow dealing outside traditional exchanges without public disclosure of prices.

pp. 4, 13, 19, 42, 55

District Court

p. 44

Dodd-Frank Act

p. 12

Dr Wise

pp. 58, 59, 61

Dual filing

An arrangement that came into effect with the enactment of the SFO, dual filing is a regime under which all corporate disclosure and listing application materials are filed with both The Stock Exchange of Hong Kong Ltd (SEHK) and the SFC. It allows the SFC to exercise enforcement powers against persons issuing false or misleading corporate information.

pp. 8, 23, 46, 55, 66, 136

E

Equity-linked investments (ELIs)

pp. 59, 61

Exchange-traded funds (ETFs)

These are basically index-tracking investment funds traded on stock exchanges, much like stocks.

pp. 13, 41, 51, 52, 59, 60, 61

Executive Committee (ExCo), SFC

pp. 21, 30, 31, 130

Executive Council, HKSAR

p. 31

Executive Director, SFC (ED)

pp. 20, 21, 26, 30, 31, 46

F

Federation of Share Registrars Ltd

p. 52

Securities and Futures (Financial Resources) Rules (FRR)

pp. 53, 71, 73

Financial Secretary, HKSAR

pp. 20, 22, 24, 64, 65

Financial Services and the Treasury Bureau (FSTB)

pp. 24, 61

Financial Services Authority, UK (FSA)

An independent non-governmental body, the FSA is the single statutory body responsible for regulating the United Kingdom's financial services industry, including the authorization and supervision of deposit taking, insurance and investment business.

pp. 30, 77

Financial Stability Board (FSB)

The group was established in April 2009 as an enlarged version of the Financial Stability Forum, itself an advisory group founded in 1999 to promote international financial stability through better information exchange and international co-operation. Membership of the FSB includes all countries in the Group of Twenty as well as Spain and the European Commission. It collaborates with the International Monetary Fund to identify problems in the financial system, provides early warning of macroeconomic and financial risks and oversees action to address them.

pp. 5, 13, 16, 17, 30, 55

Financial Supervisory Commission, Taiwan

An independent authority responsible for regulating Taiwan's banking, securities and insurance sectors.

p. 55

G

Group of Twenty (G-20)

The Group of Twenty (G-20) Finance Ministers and Central Bank Governors was founded in 1999 to bring together systemically important industrialised and developing economies to discuss key issues of the global economy. The G-20 helps support growth and development world-wide by providing opportunities for open and constructive discussion between industrial and emerging countries on key issues related to global economic stability.

pp. 13, 17

H

Hang Seng China Enterprises Index

p. 52

Hang Seng Index

p. 52

High Court (HC)

p. 23, 30, 44, 45, 139

Hong Kong Council of Social Service

p. 37

Hong Kong Exchanges and Clearing Ltd (HKEx)

HKEx owns and operates the only stock exchange and the only futures exchange in Hong Kong. It is the holding company of SEHK, Hong Kong Futures Exchange Ltd and their related clearing houses.

pp. 4, 17, 30, 31, 41, 47, 51, 52, 53, 54, 136, 137

Hong Kong Institute of Certified Public Accountants

p. 30

Hong Kong Monetary Authority (HKMA)

pp. 6, 7, 17, 19, 30, 41, 42, 43, 47, 51

Hong Kong Society of Financial Analysts

p. 60

I

Initial public offering (IPO)

pp. 6, 13, 42, 44, 46, 50, 54, 59, 60, 133

Insider dealing

pp. 6, 15, 44, 45, 46, 74

International Organization of Securities Commissions (IOSCO)

An international co-operative body made up of securities regulators world-wide, IOSCO is recognised as the international standard-setter for securities markets.

pp. 5, 7, 16, 17, 30, 54, 55

InvestEd (www.invested.hk)

This is the SFC portal that provides investors with educational information on investments and regulations.

pp. 5, 58, 59, 60, 61, 67

InvestEd Intelligence

A bimonthly e-newsletter with a diverse range of educational information about investing.

pp. 7, 58, 61

Investment-linked assurance scheme (ILAS)

pp. 19, 27, 40, 68, 131, 134

Investor Compensation Co, Ltd

pp. 5, 30, 31, 47

Investor Compensation Fund

A fund established and managed by the Investor Compensation Co, Ltd to pay compensation to investors of any nationality who suffers pecuniary losses as a result of a default of a licensed intermediary or authorized financial institution in relation to exchange-traded products in Hong Kong.

pp. 5, 30, 31, 67, 133

Investor Education Council (IEC)

pp. 5, 15, 58, 61

J

Judicial review

p.23

K

Key facts statements (KFS)

A product summary that highlights the key features and risks of an SFC-authorized retail investment product in a clear, concise and effective manner.

pp. 40, 41, 58, 59, 61

“Know your client”

p. 42

L

Legislative Council (LegCo)

pp. 18, 22, 30, 46, 47

Lehman Brothers (LB)

pp. 6, 7, 13, 14, 15, 18, 43, 47, 76

Listing Rules

pp. 18, 35, 53

M

Mandatory Provident Fund (MPF)

pp. 27, 68, 134

Mandatory Provident Fund Schemes Authority

pp. 30, 31

Market manipulation

pp. 14, 44, 45, 74

Market Misconduct Tribunal

An independent full-time body established under the SFO, which conducts civil proceedings in public and, where appropriate, imposes civil sanctions against those it determines to be guilty of market misconduct.

p. 4

Memorandum of Understanding (MOU)

This refers to a co-operative arrangement or agreement signed to promote collaboration between organisations.

pp. 52, 55

Minibond

p. 43

Mutual funds

pp. 27, 40, 66, 68, 69, 132, 134

N

Non-executive Director, SFC (NED)

pp. 20, 21, 26, 30, 31

O

Office of The Ombudsman, HKSAR

p. 23

OTC Derivatives Regulators' Forum

p. 54

P

Performance pledges, SFC p. 27

Police, HKSAR pp. 43, 61

Prosecution pp. 44, 46, 74

Process Review Panel (PRP)
An appointed group that reviews and advises on the adequacy of the SFC's internal procedures governing operational decisions and actions made by the SFC and its staff in the performance of its regulatory functions. pp. 20, 23, 30, 139

R

Real Estate Investment Trusts (REITs) pp. 31, 46, 47, 68, 131

Regulated activity pp. 3, 8, 17, 41, 66, 130

Renminbi deposits p. 11

S

Scriptless securities market pp. 7, 18, 52

SFC Handbook pp. 6, 134

Securities and Exchange Commission, US (SEC) p. 77

Securities and Futures Appeals Tribunal (SFAT) pp. 20, 23, 30, 31, 45, 76, 139

Securities and Futures Ordinance (SFO) pp. 2, 5, 27, 45, 46, 47, 61, 63, 69, 133, 135, 139

SFC in Action
The SFC's first-ever six-episode TV drama to explain to the public its regulatory roles and work. pp. 6, 25

SFC Online Portal p. 53

Short selling pp. 14, 17, 30, 73, 75

Standing Committee on Standards Implementation (SCSI) pp. 16, 30, 55

Statutory body
This refers to a body corporate established by an ordinance in Hong Kong. pp. 2, 33, 77

Synthetic exchange-traded funds pp. 13, 41, 59, 60, 61

T

Taiwan Stock Exchange p. 52

Takeovers pp. 3, 4, 8, 24, 30, 31, 46, 47, 54, 55, 66, 70, 132, 134, 138

Takeovers and Mergers Panel, SFC pp. 30, 31, 70, 132, 134, 138

Task Force on Unregulated Financial Markets and Products p. 54

The Stock Exchange of Hong Kong Ltd (SEHK)
A wholly-owned subsidiary of HKEx, it operates and maintains a stock market in Hong Kong. It is also the front-line regulator of Stock Exchange Participants in relation to trading matters and listing activities on the Main Board and Growth Enterprise Market. pp. 3, 4, 18, 30, 31, 35, 41, 42, 46, 50, 53, 54, 136, 137

The Twelfth Five-Year Plan p. 11

U

Unit trusts pp. 27, 31, 40, 66, 68, 69, 132, 134

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