Unified Exchange Compensation Fund (the Fund)

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 2012.

Establishment of 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Part X of the repealed Securities Ordinance (Chapter 333) established the Fund.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Part X of the repealed Securities Ordinance remains effective in respect of the operation of the Fund to the extent described in Section 74 of Schedule 10 of the SFO.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 2012 and the state of the Fund's affairs as at that date are set out in the financial statements on pages 106 to 115.

Members of the Committee

The members of the Committee during the year ended 31 March 2012 and up to the date of this report were:

Mr Keith Lui (Chairman)
Mrs Alexa Lam
Mr Chow Ka Ming, Anderson, SC
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

22 May 2012

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the financial statements of the Unified Exchange Compensation Fund (the Fund) established under Section 99 of the repealed Hong Kong Securities Ordinance set out on pages 106 to 115, which comprise the statement of financial position as at 31 March 2012 and the statement of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 2012 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

22 May 2012

Statement of comprehensive income

For the year ended 31 March 2012 (Expressed in Hong Kong dollars)

	Note	**2012 $'000**	2011 $'000
Income			
Interest income		420	173
Recoveries	5	(1)	1,666
		419	1,839
Expenses			
Auditor's remuneration		43	40
Professional fees		14	13
Sundry expenses		1	1
		58	54
Surplus and total comprehensive income for the year		**361**	1,785

The notes on pages 110 to 115 form part of these financial statements.

Statement of financial position

At 31 March 2012 (Expressed in Hong Kong dollars)

	Note	**2012 $'000**	2011 $'000
Current assets			
Equity securities received under subrogation		1	1
Interest receivable		103	20
Fixed and call deposits with banks		72,647	71,565
Cash at bank		273	274
		73,024	71,860
Current liabilities			
Creditors and accrued charges	6	10,297	10,294
		10,297	10,294
Net current assets		62,727	61,566
Net assets		**62,727**	61,566
Representing :			
Compensation fund			
Contributions from SEHK	7	49,500	48,700
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		17,656	17,295
		1,057,445	1,056,284
Contributions to Investor Compensation Fund	11	(994,718)	(994,718)
		62,727	61,566

Approved and authorized for issue by the Securities Compensation Fund Committee on behalf of the Securities and Futures Commission on 22 May 2012 and signed on its behalf by

Keith Lui
Chairman

Tai Chi Kin
Committee Member

The notes on pages 110 to 115 form part of these financial statements.

Statement of changes in equity

For the year ended 31 March 2012 (Expressed in Hong Kong dollars)

	2012 $'000	2011 $'000
Compensation Fund balance as at 1 April	61,566	58,681
Net contribution from SEHK	800	1,100
Total comprehensive income for the year	361	1,785
Compensation Fund balance as at 31 March	**62,727**	61,566

The notes on pages 110 to 115 form part of these financial statements.

Statement of cash flows

For the year ended 31 March 2012 (Expressed in Hong Kong dollars)

	2012 $'000	2011 $'000
Cash flows from operating activities		
Surplus for the year	361	1,785
Interest income	(420)	(173)
Decrease in equity securities received under subrogation	–	1
Increase/(decrease) in creditors and accrued charges	3	(11)
Net cash (used in)/generated from operating activities	(56)	1,602
Cash flows from investing activities		
Interest received	337	157
Net cash generated from investing activities	337	157
Cash flows from financing activities		
Contributions from SEHK	800	1,100
Net cash generated from financing activities	800	1,100
Net increase in cash and cash equivalents	1,081	2,859
Cash and cash equivalents at beginning of the year	71,839	68,980
Cash and cash equivalents at end of the year	**72,920**	71,839

Analysis of the balance of cash and cash equivalents:

	2012 $'000	2011 $'000
Fixed and call deposits with banks	72,647	71,565
Cash at bank	273	274
	72,920	71,839

Notes to the financial statements

For the year ended 31 March 2012 (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 Limited (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 the 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 the SEHK (2011: 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.

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. Note 3(i) provides information on any changes in accounting policies resulting from initial application of these developments to the extent that they are relevant to the Fund for the current and prior accounting periods reflected in these financial statements.

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 2012

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.

(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:

(a) A person, or a close member of that person's family, is related to the Fund if that person:

- (i) has control or joint control over the Fund;
- (ii) has significant influence over the Fund; or
- (iii) is a member of the key management personnel of the Fund or the Fund's parent.

(b) An entity is related to the Fund if any of the following conditions applies:

- (i) The entity and the Fund are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).
- (ii) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).
- (iii) Both entities are joint ventures of the same third party.
- (iv) One entity is a joint venture of a third entity and the other entity is an associate of the third entity.
- (v) The entity is a post-employment benefit plan for the benefit of employees of either the group or an entity related to the group.
- (vi) The entity is controlled or jointly controlled by a person identified in (a).

3. Significant accounting policies (cont'd)

(h) Related parties (cont'd)

(vii) A person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).

Close members of the family of a person are those family members who may be expected to influence, or be influenced by, that person in their dealings with the entity.

(i) Changes in accounting policies

The IASB has issued a number of amendments to IFRSs and one new Interpretation that are first effective for the current accounting period of the Fund. Of these, the following developments are relevant to the Fund's financial statements:

- IFRS 24 (revised 2009), *Related party disclosures*
- Improvements to IFRSs (2010)

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

4. Taxation

Section 87 of the Hong Kong Inland Revenue Ordinance exempts the Fund from Hong Kong Profits Tax.

5. Recoveries

In relation to the share distribution from C.A. Pacific Securities Ltd. and C.A. Pacific Finance Ltd., the liquidators had advised SFC that shares were allocated to the Fund under its subrogation rights, subject to paying a processing fee to the liquidators. The Fund recognised as recoveries the sale proceeds of shares allocated and the remaining shares at market value as of 31 March 2012 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 are classified as financial liabilities measured at amortised cost in accordance with the determination in IAS 39 unless the effect of discounting would be immaterial, in which case they are stated at cost. They are due on demand or within one year and are unsecured.

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 $1,300,000 in respect of 26 new trading rights were received from SEHK.

During the year, the SFC had refunded to SEHK of $500,000 in respect of the deposit of 10 relinquished trading rights. As at 31 March 2012, there are 6 trading rights in total that have been relinquished but not yet refunded.

Notes to the financial statements (cont'd)

For the year ended 31 March 2012

7. Set-off of SEHK deposits and refunds/contributions from SEHK (cont'd)

The movement of contributions from SEHK during the year was as follows:

	2012 $'000	2011 $'000
Balance brought forward	48,700	47,600
Add: 26 new trading rights issued (2011: 34)	1,300	1,700
Less: 10 relinquished trading rights refunded (2011: 12)	(500)	(600)
Balance carried forward	**49,500**	48,700

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.

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 up to 31 March 2012 amounted to $994,718,000 (2011: $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.

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 2012, 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 $726,000 (2011: $716,000). Other components of accumulated surplus would not be affected (2011: 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.

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 2012, 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:

	2012 $'000	2011 $'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 2012

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 2012 and which have not been adopted in these financial statements.

	Effective for accounting periods beginning on or after
Amendments to IAS 1, *Presentation of financial statements – Presentation of items of other comprehensive income*	1 July 2012
IFRS 9, *Financial Instruments*	1 January 2015

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.