



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

SFC

證監會

Regulatory Partnership

Annual Report 2001 – 2002

# Who We Are and What We Do

The Securities and Futures Commission (SFC) is an independent statutory body established by the Securities and Futures Commission Ordinance. We are responsible for administering the laws governing the securities and futures markets in Hong Kong and facilitating and encouraging the development of these markets.

Our statutory regulatory objectives as set out in the new Securities and Futures Ordinance 2002 are\*:

- **to maintain and promote the fairness, efficiency, competitiveness, transparency and orderliness of the securities and futures industry;**
- **to promote understanding by the public of the operation and functioning of the securities and futures industry;**
- **to provide protection for members of the public investing in or holding financial products;**
- **to minimize crime and misconduct in the securities and futures industry;**
- **to reduce systemic risks in the securities and futures industry; and**
- **to assist the Financial Secretary in maintaining the financial stability of Hong Kong by taking appropriate steps in relation to the securities and futures industry.**

In carrying out our mission, we aim to ensure Hong Kong's continued success and development as an international financial centre.

The SFC is divided into four operational divisions: Corporate Finance, Intermediaries and Investment Products, Enforcement, and Supervision of Markets. Each division has distinct responsibilities.

\* The Securities and Futures Commission Ordinance and nine other securities and futures related ordinances were consolidated into a new Securities and Futures Ordinance, which was passed by LegCo on 13 March 2002 and is expected to come into operation by the end of 2002.

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

### Regulatory Partnership

The cover photo shows the arms of four individuals in a balanced support configuration that symbolises the partnership between four key market participants: the issuer, intermediary, investor and the regulator.

Markets develop because investors trust their efficiency, fairness, transparency and freedom from misconduct. Too much regulation impedes market development and drives business away. Too little leaves investors at risk. The Commission must find the right balance through focusing on areas of regulatory risk, and judiciously using its limited resources to advance market integrity, promote market development, as well as providing appropriate investor protection. This search for balance is a partnership with the market community.

To help Hong Kong become the preferred centre for securities and futures business in the Asia Pacific time zone, the Commission must pick the right regulatory tools and use them without fear or favour.

Under-enforcement does as much harm as over-regulation. Regulation is more a craft than exact science. The photographs of hands in different activities within this Annual Report serve to convey the message that we will continue to discharge our responsibilities firmly, diligently, and with the assistance of the market, the right judgement and balance.



# Chairman's Statement



Andrew L T Sheng, SBS, JP  
Chairman

**“The new Securities and Futures Ordinance ushers in an era in which the Commission must set high standards of accountability and transparency.”**

#### **This Chairman's Statement is about:**

- **The market in 2001-2002;**
- **The Commission's finances;**
- **The need for a regulatory partnership;**
- **Work progress in the past year;**
- **Future work plan; and**
- **A note of thanks**

#### **Introduction**

In the aftermath of Enron, US Securities & Exchange Commission Chairman, Harvey Pitt, testified to Congress that “companies must be subject to an affirmative obligation to provide reliable information that is informative, relevant, comprehensible and timely”. The theme of last year's Annual Report was corporate governance. This year, our Annual Report seeks to put the Commission's objectives and work into perspective.

## “Pick important problems, fix them and tell everyone: this essentially means we have to adopt a risk-based approach to regulation.”

The Report aims to be informative, relevant, comprehensible and timely as to the objectives of the Commission, its achievements and performance.

### The Market

Like most markets in the world, Hong Kong was hit by the decline in markets following the technology boom of 2000. The Hang Seng Index (HSI) lost momentum from its peak level of 16,164 in February 2001, following the slide in telecom and technology shares and the prospect of a protracted global economic slowdown. The 9.11 event pushed the HSI down to a year-low of 8,934 in September.

By the end of March 2002, the HSI and the Growth Enterprise Market (GEM) index closed at 11,033 and 204 respectively, falling by 13.5% and 20.4% during the year. There were 901 companies listed on the stock exchange with a total market capitalisation of HK\$3,924 billion (US\$503 billion), confirming Hong Kong's position as the 10th largest market in the world.

Average daily turnover in the Hong Kong market declined by 25% to \$7.7 billion in 2001-2002, compared with \$10.3 billion in the previous year. The level of futures and

options trading was buoyed by a strong hedging demand in a volatile market, with the total number of contracts traded amounting to 10.1 million, about the same as last year.

### Austerity in Adversity

Such a sharp decline in daily turnover and market activity had its corresponding impact on the Commission's income, since the principal revenue is from a levy of 0.005% on total stock exchange turnover as well as licensing and corporate finance fees. By the end of the half-year to September 2001, the Commission's income was down 15% compared with budget, incurring a deficit of \$18 million. Based upon projected trend at that time, the deficit for the financial year would have been at least \$88 million, without drastic curbs on expenditure.

Accordingly, beginning last November, the Commission introduced a salary and hiring freeze, as well as severe expenditure cuts. A year-end performance linked remuneration payment, awarded to staff previously when market conditions were favourable, was not made. Despite the full year effect of an increase in staff during the previous year, we managed to reduce total staff costs by 4.4% this financial year.

The strict cost control measures proved to be effective. We managed to cap our whole year deficit to \$54.2 million, 38.3% below the forecast deficit at mid-year and only 2.5% above the approved budget deficit of \$52.9 million, which was estimated on the basis of an average daily turnover of \$11 billion. In fact, total revenue in this financial year was down 27% from the previous year. The reserves stood at a healthy level of \$624 million at the end of March 2002. (See further details in the *Corporate Affairs* chapter and the *Financial Statements*.)

### Budget for 2002-2003

The forecast for the financial year ending March 2003 is fraught with uncertainty. We have prudently assumed that daily turnover will be \$7 billion, 9.1% below the average level achieved in 2001-2002. There are limits to which we can curb total expenditure, since 73% are staff costs, and our regulatory work will not necessarily decline in a year of low market activity. On the contrary, our work may increase significantly. Reflecting this, budgeted expenditure will rise by 7.9% compared with 2001-2002.

Our Budget for 2002-2003 was submitted to the LegCo in March. We are now targeting a further 5% cut from the expenditure in the Budget. Barring no major increase in market turnover, our approved budget deficit for 2002-2003 is estimated at \$117.6 million. Taking into consideration a 5% expenditure cut, the deficit would be \$96.5 million. Other things being equal, an increase in market turnover of \$1 billion per day would reduce the estimated deficit by \$24.8 million.

In spite of this, for the 10th consecutive year the Commission has not asked for Government funding. We will be drawing down on our financial reserves, which at the end of March 2003 will be around \$500 million, roughly 14 months of estimated expenditure.

**“Regulators must work in partnership with the majority of the market participants, who play by the rules, and sanction those who flout the rules.”**

Indeed, we have decided to pass on our success in becoming more efficient by proposing a reduction in licensing fees and also warrant issue fees. The licensing fees will be reduced by as much as 8%, despite the fact that they have remained unchanged since 1993, whilst the consumer price index has risen by 28% during the interim.

### Regulatory Partnership

Securities markets go through major cycles of boom and recession. Securities regulators must respond rapidly to challenges arising from the market cycles brought about by the combination of technology, globalisation, innovation and competition. Some changes are structural, others cyclical.

Regulatory oversight under these volatile conditions requires the regulators to work with markets, listening closely to market concerns, focusing on areas which carry the largest risks, and ensuring that regulatory costs are not so significant as to impede innovation and development. In short, regulators must work in partnership with the majority of the market participants, who play by the rules, and sanction those who flout the rules. Regulators must also work with the market to clearly define the rules of the game.

Harvard Professor Malcolm Sparrow in his landmark book on regulatory craft<sup>1</sup> had this maxim: “Pick Important Problems, Fix Them and Tell Everyone.” This essentially means we have to adopt a risk-based approach to regulation and select the right regulatory tools. It also means that we must review carefully all our policy objectives and processes to ensure that the processes meet the objectives, which in turn lead to the right policy outcomes.

<sup>1</sup> Sparrow, Malcolm K. (2000), *The Regulatory Craft*, The Brookings Institution Press.

During the last few years, the Commission has been working hard to practise this approach. We have identified the critical areas that impede Hong Kong's development as a leading international financial centre of a standard that is comparable to London and New York. Much has been achieved, but much remains to be done.

In the legislative area, the Legislative Council approved on 13 March 2002 the long-awaited Securities and Futures Ordinance. The Ordinance consolidates and modernises 10 pieces of securities and futures legislation written over the past 25 years. It will introduce a more cost-efficient licensing system for intermediaries, increase market transparency, maintain a level playing field, and facilitate product innovation. I would like to think that in terms of securities law standards, the Ordinance modernises our securities legislation on par with leading markets that have also made recent legislative reforms, such as the United Kingdom or Australia. (Also see pages 54 to 57)

During the legislative process, we have forged a strong partnership with the securities community, the Financial Services Bureau, the Department of Justice, and the Hong Kong Monetary Authority. We were able to reach a consensus on a range of policies and rules that would not only meet international standards, but also fit in with local conditions and legal tradition.

### **Work Progress in 2001-2002**

In the market development area, two major studies were undertaken in 2001-2002. Firstly, jointly with HKEx, the Commission hired McKinsey & Co to undertake a strategic study of Hong Kong's securities markets and its future development. This has helped to promote better understanding of the relative roles and functions of HKEx and the Commission in market development work.

Secondly, the Commission hired consultants Accenture to complete a second in-depth review of the architecture of the physical financial infrastructure under the aegis of the Steering Committee on the Enhancement of Financial

Infrastructure (SCEFI II). The blueprint on implementing scripless trading and a robust and efficient financial infrastructure to world-class standards is expected to be completed by the end of the next quarter.

In the area of market consultation on rules, the Commission has worked with the community on a whole range of market reforms. A total of 25 market consultations were made on areas including hedge funds, new compensation fund, financial regulatory rules etc. During the year, the Commission published 16 codes and guidelines to facilitate new product developments or remove market impediments or obsolete regulations, compared with 13 in the previous year. (See page 111 for a full list)

In the area of corporate finance, sustained efforts with HKEx have been made to improve listing and disclosure standards. The derivative warrant market was successfully re-launched during the year. We have developed new procedures to enable retail debt and other products to be launched more efficiently. To facilitate public securities offerings, we have proposed new rules which will allow price stabilization in line with international standards. Amendments were made during the year to the Takeovers and Share Repurchases Codes to strengthen investor protection, while a conduct code that aims to uphold standards amongst institutions advising corporates in the listed sector was introduced. (Also see pages 22 to 27)

The enforcement area witnessed a year of record successful prosecutions. More severe penalties were meted out to insider dealers and persons manipulating stocks on the market. The first immediate custodial sentence for market manipulation was imposed on two persons in a clear warning to those who might be tempted to break the law. We have recently strengthened the enforcement team by re-grouping our disciplinary staff to achieve more effective deterrence and detection of misconduct or abuses in the market. As we de-regulate, we must ensure effective enforcement. (Also see pages 40 to 47)

Since we took over direct supervision of securities and futures intermediaries from the exchanges on 6 March 2000, considerable efforts have been made to improve the level of regulatory supervision and guidance. Using better monitoring tools, we have implemented a risk-based approach towards regulation, focusing on intermediaries that exhibit the highest risks. Given the deterioration in trading turnover, greater precautionary measures have to be taken by both the regulator and investors. Two small brokers failed during the year amid allegations of fraud or misconduct. We have also strengthened communication with the industry to ensure that its concerns can be addressed at an early stage. (Also see pages 33 to 36)

The new Securities and Futures Ordinance ushers in an era in which the Commission must set high standards of accountability and transparency. The chapter on *Corporate Governance* this year provides more detailed information than ever before.

### Focus in 2002-2003

In the coming year, we must consolidate the gains achieved through the successful implementation of the 1999 market reform proposals: the demutualisation of the stock exchange in 2000; the implementation of the enhanced financial infrastructure; and the enactment of the new securities law.

What our strategic studies and stakeholder survey tell us is that there is much work ahead to de-regulate to allow greater innovation in product range and reduce the regulatory burden where possible. We must seek to increase the liquidity of the market and modernise the regulatory framework to ensure that it is user-friendly. At the same time, given limited resources, we must ensure regulatory credibility by enforcing the law clearly, firmly and equitably.

**“We must seek to increase the liquidity of the market and modernise the regulatory framework to ensure that it is user-friendly.”**

Structure follows strategy. The Commission is re-setting its internal priorities to facilitate market and product development, monitor and strengthen the institutional structure, and strengthen the Commission internally to meet future challenges.

- Hong Kong will become one of the first jurisdictions in the world to allow public sale of hedge funds. We have a plan to move quickly to scripless trading securely, with efficient and robust delivery versus payment infrastructure. We will continue to enhance ties with the Mainland so that Hong Kong can benefit from the opportunities arising from the development of the Mainland market. The whole range of work processes to facilitate public offering of securities will be reviewed.
- The new Ordinance is vital to strengthening the market institutional structure. As the industry begins to consolidate in light of the low market turnover, we will help intermediaries manage their risks. We will work with the financial sector, including the broking and banking community, to reduce risks in the system. We will also work with the market to raise corporate governance of listed companies in Hong Kong to higher standards.
- We will enhance investor education to help new and existing investors to understand better the rapid changes in the marketplace.
- By re-organising priorities and changing our work processes, we seek to improve our regulatory efficiency and reduce regulatory burden on the market.

Shortly, the Commission will be issuing a three-year strategic plan with more details of our initiatives. The plan will outline our efforts to enhance efficiency and effectiveness of our work, and improve interaction with

stakeholders. Internally we aim to enable the sharing of institutional information and knowledge, the automation and integration of work processes and the upgrade of service quality. (Also see pages 60 to 61)

### The Team

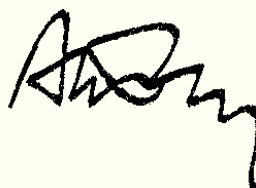
We could not have achieved the solid progress last year without the major contributions made by the staff. Last year witnessed a major turnover at the Executive Director and Director levels. Paul Bailey, a founding staff of the Commission, has retired; Andrew Procter is now enforcement director at the Financial Services Authority in the UK; and David Stannard has returned to legal practice as planned. We were extremely fortunate to obtain the services of Ashley Alder and Alan Linning, both highly respected legal practitioners from the private sector. Alexa Lam, who as Chief Counsel helped to steer the Securities and Futures Bill through its various stages, assumed duties as Executive Director, Intermediaries and Investment Products. The section on the *Directors of the Commission* outlines their responsibilities and background.

Two long serving Senior Directors, Alex Pang and Barbara Shiu, followed the exemplary footsteps of former Deputy

Chairman Laura Cha to take up positions at the China Securities Regulatory Commission. We take pride in their selfless contribution to service in the Mainland.

We must put on record the tremendous contributions of the present and past staff of the Commission, who professionally and diligently served the market in the face of rising expectations on the public sector. I must also thank the unstinting support and advice of the Non-Executive Directors, members of the Advisory Committee and all the various Committees and Panels of the Commission, who helped improve our policies and direction through these challenging times.

Without public understanding and support no financial regulator can exercise its powers with success. We hope this year's Annual Report will help you understand our work better.



**Andrew L T Sheng**  
Chairman

# Whom and How We Regulate

## Whom we regulate

- Securities dealers, futures dealers, securities margin financiers, securities investment advisers, futures advisers, corporate finance advisers, automated trading service providers, leveraged foreign exchange traders, asset managers and their representatives

## How we do it

- Set licensing standards to ensure that all practitioners are fit and proper
- Approve licences and maintain licensees' names on a public register
- Issue codes and guidelines to inform the industry of its expected standard of conduct
- Ensure compliance with ordinances, codes, guidelines, rules and regulations
- Set standards for the authorization and operation of investment products
- Authorize investment products and their promotion
- Handle complaints of misconduct of licensed persons
- Investigate and take action against misconduct

- Hong Kong Exchanges and Clearing Limited (HKEx)

- Oversee the performance of its role as the frontline regulator of listing-related matters
- Approve the creation of new markets, new products and changes to its rules and regulations
- Monitor HKEx's compliance with Listing Rules
- Monitor the trading of shares, options and futures on its markets
- Oversee its systems and technology

- Listed companies

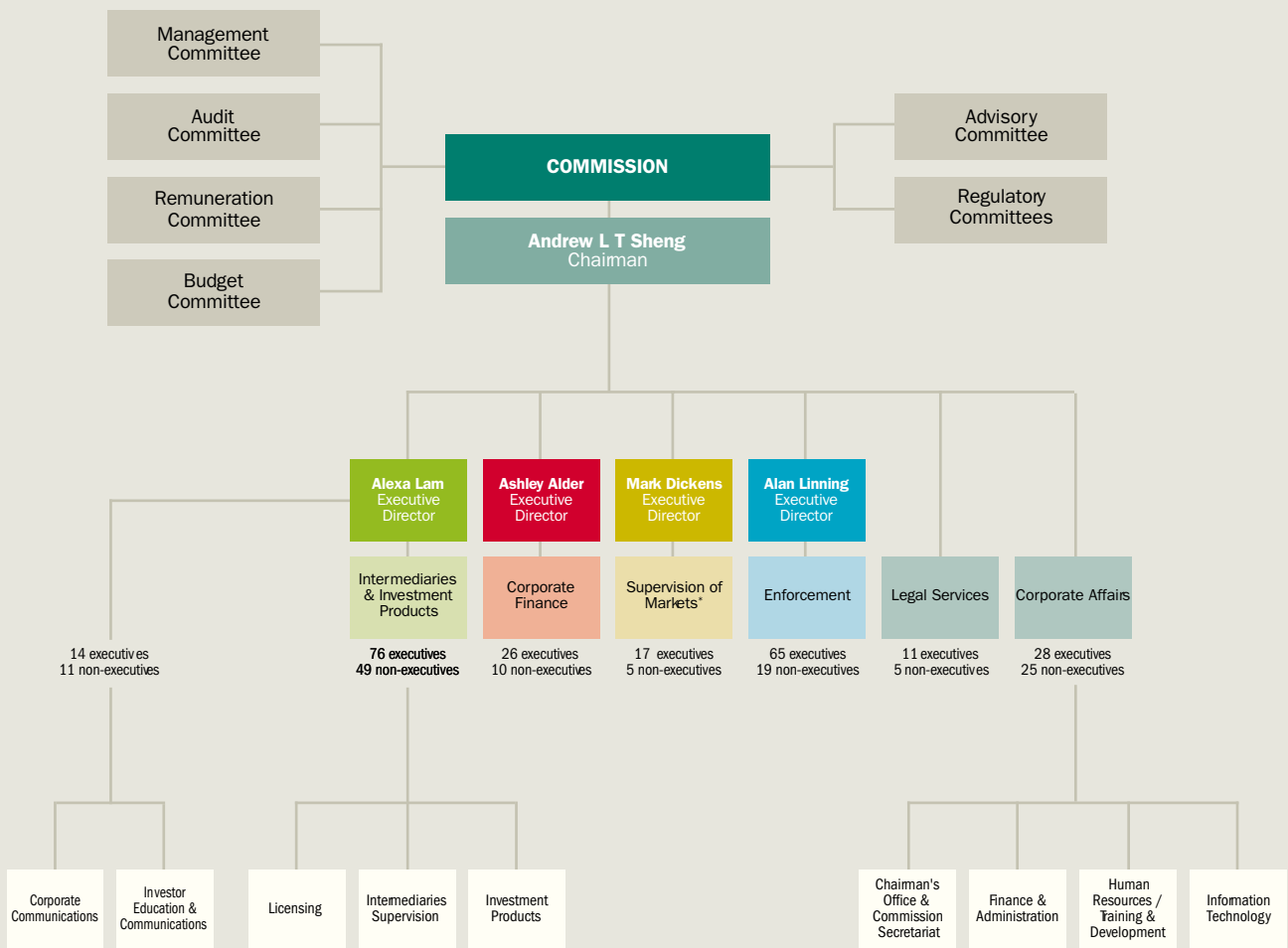
- Approve changes of Listing Rules in relevant markets
- Administer the Takeovers Code
- Monitor share dealings of directors and substantial shareholders
- Monitor share buy-backs by listed companies
- Inspect listed companies suspected of prejudicial or fraudulent transactions

- All participants in trading activities

- Monitor unusual market movements and direct trade suspension of related stocks to maintain an informed and orderly market
- Investigate and take action against insider dealing, market manipulation, and other breaches of the law

# How We Are Organised

To fulfil its functions, the SFC is divided into four operational divisions: Corporate Finance, Intermediaries and Investment Products, Enforcement, and Supervision of Markets. The operational divisions are supported by the Legal Services Division and Corporate Affairs.



\* Including Research Department

# Directors of the Commission

The Commission is a statutory body which consists of an equal number of Directors, half of whom are Executive Directors, including a Chairman, and half comprise independent Non-Executive Directors. The Directors of the Commission are appointed by the HKSAR Chief Executive. The Commission presently has 11 Directors, of whom five are Executive Directors and six are Non-Executive Directors. One Executive

## Executive Directors



Andrew L T Sheng

### Andrew L T Sheng, SBS, JP

*Chairman (from 1 October 1998)*

Chartered Accountant; Deputy Chief Executive, Hong Kong Monetary Authority (1993–1998); Central Bank of Malaysia (1976–1993 including a secondment to the World Bank, Washington, D.C. between 1989 and 1993).

\* Appointment expires on 30 September 2003.

### Mark Dickens

*Executive Director, Supervision of Markets Division*

*(from 1 April 1999)*

SFC: Executive Director of Enforcement (1997–1999), Senior Director of Corporate Finance (1992–1996), Assistant Director of Corporate Finance (1991–1992); Australian National Companies and Securities Commission, including General Counsel and Senior Director, Market Supervision (1980–1991).

\* Appointment expires on 31 March 2005.



Mark Dickens



Alexa Lam

### Alexa Lam

*Executive Director, Intermediaries and*

*Investment Products Division (from 1 December 2001)*

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, University of Hong Kong (1997–1998); Private law practice in Hong Kong, New York and Chicago (1981–1997).

\* Appointment expires on 28 February 2003.



Ashley Alder



Alan Linning

### Ashley Alder

*Executive Director, Corporate Finance Division (from 1 October 2001)*

Partner, Herbert Smith (1984–2001: Partner (1994–2001)); Solicitor admitted to practice in England and Wales in 1986 and Hong Kong in 1990.

\* Appointment expires on 30 September 2004.

### Alan Linning

*Executive Director, Enforcement Division (from 1 November 2001)*

International Partner, Dispute Resolution Practice Group, Baker and McKenzie, Hong Kong (1993–2001); Solicitor admitted to practice in Scotland in 1985 and Hong Kong in 1988.

\* Appointment expires on 31 October 2004.



Andrew Procter



Paul Bailey

### Andrew Procter

*Executive Director, Intermediaries and*

*Investment Products Division*

SFC (1996–2001: Executive Director (from 1 January 1998 to 30 November 2001)).

### Paul Bailey

*Executive Director, Enforcement Division*

SFC (1989–2001: Executive Director (from 1 April 1999 to 31 October 2001)).

### David Stannard

*Executive Director, Corporate Finance Division*

*(from 1 January 1999 to 30 September 2001).*



David Stannard

Director post is currently vacant. When the new Securities and Futures Ordinance has come into force, there must be no fewer than eight members of the Commission, and the majority must be Non-Executive Directors. The Commission has a number of statutory functions and also formulates overall policy and strategy. Last year the Commission met on 13 occasions.

## Non-Executive Directors



Henry H L Fan



Raymond P L Kwok



Daniel R Fung



Anna H Y Wu



T Brian Stevenson



The Hon Jasper Tsang Yok Sing



The Hon Bernard Chan

### Henry H L Fan, SBS, JP (from 15 November 1995)

Managing Director, CITIC Pacific Limited; Deputy Chairman, Cathay Pacific Airways Limited; Deputy Chairman, Takeovers and Mergers Panel; Member, Economic Advisory Committee; Member, Services Promotion Strategy Group; Member, Standing Committee on Company Law Reform; Member, Selection Committee on the Admission of Talents Scheme and Treasurer, University of Hong Kong.

\* Appointment expires on 14 November 2003.

### Raymond P L Kwok (from 1 August 1998)

Vice Chairman and Managing Director, Sun Hung Kai Properties Limited; Chairman and Chief Executive Officer of Sunevision Holdings Limited; Chairman, SmarTone Telecommunications Holdings Limited; Director, Kowloon Motor Bus Holdings Limited; Director, Route (3) Company Limited and Airport Freight Forwarding Centre Company Limited; Vice President of the Council of the Chinese University of Hong Kong; Member, President's Council on International Activities in Yale University; Member, the Asia Advisory Board of Harvard Business School.

\* Appointment expires on 31 July 2002.

### Daniel R Fung, SC (from 1 January 1999)

Queen's Counsel (1990); Senior Counsel (1997); Former Solicitor General (1994–1998); Member, Central Policy Unit (1993–1994); Member, Basic Law Consultative Committee (1985–1990); Board Member, Airport Authority (1999); President, China Law Council; Vice President of Academy of Experts; Member of the World Bank International Advisory Council on Law and Justice; International Consultant to the UNDP on Corporate Governance in the PRC; Director of Salzburg Seminar.

\* Appointment expires on 31 December 2002.

### T Brian Stevenson, SBS (from 1 January 1999)

Chartered Accountant; Steward, Hong Kong Jockey Club; Non-Executive Director, the Hong Kong and Shanghai Banking Corporation Limited; Non-Executive Director, Ocean Park Corporation; Member, Services Promotion Strategy Group.

\* Appointment expires on 31 December 2002.

### Anna H Y Wu, SBS, JP (from 1 January 1999)

Chairperson, Equal Opportunities Commission; Chairman, Operations Review Committee of Independent Commission Against Corruption; Non-Executive Director, Mandatory Provident Fund Schemes Authority; Chairperson, University of Hong Kong Academic Board for the Postgraduate Certificate in Laws (PCLL); Council Member, Lingnan University; Member, Legislative Council (1993–1995); Chairman, Consumer Council (1997–1999).

\* Appointment expires on 31 December 2002.

### The Hon Jasper Tsang Yok Sing, JP (from 15 November 2001)

Member, Legislative Council; Supervisor, Pui Kiu Middle School; Council Member, Open University of Hong Kong; Member, Chinese People's Political Consultative Conference.

\* Appointment expires on 14 November 2003.

### The Hon Bernard Chan, JP

Non-Executive Director (from 1 January 2001 to 27 September 2001)

# Corporate Governance and the SFC

The SFC believes in practising what we preach. We continuously seek to enhance our corporate governance, accountability and transparency through review of our internal procedures, sometimes with the help of independent bodies and professionals.

## In this chapter, we will discuss:

- The accountability of the Commission
- Independent and external reviews
- Internal oversight committees
- Public redress mechanism
- Efforts to further improve transparency
- Our performance pledges

## The Commission

The Commission presently has 11 Directors, of whom five are full-time Executive Directors and six are independent Non-Executive Directors. One Executive Director post is currently vacant. After the new Securities and Futures Ordinance has come into force, the majority of the Directors of the Commission must be Non-Executive Directors. The Commission has a number of statutory functions and also formulates overall policy and strategy. Last year the Commission met on 13 occasions.



<b>Average attendance:</b>	<b>76%</b>
<b>Executive Directors' average attendance:</b>	<b>83%</b>
<b>Non-Executive Directors' average attendance:</b>	<b>70%</b>

The Commission reports regularly to the Financial Secretary. It also reports regularly to the Legislative Council (LegCo) Panel on Financial Affairs on legislative and policy issues. Our annual report is submitted to the Financial Secretary and laid before LegCo as required by the Securities and Futures Commission Ordinance.

As a public body, the Commission is mindful of its duty to manage our fiscal affairs prudently. The Commission submits its annual estimates of income and expenditure to the Chief Executive of the Hong Kong Special Administrative Region (HKSAR), who has delegated the authority for approval to the Financial Secretary. The Commission must seek prior approval of the Financial Secretary for expenditure which exceeds the approved budget by more than 10%.

## Independent and External Reviews

The Commission is regularly monitored and reviewed by external independent bodies. These safeguards ensure that the Commission acts in a fair and equitable manner and follows due process.

### An Independent Review Panel

The SFC has completed its first ever independent process review. In November 2000, the Chief Executive of the HKSAR appointed an independent **Process Review Panel** (PRP) to review and monitor the processes of the Commission, the first such known review panel for securities regulators globally. The PRP determines if the Commission is fair and even-handed in handling investigations and complaints as well as making decisions.

The PRP comprises 12 members, including industry experts, academia, legal and accountancy professionals, the Department of Justice, the Commission's Chairman and a Non-Executive Director.

The Panel reviewed the Commission's internal operating procedures, followed by a careful scrutiny of randomly selected cases handled by the operational divisions in the areas of inspection of intermediaries; investigation,

discipline and enforcement action; licensing procedures; and handling of corporate finance matters, including those relating to takeovers and listing.

Since its establishment on 1 November 2000, the PRP has held eight meetings, in addition to the regular meetings held by the Panel's two Working Groups. The PRP made a wide range of invaluable suggestions for improving the Commission's operational processes, many of which have been adopted. In particular, we have streamlined and standardised a number of registration and inspection procedures, facilitating business processes and regulatory compliance. The PRP's first report has been submitted to the Financial Secretary.

#### Securities and Futures Appeals Panel

The independent **Securities and Futures Appeals Panel** hears appeals against decisions made by the SFC relating to the registration, regulation and discipline of intermediaries. Appointed by the HKSAR Chief Executive, the Panel is currently a part-time merits review panel headed by a barrister with industry experts as members. Three appeals were lodged this year, of which two have been withdrawn on settlement and one is in progress. Four appeals lodged in previous years were concluded: two were dismissed and two were concluded with reduced sanction.

The new Securities and Futures Ordinance will provide effective redress through the establishment of a full-time statutory **Securities and Futures Appeals Tribunal** headed by a full-time judge. The Securities and Futures Appeals Tribunal will supersede the Securities and Futures Appeals Panel but with greater power to over-rule or support the SFC's decision.

#### ICAC Reviews

The operational divisions are audited by independent bodies annually. During the year, the **Independent Commission Against Corruption** (ICAC) performed five reviews on the areas of complaints handling, intermediaries registration, intermediaries supervision,

investment products authorization and outsourcing of information technologies services. These reviews concluded that the SFC had well documented and incorporated control procedures. The ICAC reported the results of the reviews to the Commission's Audit Committee for review and discussion of improvement measures.

#### Internal Committees

We actively engage our Non-Executive Directors in overseeing the management and operations of the SFC. Our Non-Executive Directors play an important role in helping the Commission become a more accountable and transparent regulator. Full membership lists of the internal committees are on pages 108 to 109.

<b>Targeted number of meetings:</b>	<b>1</b>
<b>Actual meetings:</b>	<b>1</b>
<b>Average attendance:</b>	<b>75%</b>



The **Budget Committee**, chaired by Henry H L Fan, a Non-Executive Director, examines the annual estimates of income and expenditure. The estimates must also receive endorsement by the full board of the Commission.

<b>Targeted number of meetings:</b>	<b>4</b>
<b>Actual meetings:</b>	<b>4</b>
<b>Average attendance:</b>	<b>83%</b>



The **Audit Committee**, chaired by T Brian Stevenson, a Non-Executive Director, recommends to the Commission the appointment of external auditors, defines the scope and planning of the external audit, reviews the audit findings and monitors the implementation of agreed improvements.

The Commission has appointed KPMG to carry out the statutory annual audits since its inception in 1989. The **Director of Audit** of the Government is also empowered by law to examine our books, records and documents.

In addition to annual audits, the Audit Committee appointed KPMG during the year to perform internal process reviews on areas including the application approval and revocation procedures for investment products; procedures for making purchase commitment and incurring expenditure; banking and investment procedures; and duty travel and corporate entertainment approval procedures.

<b>Targeted number of meetings:</b>	<b>2</b>
<b>Actual meetings:</b>	<b>3</b>
<b>Average attendance:</b>	<b>93%</b>



The **Remuneration Committee**, chaired by Daniel R Fung, a Non-Executive Director, reviews proposals on compensation structure and recommends amendments, reviews reports on pay levels and pay trends, and recommends any necessary adjustments. The pay packages of the Commission's Executive Directors are determined by the Government. The Commission, on the advice of the Remuneration Committee, determines the pay levels and pay awards of other staff.

### Cross-Divisional Audits

During the year, cross-divisional audits were introduced on fee collection operation. Corporate Finance Division, Finance Department and Intermediaries Supervision Department audited each other's fee collection procedures to strengthen objectivity and independence of internal audits.

### Public Redress Mechanism

Members of the public can lodge complaints against the Commission and its staff with the **Office of the Ombudsman** if they believe that the Commission or its staff have been guilty of maladministration in the performance of their functions. The Ombudsman received four complaints against the Commission last year, but none against its staff. The Ombudsman initiated inquiries into each of the complaints and concluded that none of them was justified. We are pleased that the Ombudsman

recognised the Commission's excellence in investor complaints handling by the granting of an Ombudsman Award 2001.

In addition to having recourse to the Ombudsman, members of the public who are dissatisfied with the Commission's performance of its functions may take civil action in the courts against the Commission, by either applying for judicial review of the Commission's decisions or by seeking other remedies. Whilst in 2001-2002, there were no instances of judicial review, one investor sought substantial damages from the Commission on the grounds that it had been negligent in the performance of its statutory functions. The Commission successfully applied to the court to have the action struck out on the grounds that it failed to disclose a reasonable cause of action. The court also awarded costs in favour of the Commission.

### Stakeholder Survey

The Commission appointed an independent research firm, Chant Link & Associates, to conduct its first ever stakeholder<sup>1</sup> survey to gauge our effectiveness as a regulator.

The survey found that stakeholders generally regarded the SFC highly and believed our programmes had had a



<sup>1</sup> Stakeholders include securities and futures brokers, financial advisers, asset and fund managers, insurance companies, investment banks, banks, listed companies, accounting firms, law firms, Hong Kong Exchanges and Clearing (HKEx), investor advocates, financial media, LegCo aides and share registrars.

positive impact on the securities and futures markets in Hong Kong. The survey also found that stakeholders considered SFC approachable and easy to deal with and overall one of the best securities regulators in Asia. However, the Commission is not complacent. There is a lot more we can do to enhance understanding of the SFC's work among stakeholders.

Most importantly, the survey pointed out that stakeholders wanted the Commission to be more transparent in making policy decisions following consultations. Guided by the survey results, we started posting submissions to consultations on the corporate website in October 2001. We included explanations for rejecting and accepting recommendations made by industry participants in consultation conclusions when appropriate.

The Securities and Futures Ordinance has been enacted and the finalisation of the 38 sets of subsidiary legislation is underway. Responding to industry participants' calls for greater participation in the formulation of regulatory policies, we are consulting the public on all subsidiary legislation. The Commission's website provides

convenient access to information on the Ordinance, and all codes and guidelines issued by the Commission.

We strengthened communication with stakeholders by starting in August 2001 the publication of a *Quarterly Report* to keep the public informed of our operations and financial position. In October 2001, we also launched a monthly newsletter, the *SFC Alert*, which targets investors and intermediaries.

We regularly seek advice from groups and committees comprising our stakeholders. The broadly represented Advisory Committee advises the Commission on any matter of policy regarding the performance of its functions. The Investor Education Advisory Committee provides ideas and support to our investor education efforts. The Academic and Accreditation Advisory Committee helps ensure the professionalism of intermediaries. The lists of members of these Committees and other Panels are on pages 104 to 110. The Commission has also formed a Shareholders Group to engage investors and collect their views. (See page 26)

## Our Performance Pledges

<b>In discharging our regulatory duties, we pledge to be responsive to the general public, market participants, and intermediaries under our supervision.</b>		
<b>Investor Enquiries</b>	Preliminary response to telephone enquiries	<b>4 working days</b>
	Preliminary response to written enquiries	<b>2 weeks</b>
<b>Public Complaints</b>	Preliminary response to verbal complaints	<b>2 weeks</b>
	Preliminary response to written complaints	<b>2 weeks</b>
<b>General Enquiries</b>	Preliminary response to enquiries via enquiry@hksfc.org.hk	<b>4 working days</b>
<b>Licensing Applications*</b>	Response to registration applications	<b>2 working days</b>
	Processing of applications from principals	<b>15 weeks</b>
	Processing of applications from representatives	<b>10 weeks</b>
<b>Investment Products Authorization</b>	Take-up of applications upon receipt	<b>2 working days</b>
	Preliminary response to applications (2 weeks for products other than unit trusts, mutual funds, investment-linked assurance schemes and pooled retirement funds)	<b>1 week</b>

\*A new licensing regime will be implemented when the Securities and Futures Ordinance comes into effect. Under the new regime, licensing applications will be processed more efficiently.

# Achievements and Work in Progress

The SFC has four operational divisions: Corporate Finance, Intermediaries and Investment Products, Enforcement, and Supervision of Markets. Each division is headed by an Executive Director and supported by the Legal Services Division and Corporate Affairs.

## Corporate Finance

### 26 executives and 10 non-executives

- Administers Takeovers and Mergers Code, and Share Repurchases Code
- Oversees the Stock Exchange's listing-related functions and responsibilities
- Administers securities legislation relating to listed companies

## Intermediaries and Investment Products

### 76 executives and 49 non-executives

- Devises and administers licensing requirements for securities and futures, and leveraged foreign exchange trading intermediaries
- Supervises and monitors intermediaries' conduct and financial resources
- Regulates the public marketing of investment products

## Enforcement

### 65 executives and 19 non-executives

- Conducts market surveillance to identify market misconduct for further investigation
- Undertakes inquiry into alleged breaches of relevant ordinances and codes, including possible insider dealing and market manipulation
- Institutes disciplinary procedures for misconduct by licensed intermediaries

## Supervision of Markets

### 17 executives and 5 non-executives

- Supervises and monitors activities of the exchanges and clearing houses
- Encourages development of the securities and futures markets
- Promotes and develops self-regulation by market bodies
- Oversees and manages the investor compensation funds

## Legal Services and Corporate Affairs\*

### 53 executives and 41 non-executives

- Provides legal services to the Commission
- Provides finance, human resources and training, information technology, management and corporate services to the Commission
- Provides strategic planning and corporate co-ordination on the Commission's work
- Promotes effective communications with stakeholders including the media
- Educates investors on their rights and responsibilities

\* This section includes the Chairman's Office, Commission Secretariat, Finance and Administration, Human Resources, Training and Development, Information Technology, Investor Education and Communications, and Corporate Communications.

## Achievements in 2001 - 2002

- Revised Takeovers and Share Repurchases Codes
- Re-launched the derivative warrant market
- Participated in various initiatives to enhance corporate governance
- Revised the GEM Listing Rules
- Issued the Corporate Finance Adviser Code of Conduct

- Made intensive preparations for the transition to a new licensing regime
- Implemented the Competence and Continuous Professional Training Requirements for intermediaries
- Intensified supervision of intermediaries on a risk-based approach
- Stepped up broker education
- Monitored a record 2,316 investment products
- Issued guidelines on index tracking funds and guaranteed funds

- Concluded 226 investigations of which 148 were completed within 12 months
- Referred four cases of suspected insider dealing to the Financial Secretary for hearing by the Insider Dealing Tribunal
- Prosecuted three cases of market manipulation and 32 entities for breaches of various ordinances
- Concluded 143 disciplinary inquiries and disciplined 105 registrants or concerned persons

- Consulted the market on scripless trading as part of the Steering Committee on the Enhancement of Financial Infrastructure (SCEFI) implementation plan
- Facilitated the launches of the block trading facility, three-year EFN futures contracts, international stock futures and options, warrant and equity linked notes trading
- Issued the Code of Conduct for Share Registrars and the Guidelines for the Regulation of Automated Trading Services
- Oversaw the introduction of the advanced clearing and settlement system and automated trading of stock options

- Enactment of the Securities and Futures Ordinance on 13 March 2002
- Drafted and consulted the public on a substantial amount of subsidiary legislation in order for the Securities and Futures Ordinance to come into effect
- Prosecuted cases on behalf of the SFC, including three successful prosecutions for market manipulation
- Streamlined work flow and achieved savings in light of budget deficit
- Revamped Electronic Investor Resources Centre (eIRC)
- Conducted Stakeholder Survey
- Better disclosure in *Annual Report*, *Quarterly Report*, and the monthly *SFC Alert*

## Work in Progress

- Improve corporate governance through Listing Rules changes and involvement in the Standing Committee on Company Law Reform
- Lead key aspects of market reforms for the development of the securities markets and regulation of the listed company sector
- Participate in Listing Rules reviews (i) allowing companies incorporated in additional overseas jurisdictions to list in Hong Kong; and (ii) relating to de-listing procedures
- Finalise the Price Stabilizing Rules
- Participate in a review of the new Listing Rules on derivative warrants and the overall market structure for warrants and other structured products

- Implement the new licensing regime and assist intermediaries during the transition
- Develop a streamlined licensing processing system
- Strengthen supervision and take precautionary ring-fencing or restrictive actions to minimize systemic risks
- Issue guidelines for the public offering of hedge funds
- Consult the market on the use of key summary fact sheets for funds

- Monitor unusual market movements closely
- Target investigations on areas of market misconduct
- Prosecute offences under the ordinances administered by the SFC
- Conduct more effective inspections into the affairs of listed companies with extension of powers under the Securities and Futures Ordinance
- Strengthen domestic and international co-operation, especially against cross-border fraudulent activities

- Work with the Government, HKEx and market participants to develop the Hong Kong securities and futures markets
- Monitor the implementation and launch of CCASS/3 and DCASS
- Work with HKEx to facilitate the introduction of new products and services, such as the extension of trading hours and pre-market opening session
- Facilitate the implementation of SCEFI's recommendations, especially the scripless market
- Implement the new investor compensation arrangements and support existing investor compensation cases

- Complete drafting of and public consultation on the subsidiary legislation
- Promote understanding of the new Ordinance within the SFC and among stakeholders including investors
- Explore means to achieve further savings
- Further streamline workflow and seek ways to deploy resources more effectively and efficiently
- Strengthen communication with stakeholders and investors

# Three-year Comparisons

	2001-2002	2000-2001	1999-2000
<b>MARKET</b>			
<b>Hong Kong remains a leading financial center in Asia</b>			
Market capitalisation (\$ billion)*	<b>3,924.4 (-7%)</b>	4,239.9 (-16%)	5,070.1
<b>Hang Seng Index down but trading has been orderly</b>			
Hang Seng Index (points)*	<b>11,033 (-14%)</b>	12,761 (-27%)	17,407
<b>Trading volume down</b>			
Average daily market turnover <sup>1</sup> (\$ billion)	<b>7.7 (-25%)</b>	10.3 (-9%)	11.3
<b>Issuers wait for better sentiment</b>			
Capital raised through IPOs (\$ billion)	<b>15.2 (-89%)</b>	132 (+329%)	30.8
<b>FINANCES AND STAFF</b>			
<b>No government funding required despite lower levies</b>			
Income (\$ million)	<b>363 (-27%)</b>	494.7 (+11%)	445.1
<b>Strict cost control curbs expenses</b>			
Expenses (\$ million)	<b>391.6 (-2%)</b>	399.5 (+4%)	385.5
<b>Steady establishment level</b>			
Staff*	<b>361 (+1.4%)</b>	356 (+8%)	329
<b>Greater retention of experience and expertise</b>			
Staff turnover (%)	<b>7.4 (-57%)</b>	17.1 (+116%)	7.9
<b>Better staff regulatory skills</b>			
Training man-day per employee	<b>7.6 (+54%)</b>	5 <sup>2</sup> (+6%)	4.7 <sup>2</sup>
<b>CORPORATE FINANCE</b>			
<b>More applications handled</b>			
General offer and privatisation applications reviewed	<b>33 (+18%)</b>	28 (-22%)	36
Days of meeting spent by Takeovers Panel	<b>7 (0%)</b>	7 (0%)	7
<b>INTERMEDIARIES AND INVESTMENT PRODUCTS</b>			
<b>Applications return to normal after exceptional year</b>			
Applications for licence	<b>3,306 (-74%)</b>	12,933 (+41%)	9,158
Total number of SFC licensees <sup>3*</sup>	<b>28,395 (-1.6%)</b>	28,844 (+13%)	25,549
<b>Focused use of resources on inspections</b>			
Routine inspections (cases)	<b>215 (-18%)</b>	262 (-4%)	273
Special inspections (cases)	<b>41 (+86%)</b>	22 (-84%)	134
Prudential meetings <sup>4</sup>	<b>101</b>	N/A	N/A
Breaches by dealers, traders and advisers noted during inspections <sup>5</sup>	<b>553 (-34%)</b>	833 (+9%)	765
<b>Rising number of investment products</b>			
Authorized collective investment schemes*	<b>2,316 (+2%)</b>	2,267 (+26%)	1,797
<b>Funds under management down in difficult year</b>			
Net asset value of authorized unit trusts and mutual funds <sup>6</sup> (US\$ billion)	<b>285 (-8%)</b>	311 (+4%)	299

N/A = figures not available

\* figures as at financial year-end

	2001-2002	2000-2001	1999-2000
<b>ENFORCEMENT</b>			
<b>Record success in prosecutions</b>			
New investigations (cases)	<b>311 (+5%)</b>	297 (+11%)	268
Prosecutions <sup>7</sup>	<b>50 (+16%)</b>	43 (+8%)	40
Disciplinary inquiries conducted	<b>143 (-5%)</b>	150 (+32%)	114
Entities disciplined	<b>105 (-21%)</b>	133 (+29%)	103
<b>SUPERVISION OF MARKETS</b>			
<b>Growing funds for investor protection</b>			
Net assets value of Unified Exchange Compensation Fund (\$ million)*	<b>780 (+24%)</b>	629 (+139%)	263
Net asset value of Commodity Exchange Compensation Fund (\$ million)*	<b>116 (+13%)</b>	103 (+12%)	92
<b>REACHING OUT</b>			
<b>Enhanced website attracts more visitors</b>			
Corporate website's average daily hit rate (hits)	<b>183,671 (+149%)</b>	73,888 (+315%)	17,794
<b>More investors benefit from on-line education efforts</b>			
eIRC's <sup>8</sup> average daily hit rate (hits)	<b>26,367 (+26%)</b>	21,000	N/A
<b>Investors more aware of their rights and responsibilities</b>			
Investor complaints	<b>721 (+28%)</b>	562 (+46%)	385
Investor enquiries	<b>3,073 (-11%)</b>	3,453 (-14%)	4,001
<b>More investigations into complaints</b>			
Complaints referred to divisions	<b>449 (+17%)</b>	385 (+68%)	229
Complaints leading to full investigations	<b>113 (+38%)</b>	82(+134%)	35
<b>More communications with the public</b>			
Press releases <sup>9</sup>	<b>216 (+10%)</b>	197 (+22%)	162
<b>CONSULTATION &amp; GUIDELINES</b>			
<b>More public consultation</b>			
Consultation papers issued	<b>25 (+150%)</b>	10 (+150%)	4
<b>Greater transparency of decisions</b>			
Consultation conclusions issued	<b>8 (+167%)</b>	3 (+200%)	1
<b>Clear regulations to reduce compliance costs</b>			
Codes and guidelines issued	<b>16 (+23%)</b>	13 (+225%)	4

<sup>1</sup> The figures represented the average daily turnover on the Main Board and GEM.

<sup>2</sup> Training programmes organised by individual departments for their own staff were not included in previous years' figures.

<sup>3</sup> Licensees included individuals, sole proprietors, partnerships and corporations.

<sup>4</sup> Prudential meetings are new initiatives implemented by the Intermediaries Supervision Department in 2001.

<sup>5</sup> A single inspection may reveal breaches of more than one provision.

<sup>6</sup> Net asset values as at 31 December 2001, 2000, 1999 respectively.

<sup>7</sup> Prosecutions included cases of market manipulation and unregistered activities, breaches of Securities (Disclosure of Interests) Ordinance and Protection of Investors Ordinance.

<sup>8</sup> The eIRC is the Electronic Investor Resources Centre launched by the Commission in June 2000.

<sup>9</sup> Excluding the number of press releases issued in compliance with the Securities (Disclosure of Interests) Ordinance.

# Significant Events 2001-2002

## 2001

### May 8

The SFC co-organised with the Hong Kong Monetary Authority and the Hong Kong Securities Institute a successful "Asia and Global Finance: New Opportunities" conference in Hong Kong, in conjunction with the Fortune 500 Global Forum.



Zhou Xiaochuan (left), Chairman of CSRC, and SFC Chairman Andrew Sheng sharing their views at the conference

### May 12

A 24-episode series of investor education radio segments, "Investors' Mastermind", sponsored by the SFC, began broadcasting on Metro Finance.

### May 22-27

Andrew Sheng and Alexa Lam joined a delegation led by the Chief Secretary of the HKSAR Government to visit the western region of the Mainland.



Chief Secretary Donald Tsang (centre) introducing the mission

### June 27

The SFC formed a Shareholders Group of academics, professionals and investor rights advocates to advance shareholders' rights and interests.

### July 5

Ashley Alder was appointed as the Executive Director, Corporate Finance.

### August 14

The first issue of the SFC's *Quarterly Report*, for the period of April–June 2001, was published to promote transparency of the SFC's work.

### August 31

Alexa Lam was re-appointed as the Executive Director, Intermediaries and Investment Products, and Alan Linning was appointed as the Executive Director, Enforcement. Mrs. Lam was previously Executive Director and Chief Counsel.

### September 3

The SFC started posting a full register of licensees on the website.

### September 28

The HKSAR Chief Executive extended Andrew Sheng's appointment as the SFC Chairman for a period of two years, from 1 October 2001 to 30 September 2003.

### October 8

The SFC and the Australian Securities & Investments Commission (ASIC) signed a Memorandum of Understanding for the exchange of information and investigatory assistance.



David Knott (right), Chairman of ASIC, signed the MOU with SFC Chairman Andrew Sheng in Hong Kong

### October 15

The SFC launched a monthly newsletter for intermediaries and investors, the *SFC Alert*.

### October 19

The SFC announced the reduction of the general offer trigger from 35% to 30% and the creeper from 5% to 2% with a view to enhancing investor protection.

**October 26**

In its consultation on the authorization requirements for public hedge funds, the SFC for the first time posted the public's comments on the corporate website.

**October 29-31**

SFC held conferences on corporate governance, equity research and hedge funds. The three conferences attracted 257 participants.

**October 30**

The SFC published a Code of Conduct for share registrars.

**November 1**

The SFC issued a Code of Conduct for corporate finance advisers.

**November 9**

The Hon Jasper YS Tsang was appointed as a Non-Executive Director and Henry H L Fan was re-appointed as a Non-Executive Director.

**December 13**

Mark Dickens was re-appointed as the Executive Director, Supervision of Markets.

**December 18**

The results of the SFC's first Stakeholder Survey were released. Stakeholders regarded the SFC highly and believed that its programmes had had a positive impact on the securities and futures markets in Hong Kong.

**2002****January 28**

The derivative warrant market was re-launched following a revision of the Listing Rules. The SFC worked closely with the HKEx on the rules revision.

**January 28**

The SFC issued new requirements for the authorization of index funds under the Code on Unit Trusts and Mutual Funds.

**January 30 - February 1**

The SFC hosted the IOSCO Emerging Markets Committee Advisory Board, IOSCO Technical Committee and Executive Committee meetings. The meetings were attended by 73 participants from 28 overseas regulators.

**February 5**

The SFC published Guidelines for the Regulation of Automated Trading Services.

**February 25**

The SFC introduced a revamped Electronic Investor Resources Centre (eIRC).

**March 13**

The Securities and Futures Ordinance 2002 was enacted, representing a major milestone in the modernisation of our securities legislation.

**March 18**

The Court has for the first time imposed immediate custodial sentences on persons manipulating stocks on the Stock Exchange of Hong Kong.

**March 28**

The Securities and Futures Ordinance was published in the Government Gazette.

# Corporate Finance





**Our mission is to enhance the disclosure based regulatory regime, to improve corporate governance practices, and to promote changes to law and regulation encouraging the development of efficient markets.**

**This chapter is about:**

- **Takeovers and Mergers Code revision**
- **Facilitating market development**
  - Derivative warrant market
  - Revised GEM Listing Rules
  - Price Stabilizing Rules
  - Financial Market Development Task Force
  - Listings of companies from additional overseas jurisdictions
- **Enhancement of corporate governance**
  - Standing Committee on Company Law Reform
  - Amendments to Listing Rules
  - Shareholders Group
  - Summary Financial Statements
- **Upholding standards**
  - Corporate Finance Adviser Code of Conduct
  - Overseeing HKEx's listing functions

**Achievements**

- Revised Takeovers and Share Repurchases Codes
- Re-launched the derivative warrant market
- Participated in various initiatives to enhance corporate governance
- Revised GEM Listing Rules
- Issued the Corporate Finance Adviser Code of Conduct

## What We Do

- **Administer the Takeovers and Mergers Code and Share Repurchases Code;**
- **Promote fair and equal treatment of public shareholders;**
- **Raise standards of investor protection and corporate governance;**
- **Oversee the Stock Exchange's listing-related functions and responsibilities;**
- **Review and recommend changes to the Listing Rules;**
- **Administer securities legislation relating to listed companies;**
- **Facilitate the development of effective and efficient capital markets; and**
- **Assist the development and promotion of Hong Kong as the preferred market for the external listing and trading of Mainland securities.**

## What We Did

### Takeovers Code and Share Repurchases Code Revision

As part of a comprehensive review of the Takeovers and Share Repurchases Codes, various proposed amendments were published in a consultation paper in April 2001. The public consultation ended in June 2001 and elicited 76 responses from a wide range of respondents. The Takeovers and Mergers Panel and the SFC made suitable amendments in light of public comments. In January 2002, the Commission issued the consultation conclusions paper.

Matters Handled by Corporate Finance		(Table 1)	
	1 April 2001 to 31 March 2002	1 April 2000 to 31 March 2001	
<b>Codes on Takeovers and Mergers and Share Repurchases:</b>			
General and Partial Offer under Takeovers Code	30	26	
Privatisations	3	2	
White wash waiver applications	26	21	
Other applications under Takeovers Code	205	223	
Applications under Share Repurchases Code	4	11	
<b>Takeovers and Mergers Panel:</b>			
Reviews of Executive rulings by Panel	2	0	
Referral by the Executive	0	1	
Disciplinary hearings	2	0	
Special meetings for review of the Takeovers and Share Repurchases Codes	3	6	
Total number of Panel meetings days	7	7	
<b>Securities (Disclosure of Interests) Ordinance:</b>			
Exemptions under Securities (Disclosure of Interests) Ordinance	365	349	
<b>Companies Ordinance:</b>			
Unlisted companies' prospectuses authorized for registration by the Registrar of Companies	19	18	
Exemptions under Section 38A and 342A of the Companies Ordinance	53	68	

By and large, our Takeovers Code is closely aligned with UK Takeovers Code standards. The Code has been amended to strengthen the rights of minority shareholders and ensure a level playing field. Key amendments included the lowering of the trigger threshold at which a general offer must be made for a public company from 35% to 30%, and reducing from 5% to 2% the amount by which a controlling shareholder's interest may increase without requiring a general offer. These were introduced on 19 October 2001 while the other changes became effective on 1 February 2002.



Newspaper announcement on the lowering of the general offer trigger level

## Facilitating Market Development

### Derivative Warrants

The Division, together with the Stock Exchange of Hong Kong Limited (SEHK), successfully re-launched the derivative warrant market in Hong Kong in January 2002. This followed a revision of the Listing Rules, which came into effect in December 2001.

The rule changes improved the market, particularly through the new requirements for issuers to provide liquidity for warrants that they have listed and easing of the restrictions in placing guidelines. By the end of March, 283 warrants had been issued by 14 issuers.

### Revised GEM Listing Rules

In July 2001, the Commission and the SEHK announced changes to the GEM Listing Rules, which became effective on 1 October.

The amendments are beneficial to the long-term development of GEM. The principal changes relate to the minimum active business period, issues of new shares within six months of listing, the moratorium period for initial management shareholders, share option schemes and public float requirements.

### Price Stabilizing Rules

Price stabilization actions are potentially manipulative and may contravene market misconduct provisions under the law.

In February 2002, the Division released proposed Securities and Futures (Price Stabilizing) Rules for public consultation. These Rules will be subsidiary to the Securities and Futures Ordinance.

The Rules would facilitate public offerings in Hong Kong by providing a “safe harbour” for managers who wish to undertake price stabilizing actions on shares or debentures. The draft Rules are in line with international standards and practice.

### Financial Market Development Task Force

In December 2001, the Financial Secretary asked the Secretary for Financial Services to set up a Financial Market Development Task Force to identify and co-ordinate new initiatives for the development of the Hong Kong financial markets. The Task Force has five Working Groups, focusing on the securities and futures markets, banking sector, debt markets, fund management and the insurance market.

The SFC Chairman chairs the Securities and Futures Market Development Working Group. In order to identify and find solutions to legal and regulatory impediments to market development in the area of securities offerings, including IPOs, a Securities Offering Issues Subgroup has been formed. The Subgroup consists mainly of market experts.

The Subgroup, chaired by the Executive Director of the Corporate Finance Division, first met in March 2002. Among the issues identified were offering structures and the processes involved in IPOs, pre-deal research reports and publicity restrictions.

The Debt Market Working Group, which is chaired by the Secretary for Financial Services, seeks to develop the retail debt market in Hong Kong. The Group has discussed issues such as content requirements for prospectuses, registration formalities and constraints on pre-registration advertising. It was agreed that interim measures should be introduced to enable issuers to leverage on prevailing low interest rates. They include streamlining procedures for the issuing of bonds where legally permissible.

Working through the Subgroup, the Commission will co-ordinate with market participants to identify and remove unnecessary regulatory barriers that hinder the development of the retail bond market.

### Listings of Companies from

#### Additional Overseas Jurisdictions

The Commission and the SEHK are reviewing the Listing Rules to allow companies incorporated in a range of overseas jurisdictions to list on the Main Board. To develop the market, primary listings could be approved from jurisdictions other than the Cayman Islands, Bermuda, and the PRC. A secondary listing route is intended to facilitate 24-hour trading for leading corporations, using the New York-London-Hong Kong loop.

### Enhancement of Corporate Governance

#### Standing Committee on Company Law Reform

In July 2001, the Standing Committee on Company Law Reform, with the support of the Commission, issued a consultation paper on proposed changes to the law on corporate governance issues. The main areas covered were directors, shareholders, and corporate reporting. The consultation period ended in October 2001 and market views on the proposals are currently being considered.

#### Proposed Amendments to Listing Rules

In January 2002, the SEHK, following consultation with the Commission, proposed amendments to the Listing Rules to strengthen corporate governance. The main areas covered in the consultation paper are protection of shareholders' rights, directors and board practices, corporate reporting, and disclosure of information. The consultation period will end on 24 May 2002.

### Shareholders Group

Shareholders have an important role to play in raising corporate governance standards in Hong Kong. In May 2001, we set up a Shareholders Group as a mechanism for engaging investors and harnessing their views. We seek their advice and feedback on issues relating to shareholders' rights and interests.

The Group consisted of 14 members including retail and institutional investors, professionals, academics, prominent advocates of investors' rights, and a Consumer Council representative. Since its establishment, five meetings had been held to discuss practical solutions for improving shareholder protection in Hong Kong, and the implications for shareholders of reform proposals.

#### The Shareholders Group

*The Group is chaired by the Executive Director of the Division and includes the following members:*

Jamie Allen	Vincent Duhamel	Mark Taylor
Rex Au Yeung	Leong Ka Chai	Judy Tsui
Prof. Andrew Chan	Tina So	David Webb
Chan Wing Luk	David Sun Tak-kei	Peter Wong Shiu-hoi
Leo Chiu	Ricky Tam Siu-hing	

### Summary Financial Statements

We recommended to the Government that listed companies be allowed to send summary financial statements to shareholders instead of the full annual report if shareholders so wish. Shareholders will retain the right at all times to a full annual report irrespective of whether they have been issued with summary financial statements. The proposal was approved during the year and companies are now able to provide more concise documents to their shareholders.

## **Upholding Standards**

### **Corporate Finance Adviser Code of Conduct**

A Corporate Finance Adviser Code of Conduct was introduced on 1 December 2001. The Code provides guidance on how a corporate finance adviser should conduct its business and work practices including the level of competence and experience required, dealing with conflicts of interest and maintaining effective risk management procedures. It also sets out the minimum standards for advisers acting as sponsors in a public offer and for those who rely on the work of experts or other professionals in rendering their advice.

### **Overseeing HKEx's Listing Functions**


Regular meetings were held with the SEHK's listing division as part of our role of monitoring the discharge of its duties. We also conducted a comprehensive review and audit of its performance as the frontline regulator of the Main Board and GEM.

### **Electronic Processing of Applications**

During the year, we saw the completion of migration from manual to electronic application processing. This was among our initiatives for raising the efficiency and effectiveness of the Commission.

# Intermediaries & Investment Products





**Our mission is to work in partnership with the industry to safeguard investor interests, facilitate market development and encourage high standards of professionalism.**

**This chapter is about:**

**Licensing Department**

- New standards for licensees
- Licence statistics
- Survey of licensees' business activities

**Intermediaries Supervision Department**

- Supervision and monitoring of intermediaries
  - financial regulation
  - conduct regulation
- Better communication with the industry

**Investment Products Department**

- Product authorization
- Product trend
- Facilitating and consulting the market
  - Hedge funds and other products
  - Financial Market Development Task Force
- Guiding the industry and upholding standards

**Achievements**

- Made intensive preparations for the transition to a new licensing regime
- Implemented the Competence and Continuous Professional Training Requirements for intermediaries
- Intensified supervision of intermediaries based on a risk-based approach
- Stepped up broker education
- Monitored a record 2,316 investment products
- Issued guidelines on index tracking funds and guaranteed funds

## What We Do

- **The Licensing Department licenses intermediaries.**
- **The Intermediaries Supervision Department ensures intermediaries comply with regulatory requirements.**
- **The Investment Products Department regulates the public marketing of unit trusts, mutual funds and other collective investment schemes.**

## Licensing Department

### What We Do

- **Act as the gatekeeper of the industry, ensuring that only fit and proper individuals and organisations are allowed to deal with investors and other market participants.**

### What We Did

#### New Standards for Licensees

New competence and continuous professional training requirements, which aim to continuously raise industry standards, came into effect on 1 April 2001. To this end, the Department has jointly organised with industry bodies a number of seminars for licensees. The Department will review the requirements in the light of market developments and will continue its efforts in enhancing the professional standards of intermediaries.

In November 2001, guidelines were issued on the use of debt collection agencies and on the prevention of unauthorized trades and over-trading.

The Securities and Futures Ordinance will bring in a new, more streamlined licensing regime. We have proposed reductions in licensing fees under the regime so that savings from the improved system can be passed on to the intermediaries. We will also assist intermediaries in the transition.

#### Licence Statistics

Licence applications during the year fell across the board (Table 1). In the securities sector, the number of applicants fell 78% to 2,423. In the commodity sector, the drop was 67% to 524. Only one application was received from leveraged foreign exchange traders while none were received from securities margin financiers. This decrease was due to an influx of applications in 2000-2001 before the introduction of the new competence requirements last year and an increase in the number of Mandatory Provident Fund advisers in the same period, as well as the adverse market conditions in 2001-2002.

The number of licensees (both businesses and individuals) decreased slightly by about 1.6% during the year, from 28,844 to 28,395 (Table 2). The number of exempt dealers fell from 167 to 153, while that of exempt investment advisers fell from 32 to 30.

#### Survey of Licensees' Business Activities

The Department is carrying out the annual survey of licensees' business activities for the sixth consecutive year. The survey will generate valuable information on the structure of Hong Kong's securities and futures industry. Questionnaires were distributed to licensees in February 2002.

## Enhancing our Service

The Commission is required by law to maintain a public register of all licensed persons. Apart from launching a new web-based public register enabling access by members of the public via the Internet, a more user friendly search engine has been added. It allows more efficient searching by licence categories.

A licensing update alert service is being added to the Commission's website. Licensed firms and other persons who have registered for the complimentary service will receive an electronic alert upon the website being updated on licensing matters.

**Applications for Licence** (Table 1)  
for the period from 1 April 2001 to 31 March 2002

Applications	Business			Individual			%
Securities				Dealing			
Dealers	Individual	Corporation	Partnership	Directors	Representatives	Total	Change
<b>Applications</b>							
received	0 (0)	30 (73)	0 (0)	207 (436)	1,169 (5,536)	1,406 (6,045)	-76.7
approved	0 (0)	40 (55)	0 (0)	279 (337)	2,348 (4,456)	2,667 (4,848)	
refused	0 (0)	0 (0)	0 (0)	0 (0)	2 (2)	2 (2)	
withdrawn	0 (0)	7 (2)	0 (0)	29 (28)	105 (154)	141 (184)	
<b>Securities</b>				<b>Investment</b>			<b>%</b>
<b>Investment</b>				<b>Adviser</b>			
<b>Advisers</b>	<b>Individual</b>	<b>Corporation</b>	<b>Partnership</b>	<b>Directors</b>	<b>Representatives</b>	<b>Total</b>	<b>Change</b>
<b>Applications</b>							
received	0 (2)	49 (99)	0 (0)	203 (426)	735 (4,139)	987 (4,666)	-78.8
approved	0 (1)	57 (87)	0 (0)	249 (378)	2,347 (2,845)	2,653 (3,311)	
refused	0 (0)	0 (0)	0 (0)	0 (1)	0 (4)	0 (5)	
withdrawn	0 (1)	10 (13)	0 (0)	27 (41)	120 (253)	157 (308)	
<b>Commodity</b>				<b>Accredited</b>			<b>%</b>
<b>Dealers</b>	<b>Individual</b>	<b>Corporation</b>	<b>Partnership</b>	<b>Dealers</b>	<b>Representatives</b>	<b>Total</b>	<b>Change</b>
<b>Applications</b>							
received	0 (0)	9 (12)	0 (0)	63 (105)	375 (1,282)	447 (1,399)	-68
approved	0 (0)	10 (3)	0 (0)	78 (71)	538 (1,087)	626 (1,161)	
refused	0 (0)	0 (0)	0 (0)	2 (0)	0 (0)	2 (0)	
withdrawn	0 (0)	2 (2)	0 (0)	3 (12)	51 (25)	56 (39)	
<b>Commodity</b>				<b>Accredited</b>			<b>%</b>
<b>Tading</b>				<b>Advisers</b>			
<b>Advisers</b>	<b>Individual</b>	<b>Corporation</b>	<b>Partnership</b>	<b>Advisers</b>	<b>Representatives</b>	<b>Total</b>	<b>Change</b>
<b>Applications</b>							
received	0 (0)	9 (17)	0 (0)	22 (61)	46 (130)	77 (208)	-63
approved	0 (0)	8 (17)	0 (0)	26 (55)	59 (120)	93 (192)	
refused	0 (0)	0 (0)	0 (0)	1 (0)	0 (0)	1 (0)	
withdrawn	0 (0)	1 (3)	0 (0)	15 (7)	3 (2)	19 (12)	
<b>Leveraged</b>				<b>Representatives</b>			<b>%</b>
<b>Foreign</b>	<b>Trader</b>	<b>Trader Non-</b>	<b>Trader</b>	<b>Non-</b>			
<b>Exchange</b>	<b>Discretionary</b>	<b>Discretionary</b>	<b>Introducing</b>	<b>Responsible</b>	<b>Responsible</b>	<b>Total</b>	<b>Change</b>
<b>Taders</b>	<b>A/C</b>	<b>A/C</b>	<b>Agent</b>	<b>Officers</b>	<b>Officers</b>		
<b>Applications</b>							
received	0 (0)	1 (0)	0 (0)	1 (1)	357 (296)	359 (297)	20.9
approved	0 (0)	1 (1)	0 (0)	1 (2)	320 (271)	322 (274)	
refused	0 (0)	0 (0)	0 (0)	0 (0)	0 (0)	0 (0)	
withdrawn	0 (0)	0 (0)	0 (0)	0 (1)	39 (28)	39 (29)	
<b>Securities</b>	<b>Securities</b>			<b>Financier's Representatives</b>			<b>%</b>
<b>Margin</b>	<b>Margin</b>			<b>Approved</b>	<b>Non-Approved</b>	<b>Total</b>	
<b>Financiers</b>	<b>Financiers</b>			<b>Directors</b>	<b>Directors</b>	<b>Total</b>	<b>Change</b>
<b>Applications</b>							
received	0 (10)			1 (17)	29 (291)	30 (318)	-90.6
approved	0 (10)			1 (17)	36 (268)	37 (295)	
refused	0 (0)			0 (0)	0 (0)	0 (0)	
withdrawn	0 (0)			0 (0)	3 (11)	3 (11)	
<b>Total number of applications received</b>						<b>3,306 (12,933)</b>	<b>-74.4</b>

Note: 31 March 2001 data in brackets

**Number of Licensed Intermediaries****(Table 2)**

as at 31 March 2002

Business	Sole Proprietors		Partnerships		Corporations		Total	% Change	
<b>Securities Ordinance</b>									
<b>Dealers</b>									
SEHK Participants	60	(73)	1	(1)	433	(435)	494	(509)	
Non-SEHK Participants	7	(9)	0	(0)	216	(207)	223	(216)	
<b>Sub-total</b>	<b>67</b>	<b>(82)</b>	<b>1</b>	<b>(1)</b>	<b>649</b>	<b>(642)</b>	<b>717</b>	<b>(725)</b>	
<b>Advisers</b>	<b>15</b>	<b>(17)</b>	<b>0</b>	<b>(0)</b>	<b>652</b>	<b>(642)</b>	<b>667</b>	<b>(659)</b>	
Margin Financiers	0	-	0	(0)	8	(10)	8	(10)	
<b>Commodities Trading Ordinance</b>									
<b>Dealers</b>									
HKFE Participants	0	(0)	0	(0)	132	(135)	132	(135)	
Non-HKFE Participants	0	(0)	0	(0)	23	(23)	23	(23)	
<b>Sub-total</b>	<b>0</b>	<b>(0)</b>	<b>0</b>	<b>(0)</b>	<b>155</b>	<b>(158)</b>	<b>155</b>	<b>(158)</b>	
<b>Advisers</b>	<b>1</b>	<b>(1)</b>	<b>0</b>	<b>(0)</b>	<b>125</b>	<b>(127)</b>	<b>126</b>	<b>(128)</b>	
<b>Leveraged Foreign Exchange Trading Ordinance</b>									
Discretionary A/C	-	-	-	-	7	(6)	7	(6)	
Non-Discretionary A/C	-	-	-	-	4	(4)	4	(4)	
Introducing Agent	-	-	-	-	0	(0)	0	(0)	
<b>Sub-total</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>11</b>	<b>(10)</b>	<b>11</b>	<b>(10)</b>	
<b>Grand Total</b>	<b>83</b>	<b>(100)</b>	<b>1</b>	<b>(1)</b>	<b>1,600</b>	<b>(1,589)</b>	<b>1,684</b>	<b>(1,690)</b>	
<b>-0.36</b>									
Individual	Directors		Representatives		Introducing Agent		Total	% Change	
<b>Securities Ordinance</b>									
<b>Dealers and Representatives</b>									
SEHK Participants	1,114	(1,111)	8,350	(8,917)	-	-	9,464	(10,028)	
Non-SEHK Participants	322	(310)	4,946	(4,560)	-	-	5,268	(4,870)	
<b>Sub-total</b>	<b>1,436</b>	<b>(1,421)</b>	<b>13,296</b>	<b>(13,477)</b>	<b>-</b>	<b>-</b>	<b>14,732</b>	<b>(14,898)</b>	
<b>Advisers and Representatives</b>	<b>1,122</b>	<b>(1,140)</b>	<b>5,277</b>	<b>(5,176)</b>	<b>-</b>	<b>-</b>	<b>6,399</b>	<b>(6,316)</b>	
Margin Financier's Representatives	17	(17)	193	(251)	-	-	210	(268)	
<b>Commodities Trading Ordinance</b>									
<b>Dealers and Representatives</b>									
HKFE Participants	301	(299)	3,490	(3,835)	-	-	3,791	(4,134)	
Non-HKFE Participants	27	(24)	262	(288)	-	-	289	(312)	
<b>Sub-total</b>	<b>328</b>	<b>(323)</b>	<b>3,752</b>	<b>(4,123)</b>	<b>-</b>	<b>-</b>	<b>4,080</b>	<b>(4,446)</b>	
<b>Advisers and Representatives</b>	<b>171</b>	<b>(185)</b>	<b>209</b>	<b>(224)</b>	<b>-</b>	<b>-</b>	<b>380</b>	<b>(409)</b>	
<b>Leveraged Foreign Exchange Trading Ordinance</b>									
Trader's Representatives	35	(30)	875	(787)	0	(0)	910	(817)	
<b>Grand Total</b>	<b>3,109</b>	<b>(3,116)</b>	<b>23,602</b>	<b>(24,038)</b>	<b>0</b>	<b>(0)</b>	<b>26,711</b>	<b>(27,154)</b>	
<b>-1.6</b>									
<b>Total number of intermediaries (business and individual)</b>							<b>28,395</b>	<b>(28,844)</b>	<b>-1.6</b>

Notes: "Directors" included approved directors of margin financiers and responsible officers of leveraged foreign exchange traders  
31 March 2001 data in brackets

## Intermediaries Supervision Department

### What We Do

- Supervise intermediaries using a risk-based approach;
- Monitor risky intermediaries through various predictive measures and preventive regulatory actions; and
- Carry out intermediaries education.

### What We Did

#### Supervision and Monitoring of Securities Intermediaries

##### The present market condition

The securities market of Hong Kong was hit by the economic downturn in the year. Brokers, especially the small-and medium-sized firms whose business heavily relied on local equities trading, continued to suffer from the combination of declining turnover and increasing competition from banks.

Statistical information and financial position of the securities market based on the data extracted from the monthly Financial Resources Rules (FRR) returns submitted by securities dealers and margin financiers are set out for the first time in Table 3. The comparative figures in the profit and loss account represented seven months' data as the revised FRR only came into effect on 12 June 2000.

Although the financial position of securities intermediaries did not change much between the end of December 2000 and 2001, there is a notable decrease in the profitability of these intermediaries for the year ended 2001 largely due to the lower market turnover and decrease in other income.

##### Regulation of Intermediaries

The Department applies a risk-based approach to the supervision and inspection of intermediaries. We set up

various risk indicators to assist in the analysis of financial information provided by intermediaries and to highlight those high risk intermediaries.

##### Financial regulation

The financial positions of intermediaries, including capital adequacy and liquidity, are monitored through analysis of their monthly FRR returns. The Department closely monitors intermediaries with the help of our enhanced early warning systems that pick up firms at risk and request them to take appropriate remedial measures. These may include increasing capital, reducing margin loan exposure and moving non-borrowing margin clients' securities to secured custody accounts.

	As at 31/12/01	As at 31/12/00
Total number of securities intermediaries	719	720
Total number of active cash clients	624,700	696,956
Total number of active margin clients	63,568	73,819
	(\$ Million)	(\$ Million)
<b>Balance Sheet</b>		
Cash in hand and at bank (note 2)	57,721	54,936
Amounts receivable from margin clients (note 3)	12,004	14,757
Amounts receivable from clients and other dealers arising from dealing in securities	21,192	30,972
Other assets	24,667	25,696
<b>Total assets</b>	<b>115,584</b>	<b>126,361</b>
Amounts payable to clients and other dealers arising from dealing in securities	41,568	46,091
Total borrowings from financial institutions	5,762	5,117
Other liabilities	19,889	24,907
Total shareholders' fund	48,365	50,246
<b>Total liabilities and shareholders' fund</b>	<b>115,584</b>	<b>126,361</b>
	12 months to 31/12/01	7 months to 31/12/00 (note 4)
	(\$ Million)	(\$ Million)
<b>Profit and Loss</b>		
Total value of transactions (note 5)	7,248,805	5,123,888
Net commission income from securities dealing	11,915	8,430
Gross interest income	3,243	2,811
Other income (note 6)	16,474	15,222
Total overheads and interest expense	(31,203)	(22,173)
<b>Net profit for the period</b>	<b>429</b>	<b>4,290</b>

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

Note 2: Cash in hand and at bank includes trust monies held on behalf of clients.

Note 3: Average collateral coverage:

As at 31 December 2001	As at 31 December 2000
3.8	3.8

Note 4: The comparative figures represented seven months' data as the revised FRR only came into effect on 12 June 2000.

Note 5: The value of transactions included trading in equities and bonds both in Hong Kong and overseas.

Note 6: Other income mainly comprised corporate finance income, fund management income, net profit/loss on proprietary trading, intercompany charges and others.



CSRC staff observed an inspection of an intermediary in Hong Kong

The Commission also appointed a firm of independent consultants to assess the financial viability and business operations of selected securities intermediaries which had substantial securities margin financing activities.

The SFC is increasingly concerned about the financial viability of intermediaries engaging in risky lending practices. We have proposed amending the FRR to improve the risk management of firms providing margin financing services and to create a larger liquidity buffer for these firms. In March 2002, a consultation paper was published.

#### ■ **Conduct regulation**

The SFC places strong emphasis on the conduct of intermediaries. Our codes and guidelines stipulate the fitness and propriety requirements expected of them.

The Department monitors integrity risk by watching for signs of unusual trends, possible anomalies in our analysis reports and alerts generated by our monitoring system, market intelligence and other sources.

When there are signs of irregularities, we promptly initiate enquiries and where necessary conduct theme inspections. The case of Teil (see box for details) was exposed in a recent theme inspection.

We may also instruct an independent accounting firm to perform extensive circularisation on selected client accounts.

Effective deterrence relies also on the diligence of the investor. Many cases of fraud have involved clients failing to carefully check their contract notes, records and statements, or placing too much misguided trust in their brokers.

#### **Ying Kit Stock Company (Ying Kit)**

On 22 January 2002, Lam Kwan Kit, the sole proprietor of the firm, was reported to have disappeared. In order to preserve assets of the firm and its clients, a restriction notice was issued on 23 January 2002. Based on our preliminary investigation, some clients' transactions were not recorded in the firm's books and some clients' securities were sold without their knowledge. Contract notes given to these clients appeared unusual. On 6 February 2002, administrators were appointed to administer the assets of the firm and its clients. It is estimated that more than 280 clients are involved. As at 28 March 2002, 276 claims against the Unified Exchange Compensation Fund totalling \$114.4 million were received.

In October 2001, the Department's monitoring team identified that the firm's liquid capital was thin and there was a downward trend in the firm's stock balance in the Central Clearing and Settlement System (CCASS). An independent accountancy firm was commissioned to perform a circularisation of certain selected client account balances. All but two (one deceased and the other lost contact) of the circularised clients confirmed their balances.

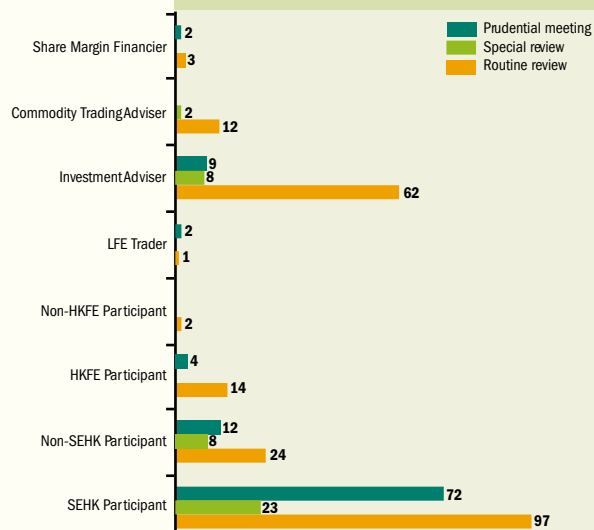
After the failure of the broker, certain clients revealed that some of them did not report discrepancies while others had overlooked the discrepancy. In light of this, we have reinforced education of the more vulnerable group of investors.

#### **Teil Stock Investment Company (Teil)**

Teil was a sole proprietor firm targeted for our theme inspections. Concerns were raised by low stock level and thin excess liquid capital as reported in its FRR returns and as reflected in our risk indicators analysis.

On 20 February 2002, our inspection staff identified a discrepancy between Teil's client stock record and its CCASS record, as well as an unusual trading pattern in certain client accounts. Chow Yuk Wah, the sole proprietor, failed to give a satisfactory explanation to the above. In order to preserve assets of the firm and its clients, a restriction notice was issued on 21 February 2002 to restrict Chow and Teil from carrying on the business of dealing in securities and from dealing with his and Teil's assets and those of its clients. An independent firm of accountants was appointed subsequently to perform a full circularisation to ascertain the number of affected clients and the amount involved. On 13 April 2002, the Commission applied to Court for the appointment of administrators to deal with the assets of the firm and its clients.

**Inspections for the period from April 2001 to March 2002 (Figure 1)**



### Better Communication with the Industry

During the past year, communication with our regulated firms strengthened significantly. The SFC held regular prudential meetings with intermediaries to discuss regulatory issues, explain the reasoning behind our rules and regulations and gather market information. The Department started joint working groups to exchange views on draft rules under the Securities and Futures Ordinance. This ensured that industry concerns were addressed at an early stage.

The Department conducted seven seminars for 1,200 participants on the revised Code of Conduct. We also held regular discussions with market participants relating to the changes and challenges in the market place.

**Breaches by Dealers and Traders Noted During Inspections**

**(Table 4)**

Nature of Breaches	SEHK	Non-SEHK	HKFE	Non-HKFE	LFE	Share
	Participant	Participant	Participant	Participant	Trader	Margin
	Participant	Dealer	Participant	Dealer		Financier
Failure to comply with Financial Resources Rules	45	1	5	0	0	1
Failure to safekeep clients' securities	53	2	0	1	0	0
Failure to maintain proper books	16	1	1	0	0	0
Failure to safekeep clients' money	28	0	0	0	0	1
Unregistered dealing & other registration issues	4	2	0	1	0	0
Breach of contract note requirement	30	2	2	0	0	1
Failure to make filing/notification	10	1	2	0	1	0
Breach of margin requirement	2	0	6	0	0	0
Illegal short selling of securities	2	0	0	0	0	0
Internal control weaknesses	93	12	9	1	1	2
Breach of Code of Conduct	86	7	7	0	0	1
Breach of Conduct of Business Guidelines	0	0	0	0	1	0
Breach of Fund Manager Code of Conduct	1	1	0	0	0	0
Breach of Internet Regulation	2	3	0	0	0	0
Non-compliance with money laundering guidelines	5	0	1	0	0	0
Breach of other rules and regulations of the Exchanges	2	0	5	0	0	0
<b>Total</b>	<b>379</b>	<b>32</b>	<b>38</b>	<b>3</b>	<b>3</b>	<b>6</b>

**Breaches by Advisers Noted During Inspections****(Table 5)**

Nature of Breaches	Investment Adviser	Commodity Trading Adviser
Failure to comply with Financial Resources Rules	6	0
Failure to safekeep clients' securities	4	1
Failure to maintain proper books	4	0
Failure to safekeep clients' money	3	0
Unregistered dealing & other registration issues	5	2
Breach of contract note requirement	3	0
Failure to make filing/notification	2	1
Marketing of unauthorized funds	1	0
Internal control weaknesses	20	6
Breach of Code of Conduct	19	2
Breach of Fund Manager Code of Conduct	6	4
Breach of Internet Regulation	1	0
Non-compliance with money laundering guidelines	1	0
Breach of other rules and regulations of the Exchanges	1	0
<b>Total</b>	<b>76</b>	<b>16</b>

Information on modifications, waivers and application procedures, as well as frequently asked questions arising from the revision of the Code of Conduct were posted on to the Commission's website.

The Department issued 28 circulars containing warnings of fraudulent activities, reminders about market conduct and assessment results by independent consultants on the financial viability and business operation of securities intermediaries. From 1 February 2002, all circulars are disseminated through FinNet, a secure private communications network for intermediaries and regulators.

## Investment Products Department

### What We Do

- **Set and enforce standards in relation to the marketing of investment products;**
- **Monitor the operation and marketing of funds;**
- **Investigate complaints and take enforcement actions; and**
- **Work with the industry to facilitate development of new products and ensure that investors are well informed.**

### What We Did

#### Product Authorization

As of 31 March 2002, the total number of authorized products reached an all time high at 2,316. The Department authorized 340 products during the year. The retail fund market continued to grow at a steady pace. Details are shown in Table 6.

Authorized Collective Investment Schemes		(Table 6)	
	31 March 2002	31 March 2001	
Unit trusts and mutual funds	1,890	1,870	
Investment-linked assurance schemes	100	76	
Pooled retirement funds	39	40	
MPF master trust schemes	49	49	
MPF pooled investment funds*	217	214	
Others	21	18	
<b>Total</b>	<b>2,316</b>	<b>2,267</b>	

\* There are 79 funds included in this category that are offered both as retail unit trusts as well as pooled investment funds for MPF purpose.

#### Product Trend

The number of applications of unit trusts and mutual funds continued to increase steadily with guaranteed funds being the most popular. However, standard equity and bond funds still comprise the bulk of the entire funds population (see Table 7). The aggregate total net asset value of all authorized unit trusts and mutual funds as at December 2001 amounted to US\$285

billion. Funds authorized in Hong Kong continued to exhibit a strong international flavour, as shown in Table 8.

The market for investment-linked assurance schemes continued to expand during the year, partly due to the growing awareness to save up for retirement, and as a result of the introduction of MPF. We authorized 25 new schemes during the year, taking the total number to 100.

Low interest rates and the state of the world equity markets prompted the emergence of equity-linked products that allow investors to enjoy a higher interest rate while bearing certain risks inherent in an equity investment. A total of seven equity-linked products were authorized.

#### Facilitating and Consulting the Market

##### Product Codes

The Department has taken action to facilitate the offer of a greater variety of products to investors and to strengthen investor protection.



E Gerald Corrigan, Managing Director, Goldman Sachs & Co, speaking at the conference on the Regulation of Hedge Funds organised by the SFC in October 2001.

- In response to suggestions that hedge funds should be authorized for sale in Hong Kong, the Department published a consultation paper on the offering of these products in late October 2001, followed by a conference on the subject. To ensure full transparency, responses from the public were published on the SFC's website for the first time. We expect to conclude the consultation and publish a set of guidelines by May 2002.
- Minimum subscription requirements for Hong Kong dollar denominated money market funds were removed in October 2001 to enable smaller investors to access these funds.
- The Department published a set of Guidelines on Index Tracking Funds in January 2002, following market consultation in July 2001.
- To enhance investor protection, we raised the qualification requirements on guarantors of guaranteed funds and required improvements to disclosure in the offering documents of guaranteed funds.

#### Financial Market Development Task Force

If Hong Kong is to further strengthen its position as the premier regional fund centre, accurate information about its fund industry is essential. Before the year end, we started the third annual Fund Management Activities Survey to collect information on assets managed by our intermediaries for the year 2001.

We consulted the industry on the needs and problems of the fund sector in Hong Kong. The Department represents the SFC on the Fund Management Working Group, under the Government's Financial Market

Development Task Force. The Working Group examines issues relating to the development or hindrance to development of the fund industry of Hong Kong. It will make recommendations on how to develop Hong Kong as an international fund management or fund service centre. The Working Group has been studying issues relating to tax, legal and regulatory requirements, support services and promotion strategies.

#### Guiding the Industry and Upholding Standards

As well as authorizing collective investment schemes, we monitor the on-going compliance of authorized funds. Although the Commission cannot directly order compensation, we played a pivotal role over the past year in monitoring payments to investors in 58 cases of administrative errors on fund valuation or pricing.

A Guidance Note to those advertising or offering collective investment schemes on the Internet was published in May 2001.

**Authorized Unit Trusts and Mutual Funds (Table 7)**  
as at 31 March 2002

	Total			
	Number	%	NAV* (US\$ Million)	%
Bond	290	17	48,498.8	17.0
Equity	1,063	61	181,547.2	63.7
Diversified	121	7	26,122.9	9.2
Money Market	61	4	12,222.0	4.3
Fund of Funds	82	5	2,283.0	0.8
Warrant	4	0	1.3	0.0
Index	38	2	5,210.3	1.8
Guaranteed	73	4	5,779.5	2.0
Other specialised#	8	0	3,545.0	1.2
	1,740	100	285,210.0	100
Umbrella structures	150			
<b>No. of Authorized Funds</b>	<b>1,890</b>			

\* Net Asset Value as at 31 December 2001

# Includes: Futures & Options Funds & Leveraged Funds.

Circulars were issued to ease the compliance burden of fund managers when dealing with professional investors, and to clarify, in the wake of the 9.11 incident and market disruption in the US, the circumstances that might warrant suspension of dealings of authorized funds.

We detected 25 cases of suspected contravention of the Protection of Investors Ordinance in regular monitoring of investment advertisements that are not authorized. Of these, 12 cases were referred to the internal Complaints Control Committee for further action.

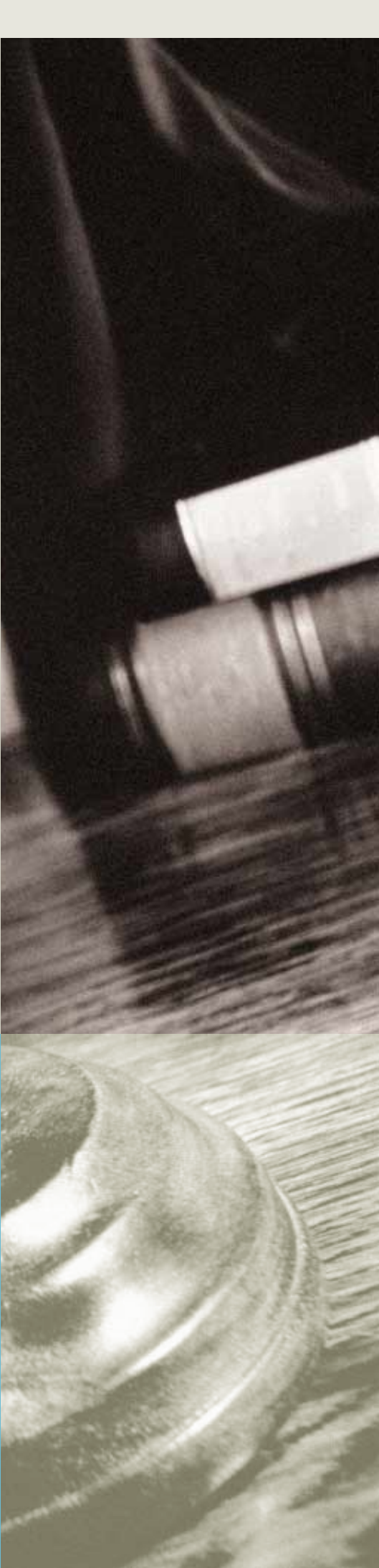
**Origin/Net Asset Value of Authorized Funds** (Table 8)  
as at 31 March 2002

	Umbrella Number	Sub-funds Number	Single Funds Number	Total			
				Number	%	NAV* (US\$ Million)	%
Hong Kong	11	22	57	90	5	5,996.4	2.1
Jersey	3	35	0	38	2	3,288.9	1.2
Luxembourg	57	952	11	1,020	54	170,369.8	59.7
Ireland	38	271	20	329	17	35,363.5	12.4
Guemsey	4	66	4	74	4	2,884.2	1.0
United Kingdom	2	36	19	57	3	24,264.2	8.5
Other Europe	0	0	15	15	1	11,850.0	4.2
Bermuda	2	25	9	36	2	1,158.4	0.4
British Virgin Islands	3	8	12	23	1	1,020.4	0.4
Cayman Islands	29	118	42	189	10	8,888.2	3.1
Others	1	4	14	19	1	20,126.0	7.0
<b>No. of Authorized Funds</b>	<b>150</b>	<b>1,537</b>	<b>203</b>	<b>1,890</b>	<b>100</b>	<b>285,210.0</b>	<b>100</b>

\* Net Asset Value as at 31 December 2001 (excluding "umbrella funds").

# Enforcement





**Our mission is to protect investors and Hong Kong's markets by detecting and deterring unlawful activity and unethical behaviour through effective enforcement.**

**This chapter is about:**

- **Surveillance**
- **Investigations**
  - Market manipulation
  - Insider dealing
  - Disclosure of interests compliance
  - Inspections of books and records of listed companies
  - Unregistered activities
  - Unauthorized investment products
- **Disciplinary actions**
- **Co-operation with other law enforcement agencies**

**Achievements**

- Concluded 226 investigations of which 148 were completed within 12 months
- Referred four cases of suspected insider dealing to the Financial Secretary for hearing by the Insider Dealing Tribunal
- Successfully prosecuted three cases of market manipulation and 32 entities for breaches of various ordinances
- Concluded 143 disciplinary inquiries and disciplined 105 registrants or concerned persons

## What We Do

- **Enforce laws relating to the securities and futures industry, leveraged foreign exchange trading, and investment arrangements;**
- **Report suspected insider dealing to the Financial Secretary;**
- **Inspect books and records of listed companies if impropriety is suspected;**
- **Enforce disclosure of interests of substantial shareholders, directors and chief executives of listed companies;**
- **Suppress illegal or improper practices in trading, investment arrangements and the provision of advice or other financial services; and**
- **Co-operate with domestic and overseas regulatory bodies in investigations in Hong Kong and overseas.**

## What We Did

This was a fruitful year. The Division now investigates more quickly and has cleared the backlog of older cases. The Magistrates' Court and the Insider Dealing Tribunal have shown an encouraging readiness to impose severe penalties on those guilty of market manipulation and insider dealing. This should serve as a strong deterrent to those who might be tempted to break the law.

The Division continued the diligent inspection of books and records of selected listed companies. We also achieved a new record in successful prosecutions for failures to disclose substantial shareholdings in listed companies and the holdings of listed company's directors and chief executives. This mandatory corporate disclosure is the key to enhancing transparency and fostering better corporate governance.

Our focus on shareholding disclosure has already seen results. Our efforts, since the crackdown began last year, have been rewarded in that we have noticed a marked decline in the number of suspected cases of insider dealing.

### Surveillance

The Division's dedicated team of skilled surveillance staff is responsible for monitoring day-to-day trading in the stock and derivative markets in Hong Kong. Equipped with automated surveillance and trading analysis programs, we identify unusual price and turnover movements.

During the year, we enhanced our computer systems to strengthen our daily surveillance and analysis, paying special attention to the warrant market. In cases of suspected market manipulation, insider dealing or any other market abuse, we obtain trading details from brokers to conduct preliminary inquiries. If market misconduct is indicated, we initiate a full investigation.

We obtained trading records from brokers on 106 occasions, and referred a total of 35 cases for full investigation.

In the course of our preliminary inquiries, we identified 18 listed companies (nine cases in the previous year) in which the public float was concentrated in the hands of a small number of shareholders. As a result, we required these companies to fully disclose their shareholding profiles.

There were 96 further instances of listed companies requesting the suspension of trading in their shares due to unusual price or volume movements or the imminent release of price sensitive information. Suspensions were usually lifted on the day after the company had issued an announcement containing news that might have an influence on its stock, or a statement that it was unaware of the reason for the unusual price or volume movement in its shares.

We also spotted a number of apparent attempts to manipulate the closing price of thinly traded stocks and referred six cases for full investigation.

## Investigations

The Division continued 181 ongoing investigations from the previous year. Another 311 new cases were referred during the year by various sources including the public, foreign regulators, law enforcement agencies in Hong Kong, the Exchanges and other SFC departments. Out of these 492 cases handled, 226 have been concluded and the remaining 266 are subject to continuing investigations, hearings or prosecutions.

## Market Misconduct

This year's enforcement programme focused on the fundamentals of establishing a fair and open market by paying careful attention to disclosure issues.

### Market Manipulation

Our determination to crack down on market manipulation was evidenced by the successful prosecution of four people in the Magistrates' Court for manipulating the shares of Good Fellow Group Limited (Case 1 in Table 1), Perfectech International Holdings Limited (Case 2) and The Hong Kong Parkview Group Limited (Case 3).

**Successful Prosecutions - Market Manipulation (Table 1)**

1 April 2001 to 31 March 2002

Case/Defendants	Date of Conviction	No. of Summonses Involved	Penalty	Costs of Investigation Awarded (\$)
1) Yeung Yik Cheung	18 Dec 2001	1	3 months' imprisonment suspended for 12 months	66,080
2) Lau Kwai Ngor	18 Feb 2002	1	\$30,000 fine	67,424
3) Choy Wai Zak	18 Mar 2002	2	8 months' imprisonment	26,084
Yuen Sze Ning, Cyril	18 Mar 2002	1	4 months' imprisonment	13,043
<b>Total: 4 entities</b>				<b>172,631</b>

In the Hong Kong Parkview case, the Magistrate sentenced one defendant to four months' imprisonment on two charges, the sentences to be served consecutively, and the other defendant to four months. The Magistrate refused the defendants' applications for suspended sentences saying that

this would not reflect the seriousness of the crime or the need to sentence as a deterrent. (See page 56 for details)

The results in each case show that the Courts are getting tougher on convicted manipulators. The Good Fellow case resulted in a three-month prison sentence, suspended for 12 months. The Magistrate fined the defendant in the Perfectech case, but warned that such a serious offence would have warranted a custodial sentence if the defendant had not pleaded guilty. In each case, the Courts ordered the defendant to pay the SFC's full costs.

We also disciplined seven registrants for facilitating market manipulation. These actions serve to remind intermediaries that they have a responsibility to the integrity of the market which goes beyond merely satisfying a client's order. If a client's trading activities appear unusual or suspicious, an intermediary is obliged to question the client's motives. The intermediary should only execute a client's instructions when satisfied with the client's explanation. Vigilant intermediaries can help create a climate in which market manipulation is less likely.

### Insider Dealing

During the year, the Division investigated 21 cases of apparent insider dealing. Of these, we referred four to the Financial Secretary for consideration of the appointment of an Insider Dealing Tribunal (IDT). We concluded six with no further action. Investigations continue in 11 cases. These ongoing investigations relate to possible insider dealing before the impact of our focus on non-disclosures of listed company shareholdings was felt. This highlights the link between non-disclosure and the opportunity for misconduct.

During the year, three suspected insider dealing cases were heard by IDTs appointed by the Financial Secretary and the final appeal of an insider from a previously completed IDT inquiry was dismissed. As a result, a total sum of penalty, disgorgement and

Penalty Ordered by IDT on Insiders						(Table 2)
1 April 2001 to 31 March 2002						
Case	Insider Dealers	Shares of Listed Company Involved	Date of Judgement	Disgorgement of Profit (\$)	Penalty (\$)	Cost (\$)
1)	Cheung Nim Che, Francis Pang Kam Chi, Cammie Zhang Xiao Zhu	Tysan Holdings Ltd.	28 Jun 2001	4,005,818 1,088,721 1,175,474	5,000,000 1,000,000 750,000	3,178,542 373,946 186,973
2)	Huo Sheng Pu*	Indesen Industries Co. Ltd.	2 Nov 2001	16,500,000	16,500,000	315,695
3)	Lau Chan Wing, Raymond Zhang Tie Cheng Lok Fai Tseung Wai Lok Chung Ming Chee, Athine	China Apollo Holdings Ltd.	(Judgment re penalty to be delivered later in 2002)			
<b>Total: 9 persons</b>				<b>22,770,013</b>	<b>23,250,000</b>	<b>4,055,156</b>

\*The insider is appealing the penalties imposed by IDT.

costs amounting to \$50 million was ordered to be paid by four insiders (Table 2). Details are set out below.

In 2000, the Court of Appeal dismissed the application of two persons implicated in the Tysan Holdings Limited inquiry to quash the IDT's unpublished findings. In June 2001, a reconstituted IDT ordered three insider dealers to pay penalties and disgorgement totalling \$13 million, and costs totalling \$3.7 million.

In the Indesen Industries Company Limited inquiry, the IDT identified one person as an insider dealer and ordered him to pay a penalty and disgorgement totalling \$33 million and costs of \$315,695. The decision is now under appeal.

The China Apollo Holdings Limited inquiry was completed in August 2001. The IDT unanimously identified five people as insider dealers. In March 2002, the IDT adjourned the hearing on penalties which will be resumed and finalised later in 2002.

In November 2001, the final appeal against the record penalties imposed in the Harry Holdings Limited insider dealing inquiry was dismissed.

Three more IDT inquiries are about to start: HKCB Bank Holdings Company Limited/Lippo China Resources Limited/Lippo Limited; Siu Fung Ceramics Holdings Limited; and Medtech Group Company Limited.

## Listed Companies

### ■ Disclosure of Interests Compliance

The aftermath of Enron's collapse has also focused attention on the importance of corporate governance. An essential element to the improvement of better corporate governance is disclosure of the shareholdings of substantial shareholders and directors. The Securities (Disclosure of Interests) Ordinance (SDIO) requires directors, chief executives and substantial shareholders of listed companies to disclose, on a timely basis, their shareholdings, including subsequent changes. Prompt and full disclosure helps inform investors about the direction of a corporation and corporate insiders' views of its prospects. It also helps prevent market misconduct.

The Division has devoted extra resources to encourage strict compliance. During the year, we prosecuted 14 people and eight companies (as against nine people and three companies in the previous year) for material SDIO breaches (Table 3). We issued 72 warning letters for minor and inadvertent breaches.

In anticipation of the tightening of corporate disclosure requirements in the new Securities and Futures Ordinance, we will continue to commit resources to ensuring strict compliance in this area.

<b>Successful Prosecutions - Securities (Disclosure of Interests) Ordinance</b> (Table 3)				
1 April 2001 to 31 March 2002				
Case/Defendants	Date of Conviction	No. of Summonses Involved	Fine (\$)	Costs of Investigation Awarded (\$)
1) Poon Siu Chung	24 Apr 2001	12	63,000	39,531
2) Lawnside International Ltd.	17 May 2001	1	5,000	-
3) Tsoi Ka Chi, Morris Shaw Wen Fei	5 Jun 2001	1	6,000	4,400
		1	5,000	4,400
4) Yu Pun Hoi	31 Jul 2001	2	20,000	14,990
5) Huang Tie Ying	7 Aug 2001	5	25,000	7,337
6) Fung Lee Woo King	21 Aug 2001	4	20,000	5,693
7) Tianjin Investment Holdings Ltd. Tsinlien Group Co. Ltd.	4 Sept 2001	4	20,000	12,949
		4	20,000	12,949
8) Chu Wai Ling	11 Sept 2001	4	14,000	12,112
9) Lin Chin Yao	25 Sept 2001	1	4,000	9,806
10) Wilson Leung	9 Oct 2001	2	10,000	23,771
11) Lee Sam Yuen, John D. H. International Ltd.	16 Oct 2001	6	30,000	28,139
		6	30,000	18,089
12) Zhong Shan Tse Yu Pui	27 Nov 2001	6	24,000	16,154
		7	35,000	10,937
13) China Everbright Ltd.	11 Dec 2001	1	2,000	7,559
14) China Convergence Corp Ltd. Gold Chief Investment Ltd.	8 Jan 2002	2	14,000	9,318
		2	14,000	9,318
15) Man Chin	15 Jan 2002	1	5,000	9,432
16) Simon Murray	15 Jan 2002	2	8,000	14,515
17) New Excellence Holdings Ltd.	30 Jan 2002	6	24,000	16,430
<b>Total: 22 entities</b>		<b>80</b>	<b>398,000</b>	<b>287,829</b>

Following an independent inspection conducted by a director of the Division, who was appointed by the Financial Secretary, a report on the ownership of Oxford Properties & Finance Limited (Oxford) was handed over to the Financial Secretary on 24 December 2001. The report showed that less than 25% of Oxford was in independent public hands, in breach of the SEHK Listing Rules. The majority shareholder had hidden his control of almost 90% of Oxford from the minority shareholders and market.

#### ■ Inspection of books and records of listed companies

If directors and officers of a listed company are suspected of impropriety in the management of its affairs, we can inspect the company's books and records under section 29A of the SFC Ordinance. During the year, three such inspections were conducted. We share responsibility for investigating corporate misconduct with the ICAC and Hong Kong Police Force, and referred the results of one inspection to the ICAC for further investigation. The other two inspections continue.

Under the new Ordinance, our inspection powers will be more extensive, so we expect to be more active in investigating listed company malpractice, especially corporate governance matters.

#### Unregistered Activities

We continued enforcement action against unregistered securities and commodities dealing, investment advising and securities margin financing activities and prosecuted 11 people and three companies (Table 4). We also took disciplinary action against 14 registrants.

<b>Successful Prosecutions - Unregistered Dealing and Related Offences</b> (Table 4)				
1 April 2001 to 31 March 2002				
Case/Defendants	Date of Conviction	No. of Summonses Involved	Fine (\$)	Costs of Investigation Awarded (\$)
<b>Securities Ordinance</b>				
1) Chan Kung Mong	10 Apr 2001	1	10,000	7,000
Cheung Chi Fun		1	10,000	7,000
Talent Best Ltd.		1	10,000	3,566
2) Lai Tik Kei	3 Jul 2001	1	2,000	6,585
Lam Yik Mang		1	2,000	7,649
Kwok Wai Leung	25 Sept 2001	1	3,000	5,000
Yu Chi Sing	26 Sept 2001	1	1,000	1,500
3) Cheung Tak Kwai, Stanley HK Stock Limited	3 Oct 2001	1	3,000	8,150
		1	10,000	2,465
4) Tam Yui Man	5 Oct 2001	3	15,000	14,997
Wong Lai Ho	17 Oct 2001	1	2,000	2,000
5) Ngan On Nang, Sabrina Roofer Finance Co. Ltd.	11 Dec 2001	1	20,000	22,025
		1	50,000	22,025
<b>Commodities Trading Ordinance</b>				
6) Ho To Yan	26 Feb 2002	5	12,500	3,000
<b>Total: 14 entities</b>		<b>20</b>	<b>150,500</b>	<b>112,962</b>

#### Unauthorized Investment Promotion

We prosecuted four companies and six persons under the Protection of Investors Ordinance for possessing or issuing unauthorized advertisements and documents in relation to investment arrangements with guaranteed returns (Table 5).

#### Disciplinary Actions

Honest, efficient and financially sound intermediaries help ensure that Hong Kong remains a premier international financial centre in the region, and keep our markets clean. All trades on the exchanges go through intermediaries. Intermediaries without proper checks and

Successful Prosecutions – Protection of Investors Ordinance 1 April 2001 to 31 March 2002				
Case Defendants	Date of Conviction	No. of Summonses Involved	Costs of Investigation	
			Fine (\$)	Awarded (\$)
1) Yourshare Holdings Corp	21 Aug 2001	1	10,000	11,253
2) Crown Asset Management Ltd.	24 Sept 2001	2	4,000	16,000
Cousins Pauline Ellen		2	An order of absolute discharge granted	
3) Asia Network Base (H.K.) Ltd.	25 Feb 2002	6	40,000	5,000
FungTak Hoi, Alrick		2	10,000	500
Kam Chi Yin, Paul		2	10,000	500
Li Ka Yin, Wallace		4	10,200	500
4) Ho To Yan	26 Feb 2002	4	10,000	3,000
5) LM Investment Management HK Ltd.	26 Feb 2002	5	50,000	7,187
Nutbeam Melanie Jane		1	5,000	7,187
<b>Total: 10 entities</b>		<b>29</b>	<b>149,200</b>	<b>51,127</b>

balances, who do not know their clients and do not question suspicious trading strategies, put their clients at risk and create a climate in which market misconduct can flourish. The Magistrate in the Good Fellow market manipulation prosecution highlighted the broker's complicit role in that case.

To ensure intermediaries have safeguards which protect their clients and do not facilitate market misconduct, we conducted 143 disciplinary inquiries this year. Of these, we concluded 92 cases, resulting in us disciplining 105 entities and issuing five warning letters (Table 6 shows significant disciplinary actions). The following are the highlights:

- Disciplined 10 registrants for serious misconduct involving dishonesty. Of these, we revoked the licences of three for misappropriation of clients' securities and misuse of client accounts, and one for committing a criminal offence in the course of carrying out his function as a registrant. We found another six had conducted unauthorized trading in clients' accounts. We revoked the licence of four and publicly reprimanded the other two;
- Discovered the staff of two brokerages conducting unauthorized and improper trading in some derivative warrants listed on the SEHK and revoked the licence of one and publicly reprimanded the other;

Significant Disciplinary Actions 1 April 2001 to 31 March 2002			
Registrants	Date of Action	Misconduct	Disciplinary Action
1) Wong Kwai Sum	19 Apr 2001	Created false accounting records and used his former employer's funds to settle his trading loss	Revocation
2) Lai Wei Fong	24 Jul 2001	Conducted unauthorized trades in clients' accounts	Revocation
3) Chan Tai Chung	16 Aug 2001	Conducted personal trades in third parties' accounts without authorization	Revocation
4) Frank Yu	26 Oct 2001	Facilitated unauthorized and improper trading in some derivative warrants	Revocation
5) Fung Tat Shing, Frank	8 Nov 2001	Conducted unauthorized trading through client's account	Revocation
6) Leung Fung Ling	15 Nov 2001	Misappropriated clients' securities to cover her trading loss	Revocation
7) Ho Suk Jan	15 Nov 2001	Misappropriated clients' securities to cover her trading loss	Revocation
8) Chan Choi Ha, Wendy	6 Dec 2001	Misappropriated clients' assets	Revocation
9) Wong Fung Kwan	20 Dec 2001	Unauthorized trades & misappropriation	Revocation
10) Chiu Chi Man, Wesley	15 Jan 2002	Convicted of false accounting and evasion of liability by deception	Revocation
11) Lee Chung Bing	29 Jan 2002	Conducted unauthorized trades in clients' accounts	Revocation
12) Poon Pong Wah	12 Jul 2001	Used a copy of an ex-colleague's identity card to open a fake trading account to conduct his own trading	30 months' suspension
13) Chan Sheung Chi, Steven	27 Mar 2002	Failed to comply with the Code on Takeovers & Mergers and conduct fell far short of that expected from a registrant	24 months' suspension
14) Li Chi Keung, Saymond	11 Oct 2001	Made false representation to the SFC and failed to obtain written authorization from clients	12 months' suspension
15) Wong Ming Leuk	11 Feb 2002	Failed to act in the best interest of clients and to follow proper account opening procedures	12 months' suspension
16) Fung To	11 Mar 2002	Responsible for allowing his staff to introduce clients to trade in black market leveraged foreign exchange contracts and Hang Seng Index Futures contracts	12 months' suspension
17) So Wai Yin, Irene	4 Oct 2001	Granted credit limit to relatives' accounts and allowed these accounts to continue trading when significantly undermargined	9 months' suspension

- Disciplined 39 registrants for a variety of less serious misconduct including failure to keep adequate records, failure to comply with proper internal procedures, and pledging client shares without proper authorization. Of these, we suspended the licences of 14 for between one week and 30 months, publicly reprimanded 22, privately reprimanded two and issued one warning letter;
- Disciplined 10 registrants for breaches of the Financial Resources Rules. Of these, we suspended the licence of three and publicly reprimanded three; and

- Disciplined 13 for other internal control failings. Of these, we suspended the licence of one, publicly reprimanded 10, privately reprimanded one and issued one warning letter. Seven intermediaries were subject to independent accountant review.

During the year, in a number of cases we took action against intermediaries who accommodated conduct which provided a climate which makes market misconduct easier or can damage market integrity (including the seven registrants we disciplined for facilitating market manipulation). For example, brokers who accepted small board lot orders late in the day several spreads above the prevailing price which are likely to unduly influence the day's closing price; brokers who passed unverified market rumours on to clients in a placement; brokers who failed to inquire into the independence of subscribers in an IPO; and brokers who accepted third party orders in accounts when they were not even sure who their client was.

### Enforcement Co-operation

In a world of global markets, where technology has effectively abolished borders, both local and international law enforcement co-operation is needed to properly regulate financial markets. So, we keep in close contact with domestic enforcement agencies and our counterparts in other jurisdictions.

While investigating possible manipulation in the shares of Gay Giano International Group Ltd, we discovered possible fraud. We referred the matter to the Hong Kong Police Force. After further investigation, the Police have laid charges and a trial date is set for June 2002. The following inserts are several noteworthy cases.

#### Case 1. Victory Enterprises Investments Limited

Even with co-operative intermediaries and active intermediary supervision and discipline programs, we can only do so much. Investors also have to be on their guard against fraud and misconduct and should carefully monitor their investment affairs. This year, we discovered two staff of Victory Enterprises Investments Limited had been using securities in client accounts to cover their own trading losses and had held back account statements from clients to hide their misconduct. The staff had been cheating 79 clients and possibly caused losses of almost \$11 million. We revoked their licences. The Hong Kong Police Force are investigating. The case should be a strong warning to investors about what can go wrong if they don't keep an eye on their investments and ask their intermediary questions.

#### Case 2. Hong Kong Forex Investment Ltd

If investors deal in unregulated products, they put themselves at greater risk. In March this year, we concluded disciplinary action against Hong Kong Forex Investment Ltd for introducing clients to trade in black market leveraged foreign exchange contracts and Hang Seng Index futures contracts in Macau between 1999-2000. As a result, 13 entities were disciplined. This type of trading is extremely risky as it is essentially an unregulated bet against the company the investor deals with. However, many investors knew they were dealing in unregulated products through the company and were attracted by the supposed rewards. We will take action against any such operations we find. Investors should be aware, though, that recovering their money is much harder when they suffer losses from unregulated products.

#### Boiler Rooms

This year, we received 106 complaints in relation to boiler rooms apparently operating out of Hong Kong, compared with 25 last year. "Boiler rooms" are frauds in which unscrupulous but plausible salespeople cold call potential investors and use high pressure sales tactics to persuade them to buy real or bogus investments. Usually, they are located in one country and approach the investor in another by telephone, email, fax or postal mail. Once the investor sends money, often over seas, the salesperson disappears.

Some boiler rooms use business centres in Hong Kong to disguise the real jurisdiction in which they operate. We work hard to prevent this abuse. We have referred 61 complaints to the Hong Kong Police Force and 60 to the authorities of the jurisdictions where the boiler rooms seem to be based for further investigation and intelligence. We also warn the Hong Kong business centres and facilities providers involved to avoid these suspected boiler room operators.


In January 2002, as a result of a referral from us, the Hong Kong Police Force raided the Wan Chai office of Global Options Trading, which was promoting heating oil options to mainly Australian investors. In its two months of operation, the firm had collected about \$2 million from investors.

Also, in July 2001, a joint Thai, American and Australian task force raided the Bangkok offices of another boiler room, called the Brinton Group and Benson Dupont Capital Management, after a two-year investigation prompted by referrals made by ourselves and our Australian and New Zealand counterparts.

In order to protect investors against this kind of fraud, our website lists details of suspected boiler rooms and advises investors on how to deal with cold callers.

# Supervision of Markets





**Our mission is to ensure that the regulation and development of Hong Kong's securities and futures markets meet international standards.**

**This chapter is about:**

- **Facilitating market development**
  - Financial Market Development Task Force
  - Relaxing short selling restrictions
  - Helping product innovation
- **Strengthening financial infrastructure**
  - FinNet
  - Scripless trading
  - Upgrading derivatives systems
  - Enhancing clearing systems
- **Automated trading services**
- **Code of Conduct for Share Registrars**
- **Preparing for emergencies**
- **Investor compensation**

**Achievements**

- Consulted the market on scripless trading as part of the Steering Committee on the Enhancement of Financial Infrastructure (SCEFI) implementation plan
- Facilitated the launches of the block trading facility, three-year EFN futures contracts, international stock futures and options, warrant and equity linked notes trading
- Issued the Code of Conduct for Share Registrars and the Guidelines for the Regulation of Automated Trading Services
- Oversaw the introduction of the advanced clearing and settlement system and automated trading of stock options

## What We Do

- **Supervise and monitor the activities of the exchanges and clearing houses;**
- **Facilitate the development of and encourage participation in the Hong Kong markets;**
- **Strengthen market infrastructure; and**
- **Oversee and manage Hong Kong's investor compensation funds.**

## What We Did

### Facilitating Market Development

#### Financial Market Development Task Force

The Securities and Futures Market Development Working Group under the Task Force has formed a Market-wide Issues and Product Initiatives Subgroup to tackle issues on market-wide policies and product initiatives. The Executive Director of the Supervision of Markets Division chairs the Subgroup. The Division also provides secretarial support to the Working Group and coordinates work within the SFC to develop and implement these initiatives.

#### Relaxing Short Selling Restrictions

Improving the quality of our markets is key to maintaining Hong Kong's competitiveness. In consultation with HKEx and market participants, the SFC proposed relaxations for certain types of short selling activities to enhance market liquidity. We proposed changes to legislation to allow stock futures market makers to short naked underlying securities for hedging their stock futures positions. The rules became effective on 26 October 2001. Following this, we proposed tick rule exemptions for index arbitrage and stock futures hedging transactions. The related SEHK rules took effect in December 2001.

We will evaluate the effectiveness of the existing criteria for exempting index arbitrage and the existing reporting system. The current short selling legislation will also be reviewed, taking into account the needs of market participants.

#### Helping Product Innovation

The Division established an appropriate regulatory environment to assist the introduction of new products by HKEx.

- In October 2001, we approved a six-month pilot scheme of a Block Trading Facility for HKEx's futures and options contracts. The facility allows exchange participants to negotiate and conclude large-sized orders privately off the exchange. The scheme will be reviewed taking into account its impact on the market and the trading behaviour of brokers.
- In the same month, the Hong Kong Futures Exchange (HKFE) introduced 20 International Stock Futures (ISF) and 20 Options on International Stock Futures (ISO) contracts. The underlying stocks of the ISF are blue chips listed on exchanges in the US, Japan, Korea and Taiwan. The SFC's levy for ISO has been reduced from \$1 to \$0.2, and the Compensation Fund levy for ISO from \$0.5 to \$0.1.



Mark Dickens (second from right), Executive Director, Supervision of Markets, attending the Futures and Options World's Derivatives Expo in November 2001.

- To promote Hong Kong as a regional debt market, the HKFE launched the three-year Exchange Fund Note (EFN) Futures Contract in November 2001.
- Also in November, HKEx applied to offer trading facilities for Warrants and Equities Linked Notes. We are working with HKEx on more detailed plans and the proposed rule changes.

### Strengthening Financial Infrastructure

Hong Kong proposes to introduce systems for single clearing, straight-through processing and securities dematerialisation in order to maintain its competitiveness among the financial centres of the world. In September 1999, the Steering Committee on the Enhancement of Financial Infrastructure (SCEFI) outlined a blueprint for the introduction of these essential building blocks.

#### Financial Services Network (FinNet)

By March 2002, the majority of the participants have connected to FinNet, a secure private network recommended by SCEFI to facilitate communications and financial transactions among intermediaries and regulators in Hong Kong.



FinNet enhances communications between the regulators and the industry

#### Scriptless Market

We consulted the market on proposals for a scripless securities market in February 2002. Submissions will be analysed and reviewed.



SFC consulted the market on scripless trading

#### Upgrading Derivatives Systems

In August 2001, stock options trading on the derivatives market migrated from the Traded Options System (TOPS) to the Automated Trading System (HKATS). TOPS continues to clear transactions in stock options. The implementation of an integrated clearing system, known as Derivatives Clearing and Settlement System (DCASS), is in progress. HKEx, in consultation with the SFC, commissioned a network review on the integrated system to ensure the stability, reliability and security of the network of derivatives systems. HKEx has largely adopted and implemented the consultant's recommendations.

#### Enhancing Clearing Systems

In the securities market, a new generation of Central Clearing and Settlement System (CCASS/3) is being developed to upgrade its technology architecture to an open and net-enabled architecture using the network shared with FinNet. To achieve the synergy and integration between CCASS/3 and DCASS, a Common Collateral Management System (CCMS) and a Common Risk Management System (CRMS) will be built to provide an integrated platform for collateral management and risk management across securities and derivatives markets.

The Division met regularly with the project teams responsible for the implementation of the systems to monitor progress. We conducted regular reviews of project management status, testing procedures, rollout plan and contingency plans to facilitate the introduction of HKEx's enhanced system.

### Automated Trading Services

In February 2002, following a year of consultation and review, we published the Guidelines for the Regulation of Automated Trading Services (ATs). The guidelines will become effective upon the commencement of the Securities and Futures Ordinance and will apply for the purposes of authorizing and licensing ATs.

### Code of Conduct for Share Registrars

We worked with the Federation of Share Registrars on the Code of Conduct for Share Registrars. The Code was issued in August 2001 and sets out the operational standards and guidelines for share registrars for the purposes of enhancing protection for investors and market participants.

### Preparing for Emergencies

We regularly update the SFC's procedures for handling the unexpected and coordinate the initiatives throughout the organisation. Our contingency measures were thoroughly tested during the pressures that arose in the markets following the 9.11 incident and the Morgan Stanley Capital International index rebalancing exercise. The merger and demutualisation of HKEx also necessitated the updating of its contingency plans to recognise the new structure, and to take into account new products and other initiatives. The Division constantly reviews and updates the contingency plans of HKEX and the Commission.

### Investor Compensation

To provide protection consistent with modern markets, the SFC proposed a new investor compensation scheme which will increase compensation level to \$150,000 per investor under appropriate circumstances. It will extend coverage to investors dealing with all licensed intermediaries dealing in HKEX's products including securities and futures dealers, registered institutions under the Banking Ordinance, and margin financiers.

The SFC proposed that the expanded protection would be funded by adding 0.002% to the transaction levy, which would in turn be paid into the Unified Exchange Compensation Fund. LegCo approved the proposal, which brought the total levy on each transaction to 0.007% from 1 September 2001.

The new scheme will become effective when the Securities and Futures Ordinance comes into effect. We are preparing related rules and setting up an independent investor compensation company to oversee scheme administration.

As at 31 March 2002, the net asset values of the existing compensation funds - the Unified Exchange Compensation Fund (UECF) and the Commodity Exchange Compensation Fund (CECF) - were \$779.7 million and \$116.3 million respectively. During the year, payments totalling \$21 million were made from the UECF to 258 claimants of C.A. Pacific Securities Ltd, Chark Fung Securities Co. Ltd, Win Successful Securities Company and Foreground Securities Co. Ltd. The claimants of these defaulting brokers have received, or will receive, the amount allowed by the SEHK up to a maximum of \$150,000 per claimant under the agreed compensation arrangement.

During the year, the Division worked closely with the liquidators and HKEx on the distribution of assets to the claimants of C.A. Pacific Securities Ltd, which will be subject to a court decision in 2002. Payments totalling \$0.5 million and \$1.9 million were made to eight clients of Wei Xin Securities Limited and 52 clients of C.K. Securities Company respectively after the liquidators' dividends of the firms were received.

In January 2002, the SFC issued a restriction notice against Ying Kit Stock Company in view of its financial difficulties. HKEx issued notice of claim and set the compensation limit to be \$150,000 per claimant. Additional provision totalling \$21.4 million for the UECF was made to cover the anticipated compensation for Ying Kit. No payment had been made yet as at 31 March 2002.

# Legal Services

## This chapter is about:

- The Securities and Futures Ordinance
- Criminal prosecutions
- Legal support to Commission work

## Achievements

- Enactment of the Securities and Futures Ordinance on 13 March 2002
- Drafted and consulted the public on a substantial amount of subsidiary legislation in order for the Securities and Futures Ordinance to come into effect
- Advised on numerous possible breaches of ordinances and prosecuted cases on behalf of the SFC, including three successful prosecutions for market manipulation

## What We Do

- Assist with legislative reform of the securities market;
- Provide legal advice to the Commission and the operating divisions; and
- Conduct prosecutions in the Magistrates' Court in respect of a wide range of regulatory offences and conducting appeals before the Securities and Futures Appeals Panel.

## What We Did

### The Securities and Futures Ordinance

On 13 March 2002, the Securities and Futures Ordinance was enacted. This was the culmination of more than a decade of hard work by many people. The Financial Services Bureau, the Department of Justice and the Legislative Council Bills Committee with The Hon Sin Chung-kai as Chairman and The Hon Margaret Ng as Deputy Chairman all played influential parts. Much of the heavy-lifting for the project was done within the Commission with the operational divisions addressing policy issues and the Legal Services Division assisting with the drafting, coordination, and managing the process.

Consideration of the Securities and Futures Bill in the Legislative Council began in November 2000. After debating the policy issues, the Bills Committee embarked on a careful clause-by-clause examination of the Bill. This exercise was completed on 26 October 2001. Work on the committee stage amendments, which reflected comments from market participants as well as the views of the Bills Committee, continued well into February 2002.



Legislators approved the Securities and Futures Ordinance on 13 March 2002.

Many in the Commission devoted considerable effort to assist the passage of the Bill through this crucial, final phase. The Chief Counsel and other counsel from the Division attended over 40 Bills Committee meetings during the past year together with senior staff from the relevant divisions to explain the policy considerations. Usually this involved the attendance of at least one Executive Director. Many hours of preparation were required before each meeting, with explanatory and background papers presented to the Bills Committee. Papers and tables summarising market comments and the Administration's responses, the derivation of the provisions under discussion and international comparisons were also produced and tabled. The Commission also assisted with the drafting of the committee stage amendments.

The Second Reading debate on the Securities and Futures Bill resumed on 13 March 2002, and was immediately followed by the Third Reading and enactment of the Securities and Futures Ordinance on the same day.

Throughout the past year, the Division has been engaged in the drafting and refinement of 38 pieces of subsidiary legislation which will underpin the new Ordinance. Drafts of most subsidiary legislation have been released for public consultation. Consultation so far has been completed on 11 items of subsidiary legislation. In 2002, the Division hopes to complete the consultation and secure the clearance of all of these items of subsidiary legislation by the LegCo Subcommittee responsible for their vetting. We will also play a key role in Commission initiatives to inform market participants, investors, the general public and other stakeholders about the new legislation and assisting with a smooth transition to the new regime.

#### First Immediate Custodial Sentences: Choy Wai Zak and Cyril Yuen Sze Ning

Choy and Yuen were convicted of market manipulation known as share ramping following a four and a half day trial under section 135(1)(a) of the Securities Ordinance. It was found that on three trading days between 19 and 23 November 1999, Choy and Yuen traded Hong Kong Parkview shares with each other in the closing minutes of the day's trading, which had the effect of pushing up the share price. These trades dominated the action in Hong Kong Parkview shares, inflated the price and created a false and misleading appearance of active trading.

Choy was also convicted under section 135(3) of the Securities Ordinance of conducting "wash sales" - purchases and sales of Hong Kong Parkview shares which involved no change in the beneficial ownership. On 15 November 1999, Choy traded 60,000 Hong Kong Parkview shares between his two securities accounts which raised the price of the shares and created a false and misleading appearance of active trading in the shares.

Choy was sentenced to four months' imprisonment for each offence, to be served consecutively, and Yuen was sentenced to four months. They were also ordered to pay the SFC's investigation costs of \$39,128. Choy has launched an appeal against sentence. Yuen is appealing against his conviction.

#### Criminal Prosecutions

The Division advised in relation to numerous possible breaches of the relevant ordinances and prosecutions over the past year, including breaches of the Protection of Investors Ordinance, unregistered dealing, unregistered securities margin financing, failure to disclose shareholdings and changes to shareholdings under the SDIO.

Notable were three cases of market manipulation. In two of the cases, the defendants were convicted after trial: one defendant received a suspended prison sentence in the first case whilst two defendants in the second case received immediate custodial sentences, for the first time, for market manipulation (see box on left). In the remaining case, the defendant received a more lenient sentence of a fine as a result of her guilty plea.

#### Legal Support to Commission Work

##### Securities and Futures Appeals Panel

Three appeals were lodged this year, of which two have been withdrawn on settlement and one is in progress. Four appeals lodged in previous years were concluded: two were dismissed and two were concluded with reduced sanction. (Also see other SFC governance matters on pages 12-15)

##### Takeovers and Mergers Panel

The Division provided legal advisers to assist the Takeovers and Mergers Panel in connection with two cases during the past year. One case was an application for a review of a ruling by the Executive that certain shares did not carry voting rights within the meaning of the Takeovers and Mergers Code. The other case was disciplinary proceedings to decide whether dealings in a company's shares were in breach of the Code and the sanction that should be imposed.

##### Civil Actions

We were not required to handle any major civil litigation last year, but the Commission did issue legal proceedings in two separate cases against parties who had failed to comply with a notice under section 33(4) of the Securities and Futures Commission Ordinance, which required them to produce records or documents as part of an investigation by the Commission. Both parties subsequently complied with the notices and met the Commission's costs. The Commission secured the appointment by the Court of an administrator in respect

of Ying Kit Stock Company following the disappearance of the owner and the issue of a restriction notice in respect of the business.

### Legal Advice

The Division provided legal advice and support to the Commission's four operational divisions on areas concerning the performance of the Commission's regulatory functions, including disciplinary matters and the exercise of the Commission's statutory powers and investigations. We also advised the SFC on general legal matters such as copyright, personal data privacy, employment, and commercial contracts with suppliers and service providers.

### Major Features of the Securities and Futures Ordinance

- **Streamlined Licensing**  
One licence will now cover all the regulated activities that the licensee is eligible to conduct. This should simplify the licensing and compliance system and reduce costs.
- **New Proportionate Disciplinary Sanctions on Licensees**  
The Ordinance provides for additional types of sanctions including the power to fine. It also has provision for the Commission to suspend or revoke a licence in respect of only part of a licensee's business. These innovations will result in greater flexibility in tailoring appropriate sanctions.
- **Combating Market Misconduct**  
Parallel civil and criminal regimes will enable the Commission more effectively to combat market misconduct. A Market Misconduct Tribunal will be created to build on the work of the Insider Dealing Tribunal by handling civil cases of market misconduct such as market manipulation and other forms of market abuse. The Tribunal will be able to impose a greater range of civil sanctions such as "cease and desist" and "cold shoulder" orders, disqualifying a person from directorship or management of a company and ordering disgorgement of profits. As an alternative to legal proceedings, all types of market misconduct will be subject to criminal prosecution which, if successful, may result in more severe penalties on conviction, including up to 10 years' imprisonment or a fine of up to HK\$10 million.
- **Private Rights of Civil Action**  
There will be statutory rights of action through the civil courts for individuals who have suffered pecuniary loss caused by market misconduct or false or misleading public statements concerning securities.
- **Strengthening Disclosure of Interests Regime**  
Equal and timely access for investors to information about controlling interests in listed companies will be ensured through a tighter regime of disclosure of interests in listed companies. The disclosure requirements will apply to those acquiring or disposing of an interest
- of 5%, rather than the former 10%, or more of the issued voting share capital of a listed company (including interests in underlying securities). The notification period will be reduced from the existing five days to three business days.
- **Investor Compensation**  
A new investor compensation scheme will be introduced with a per-investor limit of HK\$150,000. Coverage will now extend to a much broader range of intermediaries, not just SEHK and HKFE participants. An independent investor compensation company will be formed to administer the scheme.
- **Facilitating Market Innovation**  
The emergence of electronic trading networks and the new regulatory issues posed by this are addressed in the Ordinance with a licensing regime extending to cater for companies providing automated trading services. Different procedures will apply depending on the nature of the services. The licensing regime will apply to stockbroking-style services, while those that duplicate a stock exchange function will require separate authorization. The intention is a flexible regime which can cater for future market development in this area without the need to amend the Ordinance.
- **Checks and Balances: the SFC's Accountability**  
Along with the extension of the Commission's powers in certain areas such as its supervision, investigatory, intervention powers, the corresponding checks and balances on the Commission are improved and enhanced in the Ordinance. These include the preservation or raising of the existing statutory thresholds applicable to the exercise of its powers by the SFC, provisions in the Ordinance which clearly preserve the privilege against self-incrimination and the stringent secrecy and confidentiality obligations to which the SFC and its staff are subject. A powerful safeguard will lie in the establishment of an independent full-time appeals tribunal chaired by a judge – the Securities and Futures Appeals Tribunal. Many SFC decisions will be appealable to this tribunal.

# Corporate Affairs

## This chapter is about:

- The Commission's finances and cost controls
- Staffing, training and development
- Staff exchanges
- e-SFC Programme
- Investor education and communications
- Handling public complaints
- Reaching out to stakeholders

## Achievements

- Streamlined workflow and achieved savings in light of budget deficit
- Revamped Electronic Investor Resources Centre
- Held conferences on current regulatory issues
- Conducted Stakeholder Survey
- Better disclosure in *Annual Report*, *Quarterly Report* and the monthly *SFC Alert*

## What We Do

- Provide finance, human resources and training, information technology, management and corporate services to the Commission;
- Provide strategic planning and corporate coordination on the Commission's work; and
- Maintain and foster effective communications with stakeholders, including the media and investors.

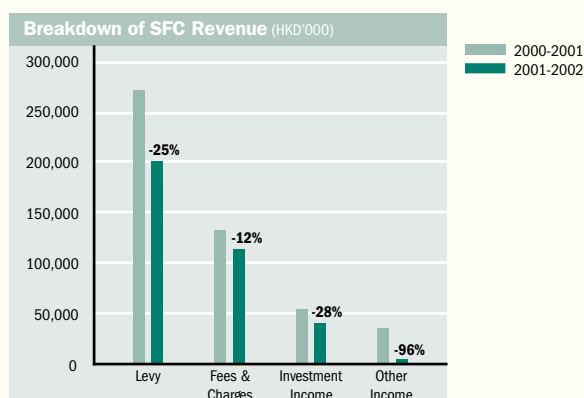
This chapter covers the work of the Chairman's Office, Commission Secretariat, Finance and Administration, Human Resources, Training and Development, Information Technology, Investor Education and Communications, and Corporate Communications.

## What We Did

### Finances and Cost Controls

Total revenue for 2001-2002 dropped by 27% from the previous year to \$363 million. Following a slowdown in market activities, there were falls in levy income, fees and charges, investment income, and other income.

Levy income, the primary source of revenue, dropped by 25% largely because the daily market turnover had shrank to an average of \$7.7 billion from \$10.3 billion in the previous financial year. Fees and charges fell 12% due to a drop in licensing applications and less income from corporate finance activities.



At mid-year, the Commission revised its Budget for the year 2001-2002 to reflect the market conditions. The projected deficit was increased to \$88 million from the \$52.9 million approved by LegCo in March 2001.

We exercised stringent cost control in the second half. We froze wage increases and headcount, deferred outsourced training programmes and cut overseas travelling and external relations expenditures. In addition to the hiring and wage freeze, we suspended discretionary variable pay. Our prompt action brought a reduction of 4.4% in actual staff costs over the previous year. The savings represented a 12.4% drop in the projected staff costs of the approved budget.

While the staff costs declined, certain other expenditures increased due to consultancy studies on market development, broker risk monitoring and phase II of SCEFI, as well as outsourcing of certain computer services. These were either expenditures that were strategically important for development of the Hong Kong market and our regulatory functions or contractually committed expenditure.

The cost control measures yielded considerable results. The actual deficit for the year came to \$54.2 million, only 2.5% higher than the original budgeted deficit of \$52.9 million. The reserve at the end of March 2002 was \$624 million, equivalent to 17 months of estimated expenditure (including depreciation) of \$450.3 million for 2002-2003.

Our Budget for 2002-2003 forecasts a total operating expenditure of \$450.3 million and an operating deficit of \$117.6 million. In March 2002, the Financial Secretary under the delegated authority from the Chief Executive approved the Budget.

Our investment policy, approved by the Financial Secretary, was revised to permit us to invest in US\$ denominated fixed income securities.



Sharing sessions, training and outings are regularly held to enhance staff's regulatory skills and employee relations.

### Staffing, Training and Development

The Commission's establishment increased slightly by 1.4% to 361 over the year, but costs were held in check. As at 31 March 2002, there were 355 permanent and 60 temporary staff, of whom about 37% held professional qualifications. Staff turnover dropped from 17.1% to 7.4%. To retain staff in a competitive and rapidly changing environment, while variable pay for 2001-2002 was suspended, the merit pay was awarded in April 2001 to staff with exceptional performance in the previous year.

Only a skilled and knowledgeable workforce can deal responsibly and efficiently with the complex legal and regulatory issues handled by the SFC. To this end we provided 3,138 man-days of training on a range of industry, management, language and information technology issues during the year.

To improve internal communication and maximise resources, our colleagues shared their expertise and experience through special sharing sessions. Presentations were also regularly made by overseas regulators and prominent local speakers.

A continuous assessment programme helped us determine the additional skill sets required for managing regulatory issues in today's fast moving markets. We introduced training on creative thinking, negotiation, presentation skills and time management. Staff were regularly updated on the developments in the Mainland markets.

During the year, nine staff members attended overseas training programmes and visited regulatory bodies in the US, UK and Asia Pacific. We organised three study visits to Shenzhen for over 100 staff.

### Staff Exchanges

Three staff were seconded to the CSRC, one each to the Financial Services Authority in the UK and the Australian Securities & Investments Commission, and one to an investment bank in the US. We received eight secondees from CSRC and two from the Taiwan Securities and Futures Commission. We also took part in the civil service staff exchange programme, having seconded one staff to the Financial Services Bureau (FSB) and in return received one staff from the civil service. To strengthen ties, we have also opened some of our training programmes to the HKMA, the FSB and the Mandatory Provident Fund Schemes Authority.

### e-SFC Programme

In April 2001, the SFC embarked on an e-SFC Programme to raise the efficiency and effectiveness of our work and to improve interaction with stakeholders, particularly those in the securities industry.

The e-SFC Programme rolls out in four 6-month segments over a two-year period. When completed, it will enable the sharing and archiving of institutional information and knowledge, the automation and integration of internal work processes and the upgrade of service quality. The following was implemented:

### Improving Internal Work Processes

We search constantly for new ways to enhance our efficiency and reduce costs. Newly developed systems, coupled with redesigned workflow, allow us to achieve better efficiency and re-deploy resources more effectively.

New systems were implemented to:

- track the progress, findings, actions taken, soft and hard information of parties allegedly involved in market manipulation or insider dealing cases;
- capture management information about the progress of application and authorization of investment products;
- streamline reporting of the SFC's field audits to facilitate the monitoring of intermediaries' financial positions; and
- settle payments to service vendors electronically. To prepare for the transition to the new licensing regime, we are studying the feasibility of allowing registrants to settle fees electronically.

### Enhancing External Work Processes

The launch of e-fax-submission not only allows issuers to file applications to the Corporate Finance Division in

pursuant to the Takeovers and Mergers Code, Companies Ordinance and Securities (Disclosure of Interests) Ordinance, but also facilitates case tracking and the construction of a centralised database.

The Securities and Futures Ordinance requires a revamp of the existing licensing system. The target launch date of the new system is September 2002.

The e-FRRR System, which enables registrants to submit the Financial Resource Rules Returns to the SFC electronically via the FinNet, has been well received by the market. Fuelled by the increasing popularity of FinNet, the FRRR e-submission rate increased to 71% of the total intermediary population as at March 2002.

### Certifying for Quality

Following the accreditation of ISO certification for our helpdesk and computer operations in 2002, we were accredited with ISO9001:2000 certification for our system development work last October. The accreditation confirms that our information technology initiatives are comparable to the best industry practice.

SFC launched new publications to educate investors.



### Investor Education and Communications

To combat additional risks that always arise in slack market conditions, we took proactive steps to inform investors of potential market misconduct and ways to protect their rights. The defaults of Ying Kit and Teil Securities highlighted the need for timely action.

Warnings were issued through the publication of a series of Open Letters to Investors and Investor Alert in the "Advice to Investors" section on the Commission's corporate website. To combat boiler room scams, we posted a list of unlicensed overseas companies.

Three new publications were launched in light of changes in the market place and investors' appetite. The *A-Z of Stock Investing* is an investor handbook. *Getting Started in Funds and MPF*, produced in collaboration with the Mandatory Provident Fund Schemes Authority, explains the fundamentals of funds and MPF investments. *Invest Wisely* educates investors on equity-linked notes in light of their increasing popularity among retail investors.

We introduced interactive games and new features on the Electronic Investor Resources Centre (eIRC), located at [www.hkeirc.org](http://www.hkeirc.org). With hyperlinks to over 500 websites, the eIRC achieved an average of 26,367 hits per day.



The SFC's Head of Investor Education and Communications, Ivy Lai (left), received an Ombudsman Award 2001 for the Commission's excellence in complaints handling. The Award is an annual event organised by the Ombudsman to promote accountability, openness and quality of service in the public sector.

The *Retail Investor Survey* gauged the effectiveness of our investor education campaigns and helped us plan ahead and better allocate our resources. The third such survey was concluded in July 2001. It rated newspapers and radio segments the most effective communication channels. Subsequently we produced 76 articles in local newspapers and 68 radio segments on key topics. We will continue to explore new communications channels.

We rolled out two Announcements of Public Interests campaigns (API) on television and radio. The two APIs, each with a slightly different thrust, focus on the importance of fact finding in the process of making investment decisions.



The SFC's Announcements of Public Interests campaign conveys to investors a message on the importance of fact finding.



We ran secondary school teacher workshops with a view to encouraging teachers to share with students the importance of investing properly. A total of 18 workshops on stock, fund and futures reached over 760 teachers. We continued to expand our community outreach programmes. We ran 31 visits or seminars, reaching 3,000 persons last year.

### Handling Public Complaints

The Commission received 3,073 investor enquiries and handled 721 complaints during the year, compared with 3,453 enquiries and 562 complaints in the previous year. The Complaints Control Committee meets every week to conduct preliminary assessment of all public complaints. This Committee is chaired by an Executive Director and has members drawn from senior staff of relevant departments. It also establishes Commission-wide procedures for the control of complaints and ensures compliance with those procedures. The Committee referred 449 cases that warranted further action to other departments, of which 113 cases were identified for full investigation by the Enforcement Division.

### Reaching Out to Stakeholders

The Commission actively engages industry participants in discussion about policy initiatives and directions at international and local conferences and seminars.

In May 2001, the Commission co-organised with the HKMA and the Hong Kong Securities Institute, a conference titled "Asia and Global Finance: New

Opportunities", in conjunction with the Fortune 500 Global Forum in Hong Kong. Over 200 delegates attended the conference.

The SFC organised in the third quarter three conferences on corporate governance, equity research and hedge funds, which attracted a total of 257 regulators and industry practitioners.

Conferences and seminars aside, the media are an important channel through which information about our work and policies is communicated to stakeholders including the general public. During the year, we issued 216 press releases and conducted 51 interviews and press briefings with local and overseas media. We spent 2,238 hours in LegCo related work, nearly two times of that in the previous year.

The SFC's corporate website [www.hksfc.org.hk](http://www.hksfc.org.hk) is an important source of information for industry participants and investors. The corporate website achieved an average of 183,671 hits per day compared to 73,888 hits per day in 2000-2001. We made enhancements on the navigation of the website and strengthened its content.

### Concern for the Community

Our staff enthusiastically support charitable causes. We participated in the Community Chest's "Dress Casual Day" on 24 October 2001 for the ninth consecutive year. We also took part in other charitable events such as contributions to the Lifeline Express, a charity for the blind.

# Cross-Border Regulatory Co-operation

## **This chapter is about:**

- SFC's involvement in IOSCO
- Assisting overseas regulators
- Combating money laundering
- Co-operation with Mainland China
- The Hague Convention

## What We Do

- **Work with overseas regulators under co-operative agreements;**
- **Participate actively in international securities regulators forum; and**
- **Develop and strengthen ties with Mainland authorities.**

Rapid globalisation and technology advancement has made the world's economies and markets more interdependent and interconnected. The need to address the risks arising from the changes has made cross-border co-operation among regulators essential, and the Commission is active in advancing this work. We have 34 formal and 10 informal co-operation arrangements with securities and futures regulatory bodies around the world.

During the year, the Commission and the Australian Securities & Investments Commission signed a Memorandum of Understanding for the exchange of information and investigatory assistance.

### IOSCO

Hong Kong actively participates in the International Organization of Securities Commissions (IOSCO) through various committees and projects. We are a member to the five Standing Committees (SC) of the influential Technical Committee (TC) that deal with different aspects of securities and intermediaries regulation.



Dr Prasam Trairatvorakul (left), Secretary General of the Securities and Exchange Commission, Thailand, and SFC Chairman Andrew Sheng met at IOSCO meetings in Hong Kong this year.

SFC Chairman Andrew Sheng is a member of a high level TC sub-committee recently established to focus IOSCO's response to the securities regulatory issues highlighted by the bankruptcy of Enron.

Alexa Lam, Executive Director of Intermediaries and Investment Products, also represents the SFC at the IOSCO Technical Committee, Implementation Committee, Project Team on Multilateral MOU and the Project Team on Securities Analysts.

The Corporate Finance Division is a member of Standing Committee One – Accounting and Auditing. SC1 monitors and comments on developments in International Accounting Standards, following IOSCO's endorsement of these standards for cross-border listings. It is also working with the International Federation of Accountants (IFAC) to foster the development of a set of high quality auditing standards for use in cross-border listings.

The Supervision of Markets Division participates in SC2 and contributes to projects on the future development of the global clearing and settlement systems, undertaken by a joint task force of the Committee on Payment and Settlement Systems and IOSCO, and by the Group of Thirty.

The Intermediaries Supervision Department participates in SC3 on the regulation of market intermediaries: intermediaries' operational risk; sound practice for the management of funds; and liquidity risk. Last year, we submitted comments on the draft Basel Capital Accord.

### IOSCO

IOSCO is a worldwide forum for securities regulators that promotes co-operation and high standards of regulation in order to maintain fair, efficient and sound markets. There are currently 110 ordinary and associate members that are securities regulators plus a further 61 affiliate members that are stock exchanges, international organisations and other similar entities.

The Enforcement Division is active in SC4, which aims to enhance co-operation, enforcement and information sharing between regulators. During the year, SC4 finalised a Guidance Note on Joint Cross-Border Investigations. Assisting the Committee, we prepared a questionnaire on co-operation in anticipation of or during civil or administrative proceedings to be distributed to members in 2002.

The Investment Products Department participates in SC5 on investment management. During the year, the Committee had reviewed requirements on fund prospectuses, corporate governance responsibilities of funds as a shareholder, risk assessment of fund operators, and fund performance reporting.

In January 2002, the SFC hosted meetings in Hong Kong of the IOSCO Emerging Markets Committee Advisory Board, the Technical Committee and the Executive Committee. The meetings attracted 73 participants from 28 regulators.

#### IOSCO Internet Surf Day

The Enforcement Division participated in the IOSCO International Internet Surf Day organised by SC4. On 23 April 2001, 291 individuals from 38 securities and futures regulators from 35 countries visited 27,493 websites. Regulators concentrated on fraudulent solicitation of investors, manipulation, the circulation of false or misleading information and insider dealing. The SFC identified seven websites that involved cross-border activity and referred them to the relevant overseas regulators for possible enforcement action.

#### Assisting Overseas Regulators

This year, Enforcement Division received 49 requests for enforcement-related assistance: 13 were requests for investigatory assistance involving the Commission in the exercise of its statutory powers; and 36 were requests for public or non-public information. On the other hand, we made 21 requests to overseas regulators and, of these, 15 were requests for investigatory assistance. In respect of licensing-related matters, the Commission received 224 requests from overseas regulatory authorities and made 474 requests.

Requests for Regulatory Co-operation	2001-2002		2000-2001		(Table 1) 1999-2000	
	In	Out	In	Out	In	Out
Enforcement-related requests for investigatory assistance	13	15	16	16	40	3
Enforcement-related requests for information	36	6	25	5	18	14
Licensing-related requests for information	224	474	214	825	257	776
<b>Total</b>	<b>273</b>	<b>495</b>	<b>255</b>	<b>846</b>	<b>315</b>	<b>793</b>

#### Combating Money Laundering

The Intermediaries Supervision Department is an active member of international anti-money laundering organisations such as the Financial Action Task Force (FATF) and the Asia Pacific Group (APG). Last year, the Department joined an APG evaluation team as financial expert to report on the anti-money laundering regime of Thailand.

#### Co-operation with Mainland China

The SFC continues to assist the Government in formulating market development policy, which will benefit both Hong Kong and China markets. The Securities and Futures Market Development Working Group of the Financial Market Development Task Force has formed a Mainland and Regional Strategy Subgroup to identify and address restrictions or issues that are obstructing Hong Kong's development to be the leading financial center of the Mainland and the region. The Subgroup, led by Alexa Lam, studies the issues of cross-border products and initiates ideas that may consolidate Hong Kong's position as a popular fund raising and fund management centre of the Mainland and the region.

During the year, the Commission and the China Securities Regulatory Commission (CSRC) continued their close liaison. We hosted the 28th Memorandum of Regulatory Co-operation (MORC) meeting in January 2002, at which executives from the CSRC, the SFC, HKEx, Shanghai Stock Exchange, and Shenzhen Stock Exchange exchanged views on various policies as well as practical issues concerning the regulation of securities

market. The Enforcement Division and its counterpart in CSRC also met to discuss market surveillance and enforcement issues to coincide with the MORC meeting. We further intensified co-operation by starting regular meetings between the Supervision of Markets Division and its counterpart in the CSRC.

Secondment of senior staff continued. During the year, three staff were seconded to the CSRC while we received eight staff.

### **The Hague Convention**

The Legal Services Division has been monitoring developments in the drafting of a future Hague Convention on the law applicable to certain rights in respect of securities held with intermediaries. The Convention hopes to address issues including the creation, perfection and enforcement of pledges, transfer of title by way of sale or collateral transaction, and issues of priority. The Division prepared and circulated a background paper on the draft Convention to interested parties prior to a regional workshop in Hong Kong last December, which was co-hosted by the Department of Justice, HKMA and the SFC. The workshop was attended by 60 government representatives, regulators, industry participants and lawyers from across the Asia Pacific region.

# Securities and Futures Commission Financial Statements

## Auditors' Report to the Securities and Futures Commission (the SFC)

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

We have audited the financial statements on pages 69 to 79 which have been prepared in accordance with International Accounting Standards adopted by the International Accounting Standards Board.

### Respective responsibilities of directors and auditors

The Hong Kong Securities and Futures Commission Ordinance (the Ordinance) requires the SFC to prepare financial statements and the directors of the SFC do so on the basis that these financial statements should give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently, that judgements and estimates are made which are prudent and reasonable and that the reasons for any significant departure from applicable accounting standards are stated.

It is our responsibility to form an independent opinion, based on our audit, on those financial statements and to report our opinion to you.

### Basis of opinion

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Society of Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the SFC in the preparation of the financial statements, and of whether the accounting policies are appropriate to the SFC's circumstances, have been consistently applied and are adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatements. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

### Opinion

In our opinion, the financial statements give a true and fair view of the state of the SFC's financial position at 31 March 2002 and of its deficit and cash flows for the year then ended, and have been properly prepared in accordance with International Accounting Standards adopted by the International Accounting Standards Board.

### KPMG

Certified Public Accountants  
Hong Kong

3 May 2002

## Income and Expenditure Account

For the year ended 31 March 2002 (Expressed in Hong Kong dollars)

	Note	2002 \$'000	2001 \$'000
<b>Income</b>			
Levies		202,620	270,250
Fees and charges		117,481	133,311
Investment income	5	41,399	57,704
Other income	6	1,485	33,476
		<u>362,985</u>	<u>494,741</u>
<b>Expenses</b>			
Staff costs	7	313,445	327,988
Premises			
rent		20,010	20,009
other		11,215	10,822
Other expenses	8	46,958	40,708
		<u>391,628</u>	<u>399,527</u>
Depreciation		25,563	21,814
		<u>417,191</u>	<u>421,341</u>
<b>(Deficit)/surplus for the year</b>		<b>(54,206)</b>	73,400
<b>Accumulated surplus brought forward</b>		<b>635,359</b>	591,959
		<u>581,153</u>	<u>665,359</u>
<b>Contribution to the Unified Exchange Compensation Fund</b>	16	–	(30,000)
<b>Accumulated surplus carried forward</b>		<b>581,153</b>	<u>635,359</u>

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

## Balance Sheet

At 31 March 2002 (Expressed in Hong Kong dollars)

	Note	2002 \$'000	2001 \$'000
<b>Non-current assets</b>			
Fixed assets	9	39,868	38,696
Held-to-maturity debt securities	10	298,110	370,204
<b>Current assets</b>			
Held-to-maturity debt securities	10	319,113	277,046
Bank deposits		38,815	102,624
Debtors, deposits and prepayments	11	24,049	29,821
Cash at bank and in hand		1,076	4,469
		<u>383,053</u>	<u>413,960</u>
<b>Current liabilities</b>			
Provision for contribution to compensation fund	16	30,000	66,174
Fees received in advance		33,301	31,271
Creditors and accrued charges		33,737	47,216
		<u>97,038</u>	<u>144,661</u>
<b>Net current assets</b>		<u>286,015</u>	<u>269,299</u>
<b>Net assets</b>		<u>623,993</u>	<u>678,199</u>
<b>Funding and reserves</b>			
Initial funding by Government	12	42,840	42,840
Income and expenditure account		581,153	635,359
		<u>623,993</u>	<u>678,199</u>

Approved and authorized for issue by the Commission on 3 May 2002 and signed on its behalf by

**Andrew L T Sheng**  
Chairman

**T Brian Stevenson**  
Non-executive Director

## Cash Flow Statement

For the year ended 31 March 2002 (Expressed in Hong Kong dollars)

	2002 \$'000	2001 \$'000
Net cash (outflow)/inflow from operating activities	(67,011)	42,889
Returns on investments – interest received	40,425	54,568
Payment to the Unified Exchange Compensation Fund	(36,174)	(163,826)
Investing activities		
Held-to-maturity debt securities bought	(246,935)	(175,125)
Held-to-maturity debt securities redeemed	277,000	25,000
Held-to-maturity debt securities sold	–	198,184
Fixed assets bought	(34,600)	(30,181)
Fixed assets sold	93	145
Net cash (outflow)/inflow from investing activities	(4,442)	18,023
Decrease in cash and cash equivalents	(67,202)	(48,346)
Cash and cash equivalents at beginning of the year	107,093	155,439
Cash and cash equivalents at end of the year	39,891	107,093

### Reconciliation of (deficit)/surplus for the year to net cash (outflow)/inflow from operating activities:

	2002 \$'000	2001 \$'000
(Deficit)/surplus for the year	(54,206)	73,400
Investment income	(41,399)	(57,704)
Depreciation	25,563	21,814
(Profit)/loss on sale of fixed assets	(43)	42
Decrease in debtors, deposits and prepayments	6,708	16,359
Decrease in creditors and accrued charges	(5,664)	(14,772)
Increase in fees received in advance	2,030	3,750
Net cash (outflow)/inflow from operating activities	(67,011)	42,889

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

	2002 \$'000	2001 \$'000
Bank deposits	38,815	102,624
Cash at bank and in hand	1,076	4,469
	39,891	107,093

## Notes to the Financial Statements

For the year ended 31 March 2002 (Expressed in Hong Kong dollars)

### 1. Status and principal activities

The Hong Kong Securities and Futures Commission Ordinance (the SFC Ordinance) established and governs the SFC. Under the SFC Ordinance, the SFC has the 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.

### 2. Income

Details of the funding of the SFC are set out in Sections 52 to 54 of the SFC Ordinance. In particular,

- (a) the SFC receives a share of the levies collected by The Stock Exchange of Hong Kong Limited and Hong Kong Futures Exchange Limited on transactions recorded on the Exchanges at rates specified by the Chief Executive in Council;
- (b) in each financial year, the SFC is eligible to receive an appropriation from the Government. Since the financial year ended 31 March 1994, the SFC has requested the Government not to make appropriations to it; and
- (c) the SFC receives fees and charges in relation to its functions and services according to the provision of subsidiary legislation.

### 3. Significant accounting policies

The SFC prepares its financial statements in accordance with International Accounting Standards (IAS) adopted by the International Accounting Standards Board (IASB), and interpretations issued by the Standing Interpretations Committee of the IASB. We set out below a summary of our significant accounting policies.

#### **Basis of preparation of the financial statements**

We have prepared these financial statements using the historical cost basis.

#### **Recognition of income**

*Levies* We record levies from the two Exchanges as income on an accrual basis.

*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.

*Investment Income* We record investment income on an accrual basis. It comprises (a) interest earned on bank deposits and held-to-maturity debt securities; (b) the amortisation of premium or discount on purchases of held-to-maturity debt securities on a straight-line basis over the periods to redemption; and (c) the gain or loss on disposal of held-to-maturity debt securities.

#### **Operating leases**

We treat the rent payable under operating leases as an expense on a straight-line basis over the period to the next rent review date. We recognise lease incentives received in the income and expenditure account as an integral part of the total lease expense.

**Retirement benefits**

We recognise obligations for contributions to defined contribution schemes as an expense in the income and expenditure account when they are payable.

**Fixed assets and depreciation**

We state fixed assets at cost less accumulated depreciation, which is calculated to write off their costs over their anticipated useful lives on a straight line basis. We use the following useful lives:

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
Mainframe computers and application systems	–	4 years
Motor vehicles	–	4 years

**Investments**

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

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

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

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

**Related parties**

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

- (a) parties that the SFC has the ability, directly or indirectly, to control or to significantly influence in making financial and operating decisions;
- (b) parties that have the ability, directly or indirectly, to control or to significantly influence the SFC in making financial and operating decisions; and
- (c) parties that are subject to common control or common significant influence.

Related parties may be individuals or corporate entities.

**Translation of foreign currencies**

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

## Notes to the Financial Statements (cont'd)

For the year ended 31 March 2002 (Expressed in Hong Kong dollars)

### 4. Taxation

In accordance with Section 3(3) of the SFC Ordinance, the SFC is exempted from Hong Kong taxes.

### 5. Investment income

	2002 \$'000	2001 \$'000
Interest income	41,362	57,557
Premium on held-to-maturity debt securities	(589)	(420)
Discount on held-to-maturity debt securities	626	364
Gain on sale of held-to-maturity debt securities	–	203
	<b>41,399</b>	<b>57,704</b>

### 6. Other income

	2002 \$'000	2001 \$'000
Legal costs recovered	241	30,605
Investigation costs awarded	585	1,894
Sale of SFC publications	535	573
Profit on sale of fixed assets	43	–
Others	81	404
	<b>1,485</b>	<b>33,476</b>

### 7. Staff costs

	2002 \$'000	2001 \$'000
Directors' fees	1,433	1,345
Directors' salaries, allowances and gratuities	26,327	27,956
Directors' bonuses/variable pay	1,263	3,795
Directors' retirement benefits	267	322
Staff salaries and allowances	264,730	276,913
Retirement benefits	11,062	9,683
Medical and life insurance	7,451	6,769
Overtime pay	912	1,205
	<b>313,445</b>	<b>327,988</b>

Directors' emoluments fell within these ranges:

	<b>2002 No. of directors</b>	2001 No. of directors
\$0 to \$1,000,000	7	8
\$1,500,001 to \$2,000,000	1	–
\$2,000,001 to \$2,500,000	2	–
\$2,500,001 to \$3,000,000	1	–
\$3,000,001 to \$3,500,000	1	–
\$4,000,001 to \$4,500,000	2	3
\$4,500,001 to \$5,000,000	–	2
\$6,500,001 to \$7,000,000	1	–
\$7,000,001 to \$7,500,000	–	1
	<b>15</b>	<b>14</b>

Emoluments paid to independent non-executive directors during the year amounted to \$1,433,000 (2001: \$1,345,000).

Aggregate remuneration of the five highest paid individuals in 2001/2002 totalling \$22,214,000 included emoluments of four executive directors and a senior staff (2000/2001: \$24,978,000 for five executive directors).

#### **Retirement 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*

*General grade staff* For general grade staff, we make monthly contributions equal to 12% of the basic pay of each staff member. 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 \$86,000 (2001 : \$856,000).

*Professional staff* For professional staff, we make monthly contributions equal to 5% of their fixed pay subject to a cap of \$4,166 per month. 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 \$456,000 (2001 : \$451,000).

This Scheme has obtained an exemption under Section 5 of 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.

## Notes to the Financial Statements (cont'd)

For the year ended 31 March 2002 (Expressed in Hong Kong dollars)

### 8. Other expenses

	2002 \$'000	2001 \$'000
Training and development	4,380	5,104
Legal and professional services	14,048	13,872
Legal claims and costs awarded	(2,500)	(3,000)
Information and systems services	15,672	11,236
Auditors' remuneration	160	159
General office and insurance	4,824	8,704
SCEFI*	7,214	1,550
External relations	3,160	3,041
Loss on sale of fixed assets	-	42
	<b>46,958</b>	<b>40,708</b>

\* SCEFI (formerly called SDNet) is the Steering Committee on the Enhancement of Financial Infrastructure which is to set up an industry wide network that will facilitate electronic communication and order routing among market operators, their participants and regulators.

### 9. Fixed assets

	Furniture, fixtures and leasehold improvements \$'000	Office equipment \$'000	Mainframe computers and application systems \$'000	Personal computers and software \$'000	Motor vehicles \$'000	Total \$'000
<b>Cost</b>						
At 1 April 2001	31,390	8,451	66,973	19,497	1,456	127,767
Additions	2,926	824	19,934	3,101	-	26,785
Disposals	-	(102)	(101)	(1,967)	-	(2,170)
<b>At 31 March 2002</b>	<b>34,316</b>	<b>9,173</b>	<b>86,806</b>	<b>20,631</b>	<b>1,456</b>	<b>152,382</b>
<b>Depreciation</b>						
At 1 April 2001	28,957	6,752	38,404	13,622	1,336	89,071
Charge for the year	3,076	843	16,977	4,547	120	25,563
Written back on disposals	-	(100)	(55)	(1,965)	-	(2,120)
<b>At 31 March 2002</b>	<b>32,033</b>	<b>7,495</b>	<b>55,326</b>	<b>16,204</b>	<b>1,456</b>	<b>112,514</b>
<b>Net book value</b>						
<b>At 31 March 2002</b>	<b>2,283</b>	<b>1,678</b>	<b>31,480</b>	<b>4,427</b>	<b>-</b>	<b>39,868</b>
<b>Net book value</b>						
At 31 March 2001	2,433	1,699	28,569	5,875	120	38,696

## 10. Held-to-maturity debt securities

	<b>2002</b>	2001
	<b>\$'000</b>	\$'000
Maturing after one year		
In the second to third years		
– unlisted	<b>145,138</b>	226,520
– listed in Hong Kong	–	8,987
– listed outside Hong Kong	<b>138,376</b>	–
After three years		
– unlisted	<b>14,596</b>	134,697
	<b>298,110</b>	370,204
Maturing within one year		
– unlisted	<b>310,116</b>	169,019
– listed in Hong Kong	<b>8,997</b>	28,006
– listed outside Hong Kong	–	80,021
	<b>319,113</b>	277,046
	<b>617,223</b>	647,250
Cost at 31 March		
– unlisted	<b>469,850</b>	530,236
– listed in Hong Kong	<b>8,997</b>	36,993
– listed outside Hong Kong	<b>138,376</b>	80,021
	<b>617,223</b>	647,250
Market value at 31 March		
– unlisted	<b>487,196</b>	550,566
– listed in Hong Kong	<b>9,074</b>	37,416
– listed outside Hong Kong	<b>136,719</b>	80,652
	<b>632,989</b>	668,634

## 11. Debtors, deposits and prepayments

There were no outstanding loans to executive staff for initial settling-in purposes at the balance sheet date (2001 : \$77,000). The maximum balance of outstanding loans to executives during the year was \$77,000 (2001 : \$267,000).

## 12. 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.

## Notes to the Financial Statements (cont'd)

For the year ended 31 March 2002 (Expressed in Hong Kong dollars)

### 13. Capital commitments

Capital commitments outstanding at 31 March 2002 not provided for in the financial statements were as follows:

	2002 \$'000	2001 \$'000
Authorized and contracted for	24,225	27,784
Authorized but not contracted for	10,868	8,911

### 14. Operating lease commitments

Non-cancellable operating lease rentals are payable as follows:

	2002 \$'000	2001 \$'000
Less than one year	25,059	18,794
Between one and five years	33,411	58,470
	58,470	77,264

During the year ended 31 March 2002, \$20,010,000 was recognised as an expense in the income and expenditure account in respect of operating leases (2001: \$20,009,000).

### 15. Related party transactions

We have related party relationship with the Unified Exchange Compensation Fund, the Commodity Exchange Compensation Fund, 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. We do not have any significant related party transactions during the year except as separately disclosed (refer to notes 16 and 18). As the SFC is an entity controlled by the Government of the Hong Kong Special Administrative Region, we are not required by IAS 24 to disclose transactions with other government controlled enterprises in the financial statements.

### 16. Contribution to the Unified Exchange Compensation Fund (the Compensation Fund)

As a result of legislation amendments in November 1998, the maximum liability of the Compensation Fund to claims of each default case can exceed the normal \$8 million limit. In order to permit the Compensation Fund to meet the possible additional claims arising from these legislation amendments, the Stock Exchange of Hong Kong Limited (the Exchange) and the SFC each committed to make a contribution of \$150 million to the Compensation Fund in the financial year ended 31 March 1999. Further commitments of \$150 million and \$30 million were made in the financial years ended 31 March 2000 and 2001 respectively.

Our provision for contributions to the Compensation Fund was:

	2002 \$'000	2001 \$'000
Balance at beginning of year	66,174	200,000
Additional provision	–	30,000
Amount utilised	(36,174)	(163,826)
Balance at end of year	30,000	66,174

## 17. Financial instruments

Financial assets of the SFC comprise held-to-maturity debt securities.

### (a) Credit risk

The Financial Secretary has approved our investment policy which only allows the SFC to invest in dated securities or in bank deposits with banks. The policy also limits the exposure to each organisation and each country, except for US Treasury, to not more than 15% and 20% of the total investment respectively. During the year, the SFC complied with the above investment policy and, as a result, was not exposed to significant credit risk.

### (b) Interest rate risk

The activities of the SFC do not expose it to significant interest rate risk.

### (c) Exchange rate risk

During the year, the Financial Secretary has approved our investment policy which also allows the SFC to invest in US dollar dated securities. As the HK dollar is pegged with the US dollar, the SFC was not exposed to significant foreign exchange risk.

## 18. Contingent liabilities

The SFC has given an undertaking to the Government to make refunds for overpayment of Special Levy as a condition for the transfer of the Special Levy surplus of \$2 million plus accrued interest to the Compensation Fund. No provision has been made in these financial statements in respect of such undertaking, as the likelihood of a claim being made for a refund of an overpayment is considered to be remote.

# Unified Exchange Compensation Fund (the Fund)

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

The members of the Committee present their annual report and the audited financial statements for the year ended 31 March 2002.

### 1. Establishment of the Fund

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

### 2. Financial results

The Committee presents the financial results which are set out in the financial statements on pages 82 to 93.

### 3. Members of the Committee

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

Mr. Mark Dickens

Mrs. Alexa Lam (appointed on 1 December 2001)

Mr. Andrew Procter (resigned on 30 November 2001)

Mr. David M. Roberts

Mr. Kwong Ki Chi, GBS

Hon. Bernard Chan (appointed on 1 April 2001 and resigned on  
18 November 2001)

Mr. T Brian Stevenson (appointed on 19 November 2001)

### 4. Interests in contracts

No contract of significance to which the Fund was a party and in which a Committee member had a material interest, whether directly or indirectly, subsisted at the balance sheet date or at any time during the year.

### 5. Auditors

The retiring auditors, Messrs. KPMG, being eligible, offer themselves for re-appointment.

On behalf of the Committee

**Mark Dickens**

Chairman

3 May 2002

## Auditors' 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 Hong Kong Securities Ordinance set out on pages 82 to 93 which have been prepared in accordance with International Accounting Standards adopted by the International Accounting Standards Board.

### Respective responsibilities of the SFC and auditors

The Hong Kong Securities Ordinance requires the SFC to keep proper accounts of the Fund and to prepare financial statements of the Fund in respect of each financial year. The directors of the SFC do so on the basis that these financial statements should give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently, that judgements and estimates are made which are prudent and reasonable and that the reasons for any significant departure from applicable accounting standards are stated.

It is our responsibility to form an independent opinion, based on our audit, on those financial statements and to report our opinion to you.

### Basis of opinion

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Society of Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the SFC in the preparation of the financial statements and of whether the accounting policies are appropriate to the Fund's circumstances, have been consistently applied and are adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

### Opinion

In our opinion, the financial statements give a true and fair view of the state of affairs of the Fund at 31 March 2002 and of its surplus and cash flows for the year then ended, and have been properly prepared in accordance with International Accounting Standards adopted by the International Accounting Standards Board.

### KPMG

Certified Public Accountants  
Hong Kong

3 May 2002

## Income and Expenditure Account

For the year ended 31 March 2002 (Expressed in Hong Kong dollars)

	Note	2002 \$'000	2001 \$'000
<b>Income</b>			
Investment income	6	37,536	32,367
Unrealised gain on revaluation of debt securities		9,779	–
		<u>47,315</u>	<u>32,367</u>
<b>Expenses</b>			
Auditors' remuneration		41	41
Bank charges		218	190
Professional fees		807	132
Sundry expenses		5	22
		<u>1,071</u>	<u>385</u>
<b>Surplus for the year</b>		<b>46,244</b>	31,982
<b>Accumulated surplus brought forward</b>		<b>191,534</b>	159,552
<b>Accumulated surplus carried forward</b>		<b>237,778</b>	<b>191,534</b>

## Balance Sheet

At 31 March 2002 (Expressed in Hong Kong dollars)

	Note	2002 \$'000	2001 \$'000
<b>Non-current assets</b>			
Debt securities	7	–	390,060
<b>Current assets</b>			
Debt securities	7	728,519	123,147
Contributions receivable	14	30,000	102,347
Interest receivable		8,383	5,358
Levy receivable		6,248	–
Bank fixed and call deposits		49,723	132,128
Cash at bank		211	57
		<b>823,084</b>	<b>363,037</b>
<b>Current liabilities</b>			
Accounts payable and accrued charges		2,724	585
Provision for compensation	4&10	40,613	123,280
		<b>43,337</b>	<b>123,865</b>
<b>Net current assets</b>			
		<b>779,747</b>	<b>239,172</b>
<b>Net assets</b>			
		<b>779,747</b>	<b>629,232</b>
Representing:			
<b>Compensation fund</b>			
Contributions from the SEHK	8	46,450	46,450
less: Compensation paid	9	(80,743)	(72,582)
Provision for compensation	4&10	(12,343)	(10,880)
add: Recoveries	11	11,277	9,854
Replenishments from the SEHK	12	16,360	16,360
		<b>(18,999)</b>	<b>(10,798)</b>
Excess transaction levy from the SEHK	13	353,787	353,787
Special contribution		3,500	3,500
Additional contributions from the SEHK and the SFC	14	630,000	630,000
Special levy surplus	15	3,002	3,002
Transaction levy	16	41,181	–
Income and expenditure account		237,778	191,534
		<b>1,269,248</b>	<b>1,181,823</b>
less: Compensation paid	9	(442,232)	(429,393)
Provision for compensation	4&10	(28,270)	(112,400)
		<b>798,746</b>	<b>640,030</b>
		<b>779,747</b>	<b>629,232</b>

Approved and authorized for issue by the Securities Compensation Fund Committee on behalf of the Securities and Futures Commission on 3 May 2002 and signed on its behalf by

**Mark Dickens**  
Chairman

**Kwong Ki Chi**  
Committee Member

**T Brian Stevenson**  
Committee Member

The notes on pages 87 to 93 form part of these financial statements.

## Statement of Recognised Gains and Losses

For the year ended 31 March 2002 (Expressed in Hong Kong dollars)

	Note	2002 \$'000	2001 \$'000
Recoveries	11	1,423	6,323
Replenishments received from the SEHK	12	–	3,627
Additional contributions from the SEHK and the SFC	14	–	330,000
Transaction levy	16	41,181	–
Special levy surplus transferred to the Fund	15	–	3,002
Decrease in provision for compensation		82,667	54,670
Compensation paid out of the Fund	9	(21,000)	(63,646)
<b>Net gains not recognised in the income and expenditure account</b>		<b>104,271</b>	333,976
Net surplus for the year		46,244	31,982
<b>Total recognised gains</b>		<b>150,515</b>	<b>365,958</b>

## Cash Flow Statement

For the year ended 31 March 2002 (Expressed in Hong Kong dollars)

	2002 \$'000	2001 \$'000
Net cash inflow/(outflow) from operating activities	1,068	(827)
Returns on investments—interest received	38,207	30,160
Investing activities		
Debt securities redeemed	123,000	142,000
Debt securities sold	—	24,737
Debt securities bought	(332,229)	(516,721)
Net cash outflow from investing activities	(209,229)	(349,984)
Financing		
Recoveries	1,423	6,323
Replenishments received from the SEHK	—	3,627
Additional contributions received from the SEHK and the SFC	72,347	327,653
Special levy surplus	—	3,002
Transaction levy received	34,933	—
Compensation paid	(21,000)	(63,646)
Net cash inflow from financing	87,703	276,959
Decrease in cash and cash equivalents	(82,251)	(43,692)
Cash and cash equivalents at beginning of the year	132,185	175,877
Cash and cash equivalents at end of the year	49,934	132,185

### Reconciliation of surplus for the year to net cash inflow/(outflow) from operating activities:

	2002 \$'000	2001 \$'000
Surplus for the year	46,244	31,982
Investment income	(37,536)	(32,367)
Unrealised gain on revaluation of debt securities	(9,779)	—
Increase/(decrease) in accounts payable and accrued charges	2,139	(442)
Net cash inflow/(outflow) from operating activities	1,068	(827)

## Cash Flow Statement (cont'd)

For the year ended 31 March 2002 (Expressed in Hong Kong dollars)

### Analysis of changes in financing:

	Recoveries \$'000	Compensation paid \$'000
Balance at 1 April 2000	3,531	(438,329)
Cash inflow/(outflow) from financing	6,323	(63,646)
Balance at 31 March 2001	<u>9,854</u>	<u>(501,975)</u>
Balance at 1 April 2001	9,854	(501,975)
Cash inflow/(outflow) from financing	1,423	(21,000)
<b>Balance at 31 March 2002</b>	<b><u>11,277</u></b>	<b><u>(522,975)</u></b>

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

	2002 \$'000	2001 \$'000
Cash at bank	211	57
Bank fixed and call deposits	49,723	132,128
	<u>49,934</u>	<u>132,185</u>

## Notes to the Financial Statements

For the year ended 31 March 2002 (Expressed in Hong Kong dollars)

### 1. Status change of the SEHK members

On 6 March 2000, the Stock Exchange of Hong Kong Limited (the SEHK) became a wholly owned subsidiary of Hong Kong Exchanges and Clearing Limited (HKEx). The members of the SEHK ceased to be SEHK shareholders and received shares in HKEx and SEHK trading rights. Most also became exchange participants of the SEHK which requires continued holding of a trading right.

Pursuant to the Exchanges and Clearing Houses (Merger) Ordinance, an exchange participant means a person who may trade on or through the Exchange Company and a "trading right" means a right to be eligible to trade on or through the Exchange Company. Following the status change and related changes to the legislation, claims against the Fund must be made in relation to a default by a SEHK exchange participant (formerly a member) and the SEHK must make deposits to the Fund for each trading right (formerly each share in the SEHK).

### 2. 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 SEHK. Part X of the Securities Ordinance governs its operation.

The SEHK receives and determines claims against the Fund. The SFC maintains and invests the money in 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 Securities Ordinance limits to \$8 million the total amount that may be paid per exchange participant default. If allowed claims exceed the limit, payments are made proportionally to claimants. The SEHK with the approval of the SFC can decide to increase the limit if it considers, among other things, that the assets of the Fund so permit. For six defaults since 1998, the SEHK proposed and the SFC approved increases in 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 Securities Ordinance. Unpaid claim amounts would be charged against future receipts by the Fund and paid when funds were available.

The Legislative Council enacted the Securities and Futures Ordinance (SFO) on 13 March 2002. The SFO and related subsidiary legislations are expected to come into effect at the end of 2002. The SFO requires the SFC to form a new single investor compensation fund (ICF) to replace the Fund and the Commodity Exchange Compensation Fund. Claims may be made against the Fund for defaults occurring prior to the effective date of the SFO. The SFC will retain a sufficient sum of money in the Fund to meet claims allowed against it and its other liabilities. Remaining balance of money in the Fund will be transferred from it into the ICF after the effective date of the SFO.

### 3. Money constituting the Fund

Under the Securities Ordinance, the SEHK must deposit and keep deposited with the SFC \$50,000 for each SEHK trading right. When the SFC makes compensation payments out of the deposits, the SFC may require the 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 (2001: nil).

## Notes to the Financial Statements (cont'd)

For the year ended 31 March 2002 (Expressed in Hong Kong dollars)

### 3. Money constituting the Fund (continued)

As explained in notes 13 and 14, the SEHK and the SFC have made contributions of their own money to the Fund. The SFC retains in the Fund investment returns earned on these contributions.

Other sources of money for the Fund include: recoveries detailed in note 11; SEHK replenishments detailed in note 12; special levy surplus detailed in note 15; and transaction levy detailed in note 16.

### 4. Significant accounting policies

The Fund prepares its financial statements in accordance with International Accounting Standards (IAS) adopted by the International Accounting Standards Board (IASB), and interpretations issued by the Standing Interpretations Committee of the IASB. In compliance with the Securities Ordinance, the income of the Fund consists of investment income and other receipts constitute part of the Fund. We set out below a summary of our significant accounting policies.

#### **Basis of preparation of financial statements**

In previous years, the financial statements have been prepared on a going concern basis. However, as described in note 2, 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 not provided in the financial statements for all expenses expected to be incurred subsequent to the balance sheet date and up to the date operation will cease as these are estimated to be immaterial.

#### **Recognition of income**

*Investment income* We record investment income on an accrual basis. It comprises (i) interest earned on bank deposits and debt securities; (ii) the amortisation of premiums or discounts on purchase of debt securities on a straight line basis over the periods to redemption before the adoption of the break-up basis for the preparation of these financial statements; and (iii) the gain or loss on disposal of debt securities.

#### **Investments**

As we have prepared the financial statements on a break-up basis, we have reclassified our investments in debt securities, which were classified as held-to-maturity debt securities before the enactment of the SFO, as current assets. We state these securities at fair value with any resultant unrealised gain or loss recognised in the income and expenditure account. The fair value of the securities is their quoted bid prices at the balance sheet date. We account for purchases and sales of debt securities on the settlement date.

#### **Recoveries and replenishments by the SEHK**

We record recoveries pursuant to Section 118 of the Securities Ordinance and replenishments from the SEHK pursuant to Section 107 of the Securities Ordinance directly to the Fund on a receipt basis.

#### **Provision for compensation**

We make provision for known liabilities arising from claims for pecuniary losses suffered by persons as a result of defaults on the part of SEHK exchange participants for which the SEHK has published a notice calling for claims pursuant to Section 112 of the Securities Ordinance. The provision covers all such claims received up to the date on which the financial statements are approved by the Committee.

As a result of the enactment of the amendments to Section 113 of the Securities Ordinance in November 1998, the maximum liability of the Fund to claims for each default case can exceed the normal \$8,000,000 limit. We charge compensation payments and provision for each default to the contributions from the SEHK as required under Sections 104 and 106 of the Securities Ordinance up to the limit of \$8,000,000. We charge any excess over \$8,000,000 to other components of the Fund.

#### Related parties

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

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

Related parties may be individuals or corporate entities.

#### 5. Taxation

In accordance with Section 87 of the Hong Kong Inland Revenue Ordinance, the Fund is exempted from Hong Kong taxes.

#### 6. Investment income

	2002 \$'000	2001 \$'000
Interest income	37,536	33,274
Premium on debt securities	–	(1,005)
Discount on debt securities	–	22
Gain on sale of debt securities	–	76
	<b>37,536</b>	<b>32,367</b>



**9. Compensation paid**

	<b>2002</b>	2001
	<b>\$'000</b>	\$'000
Compensation paid up to the \$8 million limit as set out in Section 109(3) of the Securities Ordinance		
Balance brought forward	<b>72,582</b>	68,815
Add: Compensation paid during the year	<b>8,161</b>	3,767
Balance carried forward	<b>80,743</b>	72,582
Compensation paid in excess of the \$8 million limit pursuant to Section 113(5A) of the Securities Ordinance		
Balance brought forward	<b>429,393</b>	369,514
Add: Compensation paid during the year	<b>12,839</b>	59,879
Balance carried forward	<b>442,232</b>	429,393
Total compensation paid	<b>522,975</b>	501,975

As mentioned in note 2, for six defaults since 1998, the SEHK proposed and the SFC approved increases in the \$8 million limit via payment of up to \$150,000 per claimant or if higher the claimant's proportional share of the \$8 million limit. The relevant defaults where we made payments during the year were:

C.A. Pacific Securities Ltd.	\$1,713,000
Chark Fung Securities Co. Ltd.	\$1,761,000
Foreground Securities Co. Ltd.	\$161,000
Win Successful Securities Ltd.	\$17,365,000

**10. Provision for compensation**

	<b>2002</b>	2001
	<b>\$'000</b>	\$'000
Provision for compensation to be paid up to the \$8 million limit		
Balance brought forward	<b>10,880</b>	26,658
Less: Amount paid during the year	<b>(8,161)</b>	(3,767)
Less: Unused provision reversed during the year	<b>(372)</b>	(12,233)
Add: Additional provision made for the year	<b>9,996</b>	222
Balance carried forward	<b>12,343</b>	10,880
Provision for compensation to be paid in excess of the \$8 million limit		
Balance brought forward	<b>112,400</b>	151,292
Less: Amount paid during the year	<b>(12,839)</b>	(59,879)
Less: Unused provision reversed during the year	<b>(84,701)</b>	(47,136)
Add: Additional provision made for the year	<b>13,410</b>	68,123
Balance carried forward	<b>28,270</b>	112,400

We made provision for unprocessed claims in respect of six SEHK exchange participants for which the SEHK has published a notice calling for claims pursuant to Section 112 of the Securities Ordinance. The maximum liabilities of the Fund in respect of five of these defaulted cases exceed the normal \$8 million limit.

## Notes to the Financial Statements (cont'd)

For the year ended 31 March 2002 (Expressed in Hong Kong dollars)

### 11. Recoveries

In exercising its subrogated rights, the SFC recovered for the Fund the following amounts:

	2002 \$'000	2001 \$'000
Balance brought forward	9,854	3,531
Amount recovered during the year	1,423	6,323
Total recoveries	<u>11,277</u>	<u>9,854</u>

### 12. Replenishments from the SEHK

The SFC has required the SEHK to replenish the Fund as follows:

	2002 \$'000	2001 \$'000
Balance brought forward	16,360	12,733
Amount replenished by the SEHK during the year	-	3,627
Total replenished by the SEHK	<u>16,360</u>	<u>16,360</u>

### 13. Excess transaction levy from the SEHK

The SEHK paid these amounts to the Fund from 1992 to 1994 under an agreement with the SFC and the Financial Secretary concerning the SEHK's budget and its receipt of transaction levy.

### 14. Additional contributions from the SEHK and the SFC

Since 1998, the SFC and the SEHK have each contributed \$300 million to the Fund. In 2000/01, the SFC committed a further contribution of \$30 million to the Fund.

### 15. Special levy surplus

In November 2000, the Financial Services Bureau of the HKSAR Government transferred to the Fund \$3,002,000 under the provisions of the Exchanges (Special Levy) Ordinance.

### 16. Transaction levy

From 1 September 2001, the Fund received a transaction levy chargeable at 0.002% of every leviable SEHK transaction. During the year, the Fund recognised transaction levy of \$41,181,000 (2001: Nil).

### 17. Related party transactions

We have related party relationship with the SFC and the SEHK. During the year, there were no significant related party transactions other than those disclosed in the financial statements (refer to notes 8 to 14).

## 18. Financial instruments

Financial assets of the Fund comprise debt securities.

### (i) Credit risk

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

### (ii) Exchange rate risk

All our debt securities are denominated in Hong Kong dollars and, as a result, the Fund was not exposed to foreign exchange risk.

### (iii) Market risk

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

## 19. Contingent liabilities

As at the date of this report, claims against seven exchange participants had been received by the SEHK. They are subject to the normal \$8 million limit pursuant to Section 109 of the Securities Ordinance. The validity of these claims is under investigation. We have not made any provision in these financial statements for any of these claims. The maximum liability of the Fund to these claims is \$56 million (2001: \$96 million).

# Commodity Exchange Compensation Fund (the Fund)

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

The members of the Committee present their annual report and the audited financial statements for the year ended 31 March 2002.

### 1. Establishment of the Fund

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

### 2. Financial results

The Committee presents the financial results which are set out in the financial statements on pages 96 to 103.

### 3. Members of the Committee

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

Mr. Mark Dickens	
Mrs. Alexa Lam	(appointed on 1 December 2001)
Mr. Andrew Procter	(resigned on 30 November 2001)
Mr. William D. Grossman	
Mr. Mark Ho	
Hon. Bernard Chan	(appointed on 1 April 2001 and resigned on 18 November 2001)
Mr. T Brian Stevenson	(appointed on 19 November 2001)

### 4. Interests in contracts

No contract of significance to which the Fund was a party and in which a Committee member had a material interest, whether directly or indirectly, subsisted at the balance sheet date or at any time during the year.

### 5. Auditors

The retiring auditors, Messrs. KPMG, being eligible, offer themselves for re-appointment.

On behalf of the Committee

**Mark Dickens**

Chairman

3 May 2002

## Auditors' Report to the Securities & Futures Commission (the SFC)

We have audited the financial statements of the Commodity Exchange Compensation Fund (the Fund) established under Section 77 of the Hong Kong Commodities Trading Ordinance set out on pages 96 to 103 which have been prepared in accordance with International Accounting Standards adopted by the International Accounting Standards Board.

### Respective responsibilities of the SFC and auditors

The Hong Kong Commodities Trading Ordinance requires the SFC to keep proper accounts of the Fund and to prepare financial statements of the Fund in respect of each financial year. The directors of the SFC do so on the basis that these financial statements should give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently, that judgements and estimates are made which are prudent and reasonable and that the reasons for any significant departure from applicable accounting standards are stated.

It is our responsibility to form an independent opinion, based on our audit, on those financial statements and to report our opinion to you.

### Basis of opinion

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Society of Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the SFC in the preparation of the financial statements and of whether the accounting policies are appropriate to the Fund's circumstances, have been consistently applied and are adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

### Opinion

In our opinion, the financial statements give a true and fair view of the state of affairs of the Fund at 31 March 2002 and of its surplus and cash flows for the year then ended, and have been properly prepared in accordance with International Accounting Standards adopted by the International Accounting Standards Board.

### KPMG

Certified Public Accountants  
Hong Kong

3 May 2002

## Income and Expenditure Account

For the year ended 31 March 2002 (Expressed in Hong Kong dollars)

	Note	2002 \$'000	2001 \$'000
<b>Income</b>			
Investment income	6	5,618	6,691
Unrealised gain on revaluation of debt securities		1,572	–
		<u>7,190</u>	<u>6,691</u>
<b>Expenses</b>			
Auditors' remuneration		41	41
Bank charges		66	36
Professional fees		37	16
Sundry expenses		1	1
		<u>145</u>	<u>94</u>
<b>Surplus for the year</b>		<b>7,045</b>	6,597
<b>Accumulated surplus brought forward</b>		<b>35,596</b>	28,999
<b>Accumulated surplus carried forward</b>		<b>42,641</b>	<b>35,596</b>

## Balance Sheet

At 31 March 2002 (Expressed in Hong Kong dollars)

	Note	2002 \$'000	2001 \$'000
<b>Non-current assets</b>			
Debt securities	7	–	43,071
<b>Current assets</b>			
Debt securities	7	111,159	39,505
Interest receivable		1,154	881
Levy receivable		481	593
Bank fixed and call deposits		3,677	19,141
Cash at bank		60	8
		<b>116,531</b>	60,128
<b>Current liabilities</b>			
Accounts payable and accrued charges		253	252
<b>Net current assets</b>		<b>116,278</b>	59,876
<b>Net assets</b>		<b>116,278</b>	102,947
Representing :			
<b>Compensation fund</b>			
Contributions from HKFE	8	21,600	21,300
Contract levy	9	63,643	57,684
Income and expenditure account		42,641	35,596
		<b>127,884</b>	114,580
Less: Compensation paid		(24,457)	(24,457)
Add: Recoveries	10	12,851	12,824
		<b>116,278</b>	102,947

Approved and authorized for issue by the Futures Compensation Fund Committee on behalf of the Securities and Futures Commission on 3 May 2002 and signed on its behalf by

**Mark Dickens**

Chairman

**Alexa Lam**

Committee Member

**T Brian Stevenson**

Committee Member

## Statement of Recognised Gains and Losses

For the Year Ended 31 March 2002 (Expressed in Hong Kong dollars)

	Note	2002 \$'000	2001 \$'000
Net contributions from/(refund to) HKFE	8	300	(500)
Contract levy	9	5,959	5,315
Recoveries	10	27	–
<b>Net gains not recognised in the income and expenditure account</b>		<b>6,286</b>	4,815
Net surplus for the year		<b>7,045</b>	6,597
<b>Total recognised gains</b>		<b>13,331</b>	<b>11,412</b>

## Cash Flow Statement

For the Year Ended 31 March 2002 (Expressed in Hong Kong dollars)

	2002 \$'000	2001 \$'000
Net cash outflow from operating activities	(144)	(90)
Returns on investments—interest received	6,095	6,794
Investing activities		
Debt securities redeemed	39,500	5,500
Debt securities sold	—	8,029
Debt securities bought	(67,261)	(18,053)
Net cash outflow from investing activities	(27,761)	(4,524)
Financing		
Net contribution received from/(refunded to) HKFE	300	(500)
Contract levy received	6,071	5,179
Recoveries received	27	—
Net cash inflow from financing	6,398	4,679
(Decrease)/Increase in cash and cash equivalents	(15,412)	6,859
Cash and cash equivalents at beginning of the year	19,149	12,290
Cash and cash equivalents at end of the year	3,737	19,149

### Reconciliation of surplus for the year to net cash outflow from operating activities:

	2002 \$'000	2001 \$'000
Surplus for the year	7,045	6,597
Investment income	(5,618)	(6,691)
Unrealised gain on revaluation of debt securities	(1,572)	—
Increase in accounts payable and accrued charges	1	4
Net cash outflow from operating activities	(144)	(90)

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

	2002 \$'000	2001 \$'000
Cash at bank	60	8
Bank fixed and call deposits	3,677	19,141
	3,737	19,149

## Notes to the Financial Statements

For the year ended 31 March 2002 (Expressed in Hong Kong dollars)

### 1. Status change of the HKFE shareholders

On 6 March 2000, Hong Kong Futures Exchange Limited (the HKFE) became a wholly owned subsidiary of Hong Kong Exchanges and Clearing Limited (HKEx). The shareholders of the HKFE ceased to be HKFE shareholders and received shares in HKEx and HKFE trading rights. Most also became exchange participants of the HKFE which requires continued holding of a trading right.

Pursuant to the Exchanges and Clearing Houses (Merger) Ordinance, an exchange participant means a person who may trade on or through the Exchange Company and a "trading right" means a right to be eligible to trade on or through the Exchange Company. Following the status change and related changes to the legislation, claims against the Fund must be made in relation to a default by a HKFE exchange participant (formerly a shareholder) and the HKFE must make deposits to the Fund for each holder of a trading right (formerly each shareholder in HKFE).

### 2. 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 HKFE. Part VIII of the Commodities Trading Ordinance governs its operation.

The HKFE receives and determines claims against the Fund. The SFC maintains and invests the money in 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 Commodities Trading Ordinance limits to \$2 million the total amount that may be paid per exchange participant default. If allowed claims exceed the limit, payments are made proportionally to claimants. The HKFE with the approval of the SFC can decide to increase the limit if it considers that the assets of the Fund so permit.

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 Commodities Trading Ordinance. Unpaid claim amounts would be charged against future receipts by the Fund and paid when funds were available.

The Legislative Council enacted the Securities and Futures Ordinance (SFO) on 13 March 2002. The SFO and related subsidiary legislations are expected to come into effect at the end of 2002. The SFO requires the SFC to form a new single investor compensation fund (ICF) to replace the Fund and the Unified Exchange Compensation Fund. Claims may be made against the Fund for defaults occurring prior to the effective date of the SFO. The SFC will retain a sufficient sum of money in the Fund to meet claims allowed against it and its other liabilities. Remaining balance of money in the Fund will be transferred from it into the ICF after the effective date of the SFO.

### 3. Money constituting the Fund

Under the Commodities Trading Ordinance, the HKFE must deposit and keep deposited with the SFC \$100,000 for each holder of HKFE trading rights. The SFC has discretion to add to the Fund the investment return earned on the deposits net of Fund expenses or pay interest to the HKFE. In practice, the SFC adds the investment return to the Fund.

Other sources of money for the Fund include a contract levy chargeable on contracts traded on the HKFE as detailed in note 9 and recoveries as detailed in note 10.

#### 4. Significant accounting policies

The Fund prepares its financial statements in accordance with International Accounting Standards (IAS) adopted by the International Accounting Standards Board (IASB), and interpretations issued by the Standing Interpretations Committee of the IASB. In compliance with the Commodities Trading Ordinance, the income of the Fund consists of investment income and other receipts constitute part of the Fund. We set out below a summary of our significant accounting policies.

##### **Basis of preparation of financial statements**

In previous years, the financial statements have been prepared on a going concern basis. However, as described in note 2, 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 in the financial statements for all expenses expected to be incurred subsequent to the balance sheet date and up to the date operation will cease as these are estimated to be immaterial.

##### **Recognition of income**

*Investment income* We record investment income on an accrual basis. It comprises (i) interest earned on bank deposits and debt securities; (ii) the amortisation of premium or discount on purchase of debt securities on a straight line basis over the periods to redemption before the adoption of the break-up basis for the preparation of these financial statements; and (iii) the gain or loss on disposal of debt securities.

##### **Investments**

As we have prepared the financial statements on a break-up basis, we have reclassified our investments in debt securities, which were classified as held-to-maturity debt securities before the enactment of the SFO, as current assets. We state these securities at fair value with any resultant unrealised gain or loss recognised in the income and expenditure account. The fair value of the securities is their quoted bid prices at the balance sheet date. We account for purchases and sales of debt securities on the settlement date.

##### **Recoveries**

We record recoveries pursuant to Section 95 of the Commodities Trading Ordinance directly to the Fund on a receipt basis.

##### **Contract levy**

We record contract levy directly to the Fund on an accrual basis.

##### **Provision for compensation**

We make provision for compensation for known liabilities arising from claims for pecuniary losses suffered by persons as a result of defaults on the part of the exchange participants of the HKFE which are determined up to the date on which the financial statements are approved by the Committee. We charge such provisions directly to the Fund.

##### **Related parties**

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

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

Related parties may be individuals or corporate entities.

## Notes to the Financial Statements (cont'd)

For the year ended 31 March 2002 (Expressed in Hong Kong dollars)

### 5. Taxation

In accordance with Section 87 of the Hong Kong Inland Revenue Ordinance, the Fund is exempted from Hong Kong taxes.

### 6. Investment income

	2002 \$'000	2001 \$'000
Interest income	5,618	6,736
Premium on debt securities	–	(123)
Discount on debt securities	–	48
Gain on sale of debt securities	–	30
	<b>5,618</b>	<b>6,691</b>

### 7. Debt securities

	2002 \$'000	2001 \$'000
Maturing after one year		
In the second to third years – unlisted	54,826	28,040
After three years – unlisted	3,265	15,031
	<b>58,091</b>	<b>43,071</b>
Maturing within one year		
– listed in Hong Kong	–	3,988
– listed outside Hong Kong	5,833	15,003
– unlisted	47,235	20,514
	<b>53,068</b>	<b>39,505</b>
	<b>111,159</b>	<b>82,576</b>

In previous year, we stated debt securities at amortised cost less any provisions for impairments as those securities were held-to-maturity securities. We also provide the market value of debt securities as at 31 March below for comparison purpose. As described in note 4, assets are stated at recoverable amounts as of 31 March 2002 as financial statements have been prepared on a break-up basis. We recognised an unrealised gain of \$1,572,000 on revaluation of the debt securities in the income and expenditure account.

	2002 \$'000	2001 \$'000
Market value of debt securities		
– listed in Hong Kong	–	4,040
– listed outside Hong Kong	5,833	15,124
– unlisted	105,326	65,880
	<b>111,159</b>	<b>85,044</b>

## 8. Contributions from HKFE

	2002 \$'000	2001 \$'000
Balance brought forward	21,300	21,800
Add: Contributions received during the year	800	200
Less: Refunds to outgoing shareholders	(500)	(700)
Balance carried forward	<u>21,600</u>	<u>21,300</u>

## 9. Contract levy

	2002 \$'000	2001 \$'000
Balance brought forward	57,684	52,369
Add: Contract levy recognised during the year	5,959	5,315
Balance carried forward	<u>63,643</u>	<u>57,684</u>

## 10. Recoveries

Under Section 95 of the Commodities Trading Ordinance, the SFC is entitled to receive in place of the claimants, all claims, remedies and distributions of surplus assets on liquidation of the exchange participants in relation to the loss sustained by the claimants, to the extent of the payment made by the SFC out of the Fund. The SFC has passed all amounts so received back to the Fund. During the year, \$27,000 was received and passed back to the Fund (2001 : Nil).

## 11. Related party transactions

We have related party relationship with the SFC and the HKFE. During the year, there were no significant related party transactions other than those disclosed in the financial statements (refer to notes 8 to 10).

## 12. Financial instruments

Financial assets of the Fund comprise debt securities.

### (i) Credit risk

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

### (ii) Exchange rate risk

All our debt securities are denominated in Hong Kong dollars and, as a result, the Fund was not exposed to foreign exchange risk.

### (iii) Market risk

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

# Committees and Panels

## Committees of the SFC

### Advisory Committee

Advises the Commission on any matter of policy regarding the performance of its functions.

#### Chairman

Andrew L T Sheng, SBS, JP

#### Members

Ashley Alder (from 03.12.01)  
 Didier Balme (from 01.06.01)  
 Thaddeus Beczak (from 01.06.01)  
 Ambrose Cheung (from 01.06.01)  
 Paul Chow (from 01.06.01)  
 Paul Fan (from 01.06.01)  
 Keith Ferguson (from 01.06.01)  
 Mario Francescotti (from 01.06.01)  
 Christina Hui (from 01.06.01)  
 Stephen Hui  
 Alexa Lam (from 23.04.01)

Christine Loh (from 01.06.01)  
 David Carse, JP (to 31.05.01)  
 Linus Cheung, JP (to 31.05.01)  
 Peter Clarke (to 31.05.01)  
 Dannis Lee Jor Hung (to 31.05.01)  
 Leong Ka-chai, JP (to 31.05.01)  
 Sydney Leong, JP (to 31.05.01)  
 Andrew Lo (to 31.05.01)  
 Andrew Procter (to 30.11.01)  
 Tai Tak Hing (to 02.01.02)  
 Louis Wolfe (to 06.02.02)

### Takeovers and Mergers Panel

Administers the Code on Takeovers and Mergers

#### Chairman

Kevin Westley

#### Deputy Chairmen

Clifton Chiu  
 Henry H L Fan, SBS, JP

#### Members

Nicholas Allen  
 Ian Boyce  
 David Carse  
 Edward Cheng  
 Stephen Clark  
 David Graham (from 01.04.01)  
 Teresa Ko  
 Clement Kwok  
 Angelina Lee  
 Alfred Li  
 Liu Chee-ming

David Lui  
 Frederick Ma  
 C Roger Moss  
 Gavin Nesbitt (from 01.04.01)  
 Patricia Shih (from 01.04.01)  
 Frank Slevin (from 01.04.01)  
 May Tan (from 01.04.01)  
 Carlson Tong (from 01.04.01)  
 David Webb (from 01.04.01)  
 V-Nee Yeh  
 Mark Dickens (to 31.01.02)  
 Andrew Procter (to 30.11.01)

### 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.

<b>Chairman</b> Alan Hoo, SC	<b>Members</b> Kevin Westley Clifton Chiu Nicholas Allen Ian Boyce Edward Cheng Stephen Clark David Graham (from 01.04.01) Teresa Ko Clement Kwok Angelina Lee Alfred Li	Liu Chee-ming David Lui Frederick Ma C Roger Moss Gavin Nesbitt (from 01.04.01) Patricia Shih (from 01.04.01) Frank Slevin (from 01.04.01) May Tan (from 01.04.01) Carlson Tong (from 01.04.01) David Webb (from 01.04.01) V-Nee Yeh
<b>Deputy Chairman</b> Patrick Fung, SC (from 01.01.02) Geoffrey Ma, SC (to 30.11.01)		

### Committee On Unit Trusts

Approves prospectuses of unit trusts and mutual fund corporations; imposes conditions on approval of a prospectus; authorizes mutual fund corporations and unit trusts; imposes conditions when authorizing mutual fund corporations and unit trusts and grants waivers.

<b>Chairman</b> Alexa Lam (from 01.12.01) Andrew Procter (to 30.11.01)	<b>Full Members</b> Prof. K C Chan Stuart Leckie, JP Andrew Lo David Lui Alastair Murray Joseph E Silva (from 11.09.01) Joan Wong Anna H Y Wu, SBS, JP Hendena Yu (from 26.06.01 to 31.03.02) Paul Chow (to 11.09.01)	Jonathan Hubbard (to 20.12.01) Raymond Tam (to 25.06.01) Salina Yan (to 18.06.01)
		<b>Alternate Members</b> Teh-Hsiu Fu Roger Hepper David Hughes (from 01.04.01) Lin Yoke Seetoh Paul Smith K K Tse

### Committee on Investment-Linked Assurance and Pooled Retirement Funds

Authorizes the issue of advertisements, invitations or documents in relation to investment-linked assurance schemes and pooled retirement funds; imposes conditions on the authorization of documentation of investment-linked assurance schemes and pooled retirement funds and grants waivers.

#### Chairman

Alexa Lam (from 01.12.01)  
Andrew Procter (to 30.11.01)

#### Full Members

Rex Auyeung  
Desmond Chan  
Pamela W S Chan, JP, BBS  
(to 31.03.02)  
August Chow  
Sarah Ho (from 15.05.01)  
Jonathan Hubbard (to 31.03.02)  
Stuart Leckie, JP  
Joan Wong  
Anna H Y Wu, SBS, JP

Hendena Yu (from 26.06.01 to  
31.03.02)

Roddy Anderson (to 15.05.01)  
Raymond Tam (to 25.06.01)

#### Alternate Members

Francine Kwong (from 01.04.01)  
Mak Tat-cheung (from 01.4.01 to  
31.03.02)  
Simon Ng  
Mark Saunders (to 31.03.02)

### Securities Compensation Fund Committee

Administers the Unified Exchange Compensation Fund and regulates its procedures in accordance with the Securities Ordinance.

#### Chairman

Mark Dickens

#### Members

Kwong Ki Chi, GBS  
Alexa Lam (from 01.12.01)  
David M Roberts  
T Brian Stevenson, SBS (from 19.11.01)  
Bernard Chan, JP (from 01.04.01 to 18.11.01)  
Andrew Procter (to 30.11.01)

### Futures Compensation Fund Committee

Administers the Commodity Exchange Compensation Fund and regulates its procedures in accordance with the Commodities Trading Ordinance.

#### Chairman

Mark Dickens

#### Members

William D Grossman  
Mark Ho  
Alexa Lam (from 01.12.01)  
T Brian Stevenson, SBS (from 19.11.01)  
Bernard Chan, JP (from 01.04.01 to 18.11.01)  
Andrew Procter (to 30.11.01)

### Investor Education Advisory Committee

Provides ideas and support to the Commission in setting its investor education targets.

<p><b>Chairman</b> Alexa Lam (from 01.04.01)</p>	<p><b>Full Members</b> Prof. Andrew Chan Chi Fai (to 31.03.02) Henry Chan (from 01.04.01 to 31.03.02) Michael K H Chan (to 31.03.02) Lennon W L Chan Prof. Fan Yiu Kwan (to 31.03.02) Lawrence Fok Frederick Grede (from 01.04.01) Ivy Lai Shek Kang Chuen (from 01.04.01)</p>	<p>Joseph Silva (from 20.09.01) The Hon Sin Chung Kai (from 01.04.01) Paul Chow (to 19.09.01)</p> <p><b>Alternate Members</b> Jimmy Ho (from 01.04.01) Henry Law Li Kai Ming Joseph Silva (from 01.04.01 to 19.09.01)</p>
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### Academic and Accreditation Advisory Committee

Approves industry based courses and examination for the purpose of meeting the competence requirement; endorses training programmes for the purpose of meeting the continuous professional training requirement and advises the Commission on areas to study to enhance Hong Kong's position as an international financial centre.

<p><b>Chairman</b> Alexa Lam (from 11.01.02) Andrew L T Sheng, SBS, JP (to 10.01.02)</p>	<p><b>Members</b> Prof. Dennis S S Chan Prof. Eric C Chang (from 19.02.02) Gary W K Cheung Prof. Stephen Y L Cheung Sandra Y M Lee (from 19.02.02) Vincent M K H Lee (from 19.02.02)</p>	<p>Prof. Paul B McGuinness Derek Shek (from 11.01.02) Patricia Shih Prof. K C Chan (to 18.02.02) Lee Kwok Ning, Lobo (to 18.02.02) Roger S Pyrke (to 18.02.02) Barbara Shiu (to 10.01.02)</p>
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### Share Registrars' Disciplinary Committee (from 10.12.2001)

Hears and determines disciplinary matters relating to share registrars in the first instance.

<p><b>Chairman</b> Martin Rogers</p> <p><b>Deputy Chairman</b> Stephen Clark</p>	<p><b>Members</b> Nicholas Allen Roger Best Rebecca Chow Henry H L Fan, SBS, JP David Graham David Halperin Prof. Betty M F Ho Mark Johnson Teresa Ko Dr. Bill Kwok Alan Lee</p>	<p>Clifford Levy Mark Lin Teresa Ma Michael W Scales Jim Sheridan T Brian Stevenson, SBS David Sun Carlson Tong Jason Webber Kevin Westley James Wong V-Nee Yeh</p>
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## Internal Committees

### Management Committee

Performs administrative, financial and management functions as delegated by the SFC.

<p><b>Chairman</b> Andrew L T Sheng, SBS, JP</p>	<p><b>Members</b> Ashley Alder (from 01.10.01) Mark Dickens Gerald Greiner Geoffrey Harris (from 01.09.01) Brian Ho (from 23.04.01) Alexa Lam Alan Linning (from 01.11.01)</p>	<p>Keith Lui (from 21.01.02) Joan Wong (from 21.01.02) Andrew Young (from 01.12.01) Barbara Shiu (to 25.02.02) Paul Bailey (to 31.10.01) David Stannard (to 30.9.01) Alex Pang (to 04.11.01) Andrew Procter (to 30.11.01)</p>
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### Audit Committee

Reviews the annual financial statements; reviews the management's procedures to monitor the effectiveness of the systems of accounting and internal control; recommends to the Commission the appointment of external auditors; considers the scope and planning of the external audit; reviews audit findings set out in the external auditors' management letters and management's responses to them and monitors the subsequent implementation of agreed improvements.

<p><b>Chairman</b> T Brian Stevenson, SBS</p>	<p><b>Member</b> Andrew L T Sheng, SBS, JP</p>
<p><b>Deputy Chairman</b> Anna H Y Wu, SBS, JP</p>	

### Budget Committee

Reviews and approves proposed parameters and the basis for annual budget compilation; reviews the annual budget prior to its submission to the Commission; reviews the implementation or progress of the approved annual budget half yearly and recommends to the Commission any appropriate actions and considers any other matters referred to it by the Commission.

<b>Chairman</b> Henry H L Fan, SBS, JP	<b>Members</b> Andrew L T Sheng, SBS, JP Mark Dickens
<b>Deputy Chairman</b> Raymond P L Kwok	

### Remuneration Committee

Reviews proposals on compensation structure and recommends amendments; reviews reports on trends in salary and benefits and recommends any periodic adjustments and considers any other matters referred to it by the Commission.

<b>Chairman</b> Daniel R Fung, SC	<b>Members</b> Andrew L T Sheng, SBS, JP Alan Linning (from 01.11.01) Andrew Procter (to 30.11.01)
<b>Deputy Chairman</b> Henry H L Fan, SBS, JP	

## Independent Panels

### Securities and Futures Appeals Panel

The panel is an independent statutory body whose members are appointed by the Chief Executive to hear appeals from decisions made by the Commission relating to the registration of intermediaries and certain other matters.

<b>Chairman</b> Alan Hoo, SC	<b>Members</b> Nicholas Allen Iain Ferguson Bruce Ella Cheung (from 13.10.01) Marvin Cheung, OBE, JP Peter Clarke Tim Freshwater	Dudley Leslie Harding Prof. Betty M F Ho (from 13.10.01) Rajat K Jindal Dannis J H Lee, BBS Michael T P Sze Peter S H Wong Roderick Woo Bun, JP
<b>Deputy Chairman</b> Patrick P T Fung, SC (from 01.01.02)		

### Arbitration Panel under the Leveraged Foreign Exchange Trading Ordinance

The panel resolves disputes in accordance with the Leveraged Foreign Exchange Trading (Arbitration) Rules.

<b>Chairman</b> Anthony K T Yuen	<b>Members</b> Alan Chan Davy Kwan Lam Yim Nam Joseph Y W Pang Ronald P C Tam Eddie C S Tan
<b>Deputy Chairman</b> P S Tam	

## The following were published in 2001-2002:

### Consultation Papers: 25

1. Consultation Paper on a Review of the Codes on Takeovers and Mergers and Share Repurchases	Apr 2001
2. Consultation Paper on the Draft S&F (Client Securities) Rules	Apr
3. Consultation Paper on the Draft S&F (Client Money) Rules	Apr
4. Consultation Paper on Proposed Index Funds Provisions for the Code on Unit Trusts and Mutual Funds	Jul
5. Consultation Paper on the Draft Code of Conduct for Share Registrars	Aug
6. Consultation Paper on the Draft S&F (Contract Notes, Statement of Accounts and Receipts) Rules	Sept
7. Consultation Paper on the Draft S&F (Unsolicited Calls–Exclusion) Rules	Oct
8. Consultation Paper on the Offering of Hedge Funds	Oct
9. Consultation Paper on the Draft S&F (Licensed Persons and Registered Institutions) Rules	Nov
10. Consultation Paper on the Draft S&F (Recognised Counterparty) Rules	Nov
11. Consultation Paper on the Draft S&F (Disclosure of Interests–Securities Borrowing and Lending) Rules	Dec
12. Consultation Paper on the Draft S&F (Accounts and Audit) Rules	Dec
13. Consultation Paper on the Draft S&F (Professional Investor) Rules	Feb 2002
14. Consultation Paper on Proposals for a Scripless Securities Market	Feb
15. Consultation Paper on the Draft S&F (Price Stabilizing) Rules	Feb
16. Consultation Paper on the Draft S&F (Record Keeping) Rules	Feb
17. Consultation Paper on the Proposed Amendments to the Current Financial Resources Rules	Mar
18. Consultation Paper on the Proposed Licensing Fees under the S&F (Fees) Rules	Mar
19. Consultation Paper on the Draft S&F (Information) Rules	Mar
20. Consultation Paper on the Draft S&F (Associated Entities) Rules	Mar
21. Consultation Paper on the Draft S&F (Gold Purchase) Notice	Mar
22. Consultation Paper on the Draft S&F (Registration of Commission Disciplinary Orders) Rules	Mar
23. Consultation Paper on the Draft S&F (Contracts Limits and Reportable Positions) Rules	Mar
24. Consultation Paper on the Draft S&F (Leveraged Foreign Exchange Trading–Arbitration) Rules	Mar
25. Consultation Paper on the Draft S&F (Investor Compensation) Rules	Mar

\* S&F stands for “Securities and Futures”

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1. Consultation Conclusions on the Proposed CIS Internet Guidance Note (Guidance Note for Persons Advertising or Offering Collective Investment Schemes on the Internet)	May 2001
2. Consultation Conclusions on the Draft Code of Conduct for Share Registrars	Oct
3. Consultation Conclusions on Corporate Finance Adviser Code of Conduct	Nov
4. Consultation Conclusions on Proposed Index Funds Provisions for the Code on Unit Trusts and Mutual Funds	Jan 2002
5. Consultation Conclusions on a Review of the Codes on Takeovers and Mergers and Share Repurchases	Jan
6. Consultation Conclusions on Draft Guidelines for the Regulation of Automated Trading Services	Feb
7. Consultation Conclusions on the S&F (Unsolicited Calls–Exclusion) Rules	Mar
8. Consultation Conclusions on the Proposed New Investor Compensation Arrangements	Mar

### Codes & Guidelines: 16

1. Amendments to the Codes on Takeovers and Mergers and Share Repurchases	Apr 2001
2. Guidelines on Exempt Fund Manager Status under the Code on Takeovers and Mergers	Apr
3. Guidelines on Exempt Principal Trader Status under the Code on Takeovers and Mergers	Apr
4. CIS Guidance Note (Guidance Note for Persons Advertising or Offering Collective Investment Schemes on the Internet)	May
5. Revised Guidance Note on Competence	Jun
6. Revised Guidance Note on Continuous Professional Training	Jun
7. Revised Licensing Information Booklet	Aug
8. Code of Conduct for Share Registrars	Oct
9. Amendments to the Codes on Takeovers and Mergers and Share Repurchases	Oct
10. General Circular to SFC Approved Fund Management Companies–Money Market Funds –Amendment to the Code on Unit Trusts and Mutual Funds	Oct
11. Corporate Finance Adviser Code of Conduct	Dec
12. General Circular to SFC Approved Fund Management Companies Re: Suspension of Dealings	Dec
13. Revised Codes on Takeovers and Mergers and Share Repurchases	Jan 2002
14. Provisions for Index Funds in the Code on Unit Trusts and Mutual Funds	Jan
15. Guidelines for the Regulation of Automated Trading Services	Feb
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