



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



**NEW REGULATORY FRAMEWORK
BETTER QUALITY OF MARKET**

**Enforce the Law
Protect Investors**

Annual Report 2002-2003

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 (SFCO). The SFCO and nine other securities and futures related ordinances were consolidated into the Securities and Futures Ordinance (SFO), which came into operation on 1 April 2003.

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 Securities and Futures Ordinance 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 minimise 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.

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The Securities and Futures Ordinance takes centre stage in this year's Annual Report.

The cover design is a translucent "equal" symbol, which represents fairness, openness and transparency. These are the principles on which the Commission conducts its activities. The Commission also aims to ensure the Hong Kong market is fair, open and transparent. The SFO will help us further this objective.

Objects or images depicting the equal symbol are also seen in the four operational divisional reports. They illustrate that positive changes have been effected on the work of the Commission, and hence the market.

We are confident that the **new regulatory framework** under the SFO will lead to **better market quality**. We will **enforce the law** to give appropriate **protection to investors**.



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

Chairman's Statement

We have clear objectives laid down by law, and pledge to do our best to implement the law to protect the interests of investors.



THIS STATEMENT IS ABOUT:

- **The market in 2002-2003**
- **The Commission's finances**
- **Work in the past year**
- **Priority for 2003-2004**
- **A note of thanks**

Introduction

2002-2003 was a most eventful year. The year began shortly after the enactment of the Securities and Futures Ordinance on 13 March 2002 and ended with its commencement on 1 April 2003.

Comprising nearly 600 pages each in Chinese and English, the SFO is the largest statute in Hong Kong. It is the fruit of more than a decade of hard work by those

within and outside of the SFC, plus considerable work last year preparing the subsidiary legislation, codes and guidelines, and helping the industry and the public understand the new law.

I believe the new law strikes an appropriate balance between investor protection on the one hand, and encouraging and supporting the development of the market on the other. Our basic policy aim is a world-class regulatory framework for a fair, efficient and transparent market.

The 12 months under review saw other important market-wide developments. Market reaction to a Hong Kong Exchanges and Clearing Limited (HKEx) consultation last summer, which aimed to improve the quality of the stock market, led to a Government-commissioned independent Panel of Inquiry on the Penny Stocks Incident (PIPSI). The inquiry made constructive recommendations, which included thorough and early engagement of the market and the public when formulating policies.

The PIPSI report prompted the Government to appoint a three-member Expert Group to Review the Operation of the Securities and Futures Market Regulatory Structure. The Expert Group was led by former Australian Securities and Investments Commission (ASIC) Chairman Mr Alan Cameron, and comprised Dr Raymond Ch'ien and Mr Peter Clarke. The Expert Group completed its report in March 2003. The Government considers that the recommendations of the Expert Group are in the appropriate direction and would enhance the quality of the market. It will consult the public further on the recommendations.

The Market

Market conditions worldwide throughout 2002-2003 were affected by corporate scandals in the US and the threat of war in the Middle East.

Like the global markets post the bursting of the 2000 technology bubble, Hong Kong's Hang Seng Index (HSI)

continued a downtrend. Despite its intra-year peak of 11,975 in May 2002, the HSI retreated in line with major markets. The outbreak of atypical pneumonia in March 2003 in Hong Kong raised further concerns about local economic growth as tourism and retail consumption were badly affected. The HSI plunged to a 54-month low to close at 8,634 on 31 March 2003, falling 22% during the year. The Growth Enterprise Market index closed at 108, 47% lower.

There were 985 companies listed on the Stock Exchange, with a total market capitalisation of \$3,428.9 billion (US\$439.6 billion). This confirmed Hong Kong's position as the 11th largest market in the world by market capitalisation. Capital raised through initial public offerings jumped to \$53.3 billion, 3.5 times that of a year ago.

Average daily turnover on the Hong Kong market declined by 17% to \$6.4 billion in 2002-2003, compared with \$7.7 billion in the previous year. Futures and options trading were more active, with total transactions rising by 17% to 11.8 million contracts.

Keeping Expenditures Down

As a result of the adverse market environment, total Commission revenue for 2002-2003 dropped by 7% or \$25.8 million from the previous year to \$337.2 million. Declines were recorded in all categories of income. Please see details in *Corporate Affairs* chapter.

We continued to maintain stringent cost controls imposed since the second half of 2001. We reduced total operating expenditure after depreciation by 5% or \$21.6 million to \$395.6 million.

With capital expenditure also being kept to the minimum essential for efficient operations, our deficit for the current financial year was contained at \$58.4 million, 50% lower than the original budgeted deficit of \$117.6 million. This was roughly comparable with last year's deficit of \$54.2 million even though revenue was 7% lower. The reserves at the end of March 2003 totalled \$565.6 million.

Given our assessment that 2003-2004 market conditions will remain largely uncertain, with revenue estimated to increase marginally to \$339.9 million, the Commission forecasts an operating deficit of \$93.3 million.

After 12 years in the present premises, the Commission was given notice to vacate its existing offices by June 2003. After an extensive search of alternatives, the Commission selected Chater House as the new offices. The building is also centrally located to ensure effective discharge of our functions and maximum convenience to visitors. Because of the move, fitting out expenses will be unavoidable but kept to the minimum with modest standards of fittings, while existing furniture will be reused to the fullest extent.

Work in 2002-2003

The enactment of the SFO and its preparation for implementation rightly consumed a lot of our energies in the past year, particularly in passing the rules and regulations that underpin the primary Ordinance, as well as briefing market participants about the new law.

In addition, the Commission achieved considerable progress in a number of initiatives and projects, which are detailed in the Divisional Reports. To name a few:

- We implemented the Government-led Financial Market Development Task Force initiative to facilitate the public offering of shares and debentures, with new guidelines and proposed changes to the Companies Ordinance.
- Our risk-based supervision of intermediaries enabled us to take timely actions to protect investors in several cases, while preserving sufficient flexibility to deal with minor infractions.
- We became one of the first jurisdictions to allow hedge funds to be made available to retail investors. We also consulted the market on Real Estate Investment Trusts, so that a broader choice of

investment products may be made available to the public.

- With more focused enforcement, more cases were completed within a shorter period of time. A record number of new investigations and disciplinary inquiries were achieved. With priority on corporate misconduct, we doubled the number of listed company investigations.
- The Steering Committee on the Enhancement of Financial Infrastructure II (SCEFI II) completed and published its report last December. A High Level Forum comprising the Government, SFC, Hong Kong Monetary Authority (HKMA), and HKEx would co-ordinate the implementation of SCEFI II's recommendations.

Priority in 2003-2004

Under the new SFO, the SFC's priority is clear. We must protect investors by enforcing against securities market misconduct.

The SFO has given us new powers to pursue crimes. Throughout this Report, readers will find the range of different regulatory tools that the Commission will use: dual filing which establishes the SFC as the statutory regulator of listed company disclosure; a more transparent disclosure of interests regime; "dual route" of possible criminal and civil action against market misconduct; proportionate sanctions on intermediaries including heavy fines, and many others.

We will implement the law, operating within the checks and balances that have also been enhanced. The Commission is subject to the best international standards of transparency and accountability, and checks and balances. In addition to the appeals to the Securities and Futures Appeals Tribunal on decisions of the Commission, which are also subject to judicial review, the independent Process Review Panel reviews the processes and completed investigations of the Commission to ensure that the Commission has followed due diligence and due

process in its work. The chapter on *Corporate Governance and the SFC* has the details.

Corporate Governance and the Market

For Hong Kong to continue its status as an international financial centre and the preferred capital market for external listing of Mainland enterprises, we must improve the quality of our market. Hong Kong is continually learning from international developments in corporate governance. There have been plenty: the US Sarbanes-Oxley Act, the UK Higgs Report on Non-Executive Directors, the Smith Report on Audit Committees, and the Australian Financial Services Reform Act.

The Commission has also been active in the work of the International Organisation of Securities Commissions (IOSCO). I was honoured to co-chair with my counterpart from Italy a group that developed International On-going Disclosure Standards. We also helped draft the IOSCO standards on audit independence and oversight.

The Hong Kong Government has adopted a Corporate Governance Action Plan to upgrade the quality of corporate governance in Hong Kong. Working closely with the community, particularly HKEx and the Government, we believe that the Commission can play a significant role in raising the quality of our markets.

A Note of Thanks

The achievements of the past year could not have been made without the dedication and hard work of each and every staff member, with active support of the independent Non-Executive Directors. The staff endured the atypical pneumonia concerns with quiet strength and fortitude. They continued to work, under contingency conditions, with a renewed sense of public service that has been a source of pride to the Commission.

The staff strength at the end of March 2003 was 403, a decrease from the 415 staff in the previous year despite an increased workload. Sadly, last August we lost a staff member who passed away while at work. She was a kind,

helpful and dedicated person with a strong sense of public service.

Under such work conditions, I felt I should communicate better with staff. The need for this could probably not be more vividly illustrated than by an incident last summer, when anonymous letters making allegations on certain personnel matters were circulated among the SFC, the community and the media. The Commission asked its Audit Committee, comprising independent Non-Executive Directors, to investigate, assisted by independent consultants PricewaterhouseCoopers. The inquiry found that the allegations were not substantiated.

The Audit Committee nevertheless recommended improving the human resources and related procedures, including introducing an internal complaints mechanism for staff and conducting regular staff opinion surveys. The Commission has adopted all proposals. A new Chief Operating Officer/Executive Director is expected to be appointed shortly. The Audit Committee inquiry report is published in full on our website.

I want to put on record our deep appreciation of the Non-Executive Directors, several of whom were re-appointed during the year. The Commission also thanks members of the Advisory Committee and all its various Committees, Panels, and Groups, whose advice guided us through difficult issues in difficult times.

On the occasion of the new SFO, we understand the high expectations of the market and the public on the Commission. We have clear objectives laid down by law, and pledge to do our best to implement the law to protect the interests of investors.

Andrew L T Sheng
Chairman

Whom and How We Regulate

Whom We Regulate

How We Do It

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Whom and How We Regulate

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

- Set licensing standards to ensure that all practitioners are fit and proper
- Approve licences and maintain a public register of licensees
- 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 authorisation and operation of investment products
- Authorise 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 own compliance with Listing Rules
- Monitor the trading of shares, options and futures on its markets
- Oversee its systems and technology

- Listed companies

- Approve changes to the Listing Rules
- Administer the Takeovers Code
- Monitor share dealings of directors and substantial shareholders
- Monitor share buy-backs by listed companies
- Monitor announcements and listing application materials
- Investigate listed companies suspected of prejudicial or fraudulent transactions

- All participants in trading activities

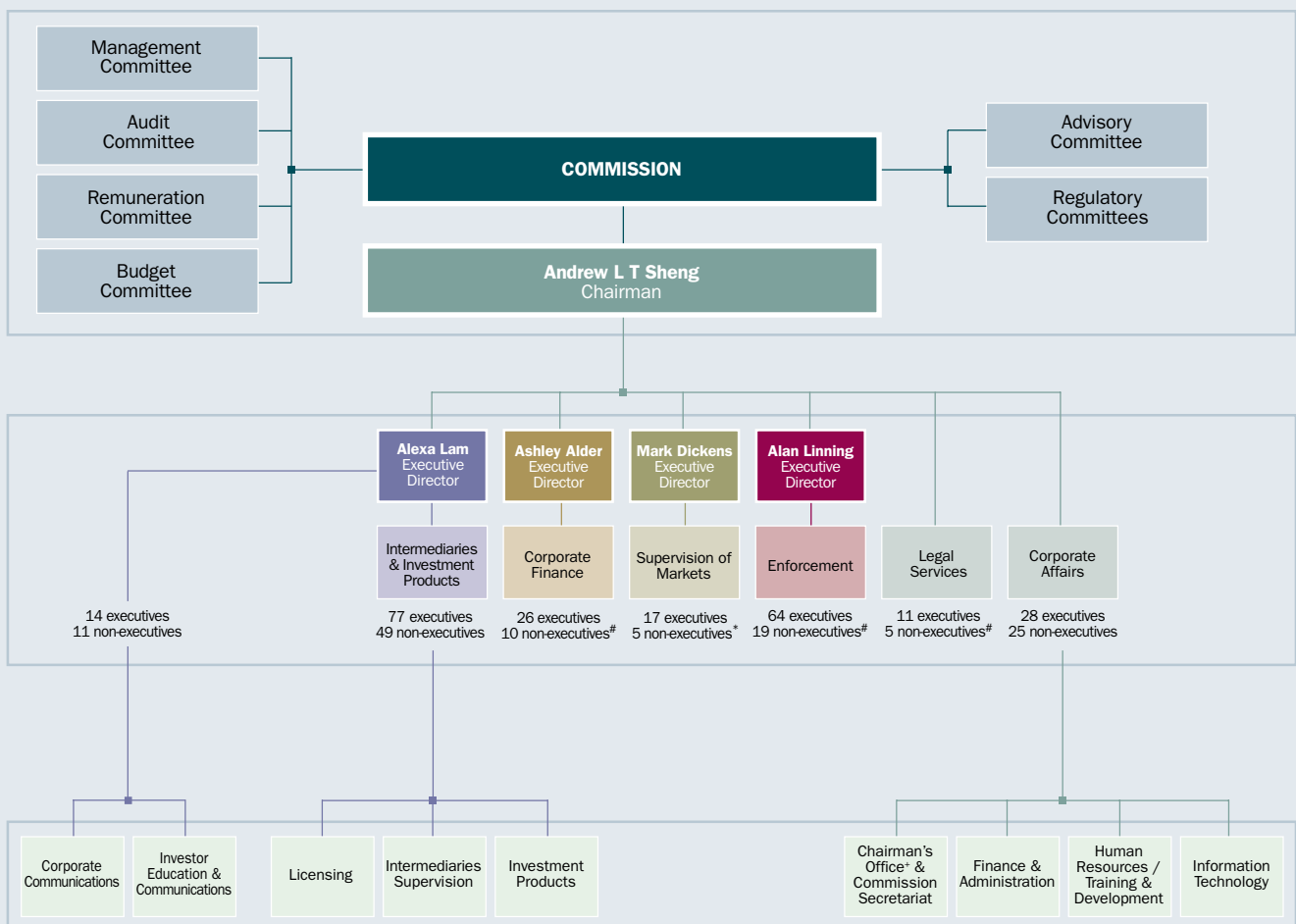
- Monitor unusual market movements and direct trade suspension of related stocks to maintain an informed and orderly market
- Investigate and take action against insider dealing, market manipulation, and other breaches of the law

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 Division.

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How We Are Organised



Excluding 12 additional posts for dual filing:

- Corporate Finance: 6 executives and 1 non-executive
- Enforcement: 3 executives and 1 non-executive
- Legal Services: 1 executive

* Including Research Department

+ Including China Policy team and Corporate Planning team

Directors of the Commission

Executive Directors

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Andrew L T Sheng, SBS, JP
Chairman (From 1 October 1998. Current appointment expires on 30 September 2003.)
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).
Also sits on Advisory Committee, Budget Committee, Management Committee, Audit Committee (to 19.08.02) and Remuneration Committee (to 18.11.02).



Mark Dickens, JP
Executive Director, Supervision of Markets Division (From 1 April 1999. Current appointment expires on 31 March 2005.)
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).
Also sits on Budget Committee, Management Committee, Securities Compensation Fund Committee, Futures Compensation Fund Committee and SFC (HKEC Listing) Committee.



Alexa Lam
Executive Director, Intermediaries and Investment Products Division (From 1 December 2001. Current appointment expires on 28 February 2005.)
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).
Also sits on Advisory Committee, Management Committee, Committee on Unit Trusts, Committee on Investment-Linked Assurance and Pooled Retirement Funds, Academic and Accreditation Advisory Committee, Investor Education Advisory Committee, Securities Compensation Fund Committee, Futures Compensation Fund Committee and SFC (HKEC Listing) Committee.



Ashley Alder
Executive Director, Corporate Finance Division (From 1 October 2001. Current appointment expires on 30 September 2004.)
Partner, Herbert Smith (1984-2001: Partner (1994-2001)); Solicitor admitted to practice in England and Wales in 1986 and Hong Kong in 1990.
Also sits on Advisory Committee, Management Committee and Shareholders Group.



Alan Linning
Executive Director, Enforcement Division (From 1 November 2001. Current appointment expires on 31 October 2004.)
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.
Also sits on Management Committee, Remuneration Committee (to 18.11.02) and SFC (HKEC Listing) Committee.

Under the Securities and Futures Ordinance, there must be no fewer than eight members of the Commission, and the majority must be Non-Executive Directors. Directors of the Commission are appointed by the HKSAR Chief Executive. The Commission has a number of statutory functions and also formulates overall policy and strategy.

As of 31 March 2003, the Commission consisted of 11 Directors, of whom five were Executive Directors and six were Non-Executive Directors. Last year the Commission met on 14 occasions.

Non-Executive Directors



Henry H L Fan, SBS, JP
(From 15 November 1995. Current appointment expires on 14 November 2003.)

Managing Director, CITIC Pacific Limited; Deputy Chairman, Cathay Pacific Airways Limited; Member, Standing Committee on Company Law Reform; Member, Selection Committee on the Admission of Talents Scheme; Director, Hong Kong Science & Technology Parks Corporation; Treasurer, University of Hong Kong. Also sits on Budget Committee, Remuneration Committee, Takeovers and Mergers Panel and Share Registrars' Disciplinary Committee.



Raymond P L Kwok
(From 1 August 1998. Current appointment expires on 31 July 2003.)

Vice Chairman and Managing Director, Sun Hung Kai Properties Limited; Chairman and Chief Executive Officer, SUNeVision Holdings Limited; Chairman, SmarTone Telecommunications Holdings Limited; Director, Kowloon Motor Bus Holdings Limited; Director, Route 3 (CPS) Company Limited; Director, Airport Freight Forwarding Centre Company Limited; Director, Real Estate Developers Association of Hong Kong; Member, General Committee of The Hong Kong General Chamber of Commerce; Member, Hong Kong Port and Maritime Board; Vice Chairman, Council of The Chinese University of Hong Kong; Member, Advisory Council of One Country Two Systems Research Institute Limited; Chairman, Management Committees of the Police Children's Education Trust and the Police Education and Welfare Trust; Member, The Ninth Chinese People's Political Consultative Conference Beijing Committee; Member, President's Council on International Activities in Yale University; Member, Asia Advisory Board of Harvard Business School.

Also sits on Budget Committee, Audit Committee (from 19.08.02) and Remuneration Committee (from 18.11.02).



Daniel R Fung, SC
(From 1 January 1999. Current appointment expires on 31 December 2004.)

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); Chairman, Broadcasting Authority; Board Member, Airport Authority (1999); Chairman, East-West Strategic Development Commission; President, China Law Council; President, International Law Association Hong Kong Branch; Vice President, 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 and on Rule of Law Programme in Cambodia and in Laos; Director of Salzburg Seminar; Member, Chinese People's Political Consultative Conference.

Also sits on Remuneration Committee.



T Brian Stevenson, SBS
(From 1 January 1999. Current appointment expires on 31 December 2004.)

Chartered Accountant; Steward, Hong Kong Jockey Club; Non-Executive Director, The Hong Kong and Shanghai Banking Corporation Limited; Non-Executive Director, Ocean Park Corporation; Non-Executive Director, MTR Corporation. Also sits on Audit Committee, Remuneration Committee (from 18.11.02), Securities Compensation Fund Committee, Futures Compensation Fund Committee and Share Registrars' Disciplinary Committee.



Anna H Y Wu, SBS, JP
(From 1 January 1999. Current appointment expires on 31 December 2004.)

Chairperson, Equal Opportunities Commission; Non-Executive Director, Mandatory Provident Fund Schemes Authority; Chairperson, University of Hong Kong Academic Board for the Postgraduate Certificate in Laws (PCLL); Member, Council of Lingnan University; Member, Legislative Council (1993-1995); Chairman, Consumer Council (1997 - 1999); Chairman, Operations Review Committee of Independent Commission Against Corruption (1997-2002).

Also sits on Audit Committee, Remuneration Committee (from 18.11.02), Committee on Unit Trusts and Committee on Investment-Linked Assurance and Pooled Retirement Funds.



The Hon Jasper Tsang Yok Sing, GBS, JP
(From 15 November 2001. Current appointment expires on 14 November 2003.)

Member, Executive Council; Member, Legislative Council; Chairman, Democratic Alliance for Betterment of Hong Kong; School Supervisor, Pui Kiu Middle School; Council Member, Open University of Hong Kong; Member, English Schools Foundation; Member, ICAC Complaints Committee; Member, Disaster Relief Fund Advisory Committee; Member, Chinese People's Political Consultative Conference. Also sits on Remuneration Committee (from 15.07.02).

Corporate Governance and the SFC

We always strive to enhance our corporate governance, accountability and transparency by adopting and implementing appropriate best practice. During the year, we changed the composition of the Audit Committee and Remuneration Committee so that they only comprise Non-Executive Directors. We believe this will strengthen our system of checks and balances. We published the number of meetings of our Board and internal committees and the average attendance rate of Directors in our last Annual Report. To further enhance transparency, we have published the attendance rates of individual Directors in this Report (see discussion below). We will monitor closely the global development in corporate governance and review the relevance of recommended best practices to us as a regulator.

In this chapter, we will discuss:

- The accountability of the Commission
- Independent and external reviews
- Internal oversight committees
- Internal control reviews
- Public redress mechanism
- Our performance pledges

The Commission

The HKSAR Chief Executive appoints our Directors and determines their remuneration packages. Presently, the Commission has 11 Directors – five full-time Executive Directors including the Chairman and six independent Non-Executive Directors. We are conducting a recruitment exercise for a Chief Operating Officer to fill an Executive Director position which has been left vacant since 1 March 2001. Since the SFO requires that the majority of the members of the Commission shall be Non-Executive Directors, an additional Non-Executive Director may be appointed later.

All important policies and decisions are discussed and approved by the Commission. In addition, our operational departments regularly brief the Directors on the latest developments in the industry and the market. The Commission receives minutes of internal committees on a regular basis. This practice facilitates the Commission in monitoring the performance of the management.

Commission meetings are held regularly every month, with additional sessions when necessary. Other Committee meetings are scheduled so that as many members as possible (which must include the Chairman or Deputy Chairman of the Committee) can attend. Inevitably, some members could not attend some of the meetings because of conflicting schedules. They were informed of the agenda and given the discussion papers, and might provide comments. Members were also kept informed of the discussions during the meeting by way of minutes.

Last year, the Commission met 14 times, with an average 79% attendance of Directors.

Number of meetings	14	
Attendance of individual Directors		
Andrew L T Sheng	10	71%
Ashley Alder	13	93%
Mark Dickens	11	79%
Alexa Lam	12	86%
Alan Linning	12	86%
Henry H L Fan	12	86%
Daniel R Fung	11	79%
Raymond P L Kwok	10	71%
T Brian Stevenson	11	79%
Jasper Tsang Yok Sing	11	79%
Anna H Y Wu	8	57%
Average attendance of meetings	79%	

The Commission reports regularly to the Financial Secretary and the Legislative Council (LegCo). By law, our annual report must be submitted to the Financial Secretary and laid before LegCo.

As a public body, the Commission is mindful of its duty to manage its fiscal affairs prudently. The Commission submits its annual estimates of income and expenditure to the HKSAR Chief Executive, 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 Process Review Panel (PRP) is an independent, non-statutory panel established by the HKSAR Chief Executive to review the Commission's internal operating procedures. It reviews whether the Commission has followed its internal procedures, including those for ensuring consistency and fairness.

The PRP comprises 12 members, including nine members from the financial sector, academia and the legal and accountancy professions, and three ex-officio members including the Secretary of Justice (or her representative), the Commission's Chairman and a Non-Executive Director of the Commission.

Over the last year, the PRP reviewed the Commission's procedures by examining various completed cases. These included the following: routine inspection of intermediaries, registration of intermediaries, authorisation of collective investment schemes, the handling of takeovers and mergers transactions and complaints, approval of prospectuses and granting of

exemptions under the Companies Ordinance and the Securities (Disclosure of Interests) Ordinance. The PRP also examined the Commission's procedures for public consultation and those for handling of complaints from the public about the conduct of intermediaries.

The PRP met four times in the past year, in addition to the regular meetings held by the Panel's two working groups. At the meetings, the PRP discussed specific topics in relation to the Commission's internal procedures and various papers containing observations and recommendations of the working groups following their case reviews.

The PRP made invaluable recommendations that cover a wide range of areas relating to specific cases and procedural issues. Most of these recommendations have been accepted by the Commission. The PRP's second annual report has been submitted to the Financial Secretary.

■ Securities and Futures Appeals Panel

The independent Securities and Futures Appeals Panel, until its replacement by a new tribunal under the SFO, heard appeals against decisions made by the SFC relating to the registration, regulation and discipline of intermediaries. Appointed by the HKSAR Chief Executive, the Panel was a part-time merits review panel headed by a Senior Counsel, with industry experts as members.

Six appeals were lodged in 2002-2003, of which two have been withdrawn (one in September 2002 and the other in April 2003), one decided by the Panel with our decision varied and three in progress. Of the six appeals, five are in relation to disciplinary decisions made by our Enforcement Division and one about a licensing decision made by our Licensing Department. Three appeals lodged in the previous year were concluded: two were withdrawn and one dismissed with our decision confirmed by the Panel. In the appeal made by Chan Sheung Chi Steven, the Panel upheld the SFC's decision to suspend Chan's registrations with the

SFC for two years for misconduct. Chan was found to have acted in concert with another person in complete disregard of the Code on Takeovers and Mergers and failed to act in accordance with the standards of conduct reasonably expected of a registered person.

The SFO replaces the existing part-time Panel with an independent full-time appeal body, namely the Securities and Futures Appeals Tribunal (SFAT). The Tribunal is chaired by a judge. A wider range of the SFC's decisions will be subject to review by the SFAT; its jurisdiction will also cover appeals from decisions of the SFC and HKMA concerning registered institutions.

■ ICAC Reviews

The Independent Commission Against Corruption (ICAC) has conducted corruption prevention reviews on the procedures of our supporting departments and operational divisions since 1990. After completing the last five reviews in 2001-2002 on the areas of complaints handling, intermediaries registration, intermediaries supervision, investment products authorisation and outsourcing of information technologies services, the ICAC has gone through all our procedures.

Last year, we discussed with the ICAC on its recommendations to improve our control procedures in the five areas to further minimise the chance of abuse and malpractice. We have gradually adopted all the recommendations of the ICAC, where appropriate.

Internal Committees

Our Non-Executive Directors play an important role in ensuring that the Commission is accountable and transparent. They monitor the performance of the Commission by asking questions and considering policies at the Board, and participating in various internal committees.

■ Budget Committee

The terms of reference of the Budget Committee require that the Chairman of the Committee to be a Non-Executive Director; the current chairman is Henry H L Fan. The Budget Committee examines and approves the proposed parameters and basis for annual budget compilation. It also reviews the estimates of our income and expenditure, which will then be submitted to the full Board for approval.

Number of meetings	1	
Attendance of individual Directors		
Henry H L Fan	0	0%
Raymond P L Kwok	1	100%
Mark Dickens	1	100%
Andrew L T Sheng	1	100%
Average attendance of meeting	75%	

■ Audit Committee

The Audit Committee, chaired by T Brian Stevenson, a Non-Executive Director, reviews the annual financial statements before their submission to the Commission for approval. It monitors the Commission's financial situation by receiving quarterly financial reports. In particular, it examines the breakdown of expenditure on legal and professional services, and information and systems services. It also regularly reviews all non-audit related fees paid to the external auditors.

The Audit Committee plays an important role in the selection and appointment of the external auditors and the design of the scope and planning of the external audit. It 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.

The Audit Committee also plays a role in monitoring our non-financial system. It considers and approves our annual internal control review programme, and monitors the implementation of measures to improve internal control procedures.

2002-2003 was a busy year for the Audit Committee. Last August, the Board asked the Audit Committee to investigate into a series of anonymous complaints alleging malpractices of internal procedures and management in the Commission. The Audit Committee appointed PricewaterhouseCoopers to assist it to conduct an independent investigation. The Audit Committee published the investigation report in February 2003, finding all the allegations not substantiated and making recommendations to improve our human resources policies and procedures.

Number of meetings	8	
Attendance of individual Directors		
T Brian Stevenson	8	100%
Anna H Y Wu	8	100%
Raymond P L Kwok¹	3	60%
Andrew L T Sheng²	2	100%
Average attendance of meetings	92%	

¹ Mr Kwok has become a member since 19 August 2002. There were five meetings during his term.

² Mr Sheng has ceased to be a member since 19 August 2002. There were three meetings during his term and he abstained from one meeting due to conflict of interests.

■ Remuneration Committee

The Remuneration Committee, chaired by Daniel R Fung, a Non-Executive Director, considers and approves the results of the annual pay review by a market consultant and any proposals on changing the compensation structure and pay ranges. The Commission, on the advice of the Remuneration Committee, determines the pay levels and pay awards of our staff. Last year, in view of the prevailing market conditions and our budgetary deficit, the Remuneration Committee decided to freeze our salary and make no awards of performance based variable pay to staff.

Number of meetings	4	
Attendance of individual Directors		
Daniel R Fung	4	100%
Henry H L Fan	3	75%
Raymond P L Kwok¹	2	100%
Alan Linning²	N/A	N/A
Andrew L T Sheng²	2	100%
T Brian Stevenson¹	2	100%
Jasper Tsang Yok Sing³	2	67%
Anna H Y Wu¹	0	0%
Average attendance of meetings	81%	

¹ Mr Kwok, Mr Stevenson, and Ms Wu have become members since 18 November 2002. There were two meetings during their term.

² Mr Linning and Mr Sheng have ceased to be members since 18 November 2002. There were two meetings during their term. Mr Linning abstained from both meetings due to conflict of interests.

³ Mr Tsang has become a member since 15 July 2002 and there were three meetings during his term.

■ Management Committee

In addition to the three committees discussed above, another important internal control mechanism is the Management Committee. The Management Committee comprises all our Executive Directors and Senior Directors and performs administrative, financial and management functions as delegated by the Commission.

At its monthly meetings, the Committee considers funding requests from departments and divisions including requests to engage outside consultants and advisers. It also has the power to determine the remuneration, allowance and conditions of employment. Every month, it reviews the staffing position, financial situation, progress of major information technology projects and latest initiatives.

Internal Control Reviews

At the beginning of each financial year, we submit our plan for internal control reviews to the Audit Committee for approval. The plan includes reviews by outside consultants and our cross-divisional audit teams. The results of the reviews are reported to the Audit Committee to ensure the internal control procedures are observed and enforced. By law, the Director of Audit may examine books, records and other documents kept by the SFC.

■ KPMG

The Audit Committee appointed KPMG during the year to review the payroll and staff benefits procedures, fee collection procedures of the Corporate Finance Division, and fixed assets acquisition and insurance policy. KPMG informed us that the control over these areas was generally satisfactory.

Since KPMG also audits our financial statements, the Audit Committee has proposed that we appoint a different auditor to conduct internal control reviews next year to enhance the independence of the reviews and the objectivity of the external auditor. We will implement this proposal in 2003-2004.

■ Cross-Divisional Audits

To supplement the annual internal control review conducted by KPMG, our cross-divisional audit teams also review different internal procedures every year. Last year, the cross-divisional team of the Corporate Finance Division looked at the revenue control system of the Finance Department. The preparation of the final report is under way.

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. In 2002-2003, the Ombudsman received five complaints against the Commission and none against its staff. The Ombudsman found two of the complaints not substantiated; the other three cases are in progress.

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 remedies. There were no judicial reviews last year.

Our Performance Pledges

In discharging our regulatory duties, we pledge to be responsive to the general public, market participants, and intermediaries under our supervision.			% of cases meeting the pledge in 2002-2003
Investor Enquiries	Preliminary response to telephone enquiries	4 working days	100%
	Preliminary response to written enquiries	2 weeks	100%
Public Complaints	Preliminary response to verbal & written complaints	2 weeks	99.4% ¹
General Enquiries	Preliminary response to enquiries via enquiry@hksfc.org.hk	4 working days	99.3% ²
Licensing Applications	Processing of applications from principals	15 Weeks	82.5% ³
	Processing of applications from representatives	10 weeks	94.2% ³
Modification/Waiver and Subordinated Loan Applications	Acknowledgement of receipt upon receiving any application	2 working days	100%
Investment Products Authorisation	Take-up of applications upon receipt	2 working days	100%
	Preliminary response to applicants after take-up for unit trusts, mutual funds and investment-linked assurance schemes	1 week	94.1% ⁴
	Preliminary response to applicants after take-up for other products	2 weeks	90% ⁴

1. Some cases did not meet the pledge due to their complexity. More time was needed to collect information to facilitate preliminary assessment.
2. Figure is based on the 967 enquiries received since 15 May 2002, when the performance pledge was announced. Some cases did not meet the pledge because of the manual processing before the introduction of an automated system in August. Of the 967 enquiries received, full replies within four days were achieved in 911 cases or 94.2%.
3. Cases that did not meet the pledge mainly consisted of those where contentious issues were involved or where there were delays in the provision of required documentation.
4. Some cases did not meet the pledge because they belonged to certain categories of investment products where there was a sudden upsurge in the number of applications.

Achievements and Work in Progress

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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 Division.

Excluding 12 additional posts for dual filing:
• Corporate Finance: 6 executives and 1 non-executive
• Enforcement: 3 executives and 1 non-executive
• Legal Services: 1 executive

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

Corporate Finance

26 executives and 10 non-executives#

- Administer Takeovers and Mergers Code, and Share Repurchases Code
- Oversee the Stock Exchange's listing-related functions and responsibilities
- Administer securities and company legislation relating to listed and unlisted companies

Intermediaries and Investment Products

77 executives and 49 non-executives

- Devise and administer licensing requirements for securities, futures, and leveraged foreign exchange trading intermediaries
- Monitor and supervise the financial viability and business conduct of intermediaries
- Regulate the public marketing of investment products

Enforcement

64 executives and 19 non-executives#

- Conduct market surveillance work
- Enforce securities laws and conduct inquiry into alleged breaches
- Inspect books and records of listed companies if impropriety is suspected
- Report suspected insider dealing cases to the Financial Secretary
- Co-operate with domestic and overseas regulatory bodies in investigations

Supervision of Markets

17 executives and 5 non-executives

- Supervise and monitor activities of the exchanges and clearing houses
- Encourage development of the securities and futures markets
- Promote and develop self-regulation by market bodies
- Oversee and manage the investor compensation funds

Legal Services and Corporate Affairs*

53 executives and 41 non-executives#

- Provide legal services to the Commission
- Provide finance, human resources and training, information technology, management and corporate services, strategic planning and co-ordination to the Commission
- Educate investors on their rights and responsibilities
- Promote effective communication with stakeholders including the media

Achievements in 2002-2003

- Issued guidelines and introduced two class exemptions for prospectuses to facilitate offers of securities
- Issued a joint consultation paper with the Government on proposed amendments to the Companies Ordinance
- Issued the Price Stabilising Rules
- Participated in various initiatives to enhance corporate governance, including promulgation of the Stock Market Listing Rules which introduce the new dual filing regime for listed company disclosure

- Prepared for the implementation of the new licensing regime and facilitated market transition
- Facilitated business with streamlined processes, exemptions in competence, and flexibility and choice in training requirements
- Took proactive regulatory actions on intermediaries to protect investors
- Strengthened the risk management of margin financing intermediaries
- Supervised a record 2,457 investment products
- Issued authorisation guidelines for hedge funds and consulted the public on Real Estate Investment Trusts (REITs) and Exchange Traded Funds (ETFs)

- Concluded 344 investigations of which 276 were completed within 12 months
- Prosecuted three cases of market manipulation and 33 entities for breaches of various ordinances
- Referred four cases of suspected insider dealing to the Financial Secretary; concluded two other cases resulting in penalties etc of \$21.3 million
- Concluded 90 disciplinary inquiries and disciplined 86 registrants or concerned persons
- Referred 15 cases of fraud and corruption to Police and ICAC and an additional 32 boiler room cases to Police

- Streamlined regulatory regime for derivative warrants and other structured products
- Relaxed short selling regulation
- Moved closer to a scripless market
- Oversaw the development of advanced market infrastructure under SCEFI recommendations
- Finalised the new single investor compensation scheme under the SFO
- Developed procedures for authorisation of Automated Trading Services

- Gazettal of 40 pieces of subsidiary legislation within a short timeframe to enable SFO commencement
- Prepared resources and provided training to staff, investors and practitioners to aid SFO compliance
- Reduced operating expenditure and contained deficit at half of the budgeted amount
- Revamped business systems to prepare for SFO commencement
- Reached out to more investors with new education initiatives
- Strengthened communication with investors and other stakeholders

Work in Progress

- Implement dual filing rules
- Improve corporate governance through Listing Rules changes and involvement in the Standing Committee on Company Law Reform
- Participate in Listing Rules reviews (i) concerning the eligibility and obligations of listing sponsors; and (ii) relating to initial and continuing listing criteria as well as delisting procedures
- Review existing laws and regulations relating to public offerings of securities
- Work with the Government and the Stock Exchange to follow up on the work of the Expert Group review of the operation of the securities and futures market regulatory structure

- Implement the new licensing regime and assist intermediaries' compliance
- Review the issue of conflicts of interests facing investment analysts
- Develop a robust risk-focused financial regulatory framework for intermediaries
- Strengthen communication with market participants
- Issue a code on REITs and guidelines on ETFs

- Target investigations on areas of corporate misgovernance, serious misconduct by intermediaries and market misconduct
- Conduct more effective inspections into listed companies with extension of powers under the SFO
- 73 cases subject to disciplinary proceeding; 10 entities awaiting hearing in Magistrates' Court; and two cases currently before Insider Dealing Tribunal
- Continue five listed company investigations
- Strengthen domestic and international co-operation, especially against cross-border fraudulent activities

- Introduce an appropriate scripless model in Hong Kong and implement other SCEFI recommendations
- Work with HKEx to facilitate the introduction of new products and services, and to improve and enhance existing ones
- Monitor HKEx's comprehensive fees review
- Monitor the launch of an integrated derivatives trading and clearing system, the common collateral management system and common risk management system
- Implement the new investor compensation arrangements and support existing investor compensation cases

- Work on legislative initiatives in relation to market reforms and further refinement of subsidiary legislation under the SFO
- Promote understanding of the SFO within the SFC and among stakeholders including investors
- Explore means to achieve further savings
- Further strengthen communication with investors and other stakeholders including continuous improvements to the SFC website

Securities and Futures Ordinance



The Securities and Futures Ordinance consolidates and modernises the 10 previous ordinances regulating the securities and futures markets in Hong Kong*. Effective on 1 April 2003, the SFO and its subsidiary legislation introduce a number of significant changes to the regulation of the securities and futures markets. We explain here some of these changes and how they may affect you as an investor or industry participant.

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New and Improved Investor Compensation Arrangements

▶ A new single Investor Compensation Fund replaces the previous schemes. It is based on a per-investor compensation limit of \$150,000 for trading securities and futures contracts respectively. This enables more transparency and allows investors to know precisely what level of compensation will be available to them should their intermediary fail. Coverage is now extended to a much broader range of firms, including both exchange and non-exchange participants, banks and securities margin financiers.

More Transparent Market Disclosure

▶ Substantial shareholders of listed companies need to disclose their interests. The notification period has been reduced from five days to three business days and the disclosure threshold for substantial shareholders reduced from 10% to 5%. In addition, there are new requirements for the disclosure of interests in shares arising under derivatives, and for disclosure of changes in the nature of an interest in shares (e.g. on exercise of an option). All these requirements will give a more complete picture of dealings by substantial shareholders and directors.

Combating Market Misconduct

▶ The possible use of civil and criminal actions will enable us to combat market misconduct more effectively. A Market Misconduct Tribunal has been set up to handle civil cases of all forms of market misconduct, including insider dealing, market manipulation, price rigging and related abuses and the dissemination of false and misleading information about securities or futures contracts. As an alternative, market misconduct may be subject to criminal prosecution which may result in a maximum penalty on conviction of 10 years' imprisonment and a fine of \$10 million. The decision to choose the criminal or civil route will be made in accordance with the Department of Justice's Prosecution Policy.

Dual Filing System to Ensure Better Corporate Disclosure

▶ The introduction of dual filing establishes the SFC as the statutory regulator of listed company disclosure. Under this arrangement, all corporate disclosure and listing application materials will be filed with both the Stock Exchange and the SFC. The SFC can exercise its enforcement powers against persons issuing false or misleading corporate information. The vetting of listing applications by the SFC will not cause any delay to the process as it will run concurrently with the Stock Exchange's process.

<p>Redress Through Civil Courts for Market Misconduct</p>	<p>▶ A new private right of civil action can assist investors to obtain damages for loss suffered as a result of market misconduct. The threat of potential civil liability should also serve as an added deterrent. Under the previous regime, if a person had suffered loss as a result of market misconduct, seeking redress through the civil courts was difficult as the person had to first establish a cause of action in law against those responsible for the misconduct. With the new statutory rights of action, findings of the Market Misconduct Tribunal in relation to market misconduct will be admissible in evidence in a private civil action.</p>
<p>Private Action for False Public Communication</p>	<p>▶ The investing public are entitled to expect that persons responsible for issuing information to them about securities and futures contracts, such as prospectuses, exercise all due care and diligence. Investors suffering loss as a result of false or misleading public statements concerning securities (or affecting the price of securities) made fraudulently or negligently, have a clear statutory right of action against those involved in issuing such statements.</p>
<p>A New Single Licensing Regime</p>	<p>▶ A new streamlined licensing system results in reduced costs for market operators without compromising investor protection. There is a universally applicable single licensing system, with one licence covering all regulated activities which a person is permitted to undertake. The public only have to check the “Public Register of Licensed Persons” on the SFC website to find out what regulated activities a licensee is eligible to conduct. The licensing regime is also extended to cater for companies providing Automated Trading Services.</p>
<p>Improving the Regulation of Intermediaries</p>	<p>▶ Proportionate disciplinary sanctions are an important deterrent to improper conduct by intermediaries. We can fine up to \$10 million, or three times the amount gained or loss avoided due to misconduct, whichever is higher. We can also suspend or revoke a licence in respect of only part of a licensee’s business. To ensure a level playing field, banks engaging in securities and futures activities are also governed by the same rules, codes and guidelines as SFC licensed corporations. They and their relevant staff are equally subject to sanctions under the SFO.</p>
<p>Enhancing SFC’s Inspection and Investigatory Powers</p>	<p>▶ Our power to obtain documents and explanations from listed companies is now extended to the parties most closely connected with the listed company. These parties include a listed company’s auditor, banks and transaction counterparties. We are able to look at the company auditor’s working papers. Such enhanced power, with adequate checks and balances, serves as a more effective tool for conducting inquiries into misconduct of listed companies which may have prejudiced the interests of shareholders.</p>
<p>Greater Accountability of the SFC</p>	<p>▶ The checks and balances on the SFC have been enhanced. These include the establishment of the Securities and Futures Appeals Tribunal, an independent full-time appeals tribunal chaired by a judge. A wide range of our decisions, primarily relating to licensing and registration, discipline and intervention, are appealable to the Tribunal. An investor may appeal to the Tribunal in relation to the amount of his or her claim on the Investor Compensation Fund as assessed by the Investor Compensation Company.</p>

* Securities and Futures Commission Ordinance (Cap. 24)
 Commodities Trading Ordinance (Cap. 250)
 Securities Ordinance (Cap. 333)
 Protection of Investors Ordinance (Cap. 335)
 Stock Exchanges Unification Ordinance (Cap. 361)

Securities (Insider Dealing) Ordinance (Cap. 395)
 Securities (Disclosure of Interests) Ordinance (Cap. 396)
 Securities and Futures (Clearing Houses) Ordinance (Cap. 420)
 Leveraged Foreign Exchange Trading Ordinance (Cap. 451)
 Exchanges and Clearing Houses (Merger) Ordinance (Cap. 555)



Three-year Comparisons

	2002-2003	2001-2002	2000-2001
Market			
Hong Kong remains a leading fund-raising centre in Asia			
Number of listed companies*	985 (+9%)	901 (+12%)	803
Market capitalisation (\$ billion)*	3,428.9 (-13%)	3,924.4 (-7%)	4,239.9
Number of IPOs	96 (-10%)	107 (+24%)	86
Capital raised through IPOs (\$ billion)	53.3 (+251%)	15.2 (-89%)	132
Hang Seng Index down but trading has been orderly			
Hang Seng Index (points)*	8,634 (-22%)	11,033 (-14%)	12,761
Trading volume down			
Average daily market turnover (\$ billion)	6.4 (-17%)	7.7 (-25%)	10.3
Finances and Staff			
No government funding required despite lower income			
Income (\$ million)	337.2 (-7%)	363 (-27%)	494.7
Strict cost control curbs expenses			
Expenses including depreciation (\$ million)	395.6 (-5%)	417.2 (-1%)	421.3
Frozen permanent establishment ¹			
Permanent established posts*			
– excluding dual filing	361 (0%)	361 (+1.4%)	356
– including dual filing	373 (+3%)	361	356
Steady retention of experience and expertise			
Staff turnover (%)	8.8 (+19%) ²	7.4 (-57%)	17.1
Strong mix of experience and expertise			
Number of lawyers, accountants and Chartered Financial Analysts*	152 (-2%)	155 (+15%)	135
Number of training programmes	263 (+2%)	258 (+6%) ³	243
Training man-days per employee	4 (-47%) ⁴	7.6 (+52%) ³	5
Corporate Finance			
More transactions handled			
Total number of transactions handled	341 (+27%)	268 (-5%)	283
General offers, partial offers, privatisations and whitewash waivers under Takeovers Code and off-market and general offer repurchases under Share Repurchases Code	77 (+24%)	62 (+22%)	51
Other applications	264 (+28%)	206 (-11%)	232
Intermediaries and Investment Products			
Licence applications increase			
Applications for licence	4,555 (+38%)	3,306 (-74%)	12,933
Total number of SFC licences ^{5*}	26,411 (-7%)	28,395 (-1.6%)	28,844
Focused use of resources on inspections			
Routine inspections (cases)	139 (-35%)	215 (-18%)	262
Special inspections (cases)	16 (-61%)	41 (+86%)	22
Prudential meetings	86 (-15%)	101	N/A
Breaches by dealers, traders and advisers noted from completed inspections during the year ⁶	510 (-8%)	553 (-34%)	833
Sustained growth in authorised products			
Authorised collective investment schemes*	2,457 (+6%)	2,316 (+2%)	2,267
Investment funds increase in value			
Net asset value of authorised unit trusts and mutual funds ⁷ (US\$ billion)	342 (+20%)	285 (-8%)	311

	2002-2003	2001-2002	2000-2001
Enforcement			
More investigations and disciplinary inquiries			
New investigations (cases)	391 (+25%)	311 (+5%)	297
Successful prosecutions (entities) ⁸	37 (-26%)	50 (+16%)	43
Disciplinary inquiries conducted	163 (+14%)	143 (-5%)	150
Entities disciplined	86 (-18%)	105 (-21%)	133
Supervision of Markets			
Growing funds for investor protection			
Net asset value of Unified Exchange Compensation Fund (\$ million)*	872 (+12%)	780 (+24%)	629
Net asset value of Commodity Exchange Compensation Fund (\$ million)*	129 (+11%)	116 (+13%)	103
Reaching Out			
Enhanced website attracts more visitors			
Corporate website's average daily hit rate (hits)	266,590 (+45%)	183,671 (+149%)	73,888
Continuing investors' interest in on-line education			
eIRC's average daily hit rate (hits)	25,896 (-2%)	26,367 (+26%)	21,000
Increased investor awareness of rights and responsibilities			
Complaints	959 (+33%)	721 (+28%)	562
Enquiries	3,982 (+30%)	3,073 (-11%)	3,453
More investigations into complaints			
Complaints referred to divisions	576 (+28%)	449 (+17%)	385
Complaints leading to full investigations	163 (+44%)	113 (+38%)	82
Better communication with the public			
Press releases issued ⁹	299 (+38%)	216 (+10%)	197
Consultation and Guidelines			
Public consultation exercises continue			
Consultation papers issued	20 (-20%)	25 (+150%)	10
Greater transparency of decisions			
Consultation conclusions issued	37 (+363%)	8 (+167%)	3
Clear regulations to reduce compliance costs			
Codes and guidelines issued	36 (+125%)	16 (+23%)	13

* Figures as at financial year-end

¹ Excluding additional posts for dual filing created in 2002-2003.

² The increase in turnover was mainly due to higher turnover of general grade staff leaving for further studies.

³ Training programmes organised by individual departments for their own staff were included from 2001-2002.

⁴ There was a reduction in training man-days although the number of the training programmes has been maintained at the same level. This was attributed mainly to the fact that training programmes this year were generally of a shorter duration. Long courses (one day or longer) by paid external consultants or overseas programmes have been reduced due to budgetary constraints.

⁵ Licensees included individuals, sole proprietors, partnerships and corporations.

⁶ A single inspection may reveal breaches of more than one provision.

⁷ NAV as at 31 December 2002, 2001 and 2000.

⁸ Prosecutions included cases of market manipulation, illegal short selling and unregistered dealing activities, breaches of Securities (Disclosure of Interests) Ordinance and Protection of Investors Ordinance.

⁹ Excluding press releases issued in compliance with the Securities (Disclosure of Interests) Ordinance.

Significant Events 2002-2003

2002

April 25

The SFC launched a new SFO section on its website as a one-stop shop to help the public understand the law.

May 2

The SFC released the Hedge Funds Guidelines after public consultation, paving the way for the offering of hedge funds to the Hong Kong public.

May 13

The independent Process Review Panel published its first annual report. It found that the SFC's internal procedures contained adequate checks and balances.

May 15

A 12-episode investor education video drama entitled *Invest With Your Heads Up* began broadcasting on public transportation.



Popular artistes help convey investor education messages.

June 24 & 25

The SFC hosted IOSCO's Asian Roundtable for Internet Project Team, where 60 representatives from 13 jurisdictions discussed trends and risk profile of securities trading on the Internet.



Arthur Docters van Leeuwen, Chairman of the Executive Board of the Securities Board of the Netherlands, chairs the Internet Project Team.

July 25

HKEx consulted the public on listing criteria and delisting procedures. Prices of many low-priced stocks fell significantly on the following day. The Financial Secretary on 31 July appointed an independent Panel of Inquiry to look into the so-called Penny Stocks Incident.

August 13

Raymond Kwok was re-appointed as a Non-Executive Director for one year.

September 10

The Financial Secretary released the Penny Stocks Incident report, which made recommendations including early engagement of the market and the public when formulating policies.

September 26

The SFC and the HKU co-organised a general education course on personal financial management. Prominent market commentators, experts, and SFC representatives were speakers.



Newspaper columnist Shek Kang Chuen talks to a packed room of students.

September 26

The Financial Secretary appointed a three-man Expert Group to review Hong Kong's three-tier securities regulatory structure, particularly in relation to listing matters. The Group submitted its report to the Financial Secretary on 21 March 2003.

September 30

The SFC joined an annual regional Internet Surf Day organised by the IOSCO to detect websites engaged in securities scams.

October 1

The SFC amended the Financial Resources Rules to improve risk management of firms engaged in securities margin lending.

October 3

The appeals against the immediate prison sentences lodged by two convicted market manipulators of the shares of The Hong Kong Parkview Group Ltd were dismissed by the High Court.

December 9

The SFC published the Report of the Steering Committee on the Enhancement of Financial Infrastructure II, which outlines recommendations to make Hong Kong the preferred location in the Asian time zone for investors.

December 12

The SFC and the HKMA signed a new Memorandum of Understanding (MOU) on the regulation of banks' securities business under the SFO.

**December 13**

The Secretary for Financial Services and the Treasury announced the target to bring the SFO into operation on 1 April 2003.

December 31

Daniel Fung, T Brian Stevenson and Anna Wu were re-appointed as Non-Executive Directors for two years.

2003**January 28**

The SFC and the Stock Exchange signed a new MOU for implementing the dual filing regime.

February 21

The SFC gazetted guidelines in the first of three stages of measures to facilitate offers of shares and debentures.

February 27

Alexa Lam was re-appointed as an Executive Director for two years.

February 28

The SFC's Audit Committee completed an independent inquiry into certain anonymous allegations against personnel matters. None of the allegations were found to be substantiated.

March 3

The SFC was admitted as a signatory of the IOSCO Multilateral Memorandum of Understanding (MMOU). Other signatories include regulators from the US, UK, Australia and Canada. The MMOU enhances regulatory co-operation and information sharing among signatories.

March 7

The SFC released a draft Code on Real Estate Investment Trusts (REITs) for public consultation.

March 10

The Academic and Accreditation Advisory Committee appointed the Hong Kong Securities Institute as an independent body to run qualifying exams.

March 19

The SFC obtained a bankruptcy order against the sole proprietor of Lawsons Securities Company following a series of regulatory actions to protect investors, which included the serving of a restriction notice and a *mareva* injunction.

March 31

In anticipation of the 1 April commencement of the SFO, the SFC published a booklet *SFO and You* and an expanded English-Chinese financial glossary, and launched a new Infoline telephone enquiry service and a more informative public register of licensees.



SFC Chairman Andrew Sheng (left) and Chief Counsel Andrew Young introduce the initiatives at a press conference.

Corporate Finance

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ENSURING QUALITY DISCLOSURE:

Under the dual filing arrangement, listed company disclosure and listing application materials will now be filed with the SFC. The SFC can thereby exercise its statutory enforcement powers against persons issuing false or misleading corporate information.



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

ACHIEVEMENTS

- Issued guidelines and introduced two class exemptions for prospectuses to facilitate offers of securities
- Issued a joint consultation paper with the Financial Services and the Treasury Bureau (FSTB) on proposed amendments to the Companies Ordinance
- Promulgated the Securities and Futures (Price Stabilising) Rules
- Participated in various initiatives to enhance corporate governance, including the promulgation of the Securities and Futures (Stock Market Listing) Rules and the signing of a new MOU with HKEx to implement the dual filing regime

THIS CHAPTER IS ABOUT

- **Takeovers matters**
- **Facilitating market development and compliance**
 - Offers of shares and debentures
 - Proposed amendments to the Companies Ordinance
 - Review of existing securities offering regime
 - Price Stabilising Rules
- **Enhancement of corporate governance**
 - Shareholders Group
 - Listing Rules amendments
- **Upholding standards**
 - Overseeing the Stock Exchange's listing functions
 - Enhanced regulation of corporate disclosure under the SFO
 - Penny Stocks Incident and Expert Group Report

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 and company legislation relating to listed and unlisted companies;**
- **Facilitate the development of effective and efficient capital markets for issuers, including Mainland enterprises; and**
- **From 1 April 2003 onwards, review prospectuses and other documents sent by listed companies to their shareholders.**

What We Did

Takeovers Matters

The Takeovers Executive administers all takeovers transactions relating to public companies, comments on takeovers announcements and documents, gives rulings and interpretations under the Takeovers Code and the Share Repurchases Code, monitors share dealings and movements during an offer period, and is available for consultation on the application of the Codes so that issues can be addressed and problems can be resolved at an early stage.

Since completion of a major review of the Codes in February 2002, the Takeovers Executive has been focusing on providing guidance and ensuring compliance with the new requirements. We had a record year both in terms of the total number of applications made under the Codes and the number of major takeovers and share repurchase transactions. There was also an increase in the number of privatisations, off-market and general offer share repurchases and hostile bids.

The Takeovers and Mergers Panel met on four occasions, once to hear a disciplinary case and three times to rule on the application of Code provisions to current transactions.

Major Disciplinary Action by the Takeovers Panel and the Takeovers Executive and Takeovers Panel Rulings

Takeovers Panel Sanctioned Anthony Wong Man Shek and Asia Financial (Assets Management) Ltd

On 2 April 2002 the Panel announced that it had imposed a five-year "cold shoulder order" denying Anthony Wong direct or indirect access to the securities markets. The Panel also publicly censured Wong and Asia Financial. From June 2000 to March 2001 Asia Financial had acquired more than 35% of the shares in Tack Hsin Holdings Ltd on behalf of seven client investment companies. The Panel found that Asia Financial and these investment companies were acting in concert and that as a result Asia Financial had breached the Takeovers Code because it had failed to make a mandatory general offer to all Tack Hsin shareholders. The takeover trigger threshold before 19 October 2001 was 35%.

Major Disciplinary Action by the Takeovers Panel and the Takeovers Executive and Takeovers Panel Rulings (Cont'd)

Takeovers Executive Sanctioned Chan Kin Sun and the Chan Family

On 10 June 2002 the Executive announced that it had imposed a 15-month “cold shoulder order” on Chan Kin Sun and publicly censured Chan and his family for breaching the Code. Chan also surrendered his registrations with the SFC as a securities dealer and commodities dealer for 30 months. The breach came to light during an investigation into price and volume movements in the shares of Truly International Holdings Ltd. It was found that Chan and his family members had collectively increased their holdings to more than 35% of Truly's shares by 5 September 2000 without making a general offer as required by the Takeovers Code.

Disciplinary Action Against Raffles International Holdings Ltd and Jimmy Lai Kam Wing

On 29 January 2003 the Executive announced that it had imposed a six-month “cold shoulder order” on Jimmy Lai and publicly censured Lai and Raffles. Lai and Raffles had breached the Takeovers Code on 20 January 2003 when Raffles, a company of which Lai was the sole owner and director, increased its shareholding in FT Holdings International Ltd from 34.99% to 36.05% without making a general offer. The 35% trigger applied to Raffles under Rule 26.6 of the Code because it had held between a 30% and 35% interest in FT Holdings immediately before the reduction of the trigger to 30% on 19 October 2001.

Takeovers Panel Upheld an Executive Ruling Concerning an Alleged Formation of a Concert Party in relation to Symphony Holdings Ltd

On 14 May 2002 the Panel announced that it had upheld an Executive ruling that certain persons were not acting in concert in connection with a general offer made for Symphony.

Takeovers Panel Ruling Concerning an Alleged Concert Party in relation to China Motor Bus Ltd (CMB)

On 11 July 2002 the Panel ruled that a concert party relationship did not exist between Chee Ying Cheung (then holding an approximate 9.8% shareholding in CMB) and Asia Time in respect of a general offer for CMB made by Asia Time. The Executive referred this matter to the Panel for a ruling because it considered there were particularly novel, important or difficult points at issue.

Takeovers Panel Upheld an Executive Ruling in relation to International Capital Network Holdings Ltd (ICN)

On 31 October 2002 the Panel upheld the Executive's ruling that a voluntary offer for ICN by Koffman Securities Ltd should be properly responded to as required by the Code including posting an offeree response document to shareholders of ICN. Shortly after Koffman announced its intention to make a voluntary offer for ICN in September 2002, ICN informed the Executive that it did not consider the offer to be in accordance with the Code and therefore it did not propose to take any action in response. The Panel agreed with the Executive that the offer had triggered obligations under the Code and that a refusal by ICN to respond to the offer would be in breach of the Code.

Facilitating Market Development and Compliance

■ Offers of Shares and Debentures

Following consultation with market participants and with the endorsement of the Government-appointed Financial Market Development Task Force, in February 2003, the SFC issued three sets of guidelines. They form part of the first phase of a three-phase initiative to reform the prospectus regime.

The guidelines constitute a facilitative interpretation of particular provisions of the current prospectus regime in the Companies Ordinance (CO) and address current market practices and procedures in order to facilitate the conduct of public offerings of shares or debentures. No legislative changes were required.

The three guidelines concern: the content and manner of publication of “awareness” and “summary disclosure” materials relating to an offer of shares or debentures made by a prospectus; the SFC's regulatory approach with respect to “repeat” offers using separately registered programme and issue prospectuses; and the adequacy for registration purposes of faxed copies of experts' consent letters and bulk print proof prospectuses.

In addition, pursuant to the SFC's exemption powers under the CO, two class exemptions were gazetted on 28 March 2003.

Matters Handled by Corporate Finance		(Table 1)	
	2002-2003	2001-2002	
Codes on Takeovers and Mergers and Share Repurchases			
General and partial offers under Takeovers Code	29	30	
Privatisations	9	3	
Whitewash waiver applications	31	26	
Other applications under Takeovers Code	255	195	
Off-market and general offer repurchases	8	3	
Other applications under Share Repurchases Code	9	11	
Total:	341	268	
Disciplinary cases dealt with by the Executive	2	0	
Takeovers and Mergers Panel			
Reviews of Executive rulings by Panel	2	2	
Referral by the Executive	1	0	
Disciplinary hearings	1 ¹	2	
<small>¹ The Asia Financial (Assets Management) Ltd hearing commenced in 2001 – 2002 and ended in 2002 – 2003</small>			
Special meetings for review of the Takeovers and Share Repurchases Code	0	3	
Total number of Panel meetings days:	4	7	
Others			
Applications for Exemption under Securities (Disclosure of Interests) Ordinance	290 ²	365	
<small>² With 474 warrants listed, 12 equity linked instruments and 3 debt instruments issued</small>			
Authorisation under section 4(2)(g) of the Protection of Investors Ordinance (PIO)	10	N/A ³	
<small>³ The Division was delegated the power to give authorisation under the PIO in February 2002</small>			
Unlisted companies' prospectuses authorised for registration by the Registrar of Companies	14	19	
Certificates of Exemption under Sections 38A and 342A of the Companies Ordinance	27 ⁴	53 ⁴	
<small>⁴ Each certificate issued can include more than one CO exemption.</small>			

The first exempts prospectuses which offer listed debentures (bonds and other debt securities) from content requirements of the CO that are the same as or similar to equivalent requirements under the Listing Rules and others that are considered irrelevant for investors or unduly burdensome for issuers.

The second exemption relieves prospectuses that offer non-listed debentures from content requirements of the CO that are considered either irrelevant for investors or unduly burdensome for issuers.

Subject to negative vetting by the Legislative Council, these class exemptions will become effective on 23 May 2003.

■ Proposed Amendments to the Companies Ordinance

The second phase of the market development project involves legislative change to the prospectus regime. This process was launched on 10 March 2003 by the publication of a joint SFC and FSTB consultation paper on proposed amendments to the CO.

The proposals are intended to provide expressly in the law for the facilitative measures set out in the three guidelines mentioned above and make other improvements to the prospectus regime, including specifying particular types of offers and invitations that can be made without the need to produce and register a prospectus.

The proposed amendments are expected to be introduced to the Legislative Council before July 2003.



Proposed CO amendments will facilitate the offering of securities.



Dual Filing Requirement

▶ Listed company disclosure and listing application materials must be filed with the SFC and as a result the SFC is now able to exercise its statutory enforcement powers against persons issuing false or misleading corporate information.

Public Offering Price Stabilisation

▶ The provisions facilitate public offerings in Hong Kong by providing a “safe harbour” for managers who wish to undertake price stabilising actions following new issues of shares or debentures, in line with international practice.

■ Review of Existing Securities Offering Regime

The third phase of this project involves a wide-ranging review of existing laws and regulations designed to reform and update comprehensively Hong Kong's securities offering regime. This review includes a study of the securities offering regulations in leading markets with a view to applying best practice solutions to Hong Kong. We hope to make recommendations for specific reforms no later than the third quarter of 2004.

■ Price Stabilising Rules

Price stabilising actions are potentially manipulative and may contravene market misconduct provisions under the law. Following market consultation in February 2002, the SFC released its conclusions on the Securities and Futures (Price Stabilising) Rules in July 2002. As one of the 40 items of subsidiary legislation under the SFO, the Rules became effective on 1 April 2003.

Enhancement of Corporate Governance

■ Shareholders Group

Investors have an important role to play in raising corporate governance standards in Hong Kong. The Shareholders Group was set up in May 2001 to get investors' views on issues relating to shareholders' rights and interests. The Group was formalised as a Standing Committee under section 6 of the SFCO in June 2002.

The Group consists of 13 members including retail and institutional investors, professionals, academics, prominent advocates of investors' rights, and a Consumer Council representative. During the year, they met six times to discuss issues relating to shareholders' interests and investor protection. Members also provided feedback on regulatory proposals.

Discussion topics included:

- Regulation of corporate information disclosure
- Scripless securities market
- New investor compensation arrangements
- Continuing listing eligibility criteria
- Guidelines for electronic public offerings
- Code of best practice on corporate governance
- Cold calling

■ Listing Rules Amendments

To strengthen the corporate governance of issuers in Hong Kong, HKEx consulted the public on amendments to the Listing Rules in early 2002. Consultation conclusions were published in January 2003. The SFC is committed to assisting HKEx to introduce rule changes that enhance Hong Kong's governance standards.

In addition, it is intended that the SFC and the Stock Exchange will jointly consult the public on proposed regulations relating to listing sponsors and their responsibilities to the market in connection with IPOs.

Upholding Standards

■ Overseeing the Stock Exchange's Listing Functions

We regularly met and liaised with the Stock Exchange's Listing Division in order to discharge our duty to oversee and monitor the performance of the Stock Exchange's listing functions.



Hong Kong remains a leading fund-raising centre in Asia, with 985 companies listed on the Stock Exchange by the end of March.

■ Enhanced Regulation of Corporate Disclosure under the SFO

On 6 May 2002, we consulted the market on a dual filing requirement, which aims to strengthen the enforcement of corporate disclosure. The Securities and Futures (Stock Market Listing) Rules implementing the dual filing requirement were gazetted on 13 December 2002 and came into force with the SFO.

In January 2003, the SFC and HKEx signed a new MOU, which details the administrative arrangements for implementing the dual filing regime.

■ Penny Stocks Incident and Expert Group Report

HKEx released a consultation paper in July 2002 proposing to revise the criteria for admission to listing and to introduce more stringent criteria for delisting.

Subsequent market reaction reflected in the prices of penny stocks on 26 July 2002 led to the withdrawal of proposals for delisting criteria for reconsideration. The Financial Secretary appointed an independent Panel of Inquiry to look into the circumstances relating to the preparation and release of the consultation paper.

The independent panel issued its report in September 2002. The FSTB, the SFC and HKEx have been following up and implementing the report's recommendations.

An Expert Group was appointed by the Financial Secretary on 26 September 2002 to review the regulatory structure of the securities and futures markets in Hong Kong.

HKEx, after discussion with industry participants, refined its proposals for delisting criteria and released a supplemental paper for public consultation in November 2002. The paper discusses what might constitute appropriate indicators and thresholds for remedial action to be taken on by an issuer to maintain a listing. The consultation period ended in February 2003.

On 21 March 2003, the Expert Group released its report and recommended the transfer of listing functions from the Stock Exchange to a new division of the SFC to be known as the Hong Kong Listing Authority (HKLA). It also recommended that the Listing Rules, administered by the HKLA, should be statutorily backed.

The Financial Secretary has accepted that the general direction recommended by the Expert Group is appropriate and will enhance the quality of our market. The Government has announced that public consultation will be conducted on the report's recommendations. The SFC will work closely with the Government and HKEx.

Intermediaries & Investment Products

32

SIMPLIFIED LICENSING REGIME:

The single licensing system means less paperwork and lower costs for intermediaries engaging in more than one regulated activity.



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

ACHIEVEMENTS

- Prepared for the implementation of the new licensing regime and facilitated market transition
- Facilitated business with streamlined processes, exemptions in competence, and flexibility and choice in training requirements
- Took proactive regulatory actions on intermediaries to protect investors
- Strengthened the risk management of margin financing intermediaries
- Supervised a record 2,457 investment products
- Issued authorisation and disclosure guidelines for hedge funds
- Consulted the public on the offering of Real Estate Investment Trusts and Exchange Traded Index Tracking Funds

THIS CHAPTER IS ABOUT

Licensing Department

- Preparing the industry for the new licensing regime
- Reducing compliance costs
- Facilitating business and raising standards

Intermediaries Supervision Department

- Supervision of intermediaries using a risk-based approach
- Devising balanced policies and regulations to promote market integrity
- On-going dialogue with the market to raise business standards

Investment Products Department

- Product authorisation
- Facilitating product development and enhancing information disclosure
- Stepping up communication with the fund industry

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

Preparing the Industry for the New Licensing Regime

The Department undertook various initiatives to facilitate industry migration to the new licensing regime under the SFO. Apart from the related subsidiary legislation we also prepared new and revised guidelines, including the *Guidelines on Transitional Arrangements* and the *Guidelines on Waivers of Certain Licensing Fees*. Seminars were also conducted for industry practitioners as well as legal and accounting professionals (See more details in *Corporate Affairs* chapter).

The Department published on the SFC website new consolidated licensing application and notification forms, including abridged conversion forms for existing licensees. The public register of licensed persons, available on the website, has also been upgraded to enhance transparency. It displays additional information such as licensees' disciplinary records, licensing conditions and complaint channels.

As regards brokers' fidelity insurance, we worked with an industry group to ensure a smooth transition from a Stock Exchange-administered scheme to a new scheme established under the SFO. The new insurance scheme became effective on 1 April 2003.

To ensure level and consistent securities and futures regulation between SFC licensed firms and HKMA authorised institutions (mostly banks), the SFC and the HKMA in December 2002 signed a new MOU.

Reducing Compliance Costs

To further reduce compliance costs, the SFC has lowered the licensing application and annual fees under the SFO by 3%. This is in addition to a 5% early bird discount for existing licensees seeking to migrate to the new licensing regime in the first year. To this end, we worked with HKEx to abolish the Stock Exchange's registration regime for its participants' sales representatives and replace the approval requirement for branches, branch managers, and change in shareholding not involving a change of control with a notification system.

The Department continued to streamline its internal processes, hence strengthening its ability to meet the performance pledges. In addition, we have substantially



Single Licence

The simplified single licensing regime offers greater convenience to brokers and investment advisers etc. They need only one licence to carry on all the regulated activities that they are eligible to conduct. The streamlined regime and compliance systems mean less paperwork and lower costs for intermediaries.

Only corporations and their individual representatives will be able to apply for a licence; for better investor protection, partnership or sole proprietor will not be permitted. Existing licensees and exempt persons have two years to migrate to the new system. Banks are required to be registered to carry on regulated activities (except securities margin financing and leveraged forex trading as these are core banking functions regulated under the Banking Ordinance).



reduced the normal processing time for representatives' change of accreditation application (which is required when they join a new firm) to one week.

Facilitating Business and Raising Standards

The licensing competence requirements were modified to allow greater flexibility for new entrants to the industry without compromising investor protection. We issued the *Guidelines for Exemptions from the Recognised Industry Qualification and Local Regulatory Framework Paper Requirements* in December 2002, setting out the circumstances under which applicants with adequate industry experience may get exemptions.

However, they would be required to undertake additional Continuous Professional Training (CPT) hours. More relaxations are provided in the revised *Guidelines on Competence* and *Guidelines on CPT* issued in March 2003.

To facilitate the pursuit of professional training and compliance with the competence requirements by market participants, we worked with the Vocational Training Council in providing a recognised examination for leveraged foreign exchange trading for the first time. In line with the new licensing regime, we also worked with the Hong Kong Securities Institute to develop new examinations for each of the regulated activities in the securities and futures area. To ensure consistency and

maintain quality of the examinations, the Academic and Accreditation Advisory Committee (AAAC) endorsed a single examination body for each of the regulated activities. This will pave the way for developing mutual recognition of qualifications with other local or foreign regulators.

The AAAC also approved four additional institutions as CPT providers. They include the Hong Kong Investment Funds Association, Department of Accountancy of the Hong Kong Polytechnic University, School of Professional Education and Executive Development of the Hong Kong Polytechnic University, and School of Continuing Education of the Hong Kong Baptist University.

On the international front, the SFC has played an active role in the IOSCO Project Team on Securities Analysts that produced a report on analyst conflicts in January 2003. The SFC is also represented at an IOSCO Chairs' Committee which is now carrying the Project Team's work forward to develop guiding principles for securities analysts.

At the same time, we surveyed the securities investment research activities in Hong Kong to assess the state of the industry, particularly with regard to the possible conflicts of interests of securities analysts. The SFC is also surveying the views of investors on the same issue.

The Chairs' Committee will survey and assess the key regulatory issues relating to credit rating agencies in member jurisdictions and will consider developing guiding principles in this regard. The SFC has been

actively monitoring the developments in this area (See chapter on *Cross-Border Regulatory Co-operation* for more details on the SFC's participation in IOSCO's work).

On the whole, the number of licence applications, including securities dealers, increased noticeably across the board during the year (Table 1). In the securities sector, the number of applicants rose by 36% to 3,312, whereas, applicants in the commodity sector increased 57% to 827. Same as the year before, only one application was received from a leveraged foreign exchange trading firm and none were received on securities margin financing.

The increase in applications from advisers (53% for securities advisers and 44% for commodities advisers) and commodities dealers (60%) was most significant. This could be attributed to factors such as brokers diversifying into futures and advisory services, and other financial intermediaries entering into the corporate finance and financial planning segments.

The number of licensees (both businesses and individuals) decreased by 7% during the year, from 28,395 to 26,411 (Table 2). The number of exempt dealers fell from 153 to 135, while that of exempt investment advisers fell from 30 to 28. Apart from market conditions, insurance agents not renewing their investment representative licences might have contributed to the decline.

Applications for Registration

for the period from 1 April 2002 to 31 March 2003

(Table 1)

Applications		Businesses			Individuals				
Securities Dealers		Individuals	Corporations	Partnerships	Dealing Directors		Representatives	Total	% Change
Applications									
received	0 (0)	22 (30)	0 (0)	296 (207)	1,466 (1,169)	1,784 (1,406)		26.9	
approved	0 (0)	29 (40)	0 (0)	271 (279)	1,452 (2,348)	1,752 (2,667)			
refused	0 (0)	0 (0)	0 (0)	0 (0)	2 (2)	2 (2)			
withdrawn	0 (0)	5 (7)	0 (0)	30 (29)	43 (105)	78 (141)			
Securities Investment Advisers		Individuals	Corporations	Partnerships	Investment Adviser Directors		Representatives	Total	% Change
Applications									
received	0 (0)	75 (49)	0 (0)	358 (203)	1,080 (735)	1,513 (987)		53.3	
approved	0 (0)	81 (57)	0 (0)	341 (249)	1,029 (2,347)	1,451 (2,653)			
refused	0 (0)	0 (0)	0 (0)	0 (0)	0 (0)	0 (0)			
withdrawn	0 (0)	5 (10)	0 (0)	31 (27)	39 (120)	75 (157)			
Commodity Dealers		Individuals	Corporations	Partnerships	Accredited Dealers		Representatives	Total	% Change
Applications									
received	0 (0)	5 (9)	0 (0)	71 (63)	640 (375)	716 (447)		60.2	
approved	0 (0)	9 (10)	0 (0)	72 (78)	605 (538)	686 (626)			
refused	0 (0)	0 (0)	0 (0)	0 (2)	0 (0)	0 (2)			
withdrawn	0 (0)	1 (2)	0 (0)	4 (3)	37 (51)	42 (56)			
Commodity Trading Advisers		Individuals	Corporations	Partnerships	Accredited Advisers		Representatives	Total	% Change
Applications									
received	0 (0)	13 (9)	0 (0)	42 (22)	56 (46)	111 (77)		44.2	
approved	0 (0)	18 (8)	0 (0)	45 (26)	59 (59)	122 (93)			
refused	0 (0)	0 (0)	0 (0)	0 (1)	0 (0)	0 (1)			
withdrawn	0 (0)	1 (1)	0 (0)	3 (15)	0 (3)	4 (19)			
Leveraged Foreign Exchange Traders		Traders – Discretionary A/C	Traders – Non-Discretionary A/C	Traders – Introducing Agent	Representatives Responsible Directors		Non-Responsible Directors	Total	% Change
Applications									
received	0 (0)	1 (1)	0 (0)	4 (1)	411 (357)	416 (359)		15.9	
approved	0 (0)	1 (1)	0 (0)	4 (1)	419 (320)	424 (322)			
refused	0 (0)	0 (0)	0 (0)	0 (0)	0 (0)	0 (0)			
withdrawn	0 (0)	0 (0)	0 (0)	0 (0)	22 (39)	22 (39)			
Securities Margin Financiers		Securities Margin Financiers			Representatives Approved Directors		Non-Approved Directors	Total	% Change
Applications									
received	0 (0)			0 (1)	15 (29)	15 (30)		-50	
approved	0 (0)			0 (1)	18 (36)	18 (37)			
refused	0 (0)			0 (0)	0 (0)	0 (0)			
withdrawn	0 (0)			0 (0)	0 (3)	0 (3)			
Total number of applications received							4,555 (3,306)	37.8	

Note: 31 March 2002 data in brackets

Number of Registered Intermediaries

as at 31 March 2003

(Table 2)

Businesses	Sole Proprietors		Partnerships		Corporations		Total	% Change	
Securities Ordinance									
Dealers									
SEHK Participants	51	(60)	1	(1)	433	(433)	485	(494)	
Non-SEHK Participants	3	(7)	0	(0)	206	(216)	209	(223)	
Sub-total	54	(67)	1	(1)	639	(649)	694	(717)	
Advisers	13	(15)	0	(0)	683	(652)	696	(667)	
Margin Financiers	0	0	0	(0)	8	(8)	8	(8)	
Commodities Trading Ordinance									
Dealers									
HKFE Participants	0	(0)	0	(0)	130	(132)	130	(132)	
Non-HKFE Participants	0	(0)	0	(0)	21	(23)	21	(23)	
Sub-total	0	(0)	0	(0)	151	(155)	151	(155)	
Advisers	1	(1)	0	(0)	127	(125)	128	(126)	
Leveraged Foreign Exchange Trading Ordinance									
Discretionary A/C	-	-	-	-	7	(7)	7	(7)	
Non-Discretionary A/C	-	-	-	-	4	(4)	4	(4)	
Introducing Agent	-	-	-	-	0	(0)	0	(0)	
Sub-total					11	(11)	11	(11)	
Grand Total	68	(83)	1	(1)	1,619	(1,600)	1,688	(1,684)	
Individuals									
	Directors		Representatives				Total	% Change	
Securities Ordinance									
Dealers and Representatives									
SEHK Participants	1,013	(1,114)	7,573	(8,350)			8,586	(9,464)	
Non-SEHK Participants	378	(322)	4,656	(4,946)			5,034	(5,268)	
Sub-total	1,391	(1,436)	12,229	(13,296)			13,620	(14,732)	
Advisers and Representatives	1,194	(1,122)	4,468	(5,277)			5,662	(6,399)	
Margin Financier's Representatives	15	(17)	139	(193)			154	(210)	
Commodities Trading Ordinance									
Dealers and Representatives									
HKFE Participants	283	(301)	3,319	(3,490)			3,602	(3,791)	
Non-HKFE Participants	27	(27)	243	(262)			270	(289)	
Sub-total	310	(328)	3,562	(3,752)			3,872	(4,080)	
Advisers and Representatives	178	(171)	212	(209)			390	(380)	
Leveraged Foreign Exchange Trading Ordinance									
Trader's Representatives	38	(35)	987	(875)			1,025	(910)	
Grand Total	3,126	(3,109)	21,597	(23,602)			24,723	(26,711)	
Total number of registrants (businesses and individuals)							26,411	(28,395)	-7.0

Notes: "Directors" included approved directors of margin financiers and responsible directors of leveraged foreign exchange traders
31 March 2002 data in brackets

Intermediaries Supervision Department

What We Do

- Monitor and supervise the financial viability and business conduct of intermediaries;
- Raise the standards of control and risk management of intermediaries to protect investors;
- Devise balanced policies and regulations to promote market integrity and development; and
- Maintain ongoing dialogue with market participants to uplift industry standards.

What We Did

Supervision of Intermediaries Using a Risk-Based Approach

Financial Viability of Intermediaries

In the past year, the economic downturn and low volume of transactions put tremendous pressure on intermediaries. However, many of them took various cost-cutting measures – such as streamlining their operation or procedures – to strengthen their competitiveness.

We understand the importance of prudent management of intermediaries' financial viability in protecting the investing public and mitigating potential systemic risk. During the year, we critically assessed the financial positions of intermediaries based on their monthly financial reports.

The statistical information and financial highlights of the securities market for 2002 are summarised in Table 3.

Statistical Information on Securities Market ¹ (Table 3)		
	As at 31/12/02	As at 31/12/01
Total number of securities dealers & securities margin financiers	696	719
Total number of active cash clients	565,585	624,700
Total number of active margin clients	56,787	63,568
	(HK\$ Million)	(HK\$ Million)
Balance Sheet		
Cash in hand and at bank ²	56,998	57,721
Amounts receivable from margin clients ³	12,242	12,004
Amounts receivable from clients and other dealers arising from dealing in securities	24,986	21,192
Other assets	34,511	24,667
Total assets	128,737	115,584
Amounts payable to clients and other dealers arising from dealing in securities	50,055	41,568
Total borrowings from financial institutions	5,380	5,762
Other liabilities	21,690	19,889
Total shareholders' fund ⁴	51,612	48,365
Total liabilities and shareholders' fund	128,737	115,584
	12 months to 31/12/02	12 months to 31/12/01
	(HK\$ Million)	(HK\$ Million)
Profit and loss		
Total value of transactions ⁵	7,066,624	7,248,805
Net commission income from securities dealing	10,109	11,915
Gross interest income	2,139	3,243
Other income ⁶	15,691	16,474
Total overheads and interest expense	-26,075	-31,203
Net profit for the period	1,864	429

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

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

³ Average collateral coverage (the number of times the aggregate market value of securities collateral deposited by clients covers the amounts receivable from margin clients on a given date on an industry-wide basis).

As at 31/12/02	As at 31/12/01
3.4	3.8

⁴ The value of shareholders' fund includes value of redeemable shares.

⁵ The value of transactions includes trading in equities and bonds both in Hong Kong and overseas.

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

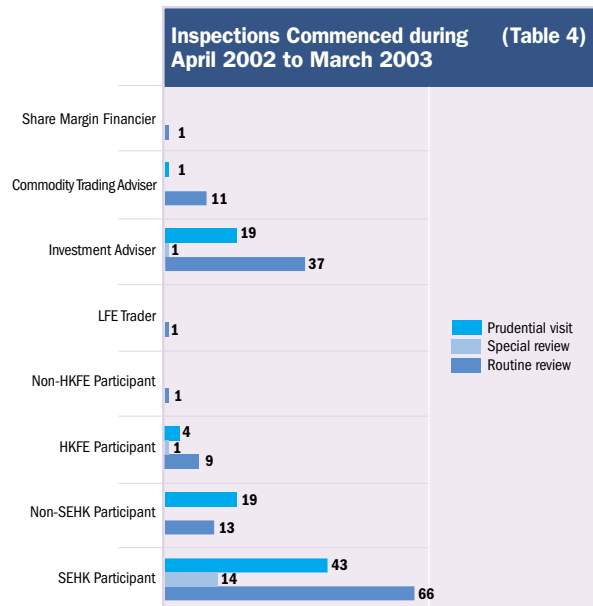
Table 3 illustrates that the securities industry as a whole had strengthened its total shareholders' fund by 6.7% as compared with 2001. Despite a significant drop in total income, the improved aggregate profit was mainly attributable to the low base in 2001 and the efforts of non-exchange participants. Due to this diversified income and market base, these intermediaries were less impacted by the local economic downturn or the shrinkage in market turnover. The industry as a whole was able to cut overheads and finance costs substantially during the year.

■ Proactive Regulatory Actions on High Risk Intermediaries

Intermediaries with weak internal controls and risk management are generally more vulnerable in difficult market environment. Although a significant portion of our resources has been allocated for preparation and implementation of the SFO, the Department continued to evaluate intermediaries' standards of controls and risk management through onsite reviews and prudential meetings throughout the year. The inspections commenced during the year and the summary of breaches by intermediaries identified during inspections are set out in Tables 4 and 5 respectively.

The risk-based approach we have adopted allows flexible use of our resources. We effectively monitor the high risk intermediaries and proactively take appropriate regulatory measures to manage down the identified risks. These measures include:

- Discussing with senior management of intermediaries about the financial risks;
- Proposing risk mitigation measures such as reducing excessive credit exposures;
- Where necessary, taking restrictive actions to ring-fence investors' assets and minimise systemic risks.



Breaches by Dealers, Traders and Advisers Noted from the Completed Inspections during April 2002 to March 2003 (Table 5)

Nature of Breaches	SEHK	Non-SEHK	HKFE	Non-HKFE	LFE	Share	Investment	Commodity
	Participant	Participant Dealer	Participant	Participant Dealer	Trader	Margin Financier	Investment Adviser	Trading Adviser
Failure to comply with Financial Resources Rules	24	3	2	0	0	2	8	2
Failure to safekeep clients' securities	37	2	1	1	0	0	3	0
Failure to maintain proper books	19	2	0	0	0	0	3	0
Failure to safekeep clients' money	26	2	1	1	0	0	2	0
Unregistered dealing & other registration issues	8	2	1	0	0	0	8	0
Breach of licensing conditions	1	1	0	0	0	0	2	1
Breach of contract note and statement of account requirements	14	1	2	0	0	1	2	0
Failure to make filing/notification	4	4	1	1	0	1	5	0
Breach of margin requirement	1	0	5	1	0	1	0	0
Marketing of unauthorised funds	0	0	0	0	0	0	1	0
Illegal short selling of securities	3	0	0	0	0	0	0	0
Internal control weaknesses	86	18	8	3	0	1	30	7
Breach of Code of Conduct	65	10	5	1	0	2	19	2
Breach of Code on Unit Trusts & Mutual Funds	0	2	0	0	0	0	2	1
Breach of Fund Manager Code of Conduct	0	4	0	0	0	0	8	3
Non-compliance with money laundering guidelines	6	1	0	0	0	0	2	1
Breach of other rules and regulations of the Exchanges	6	0	1	1	0	0	1	0
Breach of Guidance Note on Competence	1	0	0	0	0	0	0	0
Total	301	52	27	9	0	8	96	17

The following two cases illustrate our regulatory approach.

Lawsons Securities Company

The Department identified internal control deficiencies in the firm and instructed Lawsons to appoint an independent accountancy firm in May 2002 to confirm account balances directly with Lawsons' clients. The accountants reported significant discrepancies between Lawsons' stock records and the records of CCASS. To protect clients' interests, on 7 June, the Commission served a restriction notice on the sole proprietor, Law Siu Kong Christopher, prohibiting him from dealing in securities and disposing of or dealing with any assets held by himself or Lawsons.

In discovering Law's attempt to breach the restriction notice, the Commission immediately applied to Court for an injunction to preserve and protect the assets. A mareva injunction was obtained in the High Court on 18 July. On the same day, the Commission obtained a Court order appointing two administrators to deal with the assets of Law and Lawsons.

In order to deliver a clear regulatory message to the industry that the Commission will not tolerate any breach by registered persons of their fiduciary duties to hold and protect client assets, the Commission filed a petition for bankruptcy against Law on 22 January 2003, as it appeared to be expedient in the public interest to do so. The Commission obtained a bankruptcy order against Law on 19 March 2003.

Pacific Pearl Securities Limited (PPSL)

PPSL had been under the SFC's close risk-based monitoring due to its vulnerable financial position. During a detailed review of the firm's financial position in October 2002, the Department discovered unusual fund transfer activities in the accounts of PPSL. We further found that PPSL had failed to meet the minimum liquid capital requirement under the Financial Resources Rules (FRR). The Department requested the owner of the firm to rectify the shortfall of funds.

Upon our request, the unusual fund transfer stopped in mid-October and the problem appeared to have been temporarily resolved. However, our continuous monitoring identified further breaches of the FRR by the firm since 1 November 2002.

We gave an urgent deadline to the owner to meet the capital requirement and requested it not to transfer funds out of PPSL to other related parties. On 4 November, the owner finally confirmed that it was unable to rectify the shortfall and PPSL voluntarily suspended trading on the SEHK on 5 November 2002.

The Department's staff closely worked with PPSL to ensure the orderly return of assets to all its clients. All assets were returned to clients subsequently.

Devising Balanced Policies and Regulations to Promote Market Integrity

■ Rules and Regulations for New Regulatory Regime

The Department was involved in developing subsidiary legislation, codes, guidelines and forms under the SFO which are related to supervision of intermediaries. When preparing these, we consulted the market widely including industry representatives, professional bodies and other regulatory bodies.

We also issued 47 circulars during the year to continuously update intermediaries about current regulatory issues and developments such as implementation of the SFO, reinforcement of regulatory requirements and reminders about market misconduct cases.

■ Financial Resources Rules

We were concerned about the potential risks resulting from imprudent risk management policies adopted by certain intermediaries who provide securities margin financing to clients. In order to promote proper risk management practice, two amendments to the FRR were made to contain the financial risks arising from acceptance of excessive illiquid stock collateral and over-borrowing from banks by re-pledging margin clients' stock collateral. We have had no reports of material problems since these amendments became effective on 1 October 2002.

To facilitate market development and enhance flexibility of our regulatory requirements, the Department during the year approved 29 applications for subordinated loans, one application for redeemable shares for the FRR computation, and granted 19 modifications and waivers of certain regulatory requirements to intermediaries where investors' interest is not compromised.

On-Going Dialogue with the Market to Raise Business Standards

■ Market Participants

The Department formed a Working Group in May 2002 to develop a robust risk-focused financial regulatory framework for intermediaries. The Group comprises industry representatives, academics and the Commission.

In addition, the SFC and the Joint Financial Intelligence Unit (JFIU) co-organised two seminars on prevention of money laundering in June 2002. The seminars successfully reinforced intermediaries' understanding of their anti-money laundering obligations under the law and regulations.

The SFC in November 2002 began a monthly forum with representatives of brokers' associations to discuss issues of common interest and involve them in the

early stages of policy consultation. The regular meetings have helped deepen understanding between the regulator and the practitioners.

■ Regulatory Counterparts and Professional Bodies

We co-operated on many issues with the securities regulators in other jurisdictions including Mainland China, Taiwan and Korea. These issues included joint reviews on intermediaries and exchange of views on regulatory matters.

We recognise that auditors play a significant role in assessing the financial position and monitoring the compliance status of intermediaries. In May 2002, the Department, with the support of the Hong Kong Society of Accountants (HKSA), organised a discussion forum to share our regulatory views and concerns with more than 100 audit practitioners. In addition, the Department worked closely with the HKSA in the implementation of the SFO.



Codes and Rules

▶ The SFO accords greater flexibility to the SFC by giving it powers to prescribe financial and operational requirements and business conduct standards for intermediaries through rules and codes. This will enable the SFC to quickly respond to changing market conditions by making the necessary changes to the rules and codes rather than having to amend the SFO itself. There is now a clear and transparent process of market consultation in formulating these rule and code changes.



Investment Products Department

What We Do

- Authorise investment products for sale to the Hong Kong public in accordance with product codes and industry standards;
- Monitor marketing materials and disclosures of funds;
- Formulate policies for the development of new products;
- Strengthen international regulatory co-operation in relation to collective investment schemes and their operators; and
- Conduct annual survey on the fund management activities in Hong Kong.

What We Did

Product Authorisation

As of 31 March 2003, the total number of authorised products reached a record high of 2,457. During the year, 443 products were authorised and the total number of applications and withdrawals that were processed increased by 18%. There was sustained growth in the retail fund market. Details are shown in Table 6.

	As at 31/03/03	As at 31/03/02
Unit trusts and mutual funds	1,965	1,890
Investment-linked assurance schemes	129	100
Pooled retirement funds	37	39
MPF master trust schemes	47	49
MPF pooled investment funds*	241	217
Others	38	21
Total	2,457	2,316

* There are 98 funds included in this category that are offered both as retail unit trusts as well as pooled investment funds for MPF purpose.

The demand for a diversified range of investment products by the public continued to grow. While standard bond and equity funds still comprised the bulk of the funds population, guaranteed funds experienced the largest growth. The aggregate net asset value of all authorised unit trusts and mutual funds as at December 2002 amounted to US\$342 billion (Table 7). Funds authorised in Hong Kong continued to exhibit a strong international flavour (Table 8).

	Total		NAV*	
	Number	%	(US\$ Million)	%
Bond	311	17	77,702.9	22.7
Equity	1,030	57	143,289.9	41.9
Diversified	124	7	28,841.8	8.4
Money Market	65	4	69,739.1	20.4
Fund of Funds	63	4	2,375.5	0.7
Index	21	1	7,869.7	2.3
Guaranteed	181	10	11,733.7	3.4
Hedge	4	0	160.3	0.1
Other specialised#	4	0	421.3	0.1
	1,803	100	342,134.2	100
Umbrella structures	162			
No. of Authorised Funds	1,965			

* Net Asset Value as at 31 December 2002

Includes: Futures & Options Funds & Leveraged Funds.

	Origin			Total			
	Umbrella Number	Sub-funds Number	Single Funds Number	Number	%	(US\$ Million)	%
Hong Kong	13	37	41	91	5	5,350.8	1.6
Jersey	2	23	0	25	1	2,810.5	0.8
Luxembourg	58	933	12	1,003	51	211,165.8	61.7
Ireland	37	278	14	329	17	70,050.8	20.5
Guernsey	5	67	4	76	4	2,471.9	0.7
United Kingdom	2	38	14	54	3	20,854.6	6.1
Other Europe	1	4	16	21	1	11,037.2	3.2
Bermuda	2	19	8	29	1	1,486.7	0.4
British Virgin Islands	4	7	11	22	1	883.3	0.3
Cayman Islands	37	221	47	305	15	15,589.2	4.6
Others	1	1	8	10	1	433.4	0.1
No. of Authorised Funds	162	1,628	175	1,965	100	342,134.2	100

* Net Asset Value as at 31 December 2002 (excluding "umbrella funds")

The market for both investment-linked assurance schemes and Mandatory Provident Fund (MPF) pooled investment funds also continued to expand during the year as the public became more accustomed to saving up for retirement (Table 6).

In addition to authorising collective investment schemes, we monitor the marketing materials and the information reported by authorised funds to ensure high standards of disclosure.

Facilitating Product Development and Enhancing Information Disclosure

The Department has facilitated the development of a wide range of investment products in Hong Kong. We have also taken steps to enhance the disclosure standards. These initiatives are part of our continuous efforts to reinforce Hong Kong's position as a premier regional fund centre.

In May 2002, we released the Hedge Fund Guidelines, which set out the regulatory requirements for the authorisation of hedge funds that are offered to the Hong Kong public. This was followed by the Guidelines on Hedge Fund Reporting Requirements in November. Both sets of Guidelines took into consideration the views from the market after extensive consultation.

Hong Kong is one of the first jurisdictions in the world to approve the sale of hedge funds to the retail public. Subsequent to the release of the guidelines, both single strategy hedge funds and fund of hedge funds have been authorised for sale. And to ensure a level playing field for all financial intermediaries in the marketing of retail hedge funds, the Commission and the HKMA issued a *Circular to Registered Persons Regarding the Marketing of Hedge Funds*. This collaborative effort reminded SFC licensees and banks alike of their obligations to assess the suitability of hedge funds for their clients.



Collective Investment Scheme

▶ A new term “Collective Investment Scheme” is introduced in the SFO to embrace the slightly overlapping concepts of unit trusts, mutual funds and investment arrangements. This term will be flexible enough to capture new products and ensure they are regulated appropriately without the need to change the law.



In response to requests for Real Estate Investment Trusts (REITs) to be introduced in Hong Kong, we issued a consultation paper on the proposed guidelines for the authorisation and regulation of REITs in early March 2003. Given the unique features and investment characteristics of this product, the proposed regulatory requirements will be set out in a separate code (i.e. not within the existing *Code on Unit Trusts and Mutual Funds*). We expect to publish this Code by the third quarter of 2003.

We have undertaken other initiatives to facilitate the fund authorisation process without compromising investor protection. Last year, we introduced an annotation requirement for fund offering and constitutive documentation for compliance with the *Code on Unit Trusts and Mutual Funds*. We also launched *Frequently Asked Questions* on the SFC website to help the market understand the requirements of the Code. A hedge funds application checklist was published to assist preparation of supporting documents.

REITs may broaden the choice of investment products available to the public.



To further improve the existing regulatory framework for the offering of passively managed index tracking funds in Hong Kong, we published in March 2003 a consultation paper on the draft guidelines for regulating Exchange Traded Funds. We expect to issue a set of guidelines also by the third quarter of 2003.

Stepping Up Communication with the Fund Industry

During the year, we conducted seminars for industry participants to increase transparency of our regulatory functions. Nearly half of these engagements were about hedge funds. Presentations were also given on fund authorisation and REITs, especially during the consultation period to raise public awareness of the key policy proposals. Our longer term objective is to enhance understanding of our policies; maintain a productive exchange of views with the industry; and assist market practitioners to achieve best practices and standards.

Enforcement

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COMBATING MARKET MISCONDUCT:

A Market Misconduct Tribunal has been established to build on the work of the Insider Dealing Tribunal by handling civil cases of market misconduct of all forms.



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

ACHIEVEMENTS

- **Concluded 344 investigations of which 276 were completed within 12 months**
- **Successfully prosecuted three cases of market manipulation and 33 entities for breaches of various ordinances**
- **Referred four cases of suspected insider dealing to the Financial Secretary for hearing by the Insider Dealing Tribunal**
- **Two cases were concluded before the Insider Dealing Tribunal resulting in penalties etc of \$21.3 million; a further two cases are currently before the Tribunal**
- **Concluded 90 disciplinary inquiries and disciplined 86 registrants or concerned persons**
- **Referred 15 cases of fraud and corruption to Police and ICAC and an additional 32 boiler room cases to Police**

THIS CHAPTER IS ABOUT

■ Surveillance

- Listed companies

■ Investigation

- Market misconduct including market manipulation and insider dealing
- Disclosure of interests compliance
- Unauthorised investment promotion
- Unregistered dealing and illegal short selling

■ Disciplinary actions

- **Co-operation with other law enforcement agencies**

What We Do

- **Enforce laws relating to the securities and futures industry, leveraged foreign exchange trading, and investment arrangements;**
- **Inspect books and records of listed companies if impropriety is suspected;**
- **Report suspected insider dealing to the Financial Secretary;**
- **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 another successful year. While the total number of cases handled has continued to rise, we have streamlined our investigative process further without compromising thoroughness and fairness. The result is that more cases are being completed within a shorter period of time. Unnecessary time and effort is not spent on non-priority, minor matters with the Division focusing its resources to address three areas of high risk in the financial markets in Hong Kong: corporate misconduct, serious misconduct by intermediaries, and market misconduct including insider dealing. These sectors will continue to be our priorities in the coming year under the SFO and the dual filing regime.

The High Court's decision to dismiss appeals by market manipulators against immediate custodial sentences sends an appropriate message to coincide with the tougher approach envisaged with the introduction of the SFO and should be an effective deterrent to those who might be tempted to break the law.

The Commission's focus on corporate governance has resulted in a marked increase in the number of company inspections; six such inspections in 2002-2003 compared with three a year ago. Our determination to fight corporate misgovernance has also resulted in the strengthening of our co-operation with the Hong Kong Police, the ICAC and the China Securities Regulatory Commission (CSRC) in the investigation of corporate misconduct in Hong Kong and the activities of Hong Kong listed companies in the Mainland. We have also successfully worked with the Police on matters ranging from corporate fraud and theft by brokerage staff, to boiler room fraud and market manipulation.

Surveillance

The Division's surveillance team is responsible for monitoring day-to-day trading in the stock and derivative markets in Hong Kong. We have recruited more market practitioners to improve our understanding of the market. With the help of sophisticated computer systems, we work to identify and make preliminary assessments of unusual price and turnover movements.

In cases of suspected market manipulation, insider dealing or any other market abuse, we obtain trading details from brokers, conduct preliminary inquiries and refer cases for full investigation. An Internet surveillance team has been formed to monitor and identify abnormal activities on websites.

As part of daily surveillance, we monitor the media for reports of improper activities and surf the Web to identify possible unregistered dealing or unauthorised advertising of investment products and services.

During the year, we obtained trading records from brokers on 122 occasions, and referred 23 cases for full investigation. We are satisfied that on many occasions our inquiries are sufficient to put a stop to potentially unethical behaviour. In recognition of this, we have initiated such inquiries earlier and canvassed a wider pool of brokers.

There were 173 occasions of trading suspension in listed securities due to unusual price or volume movements resulting in the imminent release of price sensitive information and full information disclosure. On 167 occasions, the suspensions were initiated by the companies concerned as a result of surveillance staff discussing the matter with them. Four suspensions were directed by the Stock Exchange and

two were directed by the SFC under Rule 9 of the Securities (Stock Exchange Listing) Rules. These suspensions were usually lifted on the day after the concerned company released news which might have an impact on its stock, or statements that it was unaware of the reason for the unusual price or volume movements in its shares.

■ Listed Companies

Under section 29A of the SFCO, the SFC might inspect books and records of a listed company if its directors and officers were suspected of impropriety in the management of its affairs. We continued two ongoing investigations from a year ago and conducted six new investigations during the year: two were referred to the Police for further investigation, one was concluded with no further action, and five are still in progress.

Euro-Asia Agricultural (Holdings) Company Ltd was directed by the SFC to suspend trading on the Stock Exchange under Rule 9 as a result of a section 29A investigation. The case has put under the spotlight the quality and suitability of sponsors and other professionals helping Mainland enterprises to list in Hong Kong. We are determined to contribute to the improvement in the quality of new listings by ensuring sponsors realise we will take action against those whose work falls short of the standard expected of them.

Under the SFO, our inspection powers will be more extensive. Coupled with dual filing, we anticipate conducting considerably more investigations of listed companies.

Investigations

Corporate misgovernance, serious misconduct by intermediaries and general market misconduct such as market manipulation and insider dealing have been major areas of enforcement work.

We continued 266 ongoing investigations from 2001-2002. Another 391 new cases were referred during the year by sources including the public, foreign regulators, law enforcement agencies in Hong Kong, the Exchanges and other SFC departments. Out of these 657 cases handled, 344 have been concluded and the remaining 313 are subject to continuing investigations, hearings or prosecutions.

■ **Market Misconduct**

The enforcement programme continued to focus on the fundamentals of maintaining a fair and open market by fighting corporate misgovernance and serious market misconduct.

□ **Market Manipulation**

Combating market manipulation continued to be a priority. Our enforcement efforts were justified by the successful prosecution of four people in the Courts for manipulating the shares of Grand Field Group Holdings Ltd (Case 1 in Table 1), Climax International Company Ltd (Case 2) and China Mobile (Hong Kong) Ltd (Case 3).

We have concluded investigations in an additional nine cases and are confident that most of these will be in Court in the coming year.

Successful Prosecutions - Market Manipulation (Table 1)					
1 April 2002 to 31 March 2003					
Case	Defendants	Date of Conviction	No. of Summonses Involved	Penalty	Costs of Investigation Awarded (\$)
1)	Lau Hing Nam	24 June 2002	1	160 hours of Community Service	36,556
	Wong Kwing Ming, George	24 June 2002	1	96 hours of Community Service	36,556
2)	Hung Daniel	11 November 2002	1	160 hours of Community Service	45,885
3)	Chan Shing Chun	25 March 2003	1	\$15,000 fine	3,653
Total: 4 entities					122,650

In addition, two persons convicted in the previous year for manipulation in the Hong Kong Parkview case had their appeals against immediate prison sentences dismissed in the High Court. Mr Justice Lugar-Mawson commented: “[Market manipulation] is an offence that strikes at the fair and honest operation of the securities market. It is not a victimless crime; its victims are all other members of the investing public.”

Furthermore, we assisted in the successful prosecution in the District Court by the Police of two individuals for manipulating the shares of Gay Giano International Group Ltd. One defendant was sentenced to nine-month imprisonment, suspended for three years and the other to a 240-hour Community Service Order. Both were disqualified from being a director for five years. This was the first time the Court has disqualified a person from directorship following a conviction for market manipulation.

The heavy sentences reflect that the Courts view market manipulation as a serious crime. The SFC welcomes this. Under the SFO, the maximum penalty is increased to 10 years’ imprisonment and a \$10 million fine. These increased penalties and the tougher judicial stance of the last year should represent a significant deterrent.

□ Insider Dealing

The Division investigated 11 cases carried forward from a year before and two new cases. We referred four cases to the Financial Secretary for consideration of the appointment of an Insider Dealing Tribunal (IDT). We concluded five cases with no further action being taken and investigations continue in the remaining four cases.

During the year, two insider dealing cases were heard by IDTs. As a result, seven insider dealers were ordered to pay a total of \$21.3 million comprising penalty, disgorgement and costs (Table 2).

In addition to fines etc, the two insider dealers in the Stime Watch International Holdings Ltd (now renamed Medtech Group Company Ltd) inquiry were also disqualified from holding any directorship in any Hong Kong listed company or its subsidiaries for four and three years respectively.

Case	Insider Dealers	Shares of Listed Company Involved	Date of Judgement	Disgorgement of Profit (\$)	Penalty (\$)	Cost (\$)
1)	Lau Chan Wing, Raymond	China Apollo Holdings Ltd	6 June 2002	746,986	746,986	682,434
	Zhang Tie Cheng			755,997	377,998	383,870
	Lok Fai			0	2,425,448	1,407,522
	Tseung Wai Lok			922,465	461,232	383,870
2)	Chung Ming Chee, Arthine	Stime Watch International Holdings Ltd	14 February 2003	793,360	1,190,040	1,407,522
	Tsang King Hung			2,000,000	1,000,000	500,000
	Wong Wing Shing, Wilson			1,605,943	2,000,000	1,500,000
Total: 7 persons				6,824,751	8,201,704	6,265,218

During the year, IDT started the Siu Fung Ceramics Holdings Ltd inquiry and the hearing continues. Two more inquiries are about to start : HKCB Bank Holdings Company Ltd/Lippo China Resources Ltd/Lippo Ltd and Firststone International Holdings Ltd. Eight cases previously referred to the Financial Secretary are awaiting his decision.

■ Disclosure of Interests Compliance

An essential element to the improvement of corporate governance is disclosure of the shareholdings of substantial shareholders and directors. The Securities (Disclosure of Interests) Ordinance (SDIO) required 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 investors assess the direction of a corporation and corporate insiders' views of its prospects. It also helps prevent market misconduct and enhances market transparency.

The Division continued to commit resources to ensuring strict compliance. During the year, we prosecuted 15 people and six companies (as against 14 people and eight companies in the previous year) for material SDIO breaches (Table 3). We issued 69 warning letters for minor and inadvertent breaches.

Case	Defendants	Date of Conviction	No. of Summonses Involved	Fine (\$)	Costs of Investigation Awarded (\$)
1)	Ng Cheong Lam	9 April 2002	16	32,000	13,240
2)	Wong Chung Pak Thomas	9 April 2002	4	20,000	15,135
3)	Yung Kwok Kee Billy	15 April 2002	7	35,000	34,771
4)	Best Fortune Capital Ltd	13 May 2002	2	2,400	9,318
	Zhang Daxiang	13 May 2002	4	4,800	9,318
5)	March Match Ltd	20 June 2002	4	12,000	3,838
6)	Zhong Jianqiu	16 July 2002	1	5,000	11,696
7)	Founder Holdings Ltd	13 August 2002	1	5,600	14,809
8)	Chow Wai Wai John	27 August 2002	2	10,000	17,516
9)	China United Holdings Ltd	29 August 2002	2	1,000	15,354
10)	Hung Siu Lin Katherine	17 September 2002	4	24,000	18,802
11)	Chan Kwan Shat	15 October 2002	6	30,000	8,176
	Wong Wei Gin Lydia	15 October 2002	6	30,000	8,176
12)	Lam Kin Hing Kenneth	22 October 2002	2	10,000	12,504
13)	Top New Finance Ltd	5 November 2002	6	36,000	6,751
14)	Wu Kezhong	5 November 2002	6	36,000	6,751
	Pong Kam Wah	24 December 2002	2	10,000	16,419
15)	Khattar Sat Pal	24 December 2002	2	7,000	6,668
16)	Yip Kwong	11 March 2003	1	5,000	9,210
17)	Leong On Mei Angela	25 March 2003	2	10,000	3,919
	Maxwick Investment Ltd	25 March 2003	2	10,000	3,919
Total: 21 entities			78	335,800	246,290

■ **Unauthorised Investment Promotion**

We prosecuted five companies and three persons under the Protection of Investors Ordinance for issuing unauthorised documents on the Internet, and possessing or issuing unauthorised advertisements and documents in relation to investment arrangements with guaranteed returns (Table 4). Such arrangements related to the sale of securities or property where investors' interests were pooled and returns guaranteed.

Successful Prosecutions – Protection of Investors Ordinance (Table 4)					
1 April 2002 to 31 March 2003					
Case	Defendants	Date of Conviction	No. of Summonses Involved	Fine (\$)	Costs of Investigation Awarded (\$)
1)	GlobalLinkAsia.com.Ltd	5 June 2002	5	150,000	0
2)	Joyplace Inc	9 July 2002	2	20,000	9,053
	Lin Chih Chieh Sidney	9 July 2002	2	14,000	9,053
3)	Ho Sze Man	16 July 2002	3	9,000	9,053
4)	Hong Kong Characteristic Medicine (International Group) Co	10 September 2002	2	30,000	8,980
5)	Hong Kong Real Estate Exchange Co Ltd	8 October 2002	5	50,000	6,125
	Li Chi Hong	8 October 2002	5	25,000	6,125
6)	Midland (China) Property Development Ltd	14 February 2003	5	50,000	32,990
Total: 8 entities			29	348,000	81,379

■ **Unregistered Dealing and Illegal Short Selling**

We noted a decline in unregistered dealing and illegal short selling prosecutions. During the year, one person was prosecuted for unregistered dealing in securities and three for short selling (Table 5).

Successful Prosecutions – Unregistered Dealing and Illegal Short Selling (Table 5)					
1 April 2002 to 31 March 2003					
Case	Defendants	Date of Conviction	No. of Summonses Involved	Fine (\$)	Costs of Investigation Awarded (\$)
Unregistered Dealing					
1)	GlobalLinkAsia.com.Ltd	5 June 2002	1	30,000	14,178
Illegal Short Selling					
2)	Heng Hian Mok	26 November 2002	24	48,000	8,355
3)	Chan Shing Chun	25 March 2003	3	45,000	10,959
4)	Choy Tin Woo Johnnie	25 March 2003	1	25,000	22,429
Total: 4 entities			29	148,000	55,921

Disciplinary Actions

For Hong Kong to remain an international financial centre it is essential that tough disciplinary action is taken against intermediaries who put their clients' interests and the integrity of the market at risk.

In 2002-2003 we conducted 163 disciplinary inquiries. Of these we concluded 90 resulting in the disciplining of 86 entities:

- Disciplined 12 registrants for serious misconduct.

Of these, we revoked the licences of seven for: conducting unauthorised trades in client accounts causing substantial losses; creating false documents to cover up; making false representations to SFC to get licences; and lacking the necessary financial integrity.

Suspended the licences of five people for eight months to three years for: conducting discretionary trades in breach of licensing conditions; breaching an undertaking to repay the outstanding balance in a client's account; failing to establish clients' identities; assisting a person trading through nominee accounts; and breaching the Code on Takeovers and Mergers.

- Suspended the licences of 20 registered persons for one week to six months for: contravening HKEx's Placing Guidelines for Derivative Warrants; failing to obtain written authorisations from clients before accepting third parties' orders; providing misleading information; improper debt collection, unregistered portfolio management; delay in executing clients' orders; circumventing HKEx's rules; facilitating potentially improper or illegal clients' trade; and window dressing the company's financial position.

- Publicly reprimanded 44 registered persons for: contravening HKEx's Placing Guidelines for Derivative Warrants; poor internal controls; failure to supervise staff to conduct businesses properly; and other misconduct.
- Privately reprimanded 10 registrants

Table 6 shows our significant disciplinary actions.

Significant Disciplinary Actions (Table 6)			Disciplinary Action
1 April 2002 to 31 March 2003			
Registrants	Date of Action	Misconduct	
1) Ngai Tsz Keung	4 April 2002	Made false representation of his educational qualification for obtaining registration	Revocation
2) Fung Hing Chiu Herman	8 April 2002	Conducted unauthorised trades in a client's account and issued a dishonoured cheque	Revocation
3) Chan Siu Ping	31 May 2002	Conducted unauthorised trades in clients' accounts and forged a client's signature to withdraw funds for her own use	Revocation
4) Leung Lam Yuen Ching Juanita	18 July 2002	Conducted unauthorised trades in clients' accounts and created false documents to clients	Revocation
5) Tam Hau Lok	20 September 2002	Failed to honour his financial obligations and did not have the necessary financial integrity	Revocation
6) Chan Hing Fung Katie	21 October 2002	Conducted unauthorised trades in clients' accounts and created false documents to clients	Revocation
7) Leung Yuen Yee Winnie	17 March 2003	Making preferential allocation of trades to the detriment of clients	Revocation
8) Tse Hon Pan	27 May 2002	Conducted numerous discretionary trades in clients' accounts in breach of his licensing conditions	3 years' suspension
9) Chan Kin Sun	10 June 2002	Breached the Code on Takeovers and Mergers	2.5 years' suspension
10) Ng Yin Hing	16 April 2002	Conducted unauthorised trades in a client's account and breached the undertaking to repay	2 years' suspension
11) Ng Kwun Wing	27 May 2002	Failed to establish the identities of the persons placing orders and making settlement instructions	9 months' suspension
12) Yeung Ching Kwong	9 May 2002	Assisted a dealer's representative to trade through 2 nominee accounts and created false records to deceive his employer	8 months' suspension

In addition to the discipline, we also issued 51 warning letters in cases of less serious nature.

Failure to check the identities of third parties placing orders in client's accounts remains prevalent. This puts clients' assets at risk, makes market misconduct easier and damages market integrity. We will continue to focus on this area over the coming year.

HKEx's Placing Guidelines for Derivative Warrants

We publicly reprimanded three brokerages and seven individuals, and suspended two individuals' registrations for contravening HKEx's Placing Guidelines for Derivative Warrants.

Some intermediaries provided names of clients to placing agents to ostensibly satisfy the Placing Guidelines in force at the times. These schemes created the false appearance that there were sufficient independent persons holding the warrants at the time of listing, and could have misled investors as to the real state of movement for the warrants and the viability of the post-listing market.

Some intermediaries failed to understand the Placing Guidelines before acting as placing agents.

If intermediaries operate without being fully conversant with all relevant rules and regulations, we will take action even in situations where the rules are no longer in force.

We started late last year to publish a monthly digest of enforcement actions, the *SFC Enforcement Reporter*. We have received positive feedback from the market. In the coming year, we intend to provide the industry with more information regarding matters that concern us and to use disciplinary actions and prosecutions as examples to reinforce regulatory messages.

The cases on the next page have been highlighted in the *SFC Enforcement Reporter* and are important messages to intermediaries.

Lessons to Learn

Case 1. Phoenix Capital Futures Ltd

We discovered that Phoenix had window-dressed its financial position in order to report compliance in its monthly Financial Resources Rules (FRR) returns. In March, we suspended Phoenix's registration for two weeks. Chan Siu Man, Kirby, the dealing director responsible for finance and compliance functions, was also suspended for two weeks.

We attach great importance to registrants' observance of the FRR since it is the cornerstone of prudential regulation. We will not tolerate window-dressing activities. FRR breaches are serious enough to warrant suspension or even revocation, even if there is no loss to investors.

Case 2. Chan Kin Sun

Chan Kin Sun was suspended for 30 months after the SFC Takeovers Executive imposed an order denying him access to the securities market (a cold shoulder order) for 15 months for breaching the Code on Takeovers and Mergers. The length of the suspension took into account not only his conduct in relation to the Takeovers Code breach but also his recidivism – Chan had been suspended for 30 months in 1997. Repeat offenders should expect to receive much tougher penalties.

Case 3. Chiang Yuk Oi

We expect co-operation and assistance from intermediaries at all times. Following the successful prosecution of an individual for manipulating the shares of Good Fellow Group Ltd, we suspended the registration of Chiang Yuk Oi for six months for giving materially inconsistent answers in SFC interviews and to the Court during the prosecution. Actions that attempt to jeopardise our investigation and court proceedings will be punished.

Co-operation with other Law Enforcement Agencies

In order to combat financial and corporate crime effectively, we keep in close contact with domestic enforcement agencies and our counterparts in other jurisdictions.

We have referred 47 cases during the year to the Hong Kong Police and ICAC for further investigation and action. To create a better understanding of how our respective organisations work, two officers from the Commercial Crime Bureau were seconded to the SFC's

Enforcement Division for a three-month period. It is hoped that secondments will become a regular occurrence so that benefits can be brought to both organisations through an exchange of experience, expertise and training.

Boiler Rooms

During the year, we received 68 complaints in relation to boiler room fraud, compared with 106 in 2001-2002.

"Boiler rooms" refer to groups of professional-sounding salespersons who cold call and use high pressure sales tactics to urge potential investors to buy real or bogus investments. Very often, they are located in one country and approach investors in another by telephone, email, fax or post. Once the investors send money, often overseas, the salesperson disappears.

Out of the 68 cases which we handled, 33 involved boiler rooms using the facilities of business centres or secretarial firms in Hong Kong to disguise the real jurisdictions in which they operate. They had no real operations in Hong Kong. This year, we are stepping up measures to discourage business centres and secretarial firms in Hong Kong from innocently or knowingly facilitating boiler room operators.

Some complaints were referred to us from overseas regulators. In September 2000, following a referral from the UK's Financial Services Authority, we started investigating the operations of a company called FCS Fund Management. The company was suspected of having operated in Hong Kong without an SFC licence. The SFC then referred the case and its initial findings to the Police and we worked closely together on it. The former chairman of FCS, Graham Hammond, surrendered himself to the Serious Fraud Office in London and was then convicted of 20 counts of furnishing false information and jailed for eight years in August 2002. This case illustrates the success and importance of continuing co-operation between the SFC, domestic enforcement agencies and our counterparts in other jurisdictions.



**With the
Additional SFO
Powers, We
Expect to :**

**Investigate
More Listed
Company
Malpractice**

- ▶ The new provisions extend the SFC's power to obtain documents and seek explanations from parties closely connected with the listed corporations, namely their banks, auditors and transaction partners.

**Use the Dual
Route to Combat
Misconduct**

- ▶ A Market Misconduct Tribunal (MMT) is created to handle civil cases of market misconduct. The MMT can impose a greater range of civil sanctions. As an alternative to civil proceedings, market misconduct will also be subject to criminal prosecution which may result in more severe penalties on conviction.

**Raise Disclosure
Quality**

- ▶ The tighter disclosure of interests law ensures equal and timely access for investors to information about controlling interests in listed companies.

**Impose More
Proportionate
Punishments
on Intermediaries**

- ▶ We have a broader range of sanctions to deal with intermediaries' misconduct. We can fine up to \$10 million or three times the gains or losses avoided, whichever is higher. We can impose partial suspensions and revocations of licences. To impose proportionate sanctions where they are due, we propose to fine in combination with suspensions and other disciplinary sanctions.



Supervision of Markets

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ADDED LEVEL OF INVESTOR CONFIDENCE AND SECURITY:

The new single investor compensation scheme extends the coverage to a broader range of intermediaries, including both exchange and non-exchange participants, banks and securities margin financiers. The compensation limit is raised to \$150,000 per investor.



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

ACHIEVEMENTS

- Streamlined regulatory regime for derivative warrants and other structured products
- Relaxed short selling regulation
- Moved closer to a scripless market
- Oversaw the development of advanced market infrastructure, including the launch of CCASS/3 clearing system and the upgrade of AMS/3 and HKATS trading systems
- Finalised the new single investor compensation scheme under the SFO
- Developed procedures for authorisation of Automated Trading Services

THIS CHAPTER IS ABOUT

- **Facilitating market development**
 - Encouraging product innovation and enhancement
 - Relaxing short selling regulation
- **Strengthening financial infrastructure**
 - SCEFI II Report
 - Review of HKEx's systems
 - Upgrade of CCASS/3 and derivatives clearing system
- **Publication of ePO Guidelines**
- **Market research**
- **Processing investor compensation claims**

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

■ Encouraging Product Innovation and Enhancement

The SFC worked with HKEx to widen its product range and streamline the regulatory requirements for the following products:

- In May 2002, the Hong Kong Futures Exchange (HKFE) introduced Dow Jones Industrial Average (DJIA) Futures contract for trading. The underlying DJIA is recognised around the world and widely used to track the performance of the US market.

- Effective 27 May 2002, HKFE increased the contract size of the One-month and Three-month HIBOR Futures contracts to five times their original contract size. The Exchange and Settlement Fees increased by only 2.5 times, resulting in an effective fee reduction of 50%.
- The Division worked together with our Corporate Finance Division, HKEx and other market participants to streamline the regulatory regime for derivative warrants and other structured products. HKEx introduced a new chapter in its Listing Rules in July 2002 to provide a platform for the listing of all structured products. The products launched under the new rules included derivatives warrants and equity-linked instruments.
- In November 2002, the HKFE launched the Mini-Hang Seng Index (HSI) Options contract, with a contract size which is one-fifth of the standard HSI Options contract. To encourage trading of the contract, the Commission reduced the SFC levy from \$1 to \$0.2 and the Compensation Fund levy from \$0.5 to \$0.1 upon the commencement of the SFO.

■ Relaxing Short Selling Regulation

To maintain the competitiveness of our markets and to reduce the compliance burden of market participants, we proposed changes to legislation to relax short selling regulation. The Securities (Miscellaneous) (Amendment) Rules 2002, which commenced in November 2002, extended the current naked short selling exemptions to all market makers recognised by SEHK and HKFE in their performance of market making transactions and hedging transactions.

The Rules also provide alternative reporting mechanisms for covered short selling orders to enable timely execution of transactions. To complement these exemptions, we worked with HKEx to implement corresponding exemptions from the tick rule for various market making transactions.

Strengthening Financial Infrastructure

■ SCEFI II Report

The Steering Committee on the Enhancement of the Financial Infrastructure (SCEFI) II Report was released in December 2002. Taking into account the changing business environment since the release of the first SCEFI Report in 1999, the Steering Committee incorporated three strategic objectives into the SCEFI II report: ensuring an efficient and robust market infrastructure; improving connectivity and interoperability for foreign investors; and creating superior liquidity.

A High Level Forum chaired by the Permanent Secretary for Financial Services and the Treasury (Financial Services) has been set up to oversee the implementation of SCEFI II recommendations. The Division chairs two of the three Implementation Working Groups (IWGs), including the Scripless Market IWG and the Interoperability IWG. The third one, the Clearing and Settlement Infrastructure IWG, is chaired by HKEx.

□ Scripless Market

A consultation paper on the proposals for a scripless market was issued in February 2002. The Scripless Market IWG, consisting of representatives from the Government, HKEx, the Federation of Share Registrars and the SFC, was formed to implement a scripless market model for Hong Kong. Work is in progress to develop the technical and operational details, including the preparation for necessary legislative changes. Focus groups of legal experts, market participants and listed companies have been formed to advise on the issues that may arise from the implementation.

□ Interoperability

The Interoperability IWG focuses on cross-border linkage and integration. To identify the way forward for the Interoperability IWG, the SFC visited a number of major market participants to understand their back

office operations and features in the current clearing and settlement systems. We found that most of their operations were highly automated.

□ Clearing & Settlement Infrastructure

The Clearing and Settlement Infrastructure IWG focuses on issues related to clearing and settlement. HKEx engaged a consultant firm to conduct a business case study on the SCEFI II recommendations. A consultant report was presented to the High Level Forum. The SFC is reviewing the consultant's assessments and proposals.



Investors have fast and easy access to the stock market through electronic channels.

■ Review of HKEx's Systems

During the year, HKEx encountered certain system problems, including interruption to the Hong Kong Futures Automated Trading System (HKATS) of HKFE. The SFC requested HKEx to conduct a series of comprehensive reviews on the technical architecture of its critical systems, the related operational procedures and the overall IT quality framework.

These reviews aim to identify areas for improvement in the technical architecture; ensure the implementation of proper operational procedures and checks and balances; and strengthen the quality of HKEx's IT system so that it will be in line with industry best practices. Independent consultants were engaged to conduct the reviews. The SFC has been closely monitoring the progress of these reviews and HKEx has largely followed and implemented the consultants' recommendations.

Following a system interruption of HKATS in late January 2003, we requested HKEx to engage an independent consultant, who will report to the SFC, to retest HKATS by using a standard higher than the industry best practice. We further requested the oversight of the retesting by a Board level committee. We will continue to work with HKEx on the matter.

■ Upgrade of CCASS/3 and Derivatives Clearing System

The next generation of the Central Clearing and Settlement System (CCASS/3) - with its open architecture, accessibility via the secured network FinNet, new collateral management functions and upgraded security functions - was successfully introduced in phases throughout 2002. We conducted regular reviews and monitored management of implementation as well as development of contingency plans to facilitate the introduction of stages 1 and 2 in May 2002 and December 2002 respectively. Stage 3 of CCASS/3, which will allow participants' supplied systems to directly access to CCASS/3 through an open gateway, is expected to be launched in 2003.

The implementation of an integrated derivatives clearing system, known as Derivatives Clearing and Settlement System (DCASS) and the upgraded trading system is under way. We continue to monitor the implementation and introduction of these new systems.

Publication of ePO Guidelines

We published the *Guidelines for Electronic Public Offerings (ePO)* in April 2003. The new Guidelines update the previous *Guidelines for Registered Persons Using the Internet to Collect Applications for Securities in an Initial Public Offering* and extend the scope to cover all public offerings (including IPOs and follow on offerings). The Guidelines explain the SFC's position in respect of the different forms of electronic public offerings via the Internet and other electronic means which have emerged since the initial Guidelines were published in 2000. Issues of hyperlinking and electronic prospectuses are also addressed.

Market Research

The Division conducts extensive research on the developments in the securities and futures markets of Hong Kong and other major markets, with a view to assisting the formulation of policies and the monitoring of market performance. We provide support to the Commission to achieve our regulatory objectives by analysing information and identifying the latest trends. To better communicate with the market and to provide more timely information, we launched a research paper series and revamped the statistical section of our website last year. We also worked with other regulators, academia and other divisions to publish the *SFC Quarterly Bulletin*.

Processing Investor Compensation Claims

As at 31 March 2003, the net asset values of the Unified Exchange Compensation Fund (UECF) and the Commodity Exchange Compensation Fund (CECF) were \$872 million and \$129 million respectively. During the year, payments totaling \$25.6 million were made from the UECF to 265 claimants in respect of the default of Win Successful Securities Ltd, Chark Fung Securities Co. Ltd, C.A. Pacific Securities Ltd, Lawsons Securities Company, Ying Kit Company Ltd and Foreground Securities Co. Ltd. Claimants of these defaulting brokers have received, or will receive, the amount allowed by the SEHK of up to \$150,000 per claimant under the agreed compensation arrangement. No payments were made from the CECF during the year.

In addition, we continued to work with the liquidators and HKEx on the preparation work of the distribution of the remaining assets of C.A. Pacific Securities Ltd to the claimants, for which the Court's decision on the classification of certain clients (as to whether they were cash clients or margin clients) was pending during the year. The Court made a judgment in March 2003.

Payments totaling \$1.7 million and \$0.1 million were made to eight clients of Wei Xin Securities Ltd and 24 clients of HW Securities Co. Ltd respectively after the liquidators' dividends of the firms were received.



New Investor Compensation Arrangement


- ▶ A new investor compensation arrangement has streamlined the previous arrangement and provided better protection to investors. Under the new arrangement, an independent Investor Compensation Company Limited (ICC) has been set up to administer and manage a single Investor Compensation Fund.

Compensation coverage is now extended to investors dealing with a broad range of intermediaries trading HKEx's products, including exchange and non-exchange participants, banks and securities margin financiers. The compensation limit is also raised to \$150,000 per investor. ICC was incorporated on 11 September 2002.

Automated Trading Services

- ▶ The SFO clearly sets out the legislative framework for the approval of Automated Trading Services (ATS) in Hong Kong. Different procedures apply depending on the nature of the services. Where they resemble stockbroking, the licensing regime will apply; and where they are more reminiscent of a stock exchange, a separate authorisation regime will apply. This flexible framework caters for the emergence of electronic trading networks and future market development.

The SFC has developed procedures for the authorisation of ATS and handling of applications.



Legal Services

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ACHIEVEMENTS

- **Gazettal of 40 pieces of subsidiary legislation within a short timeframe to enable the commencement of the SFO**
- **Prepared for publication an article giving a comprehensive overview of the SFO as well as an outline giving specific guidance on disclosure of interests**
- **In conjunction with the other operational divisions, prepared resources and provided training to aid SFO compliance**
- **Advised on numerous possible breaches of ordinances and conducted prosecutions in respect of a wide range of regulatory offences on behalf of the Commission**

THIS CHAPTER IS ABOUT

- **The Securities and Futures Ordinance**
 - Subsidiary legislation
 - Preparing the market
- **Prosecutions and appeals**
- **Legal support to the Commission's work**
- **Legal advice**

What We Do

- Assist with legislative reform of the securities market;
- Provide legal advice to the Board and the operational and support divisions; and
- Conduct prosecutions in the Magistrates' Courts in respect of a wide range of regulatory offences and handle various civil proceedings involving the Commission.

What We Did

The Securities and Futures Ordinance

■ Subsidiary Legislation

The SFO came into force on 1 April 2003, opening a new chapter in Hong Kong's regulation of the securities and futures markets.

Since the enactment of the SFO in March 2002, the Division devoted substantial resources to drafting the considerable body of subsidiary legislation needed to underpin the SFO. The legislative drafting team played a pivotal role in co-ordinating this major cross-divisional exercise involving a total of 40 pieces of subsidiary legislation and completing the task within a tight timeframe. The subsidiary legislation prescribes many of the detailed and technical requirements of the new regulatory regime and, as it can be amended relatively quickly, is instrumental in providing the SFO with the necessary flexibility to address changing market and global conditions.

To transform policy instructions into law and ensure a transparent process, several key steps were required to be taken in respect of each item of subsidiary legislation. These included:

- Producing drafts for public consultation and redrafting in the light of comments received;



Chief Counsel Andrew Young talks on SFO.

- Liaison with the Department of Justice and the FSTB;
- Drafting papers explaining each item for submission to the Legislative Council House Subcommittee on Draft Subsidiary Legislation to be Made under the SFO under the chairmanship of the Honourable Sin Chung Kai;
- Attending debates in the Subcommittee to answer Members' questions and further refining the drafts and producing explanatory memoranda; and
- Arranging for the gazettal of the subsidiary legislation and drafting explanatory briefs for the purposes of negative vetting by the Legislative Council.

Most of the 40 pieces of subsidiary legislation had been gazetted in batches by 13 December 2002 and the seven-week negative vetting period elapsed for these items on 12 February 2003. The last few items were gazetted on 17 January 2003, thus completing this mammoth exercise and paving the way for commencement of the SFO on 1 April 2003.

■ Preparing the Market

The Division participated actively last year in preparations for the SFO implementation, including giving seminars. In addition, the Division prepared a

comprehensive overview article on the SFO entitled “The Securities and Futures Ordinance 2002 – Continuity and Change” which was published in the 2002 spring issue of the *SFC Quarterly Bulletin*. It also prepared a derivation table which indicates from where in the previous legislation the various sections of the SFO have been derived and an outline providing specific and extensive guidance on Part XV on Disclosure of Interests. We also vetted the drafts of many of the 40 sets of codes and guidelines plus forms and other materials produced by operational divisions (See the chapter on *Corporate Affairs* for more details of how the SFC prepared for SFO implementation).

Prosecutions and Appeals

Under section 62 of the SFCO (now section 388 of the SFO) the Commission is empowered to prosecute offences in Magistrates’ Courts. Throughout the year the Division advised on evidence and prosecuted a large number of cases, including market manipulation, illegal short selling, unregistered dealing, breach of disclosure requirements, promotion of unauthorised investment arrangements and unauthorised online trading services.

In September 2002, China United Holdings Ltd appealed to the High Court against its conviction for two breaches of statutory disclosure requirements following a trial in the Magistrates’ Court. On 26 November 2002, Mr Justice Pang dismissed the company’s appeal. The appeals by two convicted market manipulators against their custodial sentences were also dismissed by the High Court in October 2002.

The Commission appeared, by direction of the trial judge, in the application by Lee Ming Tee to the High Court for a stay of his trial on charges of conspiracy to defraud and publishing a false statement.

Although the stay application was successful, on 11 February 2003 the Appeal Committee of the Court of Final Appeal granted leave to the Secretary for Justice to appeal the decision and also granted the Commission leave to intervene in the appeal proceedings.

SFC’s Duties Towards Individual Investors Cheng Chung Keung and the SFC

During the year the SFC was involved in an important case which clarified the limits of the SFC’s duties towards individual investors.

This matter arose out of a dispute between Cheng and his futures broker who, it was alleged, had not confirmed an order status with Cheng and had liquidated an open position without his consent. The SFC declined to intervene in the dispute, because it appeared to be a private contractual matter. After Cheng had been unsuccessful in suing his broker for damages, he brought an action in the High Court against the SFC in 2001, alleging misconduct on the SFC’s part and failure by it to perform its supervisory duties. The action was dismissed as disclosing no reasonable cause of action. Cheng appealed to the Court of Appeal.

In October 2002, the Court of Appeal dismissed Cheng’s appeal. The court held that the SFC’s duties as a financial regulator were to supervise the overall operation of financial dealings in Hong Kong. As such, the SFC did not exercise its duties solely for protecting a particular investor or class of investors. To impose such a duty of care would have an adverse impact on the SFC’s operations. In any event, there was no evidence of a relationship between Cheng and the SFC which gave rise to an individual duty of care on the SFC’s part towards him. The Court confirmed the SFC’s view that the particular conduct of Cheng’s broker was a private matter and was not relevant to the question of whether the broker was properly supervised by the SFC.

The Court also noted that, in the absence of any evidence of bad faith on the part of the SFC, the Commission could also rely upon the statutory immunity contained in section 56 of the SFCO (now section 380 of the SFO).

Legal Support to the Commission's Work

■ Civil Actions

The Commission successfully secured the appointment of administrators by the High Court in respect of the property of two brokers: Law Siu Kong Christopher trading as Lawsons Securities Company and Chow Yuk Wah trading as Teil Stock Investment Company. In each case, the order was preceded by the issue of a restriction notice. Administrators were appointed principally to protect the interests of the clients and creditors of the brokerage firms. In the Lawsons case, the Court also granted, upon the Commission's application, a *mareva* injunction in order to prevent Law from dealing with and diminishing the value of his assets. The Commission has obtained a bankruptcy order against Law pursuant to a bankruptcy petition filed against him under section 46 of the SFCO.

■ Takeovers and Mergers Panel

The Division provided legal advisers to assist the Takeovers and Mergers Panel in connection with three cases during the past year. One case concerned whether a concert party had been formed in relation to the acquisition of control of a listed company and if so, the possible application of the Takeovers Code. Another case involved an application to review the Executive's ruling that the parties concerned were not acting in concert. The third case was also a review application in respect of a ruling that a voluntary offer for all the shares in a company was an offer for the purposes of the Takeovers Code, to which a proper response should be made under the Code.

Legal Advice

Throughout the year, the Division continued to render legal advice to operational and support divisions on a wide range of other matters including interpretation of statutory provisions and advice on commercial agreements, cases of suspected insider dealing and matters involving personal data privacy and copyright law. The Commission also drew up internal procedures for public consultations and revised its guidelines for the handling of external complaints.

Corporate Affairs

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ACHIEVEMENTS

- **Reduced operating expenditure and contained deficit at half of the budgeted amount**
- **Provided more training to staff despite budget cut**
- **Revamped business systems to prepare for SFO commencement**
- **Reached out to more investors with new education initiatives**
- **Strengthened communication with investors and other stakeholders**

THIS CHAPTER IS ABOUT

- **The Commission's finances and cost controls**
- **Staffing and remuneration**
- **Training and development**
- **Staff welfare and employee relations**
- **e-SFC Programme**
- **Investor education and communications**
- **Investor enquiries and complaint handling**
- **Reaching out to stakeholders**
- **Preparing for SFO implementation**

What We Do

- Provide finance, human resources and training, information technology, management and corporate services to the Commission;
- Provide strategic planning and corporate co-ordination on the Commission's work;
- Educate investors on their rights and responsibilities; and
- Promote effective communications with stakeholders including the media.

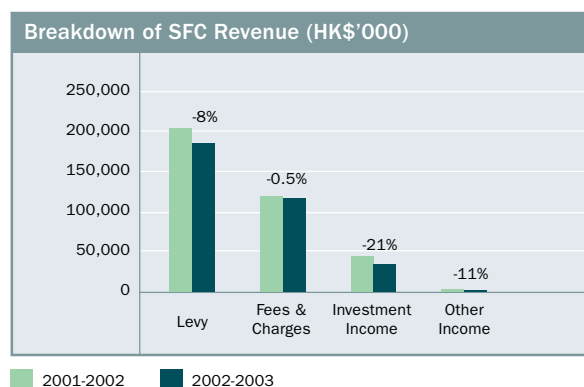
This chapter covers the work of the Chairman's Office, Commission Secretariat, Finance and Administration, Human Resources, Training and Development, Information Technology, Investor Education and Communications, and Corporate Communications.

What We Did

Finances and Cost Controls

Total revenue for 2002-2003 dropped by 7% or \$25.8 million from the previous year to \$337.2 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 8% or \$16.5 million, largely because the daily market turnover had shrunk to an average of \$6.4 billion from \$7.7 billion in the previous year. Investment income fell 21% or \$8.6 million due to the reduction of investment fund for funding the deficit and the continuous softening of interest rates.

We continued to exercise stringent cost control with measures which we had adopted since the second half of 2001. We froze salary and introduced manpower cost controls. Vacancies were not filled except for dual filing functions and urgent operational needs. We also scaled down training expenses and cut overseas training and secondment. In addition, for the second consecutive year there were no variable pay awards in 2002-2003. We suspended all but essential IT projects.

The cost control measures yielded considerable results. Comparing with a year ago, we have reduced our total operating expenditure after depreciation by 5% or \$21.6 million to \$395.6 million. Half of the reduction, or \$11 million, was due to a cut in personnel expenses. In addition, capital expenditure was down by 45% to \$14.8 million.

As a result, our deficit amounted to \$58.4 million, half of the original budgeted deficit of \$117.6 million. It was comparable with the \$54.2 million deficit in 2001-2002, even though revenue was 7% lower. The reserves at the end of March 2003 was \$565.6 million, equivalent to 16 months of estimated expenditure (including depreciation) of \$433.3 million for 2003-2004.

Our budget for 2003-2004 forecasts an operating deficit of \$93.3 million. In March 2003, the Financial Secretary under the delegated authority from the Chief Executive approved the budget.

Staffing and Remuneration

The Commission's permanent established posts were frozen at 361 and temporary established posts were maintained at 12. As at 31 March 2003, there were 395 staff, comprising 355 regular staff and 40 temporary staff. This was a 5% reduction from the total staff number of 415 a year earlier. The above figures did not include the 12 permanent posts created for the additional work under dual filing. Eight of these posts had been filled at year-end, taking total staff strength to 403.

About 38% of SFC staff held professional qualifications. Overall staff turnover increased from 7.4% to 8.8%.

The Government appointed the Hay Group Limited to conduct a review in early 2002 on the remuneration of senior executives of statutory bodies and other organisations, including the SFC. In accordance with the recommendations of the Hay Report issued in June 2002, the remuneration information of the top three tiers of our senior executives is disclosed as follows:

- All Executive Directors are not entitled to any other benefits except for retirement benefits, medical and life insurance, and annual leave. A six-month "sanitisation" period is applicable to all Executive Directors upon termination of employment which is not treated as garden leave with pay, and no compensation will be made.
- In his employment contract, the Chairman's annual remuneration package comprises a fixed pay of \$7,500,000 and a performance-related variable pay of up to \$375,000. The fixed pay is constant throughout the contract period and the variable pay is awarded annually on performance basis. The Chairman has voluntarily reduced his fixed pay since 1 October 2001 from the contractual sum of \$7,500,000 to \$6,750,000 per annum. His total emoluments (including retirement benefits) during the year amounted \$6,800,000.
- The average of the total emoluments (including retirement benefits) of the other four Executive Directors during the year amounted to \$4,165,000.
- The average of the total emoluments (including retirement benefits) of the seven serving Senior Directorate Grade Staff during the year amounted to \$2,613,000.

Training and Development

Customised training to enhance staff competence and operational effectiveness continued despite a considerable reduction in the training budget. During the year, we provided 263 training programmes covering topics on industry, management, language and information technology. Sixteen general sessions to cover the SFO were organised for all staff, while a further 18 technical sessions on specific parts were organised for the operational teams.

To improve internal communication, our colleagues presented their areas of operation and shared experience in briefing sessions. These included a series of sharing sessions on Leadership, Organisational Change and Internal Management led by the Chairman.

Local and overseas external speakers were also invited from time to time to provide updates on current issues and exposure to overseas regulatory experience. Prominent overseas speakers included Mr Dan Waters, Director of Risk Assessment Division of the Financial Services Authority (FSA), UK and Mr Ian Johnston, ASIC's Executive Director of Financial Services Regulation.

We continued the secondment programme with the CSRC and sent staff to essential overseas programmes. During the year, five staff were seconded to the CSRC while we received 17 secondees from the CSRC. One staff was seconded to the FSA while four attended training in the UK and the Asia Pacific region. Locally, we also opened some of our training programmes to the HKMA, Mandatory Provident Fund Schemes Authority (MPFA) and the FSTB to facilitate exchange of regulatory experience.



ASIC's Ian Johnston shares the Australian experience in financial market reform with SFC staff.

Staff Welfare and Employee Relations

We continued to organise events and activities to improve staff communications and relations. Staff functions held in 2002-2003 included in-house staff lunches and barbecue outing etc. With the support of the Commission, a soccer team has also been formed.

Colleagues gather for a BBQ outing at Repulse Bay.



Apart from recreational activities, there was also frequent communication between the Chairman and staff. The Chairman briefed both executive and general grade staff and issued monthly notes regularly, and sent special messages on important occasions.

e-SFC Programme

The e-SFC Programme began in April 2001. It aimed to enable the SFC to conduct business electronically to gain efficiency and effectiveness, hence enhancing the Commission's responsiveness to the securities industry. The two-year project was completed at the end of March 2003.

■ Knowledge Base and Work Process

An e-Library was launched on the SFC Intranet, which enables staff to do research from their desktops easily.

To prepare for the SFO commencement, we upgraded four major business systems relating to intermediaries regulation, inspection, and investment products regulation. New workflow systems were also introduced to improve process, notably one for handling of listing application materials under dual filing. The SFO also necessitated changes to more than 20 SFC computer systems, including major revamps of those for licensing management, disclosure of interests, and filing of intermediaries' financial returns.

■ Quality Services

In January 2003, the Commission passed the certification audit for ISO9001: 2000 for both the Technology Services and System Development Services. This certification confirmed that our IT services quality continued to match the best industry standards. An information security review was conducted by a renowned IT expert in February 2003. The review confirmed that our security measures reached the high standards of other regulatory bodies in major international markets.

Investor Education and Communications

■ New Endeavours

We take innovative and proactive means to communicate with investors. During the year, we produced our first video drama for broadcast on public transportation – 2,400 buses and 200 public light buses for three months. The 12-episode *Invest with Your Heads Up* explains stock trading and settlement procedures, and measures investors can take to protect their own interests when dealing in stocks.

Also for the first time, we produced investor education VCDs and CD-ROMs, both of which contain the video series. The CD-ROM also contains interactive games and feature articles on investment activities and products from the Electronic Investor Resources Centre (eIRC).

To help young people learn more about financial planning and investment, we partnered with The University of Hong Kong to offer a course on *Financial Intelligence (FQ) – The Art of Personal Financial Management and Investment* for some 250 university students.

We published a cartoon leaflet *Wise Ways when Dealing with Brokers*, making it more interesting for the general stock investors to learn how to protect their interests.

In addition, we jointly organised with Radio Television Hong Kong an investor knowledge competition to increase investors' awareness of their rights and obligations. This radio quiz received overwhelming response from the audience, resulting in an extension of the programme from five to eight weeks.

■ **Thematic Campaigns**

We conduct thematic education campaigns to complement new developments in the market. During the year these included education on: equity-linked instruments (ELIs) when the first ELI was listed on the Stock Exchange; hedge funds ahead of the introduction of retail hedge funds; and bonds following the streamlining of the offering mechanism. Investor publications, on-line education resources, and feature articles in the print media explained the product features, investment risks, and other tips on investor protection.

We continued the annual "train-the-trainer" teacher workshops. Some 550 secondary school teachers attended a total of 13 workshops on stocks, funds, options and futures, and received a teaching kit for discussion with students in class.

We jointly organised with the Government and other public bodies the Hong Kong Financial Sector Exhibition in July 2002. The five-day exhibition highlighted the quality of the Hong Kong financial markets and focused on market and product development, financial infrastructure, regulatory reform, consumer protection, public education, professional development and international co-operation.

■ **SFO**

We published a booklet called *SFO & You* to explain the key changes brought about by the SFO in plain language and how they affect the investors. We also published an updated leaflet *When and How to Make a Complaint* to explain how an investor can make a complaint in a more effective manner.

Investor Enquiries and Complaint Handling

During the year, we received 3,982 investor enquiries, compared with 3,073 enquiries in the previous year. We also received 959 public complaints, against 721 in the previous year.



All complaints are taken seriously and first reviewed by the Complaints Control Committee, which is chaired by an Executive Director and consists of six senior executives from various divisions and departments. The committee meets every week and makes a preliminary assessment of all public complaints to decide whether further action needs to be taken, taking into account information from the complainant and the subject of complaint.

Each operational division and department has also established a guideline for staff to follow when handling complaints referred to them for assessment or investigation.

Statistics of Public Complaints		
Nature of complaints	2002-2003	2001-2002
1. Conduct of licensed intermediaries	305	248
2. Listing related matters & disclosure of interests	323	144
3. Market misconduct	122	108
4. Investment products	32	18
5. Other financial activities	148	191
6. Miscellaneous	29	12
Total	959	721

Effective Complaints Handling

Warning List Saves Investor from Scam

During the year, the SFC received a complaint against an unlicensed overseas company for cold calling. We put the company's name on the Investor Alert List on the SFC website. Later, a UK investor was cold-called by a sales representative of that unlicensed company and was about to send £5,000 to invest in an "once in a life time" offer. Luckily the investor visited the SFC website and checked the Investor Alert List. He immediately withheld the money and sent an email to the SFC to say "thank you".

Forex Investor Gets Settlement

A novice investor was solicited by an account executive of a leveraged foreign exchange trading firm to open an account. The account executive allegedly promised to limit her loss to 2.5% of investment. However, almost total loss was subsequently reported. The investor lodged a complaint with the SFC. While the SFC will look into possible misconduct, it cannot intercede in pecuniary disputes. The SFC advised the investor to report the matter to the firm's management. Later on, she told the SFC that she had entered into a settlement agreement with the firm and the account executive.

Advisers Reminded of Cold Calling Prohibition

The SFC last year received several complaints from the public against cold calling by investment advisers to sell funds or offer financial advisory services. In view of the risk of mis-selling, the SFC issued a circular in November 2002 to remind all licensed investment advisers that while conducting business, they should observe the cold calling prohibition.

Reaching Out to Stakeholders

The Commission actively engages stakeholders in the development of its regulatory policies and keeps the market and the public informed of its latest news and activities.

The mass media remain an important channel through which information about our work and policies is communicated to stakeholders including the general public. During the year, we issued a record 299 press releases and our senior executives gave 34 interviews. A total of 11 press conferences and sharing sessions were held to announce new policy initiatives and discuss the Commission's work. We also handled 1,346 media enquiries during the year.



All Executive Directors meet the media to review 2002 and outline our priorities for 2003.

The SFC's corporate website www.hksfc.org.hk is another valuable source of information for industry participants and investors. We provide an email enquiry service on the website. A total of 989 public enquiries were received via email in 2002-2003. During the year, we introduced another free service where subscribers will receive an email whenever there are updates of the subscribed sections of the website. A new name search function for our enforcement press releases will ease retrieval. The website's content was significantly updated with SFO-related information to help the public better understand the new law. The website achieved an average of 266,590 hits per day compared to 183,671 hits per day in 2001-2002.

In November 2002, we began publishing the *SFC Enforcement Reporter*, a monthly summary of the Commission's enforcement action. This serves to reinforce our regulatory message that enforcement is a priority of the Commission. Meanwhile, we continued to publish the *SFC Alert* newsletter to bring the latest news about the Commission to intermediaries and investors. Although it is not a statutory requirement, we released *Quarterly Reports* to enhance transparency and accountability. The research-based *SFC Quarterly Bulletin* and its more detailed version on the website provide useful statistics and in-depth analysis into topical market issues.



Staff geared up at the start line on The Peak for the 10th Green Power Hike.



Preparing for SFO Implementation

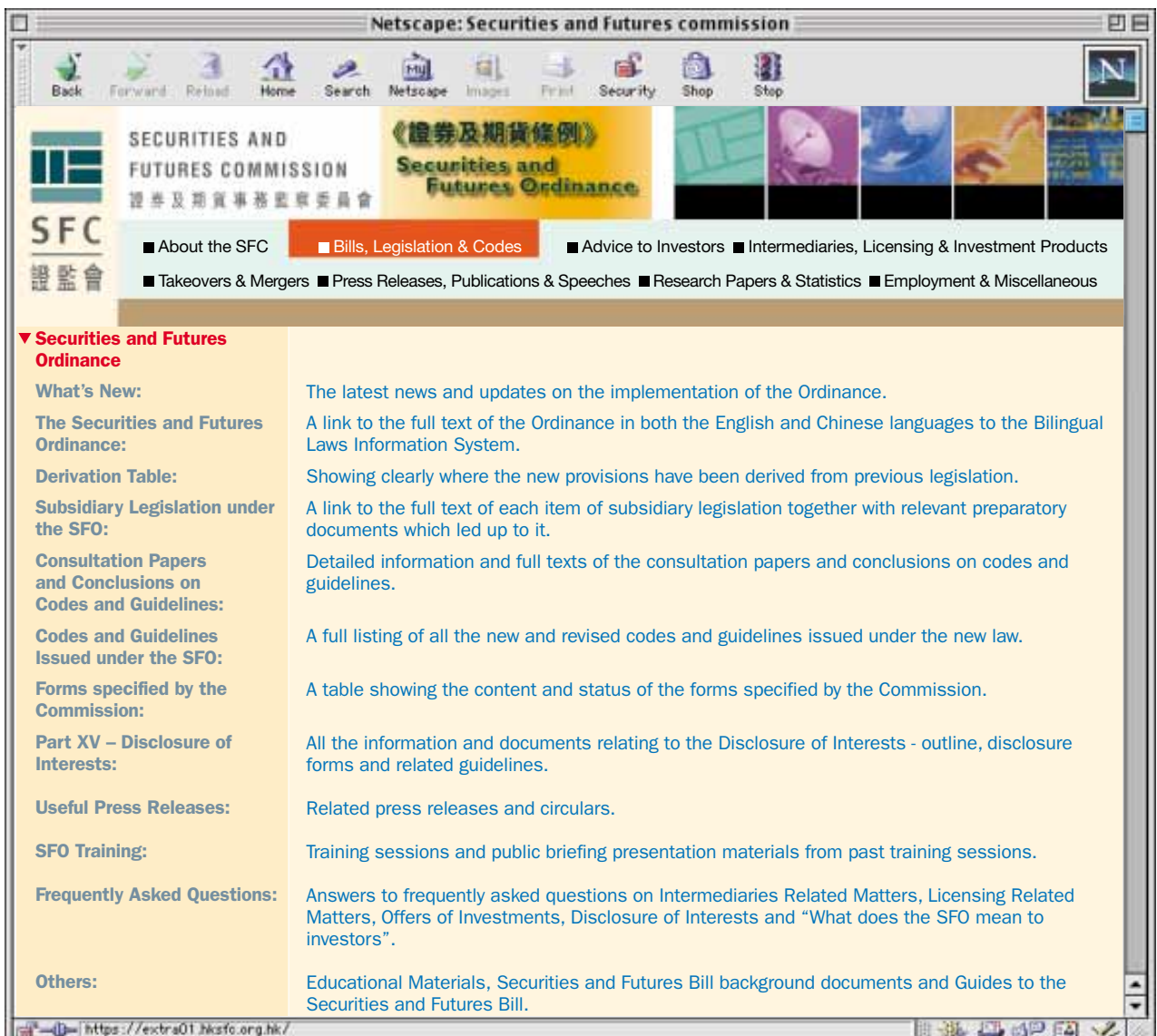
Supported by the Legal Services Division and Corporate Affairs Division, all operational divisions of the SFC had been actively involved during last year in preparing for the SFO implementation, including initiatives to inform and educate market participants, investors, the general public and other stakeholders.

Concern for the Community

The Commission and its staff support community and charitable projects enthusiastically. We have participated in fund-raising activities such as the Community Chest Green Day and the Dress Casual Day 2002. Our staff also took part in charitable sports events including the BOC (HK) Walkalong for Light and the 10th Green Power Hike.

A special SFO section was created on the SFC website upon enactment of the law in March 2002. The section has been continuously updated and carries a great deal of information on the new law for the public's reference.

The following is a roadmap of the SFO section.



We organised and took part in a total of 92 SFO training seminars during the year (some in conjunction with industry associations, professional bodies and the Hong Kong Securities Institute) for market practitioners and our own staff. In all, there were more than 15,000 participants. The following is a summary table:

SFO Training Sessions Given by the SFC by the end of March 2003		
Target Audience	Number of Training Sessions Conducted	Total Number of Participants
SFC Staff	34	1,877
Members of the Hong Kong Securities Institute and the Public	15	1,368
Exchange Participants	13	3,329
All Registered Persons and Interested Market Practitioners	11	3,476
Accountants & Legal Practitioners	11	769
Investment Advisers, Exempt Dealers and Exempt Investment Advisers	6	833
Insurance Intermediaries	1	3,700
Police	1	50
Total	92	15,402

* Participants may attend more than one session.

Cross-Border Regulatory Co-operation

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THIS CHAPTER IS ABOUT

- SFC's involvement in IOSCO
- Assisting overseas regulators
- Combating money laundering
- Co-operation with Mainland China
- Financial Sector Assessment Program

What We Do

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

The SFC has always been an active participant in the global arena, working closely with its overseas and Mainland counterparts to enhance the quality and effectiveness of market regulation. The SFC has continued to strengthen international regulatory co-operation, information sharing and cross-border investigation. We currently have 35 co-operation arrangements with regulatory bodies around the world. Discussions are taking place with three additional jurisdictions in Asia.

In addition, the SFC is in the final stage of discussion with ASIC to establish a MOU on the regulation of investment funds.

IOSCO

Hong Kong actively participates in the International Organisation of Securities Commissions (IOSCO) through committees and projects. Hong Kong, represented by SFC Chairman Andrew Sheng, is a member of the IOSCO Technical Committee consisting of 16 securities regulators from the world's most developed markets.

We are also members of the five Standing Committees (SC) of the Technical Committee that deal with different aspects of securities and intermediaries regulation. The Technical Committee established a high level sub-committee to coordinate and focus IOSCO's response to the securities regulatory issues highlighted by the bankruptcy of Enron and other high-profile business failures around the world. SFC Chairman represents the SFC in this Chairs' Committee comprising Chairs and senior representatives of securities regulators from 12 jurisdictions.

Consequently, IOSCO released three Technical Committee papers prepared by three task forces in October 2002. Mr Sheng co-chaired with Dr Luigi Spaventa, Chairman of the Italian securities regulator CONSOB, the task force responsible for the Principles for Ongoing Disclosure and Material Development Reporting by Listed Entities.

Our Corporate Finance Division participated in the task forces responsible for the Principles for Auditor Oversight, and the Principles of Auditor Independence and the Role of Corporate Governance in Monitoring an Auditor's Independence.

Mr Sheng and Alexa Lam, Executive Director of Intermediaries and Investment Products, represent the SFC at the Chairs' Committee on Securities Analysts and Credit Rating Agencies.

Mrs Lam is also a member of the Implementation Committee that is currently developing the methodology for assessing implementation of the IOSCO Objectives and Principles of Securities Regulation. During the year, the SFC submitted its comments on the proposed assessment methodology, and responded to self-assessment questionnaires on implementation of these principles.

■ Standing Committees

The Corporate Finance Division participates in SC1 - Accounting and Auditing. SC1 monitors and comments on developments in International Accounting Standards. Our staff play an active role in SC1's Audit Task Force, which reviews and prepares comments on International Standards on Auditing issued by the International Audit and Assurance Standards Board.

In November, we hosted a two-day meeting of the SC1 in Hong Kong, where regulators discussed the latest issues on accounting standards and financial reporting.

The Supervision of Markets Division participates in SC2 on the regulation of secondary markets. During the year, we responded to survey questionnaires on trading halts and market closures, short selling transparency, share buy-back and the Technical Committee's mandate on indexation, and provided inputs on the reports on these subjects.

IOSCO and the Committee on Payment and Settlement Systems (CPSS) published recommendations proposed by their joint task force to promote the efficiency and effectiveness of securities clearing and settlement systems (SSS). The Division provided inputs to the task force on the assessment methodology report on the SSS recommendations and participated in the task force's new mandate on the risk management of central counterparty. It also assisted the work of the Group of Thirty on clearing and settlement.

The Intermediaries Supervision Department participates in SC3 and contributes to projects on the regulation of market intermediaries. During the year, we responded to the survey questionnaires on regulation of market intermediaries in a cross-border environment.

The Enforcement Division is active in SC4, which aims to enhance co-operation, enforcement and information sharing among regulators. After the 911 incident in 2001, IOSCO created a special project team to explore actions that securities regulators should take. One of the areas the team examined was co-operation and information sharing among securities regulators to combat financial crime and misconduct.

To achieve this, IOSCO adopted a Multilateral Memorandum of Understanding (MMOU), which is the first multilateral international arrangement of its type among financial market regulators. The SFC is a signatory, together with regulators from other major jurisdictions including the US, UK, Australia and Canada. This arrangement greatly enhances regulatory co-operation and information sharing among all signatories.

During the year, the Enforcement Division also participated in SC4's Task Force on Client Identity/Beneficial Ownership, which examines the application of the Financial Action Task Force (FATF) Forty Recommendations on client identity to financial institutions.

The Investment Products Department participates in SC5 on investment management. During the year, the SC5 considered issues on retail participation in hedge funds, index funds and the use of indices, corporate governance responsibilities of funds as shareholders, best practice standards on fund performance reporting, suspension of redemptions in times of market volatility, simplified fund prospectuses, fees and other costs of asset management services, and risk assessment of fund operators.

IOSCO and the Internet

On 24 and 25 June 2002, the SFC hosted the Asian Roundtable for Internet Project Team of the IOSCO, at which regulators discussed trends and risk profile of securities trading on the Internet.

On 30 September 2002, the Enforcement Division took part in the Internet Surf Day organised by the Asia-Pacific Regional Committee of IOSCO. We joined 12 other participating regulators within the Asia-Pacific Region, including Mainland China, Australia, Thailand and Singapore, to surf the Internet to identify possible fraudulent or abusive activities relating to the securities and futures markets. The SFC identified five websites suspected of offering unregistered dealing or investment services to the Hong Kong public for follow-up action.

Assisting Overseas Regulators

Last year, the Enforcement Division received 41 requests for enforcement-related assistance: 13 were requests for investigatory assistance involving the SFC in the exercise of its statutory powers; and 28 were requests for public or non-public information. On the other hand, we made 20 requests to overseas regulators and, of these, 14 were requests for investigatory assistance. In respect of licensing-related matters, the SFC received 200 requests from overseas regulatory authorities and made 451 requests.

	2002-2003		2001-2002		2000-2001	
	In	Out	In	Out	In	Out
Enforcement-related requests for investigatory assistance	13	14	13	15	16	16
Enforcement-related requests for information	28	6	36	6	25	5
Licensing-related requests for information	200	451	224	474	214	825
Total	241	471	273	495	255	846

Combating Money Laundering

The Intermediaries Supervision Department continued to participate actively in the work of international anti-money laundering organisations such as the FATF and the Asia Pacific Group (APG). Last year, we attended the Fifth Annual Meeting of the APG in Australia as a financial expert to present an evaluation report on the anti-money laundering regime of Thailand. We also made a presentation to a group of law enforcement officers from nine countries at the Financial Investigation Course 2002.



Our staff is one of the 150 delegates to the APG meeting in Brisbane.

Co-operation with the Mainland

The Commission and the CSRC continued to work closely during the year. We attended the 29th and the 30th Memorandum of Regulatory Co-operation (MORC) meetings in August 2002 and March 2003 organised by the Shanghai Stock Exchange and HKEx respectively. Executives from the CSRC, the SFC, HKEx, the Shanghai Stock Exchange and Shenzhen Stock Exchange exchanged views on policy initiatives and concerns about regulation of securities markets.

As part of the MORC, the Enforcement Division and the Supervision of Markets Division met with their counterparts at CSRC to discuss market surveillance, enforcement and other cross-border issues on market development. The two commissions also exchanged views on CSRC's abolition of the requirement to review PRC legal opinions in respect of overseas-incorporated companies with Mainland interests seeking to list in Hong Kong and on CSRC's not issuing "No-comment Letters" to these companies.

Financial Sector Assessment Program

Hong Kong participated in the Financial Sector Assessment Program (FSAP) conducted jointly by the International Monetary Fund (IMF) and World Bank. FSAP seeks to alert economies to likely financial vulnerabilities in order to reduce the potential for crisis. The securities sector in Hong Kong was assessed for observance of the IOSCO Objectives and Principles of Securities Regulation, CPSS-IOSCO Recommendations for Securities Settlement Systems, OECD Principles of Corporate Governance, IMF Code on Good Practices on Transparency in Monetary and Financial Policies, and Anti-Money Laundering and Combating the Financing of Terrorism.

Workshops

In March 2003, the SFC also participated in the Fifth International Regulators Technical Workshop hosted by the US Securities and Exchanges Commission to exchange views and improve international co-operation on fund management regulation. Other participants included regulators from the UK, US and Australia.

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 Ordinance)

We have audited the financial statements on pages 79 to 91 which have been prepared in accordance with International Financial Reporting Standards promulgated by the International Accounting Standards Board.

Respective responsibilities of directors and auditors

The Hong Kong Securities and Futures 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 2003 and of its deficit and cash flows for the year then ended, and have been properly prepared in accordance with International Financial Reporting Standards promulgated by the International Accounting Standards Board.

KPMG

Certified Public Accountants
Hong Kong

6 May 2003

Income and Expenditure Account

For the year ended 31 March 2003 (Expressed in Hong Kong dollars)

	Note	2003 \$'000	2002 \$'000
Income			
Levies		186,166	202,620
Fees and charges		116,915	117,481
Investment income	5	32,773	41,399
Other income	6	1,319	1,485
		337,173	362,985
Expenses			
Staff costs	7	302,398	313,445
Premises			
rent		20,010	20,010
other		11,267	11,215
Other expenses	8	38,216	46,958
		371,891	391,628
Depreciation		23,662	25,563
		395,553	417,191
Deficit for the year		(58,380)	(54,206)
Accumulated surplus brought forward		581,153	635,359
Accumulated surplus carried forward		522,773	581,153

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

The notes on pages 82 to 91 form part of these financial statements.

Balance Sheet

At 31 March 2003 (Expressed in Hong Kong dollars)

	Note	2003 \$'000	2002 \$'000
Non-current assets			
Fixed assets	9	30,976	39,868
Held-to-maturity debt securities	10	388,794	298,110
Current assets			
Held-to-maturity debt securities	10	39,036	319,113
Bank deposits		178,371	38,815
Debtors, deposits and prepayments	12	25,749	24,049
Cash at bank and in hand		421	1,076
		243,577	383,053
Current liabilities			
Provision for contribution to the Unified Exchange Compensation Fund	18	–	30,000
Fees received in advance		31,557	33,301
Creditors and accrued charges		66,177	33,737
		97,734	97,038
Net current assets		145,843	286,015
Net assets		565,613	623,993
Funding and reserves			
Initial funding by Government	14	42,840	42,840
Income and expenditure account		522,773	581,153
		565,613	623,993

Approved and authorised for issue by the Commission on 6 May 2003 and signed on its behalf by

Andrew L T Sheng
Chairman

T Brian Stevenson
Non-executive Director

The notes on pages 82 to 91 form part of these financial statements.

Cash Flow Statement

For the year ended 31 March 2003 (Expressed in Hong Kong dollars)

	2003 \$'000	2002 \$'000
Net cash outflow from operating activities	(34,812)	(67,011)
Returns on investments – interest received	33,103	40,425
Payment to the Unified Exchange Compensation Fund	(30,000)	(36,174)
Investing activities		
Held-to-maturity debt securities bought	(132,002)	(246,935)
Held-to-maturity debt securities redeemed	319,700	277,000
Fixed assets bought	(17,095)	(34,600)
Fixed assets sold	7	93
Net cash inflow/(outflow) from investing activities	170,610	(4,442)
Increase/(decrease) in cash and cash equivalents	138,901	(67,202)
Cash and cash equivalents at beginning of the year	39,891	107,093
Cash and cash equivalents at end of the year	178,792	39,891

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

	2003 \$'000	2002 \$'000
Deficit for the year	(58,380)	(54,206)
Investment income	(32,773)	(41,399)
Depreciation	23,662	25,563
Profit on sale of fixed assets	(6)	(43)
(Increase)/decrease in debtors, deposits and prepayments	(335)	6,708
Increase/(decrease) in creditors and accrued charges	34,764	(5,664)
(Decrease)/increase in fees received in advance	(1,744)	2,030
Net cash outflow from operating activities	(34,812)	(67,011)

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

	2003 \$'000	2002 \$'000
Bank deposits	178,371	38,815
Cash at bank and in hand	421	1,076
	178,792	39,891

Notes to the Financial Statements

For the year ended 31 March 2003 (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. Since 1 April 2003, the SFC Ordinance was repealed by the Hong Kong Securities and Futures Ordinance (the SFO). Since then, the SFC is governed by Part II of the SFO. Under the SFO, 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. With effect from 1 April 2003, Section 14 and Sections 394 to 396 of the SFO applies. Major sources of funding include:

- (a) 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; and
- (b) fees and charges in relation to its functions and services according to the provision of subsidiary legislation.

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.

3. Significant accounting policies

The SFC prepares its financial statements in accordance with International Financial Reporting Standards (IFRSs) promulgated by the International Accounting Standards Board (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 life of the lease. 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 and any impairment losses, 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 (see the accounting policies in respect of “impairment” and “reversals of impairment” on page 84). We account for purchases and sales of debt securities on the settlement date.

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. As the SFC is an entity controlled by the Government of the Hong Kong Special Administrative Region, we are not required by the International Accounting Standards 24 to disclose transactions with other government controlled enterprises in the financial statements.

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 2003 (Expressed in Hong Kong dollars)

Other receivables

We state other receivables at their cost less impairment losses.

Cash and cash equivalents

Cash and cash equivalents comprise cash balances and call deposits.

Other payables

We state other payables at their cost.

Impairment

We review the carrying amounts of the SFC's assets at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, we estimate the asset's recoverable amount. We recognise in the income and expenditure account an impairment loss whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount.

Calculation of recoverable amount

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

The recoverable amount of other assets is the greater of their net selling price and value in use. In assessing value in use, we discount the estimated future cash flows to their present value at a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, we determine the recoverable amount for the cash-generating unit to which the asset belongs.

Reversals of impairment

We reverse an impairment loss in respect of an asset if 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 reverse an impairment loss only to the extent that the asset's carrying amount does not exceed the carrying amount that we would have determined, net of depreciation or amortisation, if we had not recognised any impairment loss.

Provisions and contingent liabilities

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

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

4. Taxation

Section 3(3) of the SFC Ordinance exempts the SFC from Hong Kong taxes. With effect from 1 April 2003, Section 3(3) of the SFO governs the tax exemption provision of the SFC.

5. Investment income

	2003	2002
	\$'000	\$'000
Interest income	34,468	41,362
Premium on held-to-maturity debt securities	(2,397)	(589)
Discount on held-to-maturity debt securities	702	626
	32,773	41,399

6. Other income

	2003	2002
	\$'000	\$'000
Legal costs recovered	91	241
Investigation costs awarded	708	585
Sale of SFC publications	444	535
Profit on sale of fixed assets	6	43
Others	70	81
	1,319	1,485

7. Staff costs

	2003	2002
	\$'000	\$'000
Directors' fees	1,404	1,433
Directors' salaries, allowances and gratuities	22,850	26,327
Directors' bonuses/variable pay	400	1,263
Directors' retirement benefits	212	267
Staff salaries and allowances	258,053	264,730
Retirement benefits	10,486	11,062
Medical and life insurance	8,709	7,451
Overtime pay	284	912
	302,398	313,445

Notes to the Financial Statements (cont'd)

For the year ended 31 March 2003 (Expressed in Hong Kong dollars)

Directors' emoluments fell within these ranges:

	2003 No. of directors	2002 No. of directors
\$0 to \$1,000,000	6	7
\$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
\$3,500,001 to \$4,000,000	1	–
\$4,000,001 to \$4,500,000	3	2
\$6,500,001 to \$7,000,000	1	1
	11	15

Emoluments paid to independent non-executive directors during the year amounted to \$1,404,000 (2002: \$1,433,000).

Aggregate remuneration of the five highest paid individuals in 2002/2003, representing the emoluments of five executive directors, was \$23,462,000 (2001/2002: \$22,214,000 for four executive directors and a senior staff).

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 \$113,000 (2002: \$86,000).

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 \$743,000 (2002: \$456,000) and the amount so forfeited available at the balance sheet date was \$57,000 (2002: \$145,000).

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

(b) MPF Scheme

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

8. Other expenses

	2003 \$'000	2002 \$'000
Training and development	2,511	4,380
Legal and professional services	8,357	14,048
Legal claims and costs awarded	2,347	(2,500)
Information and systems services	15,956	15,672
Auditors' remuneration	160	160
General office and insurance	4,524	4,824
SCEFI (Steering Committee on the Enhancement of Financial Infrastructure)	2,729	7,214
External relations	1,632	3,160
	38,216	46,958

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
Cost						
At 1 April 2002	34,316	9,173	86,806	20,631	1,456	152,382
Additions	19	397	13,563	792	-	14,771
Disposals	(191)	(97)	(96)	(295)	-	(679)
At 31 March 2003	34,144	9,473	100,273	21,128	1,456	166,474
Depreciation						
At 1 April 2002	32,033	7,495	55,326	16,204	1,456	112,514
Charge for the year	1,280	728	18,005	3,649	-	23,662
Written back on disposals	(191)	(96)	(96)	(295)	-	(678)
At 31 March 2003	33,122	8,127	73,235	19,558	1,456	135,498
Net book value						
At 31 March 2003	1,022	1,346	27,038	1,570	-	30,976
Net book value						
At 31 March 2002	2,283	1,678	31,480	4,427	-	39,868

Notes to the Financial Statements (cont'd)

For the year ended 31 March 2003 (Expressed in Hong Kong dollars)

10. Held-to-maturity debt securities

	2003	2002
	\$'000	\$'000
Maturing after one year		
In the second to third years – unlisted	120,034	145,138
– listed outside Hong Kong	254,184	138,376
After three years – unlisted	14,576	14,596
	388,794	298,110
Maturing within one year		
– unlisted	25,030	310,116
– listed in Hong Kong	–	8,997
– listed outside Hong Kong	14,006	–
	39,036	319,113
	427,830	617,223
Cost at 31 March		
– unlisted	159,640	469,850
– listed in Hong Kong	–	8,997
– listed outside Hong Kong	268,190	138,376
	427,830	617,223
Market value at 31 March		
– unlisted	187,827	487,196
– listed in Hong Kong	–	9,074
– listed outside Hong Kong	259,735	136,719
	447,562	632,989

11. Investments in subsidiaries

We recognised our investment in FinNet Limited (FinNet) and Investor Compensation Company Limited (ICC) after 1 April 2002.

The SFC formed FinNet on 6 November 2000 with an authorised share capital of \$10,000 and issued share capital of \$2 and ICC on 11 September 2002 with an authorised share capital of \$1,000 and issued share capital of \$0.2.

The objective of FinNet is to operate an electronic network to facilitate payment and delivery transactions and interconnection of all financial institutions and financial entities in Hong Kong.

The objective of ICC is to perform functions relating to the compensation of investors and other functions under Parts III and XII of the SFO.

Both companies are wholly owned subsidiaries of the SFC. However, they were not shown on the face of the balance sheet which was expressed in thousand dollars.

Both companies have not commenced operation. The balance sheets of the companies as at 31 March 2003 and the income and expenditure accounts for the year then ended were immaterial. Therefore, we have not prepared consolidated financial statements.

12. Debtors, deposits and prepayments

The maximum balance of outstanding loans to executive staff for initial settling-in purposes during the year was nil (2002: \$77,000).

Included in debtors was an amount of \$1,258,000 due from ICC for the payment of its set up costs (2002: nil).

13. Ageing analysis of debtors and creditors

There was no material debtor balance and creditor balance included in “debtors, deposits and prepayments” and “creditors and accrued charges” respectively as at 31 March 2003. Therefore we do not provide ageing analysis on debtors and creditors.

14. 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.

15. Capital commitments

Capital commitments outstanding at 31 March 2003 not provided for in the financial statements were as follows:

	2003	2002
	\$'000	\$'000
Authorised and contracted for	15,990	24,225
Authorised but not contracted for	11,969	10,868

Notes to the Financial Statements (cont'd)

For the year ended 31 March 2003 (Expressed in Hong Kong dollars)

16. Commitment to pay rents for offices

Our Landlord informed us that our existing lease for our offices in Edinburgh Tower will be terminated by 30 June 2003.

We have entered into a new operating lease for office premises for 10 years starting 1 July 2003. As we have negotiated rent free periods for both the existing and the new leases, the Commission will not have to pay any rent during the next year.

The new lease is subject to a rent review on 1 July 2008. The rent we will have to pay after 1 July 2008 will be fixed in 2008 based on the market rent prevailing in 2008 but subject to a cap set out in the lease agreement.

At 31 March 2003 the minimum amount we are committed to pay in rent for our offices up to 30 June 2008 is as follows:

	2003	2002
	\$'000	\$'000
Payable next year	–	25,059
Payable in one to five years	93,825	33,411
Payable in more than five years	6,623	–
	100,448	58,470

During the year ended 31 March 2003, \$20,010,000 was recognised as an expense in the income and expenditure account in respect of operating leases (2002: \$20,010,000). Other than office rents we have no obligations relating to operating leases.

17. Related party transactions

We have a 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 for the matters disclosed in notes 18 and 20.

18. 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. The SFC made further commitments of \$150 million and \$30 million in the financial years ended 31 March 2000 and 2001 respectively.

Our provision for contributions to the Compensation Fund was:

	2003 \$'000	2002 \$'000
Balance at beginning of year	30,000	66,174
Amount utilised	(30,000)	(36,174)
Balance at end of year	–	30,000

19. 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

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.

20. 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 2003.

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 94 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, JP

Mrs Alexa Lam

Mr David M Roberts

Mr Kwong Ki Chi, GBS, JP (nomination revoked on 16 April 2003)

Mr T Brian Stevenson, SBS

4. Interests in contracts

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

5. Auditors

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

On behalf of the Committee

Mark Dickens

Chairman

5 May 2003

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 94 to 103 which have been prepared in accordance with International Financial Reporting Standards promulgated 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 2003 and of its surplus and cash flows for the year then ended, and have been properly prepared in accordance with International Financial Reporting Standards promulgated by the International Accounting Standards Board.

KPMG

Certified Public Accountants
Hong Kong

5 May 2003

Income and Expenditure Account

For the year ended 31 March 2003 (Expressed in Hong Kong dollars)

	Note	2003 \$'000	2002 (Restated) \$'000
Income			
Net investment income	4&6	40,541	47,315
Transaction levy	4&7	68,560	41,181
Recoveries	4	720	3,905
		109,821	92,401
Expenses			
Provision for compensation made	4&10	20,034	23,406
Unused provision for compensation reversed	4&10	(4,443)	(85,073)
Recoveries re-distributed to claimants	4	1,868	2,482
Auditors' remuneration		41	41
Bank charges		253	218
Exchange difference		11	–
Professional fees		196	807
Sundry expenses		5	5
		17,965	(58,114)
Surplus for the year		91,856	150,515
Accumulated deficit brought forward	4	(256,992)	(407,507)
Accumulated deficit carried forward		(165,136)	(256,992)

The notes on pages 98 to 103 form part of these financial statements.

Balance Sheet

At 31 March 2003 (Expressed in Hong Kong dollars)

	Note	2003 \$'000	2002 (Restated) \$'000
Current assets			
Debt securities	8	555,930	728,519
Contributions receivable		–	30,000
Interest receivable		5,580	8,383
Levy receivable		5,607	6,248
Fixed and call deposits with banks		339,687	49,723
Cash at bank		17	211
		906,821	823,084
Current liabilities			
Accounts payable and accrued charges		4,590	2,724
Provision for compensation	4&10	30,628	40,613
		35,218	43,337
Net current assets		871,603	779,747
Net assets		871,603	779,747
Representing:			
Compensation fund			
Contributions from the SEHK	9	46,450	46,450
Excess transaction levy from the SEHK	12	353,787	353,787
Special contribution		3,500	3,500
Additional contribution from the SEHK		300,000	300,000
Additional contribution from the SFC		330,000	330,000
Special levy surplus	13	3,002	3,002
Accumulated deficit		(165,136)	(256,992)
		871,603	779,747

Approved and authorised for issue by the Securities Compensation Fund Committee on behalf of the Securities and Futures Commission on 5 May 2003 and signed on its behalf by

Mark Dickens
Chairman

Alexa Lam
Committee Member

T Brian Stevenson
Committee Member

The notes on pages 98 to 103 form part of these financial statements.

Statement of Recognised Gains and Losses

For the Year Ended 31 March 2003 (Expressed in Hong Kong dollars)

	Note	2003	2002 (Restated)
		\$'000	\$'000
Surplus for the year		91,856	150,515
Total recognised gains		91,856	150,515
Effect of change in accounting policy	4	(494,770)	(599,041)

The notes on pages 98 to 103 form part of these financial statements.

Cash Flow Statement

For the year ended 31 March 2003 (Expressed in Hong Kong dollars)

	2003	2002 (Restated)
	\$'000	\$'000
Net cash inflow from operating activities	43,837	16,424
Returns on investments – interest received	43,996	38,207
Investing activities		
Debt securities redeemed	391,500	123,000
Debt securities bought	(219,563)	(332,229)
Net cash inflow/(outflow) from investing activities	171,937	(209,229)
Financing		
Additional contribution from the SEHK	–	36,174
Additional contribution from the SFC	30,000	36,173
Net cash inflow from financing	30,000	72,347
Increase/(decrease) in cash and cash equivalents	289,770	(82,251)
Cash and cash equivalents at beginning of the year	49,934	132,185
Cash and cash equivalents at end of the year	339,704	49,934

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

	2003	2002 (Restated)
	\$'000	\$'000
Surplus for the year	91,856	150,515
Net investment income	(40,541)	(47,315)
Decrease/(increase) in levy receivable	641	(6,248)
Decrease in provision for compensation	(9,985)	(82,667)
Increase in accounts payable and accrued charges	1,866	2,139
Net cash inflow from operating activities	43,837	16,424

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

	2003	2002
	\$'000	\$'000
Cash at bank	17	211
Fixed and call deposits with banks	339,687	49,723
	339,704	49,934

Notes to the Financial Statements

For the year ended 31 March 2003 (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, who are required to continue 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 of the Fund and makes payments to claimants. Upon making payment to a claimant, the SFC is subrogated to the claimant's rights against the defaulter.

The 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 eight 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 came into effect from 1 April 2003.

The SFO requires the SFC to form a new single investor compensation fund (ICF) to replace the Fund and the Commodity Exchange Compensation Fund. After allowing a sufficient sum of money to meet claims against it and its other liabilities, the SFC will transfer the remaining balance of money in the Fund into the ICF after 1 April 2003. Claims for any defaults occurring after 31 March 2003 should be made against the ICF. If the sum of money in the Fund is not sufficient to meet its liabilities, the SFC shall pay into the Fund from the ICF the appropriate sum of money according to Section 242 of the SFO.

Apart from the above change and Section 112, under Section 74(1) of Schedule 10 of the SFO, Part X of the Securities Ordinance remain effective in respect of the operation of the Fund.

3. Money constituting the Fund

Before 1 April 2003, the SEHK must keep deposited with the SFC \$50,000 for each SEHK trading right under the Securities Ordinance. 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 (2002: nil).

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

Other sources of money for the Fund include: recoveries; SEHK replenishments detailed in note 11; special levy surplus detailed in note 13; and transaction levy detailed in note 7.

4. Significant accounting policies

The Fund prepares its financial statements in accordance with International Financial Reporting Standards (IFRSs) promulgated by the International Accounting Standards Board (IASB). We set out below a summary of our significant accounting policies.

Basis of preparation of financial statements

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

Change in accounting policy

In past years, we recognised investment income in the income and expenditure account and other receipts and distributions to the Fund directly. In order to improve the comprehensibility of the financial statements to readers, this year we recognise receipts (including transaction levy, recoveries and replenishments from the SEHK) and distributions (including provision made for compensation payments and re-distribution of recoveries) that are directly related to the principal activity of the Fund as income and expenses respectively in the Fund's income and expenditure account. The comparative information for the year ended 31 March 2002 has been restated retrospectively to conform to the new policy.

Accumulated surplus/(deficit) (restated)

	2003	2002
	\$'000	\$'000
Accumulated surplus brought forward as previously reported	237,778	191,534
Change in accounting policy with respect to reclassification as income		
– transaction levy	41,181	–
– recoveries	25,794	21,889
– replenishments from the SEHK	16,360	16,360
Change in accounting policy with respect to reclassification as expenses		
– compensation to claimants	(563,588)	(625,255)
– recoveries re-distributed to claimants	(14,517)	(12,035)
Effect of change in accounting policy	(494,770)	(599,041)
Accumulated deficit brought forward as restated	(256,992)	(407,507)

Notes to the Financial Statements (cont'd)

For the year ended 31 March 2003 (Expressed in Hong Kong dollars)

4. Significant accounting policies (cont'd)

The effect of the change in accounting policy for the year is to cause an increase in income of \$69,280,000 (2002: \$45,086,000) representing the recognition of transaction levy and recoveries as income and an increase in expenses of \$17,459,000 (2002: decrease in expenses of \$59,185,000) representing the recognition of compensation to claimants and re-distribution of recoveries as expenses. These resulted in a net increase in surplus of \$51,821,000 for the year (2002: \$104,271,000).

Recognition of income

Net Investment income Net investment income comprised (i) interest income from bank deposits and debt securities, (ii) unrealised gain or loss on revaluation of debt securities and (iii) realised gain or loss on redemption and disposal of debt securities. We record interest income on an accrual basis.

Transaction levy We record transaction levy as income at a fixed rate of every leviable SEHK transaction on an accrual basis.

Recoveries We recognised recoveries pursuant to Section 118 of the Securities Ordinance as income to the Fund and recoveries re-distributed to claimants as expenses. Recoveries received and re-distributed are recorded on a receipt basis.

Replenishments by the SEHK We record replenishments from the SEHK pursuant to Section 107 of the Securities Ordinance as income of the Fund on a receipt basis. For the purpose of calculating the amount to be replenished by the SEHK, we deem the compensation payment up to the amount of \$8,000,000 for each default to be charged to the contribution from the SEHK.

Translation of foreign currencies

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

Investments

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.

Impairment

We review the carrying amounts of the Funds's assets at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, we estimate the asset's recoverable amount. We recognise in the income and expenditure account an impairment loss whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount.

Calculation of recoverable amount

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

4. Significant accounting policies (cont'd)

Reversals of impairment

We reverse an impairment loss in respect of a receivable if 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.

Other receivables

We state other receivables at their cost less impairment losses.

Provision for compensation

We make provision for liabilities arising from claims resulting from defaults occurring before 1 April 2003 for which the SEHK has published a notice calling for claims pursuant to either Section 112 of the Securities Ordinance or Section 74(4) of Schedule 10 of the SFO. 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.

Other payables

We state other payables at cost.

Contingent liabilities

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

Related parties

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

- (i) parties that the Fund has the ability, directly or indirectly, to control or 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

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

6. Net investment income

	2003 \$'000	2002 \$'000
Interest income from bank deposits and debt securities	34,209	37,536
Unrealised gain on revaluation of debt securities	6,332	9,779
Net investment income	40,541	47,315

Notes to the Financial Statements (cont'd)

For the year ended 31 March 2003 (Expressed in Hong Kong dollars)

7. Transaction levy

From 1 September 2001, the Fund received a transaction levy chargeable at 0.002% of every leviable SEHK transaction.

8. Debt securities

	2003 \$'000	2002 \$'000
Maturing after one year		
In the second to third years	88,435	–
– listed outside Hong Kong	165,366	315,117
– unlisted		
After three years	44,890	40,985
	<u>298,691</u>	<u>356,102</u>
Maturing within one year		
– listed outside Hong Kong	8,406	41,673
– unlisted	248,833	330,744
	<u>257,239</u>	<u>372,417</u>
	<u>555,930</u>	<u>728,519</u>

9. Set-off of SEHK deposits and refunds

When a trading right is transferred, the SEHK must make a \$50,000 deposit with the SFC within one month of the transfer in respect of the new holder. In the absence of claims or other provisions as set out in Section 106 of the Securities Ordinance, the SFC must refund to the SEHK the deposit of the former holder within six months of the transfer. In practice, the SFC sets these amounts off against one another and does not include in these financial statements any liability of the SEHK to make a deposit during the six-month period.

The SEHK advised the SFC of eight trading rights having been transferred during the six months to 31 March 2003 (2002: 18 trading rights had been transferred during the six months to 31 March 2002).

10. Provision for compensation

	2003 \$'000	2002 \$'000
Balance brought forward	40,613	123,280
Less: Amount paid during the year	(25,576)	(21,000)
Unused provision reversed during the year	(4,443)	(85,073)
Additional provision made for the year	20,034	23,406
Add: Net provision made/(provision reversed)	15,591	(61,667)
Balance carried forward	<u>30,628</u>	<u>40,613</u>

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

11. Replenishments from the SEHK

Under Section 107 of the Securities Ordinance, the SFC may require the SEHK to replenish the Fund with an amount that is equal to that paid in connection with the satisfaction of the claim (limited to \$8,000,000 per each defaulted case) after the SFC has exhausted all relevant rights of action and other legal remedies against the defaulter.

Up to 31 March 2003, the SEHK has replenished \$16,360,000 to the Fund. In compliance with Section 107 of the Securities Ordinance, if no further recoveries were to be collected, the SFC may require the SEHK to further replenish \$66,349,000 to the Fund as follows:

	2003 \$'000
Compensation paid up to the \$8 million limit as set out in Section 109(3) of the Securities Ordinance	92,839
Less: Recoveries received	(26,515)
Add: Recoveries re-distributed to claimants	16,385
Less: Replenishments from the SEHK	(16,360)
Net amount SFC may request SEHK for replenishment	<u>66,349</u>

Under Section 74(3) of the Schedule 10 of the SFO, the SFC having allowed sufficient funds to meet claims, may reimburse the SEHK for the deposits paid by the SEHK into the Fund for each trading right. The reimbursement of these SEHK deposits may be set off against further replenishments required from the SEHK.

12. 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.

13. 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.

14. 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 7,9,11 and 12).

15. 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

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

(iii) Market risk

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

16. Contingent liabilities

As at the date of this report, claims against nine exchange participants have been received by the SEHK, where the validity of these claims is under investigation by the SEHK and for those claims the SEHK has not sought the SFC's approval to increase the limit over \$8 million. Thus, these claims are subject to the normal \$8 million limit pursuant to Section 109 of the Securities Ordinance. We have not made any provision in these financial statements for any of these claims. Under these circumstances, the maximum liability of the Fund to these claims is \$72 million (2002: \$56 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 2003.

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 106 to 113.

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, JP
Mrs Alexa Lam
Mr William D Grossman
Mr Mark Ho
Mr T Brian Stevenson, SBS

4. Interests in contracts

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

5. Auditors

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

On behalf of the Committee

Mark Dickens

Chairman
5 May 2003

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 106 to 113 which have been prepared in accordance with International Financial Reporting Standards promulgated 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 2003 and of its surplus and cash flows for the year then ended, and have been properly prepared in accordance with International Financial Reporting Standards promulgated by the International Accounting Standards Board.

KPMG

Certified Public Accountants
Hong Kong

5 May 2003

Income and Expenditure Account

For the year ended 31 March 2003 (Expressed in Hong Kong dollars)

	Note	2003 \$'000	2002 (Restated) \$'000
Income			
Net investment income	4&6	6,063	7,190
Contract levy	4&7	6,987	5,959
Recoveries	4	14	27
		13,064	13,176
Expenses			
Auditors' remuneration		41	41
Bank charges		60	66
Professional fees		27	37
Sundry expenses		1	1
		129	145
Surplus for the year		12,935	13,031
Accumulated surplus brought forward	4	94,678	81,647
Accumulated surplus carried forward		107,613	94,678

The notes on pages 110 to 113 form part of these financial statements.

Balance Sheet

At 31 March 2003 (Expressed in Hong Kong dollars)

	Note	2003 \$'000	2002 (Restated) \$'000
Current assets			
Debt securities	8	75,633	111,159
Interest receivable		957	1,154
Levy receivable		772	481
Fixed and call deposits with banks		51,767	3,677
Cash at bank		136	60
		129,265	116,531
Current liabilities			
Accounts payable and accrued charges		252	253
Net current assets		129,013	116,278
Net assets			
Representing:			
Compensation fund			
Contributions from HKFE	9	21,400	21,600
Accumulated surplus		107,613	94,678
		129,013	116,278

Approved and authorised for issue by the Futures Compensation Fund Committee on behalf of the Securities and Futures Commission on 5 May 2003 and signed on its behalf by

Mark Dickens
Chairman

Alexa Lam
Committee Member

T Brian Stevenson
Committee Member

The notes on pages 110 to 113 form part of these financial statements.

Statement of Recognised Gains and Losses

For the Year Ended 31 March 2003 (Expressed in Hong Kong dollars)

	Note	2003 \$'000	2002 (Restated) \$'000
Surplus for the year		12,935	13,031
Total recognised gains		12,935	13,031
Effect of change in accounting policy	4	52,037	46,051

The notes on pages 110 to 113 form part of these financial statements.

Cash Flow Statement

For the year ended 31 March 2003 (Expressed in Hong Kong dollars)

	2003	2002 (Restated)
	\$'000	\$'000
Net cash inflow from operating activities	6,580	5,954
Returns on investments – interest received	6,818	6,095
Investing activities		
Debt securities redeemed	51,700	39,500
Debt securities bought	(16,732)	(67,261)
Net cash inflow/(outflow) from investing activities	34,968	(27,761)
Financing		
Net contribution (refunded to)/received from HKFE	(200)	300
Net cash (outflow)/inflow from financing	(200)	300
Increase/(decrease) in cash and cash equivalents	48,166	(15,412)
Cash and cash equivalents at beginning of the year	3,737	19,149
Cash and cash equivalents at end of the year	51,903	3,737

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

	2003	2002 (Restated)
	\$'000	\$'000
Surplus for the year	12,935	13,031
Net investment income	(6,063)	(7,190)
(Increase)/decrease in levy receivable	(291)	112
(Decrease)/increase in accounts payable and accrued charges	(1)	1
Net cash inflow from operating activities	6,580	5,954

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

	2003	2002
	\$'000	\$'000
Cash at bank	136	60
Fixed and call deposits with banks	51,767	3,677
	51,903	3,737

Notes to the Financial Statements

For the year ended 31 March 2003 (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, who are required to continue 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 of the Fund and makes payments to claimants. Upon making payment to a claimant, the SFC is subrogated to the claimant's rights against the defaulter.

The 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 came into effect on 1 April 2003.

The SFO also requires the SFC to form a new single investor compensation fund (ICF) to replace the Fund and the Unified Exchange Compensation Fund. After allowing a sufficient sum of money to meet claims against it and its other liabilities, the SFC will transfer the remaining balance of money in the Fund into the ICF after 1 April 2003. Claims for any defaults occurring after 31 March 2003 shall be made against the ICF. If the sum of money in the Fund is not sufficient to meet its liabilities, the SFC shall pay into the Fund from the ICF the appropriate sum of money according to Section 242 of the SFO.

Apart from the above change and Section 89, under Section 75(1) of Schedule 10 of the SFO, Part VIII of the Commodities Trading Ordinance remain effective in respect of the operation of the Fund.

3. Money constituting the Fund

Under the Commodities Trading Ordinance, the HKFE must keep deposited with the SFC \$100,000 for each holder of HKFE trading rights before 1 April 2003. 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 and recoveries.

4. Significant accounting policies

The Fund prepares its financial statements in accordance with the International Financial Reporting Standards (IFRSs) promulgated by International Accounting Standards Board (IASB). We set out below a summary of our significant accounting policies.

Basis of preparation of financial statements

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.

Change in accounting policy

In past years, we recognised investment income in the income and expenditure account and other receipts and distributions to the Fund directly. In order to improve the comprehensibility of the financial statements to readers, this year we recognise receipts (including contract levy and recoveries) and distributions (including provision made for compensation payments) that are directly related to the principal activity of the Fund as income and expenses respectively in the Fund's income and expenditure account. The comparative information for the year ended 31 March 2002 has been restated retrospectively to conform to the new policy.

Accumulated deficit (restated)

	2003 \$'000	2002 \$'000
Accumulated surplus brought forward as previously reported	42,641	35,596
Change in accounting policy with respect to reclassification as income		
– contract levy	63,643	57,684
– recoveries	12,851	12,824
Change in accounting policy with respect to reclassification as expenses		
– compensation to claimants	(24,457)	(24,457)
Effect of change in accounting policy	52,037	46,051
Accumulated surplus brought forward as restated	94,678	81,647

The effect of the change in accounting policy for the year is to cause an increase in income of \$7,001,000 (2002: \$5,986,000) representing the recognition of contract levy and recoveries as income. These resulted in a net increase in surplus of \$7,001,000 for the year (2002: \$5,986,000).

Recognition of income

Net Investment income Net investment income comprised (i) interest income from bank deposits and debt securities, (ii) unrealised gain or loss on revaluation of debt securities and (iii) realised gain or loss on redemption and disposal of debt securities. We record interest income on an accrual basis.

Contract levy We record contract levy as income at a fixed rate on every leviable HKFE transaction on an accrual basis.

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

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.

Notes to the Financial Statements (cont'd)

For the year ended 31 March 2003 (Expressed in Hong Kong dollars)

4. Significant accounting policies (cont'd)

Impairment

We review the carrying amounts of the Fund's assets at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, we estimate the asset's recoverable amount. We recognise in the income and expenditure account an impairment loss whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount.

Calculation of recoverable amount

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

Reversals of impairment

We reverse an impairment loss in respect of a receivable if 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.

Other receivables

We state other receivables at their cost less impairment losses.

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 occurring prior to 1 April 2003 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 as expenses through the income and expenditure account.

Other payables

We state other payables at cost.

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.

5. Taxation

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

6. Net investment income

	2003	2002
	\$'000	\$'000
Interest income from bank deposits and debt securities	5,104	5,618
Unrealised gain on revaluation of debt securities	959	1,572
Net investment income	6,063	7,190

7. Contract levy

The Fund received a contract levy chargeable at \$0.5 per every leviable HKFE transaction except for Mini-Hang Seng Index Futures Contracts, Stock futures contracts and Options on Stock futures contracts which are chargeable at \$0.1 per transaction.

8. Debt securities

	2003 \$'000	2002 \$'000
Maturing after one year		
In the second to third years – unlisted	37,318	54,826
After three years – unlisted	3,510	3,265
	<u>40,828</u>	<u>58,091</u>
Maturing within one year		
– listed outside Hong Kong	–	5,833
– unlisted	34,805	47,235
	<u>34,805</u>	<u>53,068</u>
	<u>75,633</u>	<u>111,159</u>

9. Contributions from HKFE

	2003 \$'000	2002 \$'000
Balance brought forward	21,600	21,300
Add: Contributions received during the year	700	800
Less: Refunds to outgoing holders of trading rights	(900)	(500)
Balance carried forward	<u>21,400</u>	<u>21,600</u>

10. 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 note 9).

11. 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.

12. Contingent liabilities

As at the date of this report, there is no outstanding claims against the Fund (2002: nil).

Committees and Panels

Committees of the SFC

Advisory Committee

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

<p>Chairman Andrew L T Sheng, SBS, JP</p>	<p>Members Ashley Alder Didier Balme Thaddeus Beczak Ambrose Cheung Paul Chow Paul Fan Keith Ferguson (to 19.08.02)</p>	<p>Mario Francescotti Brett P Goodin (from 01.11.02) Christina Hui Stephen Hui Alexa Lam Christine Loh Samuel Poon (from 01.06.02) Dr. Eden Woon (from 01.06.02)</p>
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Takeovers and Mergers Panel

Administers the Code on Takeovers and Mergers.

<p>Chairman Kevin Westley</p>	<p>Members Nicholas Allen Ian Boyce Malcolm Brown (from 01.04.02) David Carse Edward Cheng Stephen Clark David Graham Teresa Ko Clement Kwok Angelina Lee John Lees (from 01.04.02)</p>	<p>Alfred Li Liu Chee Ming David Lui Frederick Ma (to 29.06.02) C Roger Moss Gavin Nesbitt Patricia Shih Frank Slevin May Tan Carlson Tong David Webb V-Nee Yeh</p>
<p>Deputy Chairman Clifton Chiu Henry H L Fan, SBS, JP</p>		

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.

<p>Chairman Alan Hoo, SC, JP</p>	<p>Members Nicholas Allen Ian Boyce Malcolm Brown (from 01.04.02) David Carse Edward Cheng Clifton Chiu Stephen Clark David Graham Teresa Ko Clement Kwok Angelina Lee John Lees (from 01.04.02)</p>	<p>Alfred Li Liu Chee-ming David Lui Frederick Ma (to 29.06.02) C Roger Moss Gavin Nesbitt Patricia Shih Frank Slevin May Tan Carlson Tong David Webb Kevin Westley V-Nee Yeh</p>
<p>Deputy Chairman Patrick P T Fung, SC</p>		

Committee on Unit Trusts

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

<p>Chairman Alexa Lam</p>	<p>Full Members Raphael Blot (from 01.04.02) Prof. Kakeung C Chan Stuart Leckie, JP Andrew Lo George Long (from 01.04.02) David Lui Darren McShane (from 01.04.02) Alastair Murray Lin-Yoke Seetoh (from 18.09.02) Joseph E Silva (to 17.09.02) Paul Smith (from 01.04.02) Tina So (from 22.07.02)</p>	<p>Joan Wong (to 24.05.02) Anna H Y Wu, SBS, JP</p> <p>Alternate Members Austin Caffrey (from 01.04.02) Teh-Hsiu Fu Roger Hepper Joseph Ho (from 01.04.02) David Hughes K K Tse Scobie Ward (from 01.04.02)</p>
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Committee on Investment-Linked Assurance and Pooled Retirement Funds

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

<p>Chairman Alexa Lam</p>	<p>Full Members Rex Auyeung Desmond Chan Prof. Kakeung C Chan (from 01.04.02) August Chow Sarah Ho (to 10.05.02) Anthony Lau (from 10.05.02) Stuart Leckie, JP Darren McShane (from 01.04.02) Alastair Murray (from 01.04.02)</p>	<p>Tina So (from 22.07.02) Joan Wong (to 24.05.02) Anna H Y Wu, SBS, JP</p> <p>Alternate Members Francine Kwong Kevin Lee (from 01.04.02) Simon Ng Oscar Wong (from 01.04.02)</p>
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Securities Compensation Fund Committee

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

<p>Chairman Mark Dickens, JP</p>	<p>Members Kwong Ki Chi, GBS, JP Alexa Lam David M Roberts T Brian Stevenson, SBS</p>
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Futures Compensation Fund Committee

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

<p>Chairman Mark Dickens, JP</p>	<p>Members William D Grossman Mark Ho Alexa Lam T Brian Stevenson, SBS</p>
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Investor Education Advisory Committee

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

<p>Chairman Alexa Lam</p>	<p>Full Members Lennon W L Chan (to 31.03.03) Edward Chow (from 01.04.02) Lawrence Fok Frederick Grede (to 31.03.03) Ivy Lai Cynthia Lam (from 01.04.02 to 31.03.03) Li Kai Ming (from 01.04.02) Prof. Lui Yu Hon (from 01.04.02) Lin Yoke Seetoh (from 09.10.02)</p>	<p>Shek Kang Chuen (to 31.03.03) Joseph Silva (to 08.10.02) The Hon Sin Chung Kai (to 31.03.03)</p> <p>Alternate Members Jimmy Ho (to 31.03.03) Henry Law Lin Yoke Seetoh (from 01.04.02 to 08.10.02) Wong Koon Shing (from 01.04.02)</p>
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Academic and Accreditation Advisory Committee

Approves industry based courses and examinations for the purpose of meeting the competence requirement; approves recognised institutions for providing continuous professional training, advises the Commission on areas to study to enhance Hong Kong's position as an international financial centre, and provides input for the development of industry related courses and training programmes.

<p>Chairman Alexa Lam</p>	<p>Members Prof. Charles D Booth (from 19.02.03) Prof. Dennis S S Chan (to 18.02.03) Prof. Eric C Chang Gary W K Cheung (to 21.05.02) Prof. Stephen Y L Cheung Albert Thomas Da Rosa, Junior (from 19.02.03)</p>	<p>Stephen C C Hui (from 17.06.02) Sandra Y M Lee Vincent M K H Lee Prof. Paul B McGuinness Derek Shek Patricia J Shih (to 18.02.03)</p>
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Share Registrars' Disciplinary Committee

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

<p>Chairman Martin Rogers</p>	<p>Members Nicholas Allen Roger Best, JP 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 (to 22.05.02) T Brian Stevenson, SBS David T K Sun Carlson Tong Jason Webber Kevin Westley James Wong V-Nee Yeh</p>
<p>Deputy Chairman Stephen Clark</p>		

Shareholders Group (set up in May 2001 and formalised in June 2002)

Advises the Commission on issues relating to shareholders' rights and interests.

<p>Chairman Ashley Alder</p>	<p>Members Jamie Allen Rex Auyeung Prof. Andrew Chan Lennon W L Chan Vincent Duhamel Heung Shu Fai</p>	<p>David Lui David T K Sun Mark Taylor Prof. Judy Tsui David Webb V-Nee Yeh</p>
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SFC (HKEC Listing) Committee

Exercises powers and functions equivalent to those of the Main Board and GEM Listing Committees of the Stock Exchange when real or potential conflicts of interests arise between the interests of HKEx and those of the proper performance of the Stock Exchange's listing functions. In such cases, the relevant Stock Exchange functions may be exercised by the SFC.

<p>Members present in each Committee meeting will elect a Chairman among themselves at the beginning of that meeting.</p>	<p>Members Thaddeus Beczak Eric Cheng (from 14.03.03) Stephen J Clark (from 14.03.03) Mark Dickens, JP Alexa Lam</p>	<p>Alan Linning Patricia Shih Tina So (from 14.03.03) Carlson Tong (from 14.03.03) V-Nee Yeh</p>
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Internal Committees

Management Committee

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

Chairman Andrew L T Sheng, SBS, JP	Members Ashley Alder Mark Dickens, JP Gerald Greiner Geoffrey Harris Brian Ho	Alexa Lam Alan Linning Keith Lui Joan Wong (to 24.05.02) Andrew Young
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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; considers any other matters referred to it by the Commission.

Chairman T Brian Stevenson, SBS	Members Raymond P L Kwok (from 19.08.02) Andrew L T Sheng, SBS, JP (to 19.08.02)
Deputy Chairman Anna H Y Wu, SBS, JP	

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.

Chairman Henry H L Fan, SBS, JP	Members Mark Dickens, JP Andrew L T Sheng, SBS, JP
Deputy Chairman 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.

Chairman Daniel R Fung, SC	Members Raymond P L Kwok (from 18.11.02) Alan Linning (to 18.11.02) Andrew L T Sheng, SBS, JP (to 18.11.02)	T Brian Stevenson, SBS (from 18.11.02) The Hon Jasper Tsang Yok Sing, GBS, JP (from 15.07.02)
Deputy Chairman Henry H L Fan, SBS, JP		Anna H Y Wu, SBS, JP (from 18.11.02)

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 on decisions made by the Commission relating to the registration of intermediaries and certain other matters.

Chairman Alan Hoo, SC, JP	Members Nicholas Allen Iain F Bruce Ella Cheng Marvin Cheung, SBS, JP Peter Clarke Tim G Freshwater	Dudley L Harding Prof. Betty M F Ho (to 12.06.02) Rajat K Jindal Dannis J H Lee, BBS Michael T P Sze Peter S H Wong Roderick B Woo, JP
Deputy Chairman Patrick P T Fung, SC		

Arbitration Panel under the Leveraged Foreign Exchange Trading Ordinance

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

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

Subsidiary Legislation under the Securities and Futures Ordinance

For effective regulation, the SFO provides flexibility in addressing changing market practices and global conditions by way of subsidiary legislation. All 40 sets of subsidiary legislation required to commence the SFO had been gazetted by January 2003.

Part III	Securities and Futures (Transfer of Functions – Stock Exchange Company) Order Securities and Futures (Contracts Limits and Reportable Positions) Rules Securities and Futures (Stock Market Listing) Rules Securities and Futures (Transfer of Functions – Investor Compensation Company) Order
Part V	Securities and Futures (Insurance) Rules Securities and Futures (Leveraged Foreign Exchange Trading (Arbitration)) Rules Securities and Futures (Licensing and Registration) (Information) Rules
Part VI	Securities and Futures (Financial Resources) Rules Securities and Futures (Client Securities) Rules Securities and Futures (Client Money) Rules Securities and Futures (Keeping of Records) Rules Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules Securities and Futures (Accounts and Audit) Rules Securities and Futures (Associated Entities – Notice) Rules
Part VII	Securities and Futures (Short Selling and Securities Borrowing and Lending (Miscellaneous)) Rules Securities and Futures (Unsolicited Calls – Exclusion) Rules
Part IX	Securities and Futures (Registration of Commission Disciplinary Orders) Rules
Part XI	Securities and Futures (Registration of Appeals Tribunal Orders) Rules Securities and Futures Ordinance (Amendment of Schedule 8) Order 2002
Part XII	Securities and Futures (Investor Compensation – Levy) Rules Securities and Futures (Investor Compensation – Compensation Limits) Rules Securities and Futures (Investor Compensation – Claims) Rules
Part XIII	Securities and Futures (Registration of Market Misconduct Tribunal Orders) Rules Securities and Futures (Price Stabilising) Rules
Part XV	Securities and Futures (Disclosure of Interests – Exclusions) Regulations Securities and Futures (Disclosure of Interests – Securities Borrowing and Lending) Rules
Part XVI	Securities and Futures (Collective Investment Schemes) Notice Securities and Futures (Levy) Order Securities and Futures (Levy) Rules Securities and Futures (Fees) Rules Securities and Futures (Miscellaneous) Rules Securities and Futures (Leveraged Foreign Exchange Trading – Exemption) Rules Securities and Futures (Professional Investor) Rules Securities and Futures (Recognized Counterparty) Rules Securities and Futures (Exempted Instruments – Information) Rules Securities and Futures (Offences and Penalties) Regulations
Part XVII	Securities and Futures Ordinance (Amendment of Schedule 10) Order 2002
Others	Companies Ordinance (Exemption of Companies and Prospectuses from Compliance with Provisions) (Amendment) Notice 2002 Securities and Futures Ordinance (Cap.571) (Commencement) Notice 2003 Securities and Futures Ordinance (Cap.571) (Appointment of Day – Repeal of Ordinances) Notice

Consultations, Codes and Guidelines

The following were published in 2002-2003:

Consultation Papers: 20

1. Consultation Paper on the Draft S&F (Levy) Order and the S&F (Levy) Rules	April 2002
2. Consultation Paper on the Draft S&F (Stock Market Listing) Rules and the S&F (Transfer of Functions – Stock Exchange Company) Order	May 2002
3. Consultation Paper on the Draft S&F (Disclosure of Interests – Exclusions) Regulation	May 2002
4. Consultation Paper on the Draft S&F (Short Selling Exemption and Stock Lending) Rules	May 2002
5. Consultation Paper on the Draft S&F (Leveraged Foreign Exchange Trading – Exemption) Rules	June 2002
6. Consultation Paper on the Draft S&F (Financial Resources) Rules	June 2002
7. Consultation Paper on the Draft S&F (Insurance) Rules	June 2002
8. Consultation Paper on the Draft S&F (Miscellaneous) Rules	July 2002
9. Consultation Paper on the Draft S&F (Intermediary Information) Rules	July 2002
10. Consultation Paper on the Draft S&F (Offences and Penalties) Regulations	July 2002
11. Consultation Paper on the Draft S&F (Fees) Rules	July 2002
12. Consultation Paper on the Draft S&F (Amendments of Schedule 8) Order	Aug 2002
13. Consultation Paper on Hedge Funds Reporting Requirements	September 2002
14. Consultation Document on the Proposed Revisions to the Code of Conduct for Persons Registered with the SFC	November 2002
15. Consultation Document on the Proposed Revisions to the Guidance Notes Issued by the SFC on Money Laundering	January 2003
16. Consultation Paper on the Guidance Note on Position Limits and Large Open Position Reporting Requirements	January 2003
17. Consultation Paper on the Proposed Revisions to the Guidelines for Registered Persons Using the Internet to Collect Applications for Securities in an Initial Public Offering	January 2003
18. Consultation Paper on the Draft Code on Real Estate Investment Trusts	March 2003
19. Consultation Paper on Proposed Amendments to the Companies Ordinance to Facilitate Offers of Shares and Debentures	March 2003
20. Consultation Paper on the Draft Guidelines for Regulating Index Tracking Exchange Traded Funds under the Code on Unit Trusts and Mutual Funds	March 2003

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1. Consultation Conclusions on the Draft SFC Disciplinary Fining Guidelines	April 2002
2. Consultation Conclusions on the Draft S&F (Licensed Persons and Registered Institutions) Rules	April 2002
3. Consultation Conclusions on the Draft S&F (Information) Rules	April 2002
4. Consultation Conclusions on the Draft S&F (Leveraged Foreign Exchange Trading – Arbitration) Rules	April 2002
5. Consultation Conclusions on the Draft S&F (Contracts Limits and Reportable Positions) Rules	April 2002
6. Consultation Conclusions on the Draft S&F (Recognized Counterparty) Rules	April 2002
7. Consultation Conclusions on the Offering of Hedge Funds	May 2002
8. Consultation Conclusions on the Draft S&F (Associated Entities) Rules	May 2002
9. Consultation Conclusions on the Proposed Amendments to the Financial Resources Rules made under S28 of the Securities and Futures Commission Ordinance (Cap. 24)	May 2002
10. Consultation Conclusions on the Draft S&F (Gold Purchase) Notice	June 2002
11. Consultation Conclusions on the Draft S&F (Professional Investor) Rules	June 2002
12. Consultation Conclusions on the Draft (i) S&F (Investor Compensation – Levy) Rules (ii) S&F (Investor Compensation – Compensation Limits) Rules (iii) S&F (Transfer of Functions – Investor Compensation Company) Order; and (iv) S&F (Investor Compensation – Claims) Rules	June 2002
13. Consultation Conclusions on the Draft S&F (Registration of Commission Disciplinary Orders) Rules	June 2002
14. Consultation Conclusions on the Draft S&F (Levy) Order and the S&F (Levy) Rules	June 2002
15. Consultation Conclusions on the Draft S&F (Contract Notes, Statements of Account and Receipts) Rules	June 2002

16. Consultation Conclusions on the Draft S&F (Leveraged Foreign Exchange Trading – Exemption) Rules	July 2002
17. Consultation Conclusions on the Draft S&F (Price Stabilising) Rules	July 2002
18. Consultation Conclusions on the Draft S&F (Accounts and Audit) Rules	July 2002
19. Consultation Conclusions on the Draft S&F (Client Money) Rules	July 2002
20. Consultation Conclusions on the Draft S&F (Client Securities) Rules	July 2002
21. Consultation Conclusions on the Draft S&F (Keeping of Records) Rules	July 2002
22. Consultation Conclusions on the Draft S&F (Short Selling Exemption and Stock Lending) Rules	July 2002
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30. Consultation Conclusions on the Draft S&F (Offences and Penalties) Regulations	September 2002
31. Consultation Conclusions on the Draft S&F (Insurance) Rules	September 2002
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33. Consultation Conclusions on the Draft S&F (Financial Resources) Rules	October 2002
34. Consultation Conclusions on the Hedge Funds Reporting Requirements	November 2002
35. Consultation Conclusions on the Proposed Revisions to the Code of Conduct for Persons Registered with the SFC	February 2003
36. Consultation Conclusions on the Guidance Note of Position Limits and Large Open Position Reporting Requirements	March 2003
37. Consultation Conclusions on the Proposed Revisions to the Guidance Note Issued by the SFC on Money Laundering	March 2003
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2. Hedge Funds Guidelines	May 2002
3. Addendum to the Guidance Note on Short Selling Reporting and Stock Lending Record Keeping Requirements	June 2002
4. Amendments of Paragraph 5.1 of the Code of Conduct for Persons Registered with the SFC	June 2002
5. Revised Guidance Note on Short Selling Reporting and Stock Lending Record Keeping Requirements	November 2002
6. Guidelines for Exemptions from the Recognised Industry Qualification and Local Regulatory Framework Paper Requirements	December 2002
7. Guidelines for Facilitate Offers of Shares and Debentures: <ul style="list-style-type: none"> • Guidelines on use of offer awareness and summary disclosure materials in offerings of shares and debentures under the Companies Ordinance (Cap. 32) • Guidelines on using a “dual prospectus” structure to conduct programme offers of shares or debentures requiring a prospectus under the Companies Ordinance (Cap. 32) • Guidelines on applying for a relaxation from the procedural formalities to be fulfilled upon registration of a prospectus under the Companies Ordinance (Cap. 32) 	February 2003
8. Comparison Table on Securities and Futures Ordinance Requirements for Licensing and Supervision of Intermediaries	February 2003
9. Code of Conduct for Persons Licensed by or Registered with the SFC	March 2003
10. Suggested Control Techniques and Procedures for Enhancing a Firm’s Ability to Comply with the S&F (Client Securities) Rules and the S&F (Client Money) Rules	March 2003
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14. Client Identity Rule Policy	March 2003
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17. Guidelines for the Regulation of Automated Trading Services	March 2003
18. Guidance Note on Short Selling Reporting and Stock Lending Record Keeping Requirements	March 2003
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20. Guidelines on Transitional Arrangements	March 2003
21. Guidelines on Waivers of Certain Licensing Fees	March 2003
22. Codes on Takeovers and Mergers and Share Repurchases	March 2003
23. Code of Conduct for Corporate Finance Adviser	March 2003
24. Code on Unit Trusts and Mutual Funds	March 2003
25. Code on Investment-Linked Assurance Schemes	March 2003
26. Code on Pooled Retirement Funds	March 2003
27. Code on Immigration-Linked Investment Schemes	March 2003
28. SFC Code on MPF Products	March 2003
29. Fund Manager Code of Conduct	March 2003
30. Guidance Note for Persons Advertising or Offering Collective Investment Schemes on the Internet	March 2003
31. Guidance Note issued by the SFC on Prevention of Money Laundering and Terrorist Financing	March 2003
32. Guidance Note on Position Limits and Large Open Position Reporting Requirements	March 2003
33. Guidelines for the Exemption of Listed Corporations from Part XV of the SFO (Disclosure of Interests)	March 2003
34. Fit and Proper Guidelines	March 2003
35. Guidelines on Competence	March 2003
36. Guidelines on Continuous Professional Training	March 2003

* S&F stands for Securities and Futures
SFO stands for Securities and Futures Ordinance

A

Academic and Accreditation Advisory Committee (AAAC)
p.36

Advisory Committee
p.5

Asia Pacific Group (APG)
An autonomous regional anti-money laundering body established in 1997 at the Fourth Asia/Pacific Money Laundering Symposium in Bangkok.
p.76

Audit Committee
pp.5, 12, 13

Australian Securities and Investments Commission (ASIC)
The market regulator that regulates the Australian companies, financial markets, financial services organisations and professionals who deal and advise in investments, superannuation, insurance, deposit taking and credit.
pp.3, 68, 74

Automated Trading Services (ATS)
Generally, services provided by means of electronic facilities (except those provided by a recognised exchange company or clearing house) whereby offers to sell or purchase securities or futures contracts are regularly made or accepted in a way that results in a binding transaction in accordance with established methods.
pp.17, 19, 61

B

Boiler Rooms
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.
p.54

Budget 2003-2004
pp.4, 67

Budget Committee
p.12

C

Chief Executive, HKSAR
pp.9, 10, 11, 67

China Securities Regulatory Commission (CSRC)
The executive branch of the State Council Securities Commission responsible for conducting supervision and regulation of the Mainland's securities markets in accordance with the law.
pp.48, 68, 77

Committee on Payment and Settlement Systems (CPSS)
A forum for the central banks of the Group of Ten countries (G10) to monitor and analyse developments in domestic payment, settlement and clearing systems as well as in cross-border and multi-currency settlement schemes.
p.75

Commissione Nazionale per le Società e la Borsa (National Companies and Exchange Commission of Italy) (CONSOB)
The public authority responsible for regulating the Italian securities market and protecting the investing public.
p.75

Companies Ordinance (CO)
pp.27, 28

Commodity Exchange Compensation Fund (CECF)
The fund that provides compensation to investors who suffer a loss due to the default of an exchange participant of the Hong Kong Futures Exchange.
pp.21, 60

Complaints Control Committee
p.70

Continuous Professional Training (CPT)
The systematic maintenance, improvement and broadening of knowledge and skills to enable individuals carrying on regulated activities to perform their duties competently and professionally.
p.35

Corporate Governance
pp.5, 10, 29, 30

D

Derivatives Clearing and Settlement System (DCASS)

The new clearing and settlement system to be launched by HKEx's for its derivatives market.
p.60

Director of Audit
p.14

Directors of the Commission
pp.8, 9, 10

Disciplinary Action
pp.26, 52, 53

Disclosure of Interests
pp.4, 18, 51, 55, 64

Dual Filing
pp.4, 18, 24, 29, 30

E

Electronic Investor Resources Centre (eIRC)

An SFC operated website to provide investors with educational information on investments and regulations.
pp.21, 69

Electronic Public Offerings (ePO)

The use of Internet or other electronic means to distribute prospectuses, enable the downloading of application forms or collect application information from investors etc. in a public offering of securities.
p.60

Equity-Linked Instruments (ELIs)

A structured financial product with embedded "short" positions in options which allow an investor to take a bull, bear, or range view on the underlying asset.
pp.58, 70

Exchange Traded Funds (ETFs)

Basically index funds that are listed and traded on exchanges just like stocks.
p.45

Expert Group

The three-member group appointed by the Financial Secretary in September 2002 to review the operation of Hong Kong's securities and futures market regulatory structure.
pp.3, 30, 31

F

Financial Action Task Force (FATF)

A Hong Kong inter-governmental body to develop and promote policies, both at national and international levels, to combat money laundering.
p.76

Financial Market Development Task Force

The task force set up under the direction of the Financial Secretary in December 2001 to provide a high-level forum to co-ordinate new initiatives on the development of Hong Kong's financial markets.
p.4, 27

Financial Services Network (FinNet)

A business-to-business network built to support financial communities in Hong Kong in conducting secure electronic transactions, information delivery and peer-to-peer communication.
p.60

Financial Resources Rules (FRR)

The rules that set out the capital requirements with which intermediaries have to comply in order to become and remain licensed by the SFC. The capital requirements comprise a liquid capital requirement and, for licensed corporations that are allowed to hold client assets, a paid-up share capital requirement.
pp.41, 54

Financial Secretary
pp.11, 30, 31, 67

Financial Services Authority (FSA)

The single statutory regulator in the UK directly responsible for the regulation of deposit taking, insurance and investment business.
pp.54, 68

Financial Sector Assessment Program (FSAP)

The assessment program conducted jointly by IMF and World Bank to alert economies to likely financial vulnerabilities in order to reduce the potential of crisis.
p.77

Financial Services and Treasury Bureau (FSTB)
pp.25, 28, 68

G

Group of Thirty (G30)

A private, non-profit, international body composed of senior representatives of the private and public sectors and academia that aims to deepen understanding of international economic and financial issues, to explore the international repercussions of decisions taken in the public and private sectors, and to examine the choices available to market practitioners and policymakers.

p.75

Growth Enterprise Market (GEM)

p.3

H

Hang Seng Index (HSI)

pp. 3, 20, 58

Hedge Funds

No legal definition but may refer to a wide range of investment vehicles, which can vary substantially in terms of size, strategy, business model and organisational structure, among other characteristics.

pp.4, 44

Hong Kong Futures Automated Trading System (HKATS)

The trading system of HKEx's derivatives market.

p.59

Hong Kong Exchanges and Clearing Limited (HKEx)

pp.6, 30, 31, 58, 77

Hong Kong Futures Exchange Limited (HKFE)

A subsidiary of HKEx where derivatives products such as futures and options are traded.

pp.58, 59

Hong Kong Monetary Authority (HKMA)

pp.4, 34, 44, 68

Hong Kong Society of Accountants (HKSA)

p.42

I

Independent Commission Against Corruption (ICAC)

p.12

Initial Public Offerings (IPOs)

pp.30, 60

Insider Dealing Tribunal (IDT)

pp.46, 51

International Monetary Fund (IMF)

An international organisation to promote international monetary co-operation, exchange stability, and orderly exchange arrangements.

p.7

International Organisation of Securities

Commissions (IOSCO)

The leading international grouping of securities market regulators. Its current membership comprises regulatory bodies around the world who have day to day responsibility for securities regulation and the administration of securities laws.

pp.5, 36, 75

Investor Compensation Company Limited (ICC)

An investor compensation company established under the SFO to manage the new investor compensation fund and process claims.

pp.19, 61

Investor Compensation Fund

pp.18, 19, 61

J

Joint Financial Intelligence Unit (JFIU)

The Unit jointly run by the Hong Kong Police Force and the Customs & Excise Department to receive reports about suspicious financial activity.

p.42

L

Legislative Council (LegCo)

p.11

M

Management Committee

p.13

Mandatory Provident Fund (MPF)

p.44

Mandatory Provident Fund Schemes Authority (MPFA)
p.68

Market Misconduct
p.50

Market Misconduct Tribunal (MMT)
pp.18, 19, 46, 55

Memorandum of Regulatory Co-operation (MORC)
The memorandum signed between the CSRC, Shanghai Stock Exchange, Shenzhen Stock Exchange, SEHK and the SFC to promote mutual assistance and the exchange of information so that the parties may effectively perform their respective duties according to law.
p.77

Memorandum of Understanding (MOU)
Co-operative arrangements or agreements the SFC signed with other local or international organisations.
pp.23, 30, 34, 47

Money Laundering
A wide range of activities and processes intended to alter the identity of the source of illegally obtained money in a manner which creates the appearance that it has originated from a legitimate source.
p.76

Multilateral Memorandum of Understanding (MMOU)
The multilateral MOU that enhances the level of IOSCO members' co-operation and information exchange to combat cross-border fraud and other securities violations, and improve their ability to enforce securities regulation worldwide.
p.76

N
Non-Executive Directors
pp.9, 10

O
Ombudsman
p.14

Organisation for Economic Co-operation and Development (OECD)

An international organisation to help governments tackle the economic, social and governance challenges of a globalised economy.
p.77

P
Panel of Inquiry on the Penny Stocks Incident (PIPSI)
A Government-appointed independent panel of inquiry to look into the circumstances relating to the publication of an HKEx consultation paper, following the plunge in prices of penny stocks on 26 July 2002.
pp.3, 30

Performance Pledges
p.15

Price Stabilising Rules
p.29

Prosecutions
pp.50, 51, 52, 64

Process Review Panel (PRP)
An independent body appointed by the Chief Executive to review the SFC's internal operations and procedures to ensure that they are fair and consistently followed.
pp.4, 11

Protection of Investors Ordinance (PIO)
p.52

R
Real Estate Investment Trusts (REITs)
A collective investment scheme that holds and manages real estate.
pp.4, 45

Remuneration Committee
p.13

S
Scripless Market
A securities market where a security holding does not have a physical certificate nor require a physical instrument to effect a transfer.
p.59

Secretary for Justice
p.11, 64

Securities (Disclosure of Interests) Ordinance (SDIO)
p.51

Securities and Futures Appeals Panel (SFAP)
The part-time panel that hears appeals against the SFC's decisions concerning licensing and disciplinary matters made before the commencement of the SFO.
p.11

Securities and Futures Appeals Tribunal (SFAT)
An independent full-time appeals tribunal established under the SFO to replace the SFAP but with a wider jurisdiction.
pp.4, 12, 19

Securities and Futures Commission Ordinance (SFCO)
pp.49, 64, 65

Securities and Futures Ordinance (SFO)
pp.3, 4, 18, 19, 72

Shareholders Group
p.29

Short Selling
pp.52, 58

Single Licensing Regime
pp.19, 35

Sponsors [Listing]
pp.30, 49

Staffing
p.68

Steering Committee on the Enhancement of Financial Infrastructure II (SCEFI II)
The committee set up in 2000 to further the vision of and efforts of the original SCEFI initiatives. SCEFI was set up in 1999 to recommend improvements to the financial infrastructure of Hong Kong's securities and futures industry.
pp.4, 59

Stock Exchange of Hong Kong Limited (SEHK)
A subsidiary of HKEx where a wide range of securities including equities, debts, unit trusts, exchange-traded funds and warrants are traded.
pp.41, 58, 60

Subsidiary Legislation [of the SFO]
p.63

T
Takeovers Executive
The Executive that administers the Takeovers Code, undertakes the investigation of takeovers, mergers and share repurchases and monitors related dealings.
pp.26, 27

Takeovers and Mergers Panel
pp.26, 27, 65

Third Generation of Central Clearing and Settlement System, The (CCASS/3)
The latest clearing and settlement system of HKEx's cash market.
pp.59, 60

U
Unified Exchange Compensation Fund (UECF)
The fund that provides compensation to investors who suffer a loss due to the default of an exchange participant of the Stock Exchange of Hong Kong.
pp.21, 60

Unit Trust and Mutual Funds
p.43

University of Hong Kong (HKU)
pp.22, 69

W
Website
p.71

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