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

SFC
證監會

Annual Report
2004 | 05

Investors First

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 SFO 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. The Commission is supported by the Legal Services Division and Corporate Affairs Division.

健

Healthy 健康
Steady 穩健

We Regulate

We Enforce

We Educate

Investors First

The theme of this Annual Report is "Investors First". As market regulator we have a responsibility to educate the public and enable investors to protect their own interests. The well-being of the investors is key to the healthy development of the capital markets. The Chinese character 「健」, as in "Healthy" – 「健康」 and "Steady" – 「穩健」, is made up of 「人」 – "People" and 「建」 – "Develop" or "Establish". Three page dividers help explain how we put the interests of investors first: through "Regulation" – 「規」, "Enforcement" – 「行」, and "Education" – 「信」.

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

Chairman's Statement

"Our mission in 2005-2006 is to continue to implement the SFO effectively, with emphasis on raising the quality of the market. In our daily work, our staff motto is to remember: Investors First."

[This Statement Is About]

- Investors First
- The market in 2004-2005
- Operational review
- A world-class regulator
- A note of thanks

Investors First

This year's Annual Report delivers a concise message: the Commission puts the investors' interest first.

The Commission discharges its functions in accordance with the six statutory regulatory objectives. We aim to ensure Hong Kong's continued success and development as an international financial centre. In seeking to achieve these goals, we always remember that the investor is the reason why capital markets exist. The well-being of the investors is key to the health of the capital markets.

How do we protect investors? We do so through *Regulation*, *Enforcement* and *Education*.

We regulate through consultation and consensus with the market. Our regulations balance investor interest with market development. We balance the costs and benefits of regulation. We consider the possible impact of regulations on those whom we regulate, including the indirect costs. We focus our regulatory resources on matters that are important to the well-functioning of the market.

We enforce firmly and fairly against those who harm investors or damage market integrity. The Securities and Futures Ordinance (SFO) empowers the Commission to investigate, prosecute, and discipline using proportionate penalties. We

ensure that we are consistent in our actions while having regard to the specific circumstances of each case. Our actions are subject to checks and balances.

We educate investors to protect their own interests. Investor education provides investors with the tools and knowledge to make informed decisions. An informed investor is also the best defence against fraud. Intermediary education raises the professionalism and integrity of practitioners, which is important for building investors' confidence in the Hong Kong markets.

These are our guiding thoughts on putting investors first.

The Market in 2004-2005

In 2004-2005, the stock market advanced further, supported by improving economic fundamentals, a low interest rate environment, an inflow of funds and a continued recovery of the property market. Hong Kong's GDP growth was 8.1% in 2004. Deflation finally came to an end last July, and the unemployment rate fell to a 40-month low in March 2005.

During the year, the HSI receded to a year-low of 10,968 on 17 May 2004, but rebounded to the year-high of 14,266 on 29 December 2004. On 31 March 2005, the HSI closed at 13,517, rising 7% during the year. The average daily turnover on the Hong Kong market last year rose 13% to $15.6 billion.

There were 61 IPOs raising $81.7 billion (75 IPOs raising $76.4 billion in the previous financial year). Of this, 65% was for Mainland enterprises (i.e. H-shares and red chips).

During the year, the H-share and red chip indices gained 0.3% and 7.7% respectively. The average daily turnover of H-shares and red chips was $3.3 billion and $2.3 billion respectively.

As at 31 March 2005, there were 1,096 companies listed on the stock exchange with a total market capitalisation of $6,571.4 billion (US$842.5 billion), rising 14% from the year before. Hong Kong was the ninth largest market in the world by market capitalisation.

Hong Kong was one of the most active derivative warrants markets in the world by turnover last year. It contributed about 14% to the total market turnover. Trading of futures and options was also active, with 20.1 million contracts traded, 24% higher than the year before.

We do not make investment predictions, but we expect several concerns to linger over the markets in 2005-2006.

Between last June and March 2005, the US Federal Reserve raised its Fed Funds Target Rate (FFTR) seven times by a total of 175 basis points. Interest rate concerns, the possible return of inflation, higher oil prices and movements in major currencies all may affect investor confidence and add to market volatility.

Operational Review

Our finances improved in 2004-2005 and expenditure remained under control. The SFC achieved a surplus of $169 million ($125 million in the previous year). The reserves at the end of March 2005 stood at $860 million.

Total revenue increased by 13%, or $74 million, from the previous year to $625 million. Levy income, our primary source of revenue, increased by 15% or $55 million to $435 million owing to the higher market turnover.

Total expenditure was $456 million, $30 million higher than 2003-2004. The increase was mainly because of variable pay awarded to staff who performed well. This is necessary in order to retain performing staff in view of an increased staff turnover rate as competitive demand for skilled staff increased with market recovery. We also spent more on areas considered necessary to improve market quality. Meanwhile, we continued to hold back on a general fixed pay increase, suspended since April 2001, so as to keep down

Chairman's Statement

our fixed cost. Variable pay in the future will be subject to budgetary consideration, staff performance and prevailing market conditions.

We made significant achievements in the four priorities set for 2004-2005: upkeeping market standards, facilitating market development, enforcing the law, and protecting and educating investors.

I would like to highlight some points, which are detailed in the divisional reports.

- Corporate governance standards for listed companies and regulation of listing sponsors were put in place, beginning 1 January 2005;
- We worked with the Government to give statutory backing to major listing requirements to strengthen listing regulation;
- We are tackling investment advisers' selling practices, on the back of a disciplinary settlement with a firm to pay $255 million to investors;
- We proposed measures to address risks arising from securities margin financing;
- We issued guidelines on analyst conflicts of interest;
- We consulted on a review of the disclosure of interests regime;
- We proposed to relax the geographical restriction of investment by SFC-authorised REITs;
- We agreed with HKEx on its proposed model for a scripless securities market;
- A total of 76 entities were successfully prosecuted, including a record number of market manipulation prosecutions;
- We successfully prosecuted a company disclosure offence in the first dual filing case;
- We cleared much of the backlog of discipline cases, and used settlements where appropriate;
- Dr Wise's Column, our investor education (IE) TV dramas and radio programmes were popular; and
- Teachers' IE workshops were fully subscribed, while IE became credit courses for undergraduates.

In addition, the Commission won several awards and recognition for its corporate affairs activities. You will find these and description of our staff social services in the later chapters. You will also find a review of our investor education and communications work in the past years.

Our mission in 2005-2006 is to continue to implement the SFO effectively, with emphasis on raising the quality of the market. In our daily work, our staff motto is to remember: Investors First.

A World-Class Regulator

In the past year, we signed Letters of Intent (LOIs) with our counterparts in Indonesia, Thailand and Sri Lanka to strengthen regulatory co-operation relating to investment products. We are working on similar arrangements with several other jurisdictions. These bilateral LOIs will facilitate more Asian financial products to be traded within the region, building on the regional efforts to develop Asian Bond Fund II. We also signed a Memorandum of Understanding on regulatory co-operation with the Philippines commission.

SFC staff have made significant contributions to the committee and taskforce activities of International Organization of Securities Commissions (IOSCO), leading to some landmark initiatives such as the code of conduct fundamentals for credit rating agencies, and the blueprint on combating financial fraud.

In May 2004, during the IOSCO Annual Conference in Amman, Jordan, I was privileged to be elected Chairman of the IOSCO Technical Committee.

A Note of Thanks

I would like to put on record our deepest appreciation of the services of our Non-Executive Directors (NEDs) Ms Anna Wu, Mr Brian Stevenson and Mr Daniel Fung, who joined the Board on 1 January 1999, shortly after I joined the SFC on 1 October 1998 as its fourth Chairman. We welcome Mr Eddy Fong, Mr Kenneth Kwok and Professor Liu Pak Wai whose terms began on 1 January 2005.

1998-1999 was a most difficult time for the Hong Kong securities market, after the 1997 financial crisis, and the failure of C.A. Pacific and the Government market intervention in 1998. Turnover was low, and so was internal staff morale.

The Board and the staff banded together to rebuild confidence of the international investment community in Hong Kong. In March 1999, the Financial Secretary announced three major reforms in the securities markets, in which the Commission played a significant role.

The first reform was demutualisation and merger of the exchanges; the second, consolidation of the securities laws; and the third, enhancement of the financial infrastructure. All three objectives have been largely achieved. The scripless market will be implemented progressively.

Emerging from the tech bubble and SARS, the stock market began a sustained recovery in the middle of 2003. In the six years until the end of 2004, the number of listed companies had grown 30% and the market capitalisation of the Main Board had more than doubled.

The Commission assumed the regulatory responsibility for brokers upon the demutualisation of the exchanges. From frontline regulator of brokers, we have also become the statutory regulator of listed company disclosure with the advent of dual filing. This latter role will be enhanced when the important listing requirements are given statutory backing, as proposed by the Government.

All the above could not have been possible without the experience and expertise of our NEDs in business, finance, accounting, law and public service, as well as their intellect and personal integrity. Neither could they have been achieved if not for the hard work and steadfastness of the staff.

I am pleased that the Financial Secretary has re-appointed Mrs Alexa Lam and Mr Alan Linning as Executive Directors (EDs). I thank fellow EDs Mr Mark Dickens, who left us after 14 years (serving eight years as ED), and Mr Ashley Alder, whose term ended last October. Mr Peter Au-Yang, Chief Operating Officer, has doubled up as ED of Corporate Finance since Mr Alder's departure.

By the time of the expiry of my contract in September 2005, I will have served the Commission for seven years. With the statutory backing of the listing requirements, the Commission has finally emerged as the statutory regulator of listed company disclosure, clarifying its role in the capital markets and placing the Commission on par with the roles and functions of the securities regulators in the major markets.

It has been a great honour to serve the Hong Kong market and the Commission, a great privilege to work with the NEDs, our advisers and friends in the various committees, the legislature, the Government, the market and the media, and a great pleasure to work with my fellow EDs and all my colleagues, whom I regard as friends.

It has given me great pride and satisfaction in witnessing the growth and development of the Commission over the years. I am confident that the Commission will continue to build on its strength and professionalism as the independent regulator of one of the most vibrant capital markets in Asia, if not the world.

Andrew LT Sheng
Chairman

We Regulate

We regulate through consultation and consensus with the market. Our regulations balance investor interest with market development. We balance the costs and benefits of regulation. We consider the possible impact of regulations on those whom we regulate, including the indirect costs. We focus our regulatory resources on matters that are important to the well-functioning of the market. Last year we issued nine consultation papers to formally seek the public's views on proposed regulatory enhancements and other matters. Many of them were preceded by informal soft consultations with market practitioners. We issued three codes and guidelines. In the following two pages, we set out more details on whom and how we regulate.

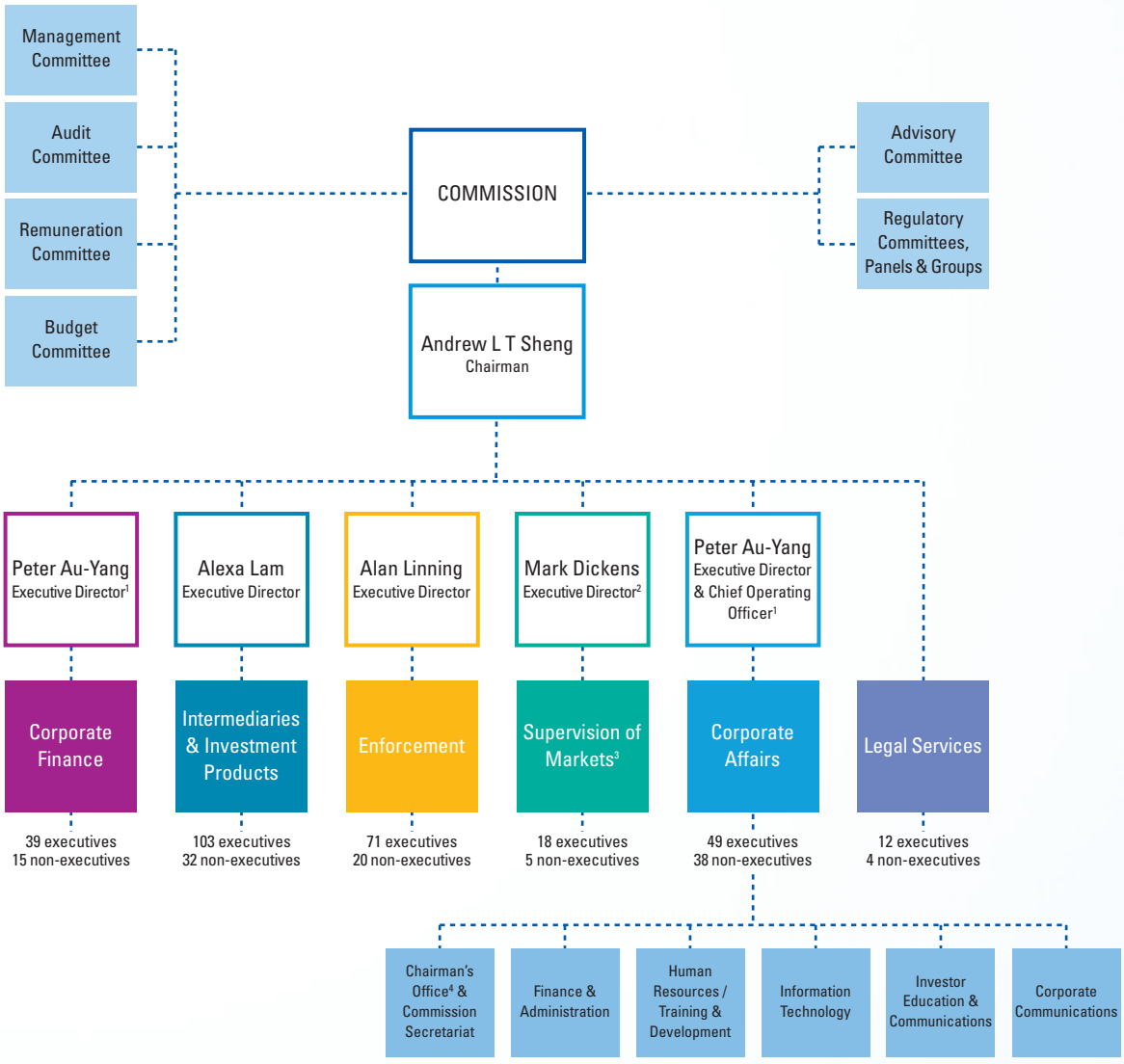
規
Regulate 規管,
Rules 規則

Whom and How We Regulate

Whom We Regulate	How We Do It
Licensed corporations and individuals carrying out the following regulated activities: ■ Dealing in securities ■ Dealing in futures contracts ■ Leveraged foreign exchange trading ■ Advising on securities ■ Advising on futures contracts ■ Advising on corporate finance ■ Providing automated trading services ■ Securities margin financing ■ Asset management	■ 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 licensees' financial soundness and 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 misconduct complaints against 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 the 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 ■ Monitor announcements and vet listing application materials under the Dual Filing regime ■ Administer the takeovers and share repurchases codes ■ Consider exemptions from prospectus requirements under the Companies Ordinance ■ Investigate listed companies suspected of prejudicial or fraudulent transactions or of providing false or misleading information to the public
Approved share registrars	■ Approve the Federation of Share Registrars as an association whose members shall be approved share registrars ■ Require approved share registrars to comply with the requirements of the Code of Conduct for Share Registrars
Investor Compensation Company Limited (ICC)	■ Recognise the ICC as an independent compensation company ■ Approve the rules and any amendment of rules of the ICC ■ Require the ICC to prepare and regularly submit financial statements, auditors' report and other documents to the SFC
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 market misconduct 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 Commission is supported by the Legal Services Division and Corporate Affairs Division.



1. Mr Au-Yang has doubled up as Executive Director of Corporate Finance and Chief Operating Officer since 23 October 2004.
2. Mr Dickens' appointment expired on 31 March 2005.
3. Including Research Department.
4. Including China Policy Team and International Policy Team.
5. Numbers of executives/non-executives refer to permanent established posts as of 31 March 2005.

Directors of the Commission

Under the SFO, there must be no fewer than eight members of the Commission, and the majority must be Non-Executive Directors. All Directors of the Commission are appointed by the HKSAR Chief Executive or the Financial Secretary with the delegated authority by the Chief Executive. The Commission has a number of statutory functions and also formulates overall policy and strategy.

As of 31 March 2005, the Commission consisted of 12 Directors, of whom five were Executive Directors and seven were Non-Executive Directors. Last year the Commission met on 12 occasions.

[Executive Directors]

Andrew L T Sheng, *SBS, JP*

Chairman

(From 1 October 1998. Current appointment expires on 30 September 2005.)

Chartered Accountant; Chairman, IOSCO Technical Committee; 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 and SFC (HKEC Listing) Appeals Committee.

Mark Dickens, *JP*

Executive Director, Supervision of Markets Division

(From 1 April 1999. Appointment expired on 31 March 2005.)

Member, HKEx Risk Management Committee (2003-2005); Director, Investor Compensation Company Ltd (2002-2005); Director, FinNet Ltd (2002-2005); 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 (to 31.03.05), Management Committee (to 31.03.05), Futures Compensation Fund Committee (to 31.03.05), Investor Compensation Fund Committee (to 31.03.05), Securities Compensation Fund Committee (to 31.03.05), and SFC (HKEC Listing) Committee (to 31.03.05).

Alexa Lam

Executive Director, Intermediaries and Investment Products Division

(From 1 December 2001. Current appointment expires on 29 February 2008.)

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, Budget Committee (from 29.03.05), Management Committee, Academic and Accreditation Advisory Committee, Committee on Investment-Linked Assurance and Pooled Retirement Funds, Committee on Real Estate Investment Trusts, Committee on Unit Trusts, Futures Compensation Fund Committee, Investor Compensation Fund Committee, Securities Compensation Fund Committee, and SFC (HKEC Listing) Committee.

Ashley Alder

Executive Director, Corporate Finance Division

(From 1 October 2001. Appointment expired on 22 October 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 (to 22.10.04), Management Committee (to 22.10.04), Public Shareholders Group (to 22.10.04), and SFC Dual Filing Advisory Group (from 16.11.04).

Alan Linning

Executive Director, Enforcement Division

(From 1 November 2001. Current appointment expires on 31 October 2006.)

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; Member of Solicitors Disciplinary Tribunal.

Also sits on Management Committee and SFC (HKEC Listing) Committee.

Peter Au-Yang

Executive Director, Corporate Finance Division and Chief Operating Officer

(From 26 May 2003. Current appointment expires on 25 May 2006.)

Co-Head – Investment Banking, Asia Pacific, The Hongkong and Shanghai Banking Corporation Ltd (1985-2003: Co-Head (2001-2002)).

Also sits on Advisory Committee (from 15.11.04), Budget Committee, Management Committee, Investor Education Advisory Committee, and Public Shareholders Group (from 23.10.04).

Mr Au-Yang has doubled up as Executive Director of Corporate Finance and Chief Operating Officer (since 23.10.04).

Directors of the Commission

[Non-Executive Directors]

Raymond P L Kwok

(From 1 August 1998. Current appointment expires on 31 July 2006.)

Vice Chairman and Managing Director, Sun Hung Kai Properties Ltd; Chairman and Chief Executive Officer, SUNeVision Holdings Ltd; Chairman, SmarTone Telecommunications Holdings Ltd; Director, Kowloon Motor Bus Holdings Ltd; Independent Non-Executive Director, Standard Chartered Bank (Hong Kong) Ltd; Director, Real Estate Developers Association of Hong Kong; Member, General Committee of The Hong Kong General Chamber of Commerce; Member, Hong Kong Port Development Council; Vice Chairman, Council of The Chinese University of Hong Kong; Chairman, Management Committees of the Police Children's Education Trust and the Police Education and Welfare Trust.

Also sits on Audit Committee, Budget Committee, Remuneration Committee and SFC (HKEC Listing) Appeals Committee.

Daniel R Fung, *SBS, SC, QC, JP*

(From 1 January 1999. Appointment expired 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; Member, Chinese People's Political Consultative Conference.

Also sits on Remuneration Committee (to 31.12.04) and SFC (HKEC Listing) Appeals Committee (to 31.12.04).

T Brian Stevenson, *SBS*

(From 1 January 1999. Appointment expired on 31 December 2004.)

Chartered Accountant; Steward, Hong Kong Jockey Club; Non-Executive Director, The Hongkong and Shanghai Banking Corporation Ltd; Non-Executive Director, MTR Corporation; Member, Public Service Commission.

Also sits on Audit Committee (to 31.12.04), Remuneration Committee (to 31.12.04), Futures Compensation Fund Committee, Securities Compensation Fund Committee, SFC (HKEC Listing) Appeals Committee (to 31.12.04), Share Registrars' Disciplinary Committee, Share Registrars' Disciplinary Appeals Committee, and Takeovers and Mergers Panel (to 31.12.04).

Anna H Y Wu, *SBS, JP*

(From 1 January 1999. Appointment expired on 31 December 2004.)

Non-Executive Director, Mandatory Provident Fund Schemes Authority; Chairperson, University of Hong Kong Academic Board for the Postgraduate Certificate in Laws (PCLL); Adviser, Shantou University Law School; Member, Council of Lingnan University; Chairperson, Investor Compensation Company Ltd; Member, Legislative Council (1993-1995); Chairman, Consumer Council (1997 - 1999); Chairman, Operations Review Committee of Independent Commission Against Corruption (1997-2002); Chairperson, Equal Opportunities Commission (1999 - 2003).

Also sits on Audit Committee (to 31.12.04), Remuneration Committee (to 31.12.04), Committee on Investment-Linked Assurance and Pooled Retirement Funds (to 31.12.04), Committee on Unit Trusts (to 31.12.04), Investor Compensation Fund Committee and SFC (HKEC Listing) Appeals Committee (to 31.12.04).

The Hon Jasper Tsang Yok Sing, *GBS, JP*

(From 15 November 2001. Current appointment expires on 14 November 2005.)

Member, Executive Council; Member, Legislative Council; Member, Standing Committee of Democratic Alliance for Betterment of Hong Kong; School Supervisor, Pui Kiu Middle School; Council Member, Open University of Hong Kong; Member, ICAC Complaints Committee; Member, Disaster Relief Fund Advisory Committee; Member, Chinese People's Political Consultative Conference.

Also sits on Remuneration Committee and SFC (HKEC Listing) Appeals Committee.

Dr York Liao, *SBS, JP*

(From 26 May 2003. Current appointment expires on 25 May 2005.)

Managing Director, Winbridge Company Ltd; Chairman, Hong Kong Council for Academic Accreditation; Director, Hong Kong Science & Technology Parks Ltd; Director, Hong Kong Applied Science and Technology Research Institute Co Ltd; Member, Board of Trustees, California Institute of Technology; Member, Steering Committee on Innovation & Technology; Member, Manpower Development Committee.

Also sits on Remuneration Committee, Committee on Investment-Linked Assurance and Pooled Retirement Funds (from 18.01.05), Committee on Unit Trusts (from 18.01.05), and SFC (HKEC Listing) Appeals Committee.

Christopher W C Cheng, *GBS, JP*

(From 15 November 2003. Current appointment expires on 14 November 2005.)

Chairman, USI Holdings Ltd; Chairman, Winsor Properties Holdings Ltd; Chairman, Standing Committee on Judicial Salaries and Conditions of Service; Director, NWS Holdings Ltd; Director, New World China Land Ltd; Director, DBS Bank (Hong Kong) Ltd; Director, PICC Property and Casualty Company Ltd; Steward, Hong Kong Jockey Club; Member, Exchange Fund Advisory Committee; Council Member, Hong Kong Trade Development Council; Member, Council of the University of Hong Kong; Charter Member, President's Council on International Activities of the Yale University; Member, INSEAD International Council; Member, Advisory Council of the One Country Two Systems Research Institute Ltd; Chairman, Hong Kong General Chamber of Commerce (2001-2003).

Also sits on Budget Committee, Remuneration Committee and SFC (HKEC Listing) Appeals Committee.

Eddy C Fong, *SBS, JP*

(From 1 January 2005. Current appointment expires on 31 December 2006.)

Certified Public Accountant; Senior Advisor, Tricor Services Ltd; Director, Applied Science and Technology Research Institute Company Ltd; Treasurer, Open University of Hong Kong and the Society of Hong Kong Academy for Performing Arts; Member, General Committee of Federation of Hong Kong Industries; Non-Executive Directors, China Resources Power Holdings Company Ltd, Li Ning Company Ltd and SUNeVision Holdings Ltd; Partner, PricewaterhouseCoopers (until 2003).

Also sits on Audit Committee (from 17 .01.05), Advisory Committee (to 23.12.04), Remuneration Committee (from 17 .01.05), Committee on Real Estate Investment Trusts (to 23.12.04), SFC (HKEC Listing) Appeals Committee (from 01.01.05), Takeovers and Mergers Panel (from 01.01.05), and Takeovers Appeal Committee (from 01.01.05).

Kenneth H W Kwok, *SC*

(From 1 January 2005. Current appointment expires on 31 December 2006.)

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

Also sits on Audit Committee (from 17.01.05), Remuneration Committee (from 17.01.05), and SFC (HKEC Listing) Appeals Committee (from 01.01.05).

Professor Liu Pak Wai, *SBS*

(From 1 January 2005. Current appointment expires on 31 December 2006.)

Pro-Vice-Chancellor and Professor of Economics, The Chinese University of Hong Kong; Member, Hong Kong Committee on Pacific Economic Co-operation; Member, Independent Commission on Remuneration for Members of the Executive Council and the Legislature of the HKSAR; Member, Skills Upgrading Scheme Steering Committee; Member, Manpower Development Committee; Member, Land and Building Advisory Committee; Director, Hong Kong Institute for Monetary Research of Hong Kong Monetary Authority; Member, Panel of Arbitrators.

Also sits on Budget Committee (from 29.03.05), Remuneration Committee (from 17.01.05) and SFC (HKEC Listing) Appeals Committee (from 01.01.05).

Corporate Governance and the SFC

As the statutory regulator of the securities and futures markets in Hong Kong, the Commission places great importance on corporate governance. We always strive to enhance our accountability to the public and the transparency of our work. We adopt and implement corporate governance practices commensurate with the best standards applicable to public bodies.

[In this chapter, we will discuss]

- The composition and operation of the Board
- Commission committees
- Conduct standards
- Internal controls
- Independent checks and balances
- Our performance pledges

The Commission

Composition of the Board

The constitution and proceedings of the Board are defined by the SFO. All the Members of the Board are appointed by the HKSAR Chief Executive for a fixed term and the SFO requires that the majority of the Members must be independent Non-Executive Directors (NEDs). The composition of the Board ensures independent supervision of the Commission's executive functions.

The remuneration package of individual Executive Directors (EDs) is determined by the HKSAR Chief Executive upon the recommendation of the Remuneration Committee of the Commission, which is chaired by an NED and comprises only NEDs. Our NEDs receive a fixed sum of honorarium every year.

At the end of the year under review, the Board comprised 12 Members: five full-time EDs including the Chairman and seven NEDs. During the year, Mr Daniel Fung, Mr Brian Stevenson and Ms Anna Wu stepped down after serving as NEDs of the Commission for six years. Mr Eddy Fong, Mr Kenneth Kwok and Professor Liu Pak Wai joined the Commission as new NEDs for a term of two years. Both Mr Alan Linning and Mrs Alexa Lam were re-appointed EDs while Mr Peter Au-Yang, Chief Operating Officer and ED, has doubled up as ED of Corporate Finance since Mr Ashley Alder left the Commission on 22 October 2004. Mr Mark Dickens, who has served the Commission for 14 years, eight of which as ED, retired on 31 March 2005.

How the Commission Operates

All important policies and decisions are discussed and approved by the Board, which meets regularly every month and holds additional meetings as necessary. Divisional staff attend Board meetings to explain policy proposals, report on important operational matters and regulatory issues. Members are also briefed on the financial positions of the Commission and provided with monthly financial statements.

To play an effective oversight role, the Board has delegated most of the regulatory powers and functions to individual EDs, staff or Committees, reserving the critical functions at the Board level. The Commission maintains a detailed delegation list.

All newly appointed Members receive briefings on the work of the Commission and are provided with

relevant SFC documents including a copy of the Code of Conduct, which sets out the legal obligations and the Commission's requirements on them. All Members are required to disclose their investment portfolio upon appointment and report any subsequent changes to the Commission.

Members have separate and independent access to the senior management and divisional staff for additional information they may require about any policy proposal. They have access to the Commission Secretary, who is responsible for ensuring the procedures of the Commission are complied with. Members and the Commission Committees can seek independent professional advice at the expense of the Commission as and when necessary.

Attendance of Directors at Commission Meetings in 2004-2005

Number of meetings	**12**	
Attendance of individual Directors		
Andrew L T Sheng	10	83%
Ashley Alder	8	100%
Peter Au-Yang	12	100%
Mark Dickens	11	92%
Alexa Lam	12	100%
Alan Linning	10	83%
Christopher W C Cheng	11	92%
Eddy C Fong	3	100%
Daniel R Fung	5	56%
Kenneth H W Kwok	3	100%
Raymond P L Kwok	10	83%
York Liao	8	67%
Liu Pak Wai	2	67%
T Brian Stevenson	7	78%
Jasper Tsang Yok Sing	10	83%
Anna H Y Wu	7	78%
Average attendance of meetings	**85%**	

The individual attendance rates are based on the respective number of Commission meetings Members were expected to attend during their terms. For details of their terms, please see Chapter on Directors of the Commission.

Commission Committees

The Commission has established the Advisory Committee, Public Shareholders' Group and other consultative and regulatory committees with a largely external membership drawn from the market. These committees provide external input to the Commission on policy matters.

NEDs play an important role in ensuring that the Commission is accountable and transparent by chairing and participating in various Commission committees, which have their respective terms of reference. The Commission committees circulate their minutes and report important issues to the Board regularly.

The NEDs' role is particularly important in several internal committees:

Audit Committee

The Audit Committee comprises only NEDs. Mr Eddy Fong, a Certified Public Accountant, is the Chairman. Senior staff including EDs are invited to attend meetings where necessary.

The Audit Committee convenes every quarter and additionally if necessary to review quarterly and annual financial statements before their submission to the Commission for approval. It endorses the appointment of external auditors for the Commission's approval every year and plays an important role in the design of the scope of internal and external audits. It reviews audit findings set out in the external auditors' management letters and management's responses to them, and monitors the implementation of agreed improvements.

The Audit Committee also examines management procedures to monitor the effectiveness of the systems of financial and internal control. It considers and approves our annual internal control review programme and cross-divisional audit programme.

For the provision of non-audit services by external auditors, the Audit Committee will critically consider each engagement on a merit basis. To ensure independence and objectivity of the annual audit, two different external auditors are appointed to perform respectively the annual audit and internal control review of the Commission.

Corporate Governance and the SFC

Attendance of Directors at Audit Committee Meetings in 2004-2005

Number of meetings	5	
Attendance of individual Directors		
Eddy C Fong (Chairman)	1	100%
T Brian Stevenson (Chairman)	4	100%
Raymond P L Kwok (Deputy Chairman)	5	100%
Anna H Y Wu (Deputy Chairman)	4	100%
Kenneth H W Kwok	1	100%
Average attendance of meetings	**100%**	

The individual attendance rates are based on the respective number of meetings Members were expected to attend during their terms in the Audit Committee. For details of their terms, please see Chapter on Directors of the Commission.

Remuneration Committee

The Remuneration Committee, chaired by Dr York Liao, comprises all NEDs. Senior staff are invited to attend the meetings where necessary.

The Remuneration Committee reviews policy on the level and structure of staff remuneration and makes recommendations to the Commission. It also considers and approves results of pay surveys. The Remuneration Committee is consulted on the re-appointment of EDs and decisions on senior management.

The HKSAR Chief Executive and the Financial Secretary under the delegated authority of the former determine the remuneration packages of the SFC Chairman and EDs taking into consideration recommendations by the Remuneration Committee. Details of the EDs' remuneration are on page 78. The pay packages comprise an annual fixed pay and a performance-related variable pay.

The SFC Chairman consults the Remuneration Committee on the payment and amount of variable pay to individual EDs as a matter of good corporate governance practice. The recommendations are reported to the Administration for information.

Attendance of Directors at Remuneration Committee Meetings in 2004-2005

Number of meetings	4	
Attendance of individual Directors		
Daniel R Fung (Chairman)	2	100%
York Liao (Chairman)	3	75%
Christopher W C Cheng (Deputy Chairman)	4	100%
Anna H Y Wu (Deputy Chairman)	2	100%
Eddy C Fong	1	50%
Kenneth H W Kwok	2	100%
Raymond P L Kwok	3	75%
Liu Pak Wai	1	50%
T Brian Stevenson	1	50%
Jasper Tsang Yok Sing	2	50%
Average attendance of meetings	**75%**	

The individual attendance rates are based on the respective number of meetings Members were expected to attend during their terms in the Remuneration Committee. For details of their terms, please see Chapter on Directors of the Commission.

Budget Committee

The Budget Committee is chaired by NED Mr Raymond Kwok. It examines and approves the proposed parameters and basis for annual budget compilation, including the estimates of our income and expenditure for the next financial year, which will then be submitted to the full Commission for approval.

Attendance of Directors at Budget Committee Meetings in 2004-2005

Number of meeting	1	
Attendance of individual Directors		
Raymond P L Kwok (Chairman)	1	100%
Christopher W C Cheng (Deputy Chairman)	1	100%
Peter Au-Yang	1	100%
Mark Dickens	1	100%
Alexa Lam	N/A	N/A
Liu Pak Wai	N/A	N/A
Andrew L T Sheng	1	100%
Average attendance of meetings	**100%**	

Mrs Lam and Prof Liu became members on 29 March 2005.

Management Committee

The Management Committee comprises all EDs, Senior Directors and the Chief Counsel. It 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 has the power to determine the remuneration, allowance and conditions of employment. Every month, it also reviews the Commission's financial and staffing positions, and progress of major information technology projects.

Conduct Standards

Code of Conduct

The Commission requires the highest standards of integrity and conduct from its staff. It sets out in the Code of Conduct its requirements and the relevant legal obligations. In particular, all Commission staff should be aware of potential conflicts of interest and ensure that their work is carried out properly, impartially and free from any suggestion of improper influence. All Commission staff are required to keep confidential information acquired in the course of duties.

The Code sets a clear policy for staff on personal dealings in securities and futures contracts and various statutory requirements relating to personal dealings. The Code requires staff to declare their investment in securities and futures contracts upon commencement of employment and report all subsequent transactions.

During the year, we thoroughly reviewed and updated the Code and provided training to staff on the revised Code and the reporting system.

Public Interest Grievances

The Personnel Manual comprises major human resources policies and procedures as approved by the Commission, which include the Equal Employment Opportunities policy, grievances procedures and disciplinary procedures. These procedures ensure that personnel matters are handled in a fair and impartial process with adequate checks and balances.

The Grievance Procedures – Public Interest Grievances is published on our website to assist those who believe that they have discovered improper practices or misconduct relating to the running of the Commission or work related activities of Commission employees, to report these to the Commission in a constructive manner. The procedures enable the following persons to report confidentially: any person who has an employment contract with the Commission, is on secondment to the Commission, is engaged as an independent consultant by the Commission or is a contractor or supplier of services to the Commission.

Complaints against Commission Staff

The Commission has a policy of transparency and accountability. It takes seriously any dissatisfaction regarding the way in which Commission staff have carried out or failed to carry out their duties. The Procedures for Handling Complaints against Commission Staff ensures prompt handling of any complaints from members of the public against our staff and facilitates effective follow-up action. We have published the procedures on our website to enhance transparency and provide clear guidance to the public.

Corporate Governance and the SFC

Internal Controls

The internal control procedures ensure that the Commission achieves its regulatory objectives and performs its regulatory functions in a fair and transparent manner and in accordance with the law. In addition, the Commission's operational procedures help safeguard assets against unauthorised use or disposition, maintain proper accounting records and ensure reliability and integrity of information used within the Commission or for publication.

Accountability and Transparency

Individual divisions and departments of the Commission follow operating manuals in performing functions and exercising powers. The manuals ensure that we comply with relevant legal, regulatory and administrative requirements. They are subject to review by the independent Process Review Panel.

The Commission is accountable for the use of its financial resources and has established detailed financial and budgetary control procedures. For the reporting and disclosure of the Commission's financial statements, we have adopted the International Financial Reporting Standards promulgated by the International Accounting Standards Board since 2000-2001.

The financial statements are considered by the Audit Committee and approved by the Board before the Chairman and one NED sign them. Each year, the revised and proposed budgets are submitted to the Financial Secretary for approval and laid before the LegCo after consideration by the Commission. By law, the Director of Audit may examine any books, accounts, vouchers, records or documents kept by the Commission.

The Commission has always been fiscally responsible. Despite our expanded functions and workload and the strain on resources, we have always exercised strict controls over our operational expenditure, in particular the personnel expenses. The Performance Comparisons chapter shows that our staff number increase was significantly less than the increase in our workload over the last 10 years (from 1994-1995 to 2004-2005). The table at the end of this chapter compares our staff complement and costs with our counterparts in Australia, UK, USA and Singapore over the period from 2001-2002 to 2004-2005.

The Commission is committed to open communication with our stakeholders and the public. We publish our Quarterly Reports and Annual Report within 45 days after the end of the relevant period. We report our operations and activities to the public through periodic newsletters, press releases, publications and press conferences. Last year, we revamped our website to enhance transparency and access to information by the public.

Internal Audit

As a relatively small organisation, we do not have a full-time internal audit unit. Instead, we have appointed PricewaterhouseCoopers to conduct internal control review for us annually. PWC's review forms part of the Commission's overall annual internal control review programme, which is approved by the Audit Committee and includes also reviews by our cross-divisional audit teams.

The purpose of the internal control review is to assess whether the systems of internal control as set out in the various Commission's manuals are adhered to, to evaluate the adequacy of the controls in place, to safeguard assets and ensure reliability and integrity of information, and to identify enhancements to current procedures and controls to improve operating efficiency. The internal controls are designed to provide reasonable, but not absolute, assurance that errors and irregularities will not occur, and that procedures are performed in accordance with management's intentions.

During the year, PWC reviewed the recruitment process, commitment, expenditure and purchases procedures, travel and entertainment policy and procedures, and investment and banking

procedures. They confirmed that the controls over these areas were generally satisfactory. Their findings and recommendations were reported to the Audit Committee.

The Intermediaries and Investment Products Division conducted a cross-divisional audit on the fees collection procedures of the Corporate Finance Division during the year. The audit report was submitted to the Audit Committee for comment and approval.

Risk Management and Contingency Plans

The operational divisions of the Commission closely monitor and assess risks in their respective regulatory areas. They regularly report their risk analysis and make recommendations in managing the risks to the Board. We have a market contingency plan, which details procedures for dealing with emergency situations that may affect Hong Kong's securities and futures markets.

We also have prepared an internal contingency plan to deal with emergency situations that may affect the Commission's operations, such as fire, flooding or other disasters that may affect the Commission's offices. The plan details the contingency measures from all operational and supporting divisions in recovering and resuming their business during and after any emergencies.

Independent Checks and Balances

The Commission is subject to various external checks and balances designed to ensure fairness and observance of due process. These include statutory rights of appeal, judicial review, and scrutiny by independent bodies such as the Process Review Panel, the Ombudsman and the Independent Commission Against Corruption.

An Independent Review Panel

The Commission's internal procedures for regulating the markets, including procedures for ensuring consistency and fairness, are reviewed on an on-going basis by the Process Review Panel (PRP). The PRP is an independent, non-statutory panel established by the HKSAR Chief Executive in November 2000. The Commission is the first securities regulator in the world to introduce such an external review system on its internal operations.

The PRP currently 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 for Justice (or her representative), the Commission's Chairman and an NED of the Commission.

Over the past year, the PRP reviewed the Commission's procedures by examining various completed cases. These included the following: application of licence by intermediaries, registration of intermediaries, registration of Registered Institutions, inspection of intermediaries, prudential visit of intermediaries, authorisation of collective investment schemes, handling of complaints against intermediaries, and investigation and disciplinary action.

Securities and Futures Appeals Panel/ Tribunal

A wide range of the regulatory decisions of the Commission are subject to a full review by the Securities and Futures Appeals Tribunal (SFAT), which is chaired by a High Court judge and comprises two other members appointed by the HKSAR Chief Executive. There were 20 appeals lodged with the SFAT during the year: five were determined, eight were withdrawn and seven were in progress.

Before the establishment of the SFAT, the independent Securities and Futures Appeals Panel (SFAP) heard appeals against decisions made by the SFC relating to the registration, regulation and discipline of intermediaries. The SFAP heard and decided on the last two appeals before it during the year. The SFC is appealing against the decision of one of the cases.

Corporate Governance and the SFC

ICAC Reviews

The Independent Commission Against Corruption (ICAC) has conducted periodic corruption prevention reviews on the procedures and practices of the Commission since 1990. In early 2004, the Government recommended that the Commission invite the ICAC to study its procedures and practices for the performance of listing-related functions from the point of view of corruption prevention and other related issues, such as building in checks and balances in the internal control system. The review was completed in the last quarter of 2004, and we had responded to the ICAC regarding the implementation of its recommendations.

Reporting to the Government

The Commission is an independent regulatory body but is subject to regular reporting and furnishing of information to the Financial Secretary and the Financial Services and the Treasury Bureau regarding our operations and important issues. We are required to consult the Financial Secretary before exercising certain powers. After consultation with the Chairman of the Commission, the Chief Executive may, upon being satisfied that it is in the public interest to do so, give the Commission written directions as to the furtherance of any of its regulatory objectives or the performance of any of its functions.

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 2004-2005
Investor Enquiries		
■ Preliminary response to telephone enquiries	4 business days	**100%**
■ Preliminary response to written enquiries	2 weeks	**99.8%**[1]
General Enquiries		
■ Preliminary response to enquiries via enquiry@sfc.hk	4 business days	**100%**
Public Complaints		
■ Preliminary response to verbal & written complaints	2 weeks	**99.8%**[2]
Licensing Applications		
Processing of licensing applications		
■ Representatives (provisional licence)	7 business days	**91%**[3]
■ Representatives (normal licence)	8 weeks	**80%**[3]
■ Representatives (responsible officer)	10 weeks	**91%**[3]
■ Corporations	15 weeks	**91%**[3]
■ Change of accreditation	7 business days	**82%**[3]
Modification/Waiver and Subordinated Loan Applications		
■ Acknowledgement of receipt upon receiving any application	2 business days	**100%**
Investment Products Authorisation		
■ Take-up of applications upon receipt	2 business days	**100%**
■ Preliminary response to applicants after take-up for unit trusts, mutual funds, investment-linked assurance schemes and MPF pooled investment funds	7 business days	**100%**
■ Preliminary response to applicants after take-up for other schemes	14 business days	**100%**

1. Only one case failed to meet the pledge due to the exceptionally heavy workload when the enquiry was received.
2. Two cases failed to meet the pledge due to their complexity. More time was needed to collect information to facilitate assessment.
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 by applicants.

Public Redress Mechanism

Members of the public can complain to the Ombudsman against the Commission and its staff if they believe that we have been guilty of maladministration in the performance of our functions. During the year, the Ombudsman concluded three complaints against the Commission, including one from the year before, and found all three complaints not substantiated.

Anyone who is dissatisfied with a Commission decision may appeal to the SFAT. Where this remedy is not available, they may take civil action in the Courts against the Commission, by either applying for judicial review of the Commission's decisions or seeking remedies. There were three judicial reviews against decisions made by the Commission last year: one was ruled in favour of the Commission, one was withdrawn after settlement and the remaining case is in progress.

Comparison of Regulatory Costs with Overseas Regulatory Agencies

	00/01	01/02	02/03	03/04	04/05	% Change 04/05 over 00/01
Securities & Futures Commission (SFC)						
■ No. of staff (including regular and temporary)	396	415	403	416	431	**8.84%**
■ Total personnel costs ($M)	328	314	303	328	356	**8.54%**
■ Total expenditure ($M)	421	417	396	423	452	**7.36%**
US Securities & Exchanges Commission (SEC)						
■ No. of staff	3,285*	3,009	3,149*	3,730*	3,871*	**17.84%**
■ Total personnel costs (US$M)	dna	335	413*	546*	585*	**74.63%#**
■ Total expenditure (US$M)	427*	487	592*	842*	888*	**107.96%**
Australian Securities & Investment Commission (ASIC)						
■ No. of staff	1,219	1,221	1,284	1,396	1,531	**25.59%**
■ Total personnel costs (A$M)	84	83	85	97	116	**38.10%**
■ Total expenditure (A$M)	139	143	160	173	196	**41.01%**
Financial Services Authority, United Kingdom (FSA)						
■ No. of staff	2,039	2,145	2,273	2,303	dna	**12.95%+**
■ Total personnel costs (£M)	103	118	129	147	dna	**42.72%+**
■ Total expenditure (£M)	188	208	218	232	dna	**23.40%+**
Monetary Authority of Singapore (MAS)						
■ No. of staff	823	870	969	979	dna	**18.96%+**
■ Total personnel costs (S$M)	88	105	97	101	dna	**14.77%+**
■ Total expenditure (S$M)	116	141	256	351	dna	**202.59%+**

SFC figures do not include staff and expenditure of Investor Compensation Company Limited, a subsidiary formed in September 2002.

* Budget figures extracted from Congressional Budget Request

\# % change 04/05 over 01/02

\+ % change 03/04 over 00/01

dna Data not available

We Enforce

We enforce firmly and fairly against those who harm investors or damage market integrity. The Securities and Futures Ordinance empowers the Commission to investigate, prosecute, and discipline using proportionate penalties. We ensure that we are consistent in our actions while having regard to the specific circumstances of each case. Our actions are subject to checks and balances. We successfully prosecuted 76 entities last year, and cleared much of the backlog of disciplinary cases. We took action against 88 entities, including settlements with 10 licensees because it was in the public interest to do so. In the following two pages, we set out our achievements in Enforcement and other divisions.

行
Enforce 執行,
Action 行動

Achievements and Work in Progress

Corporate Finance

39 executives and
15 non-executives

- Administer the Codes on Takeovers and Mergers and Share Repurchases
- Raise standards of investor protection and corporate governance
- Oversee the SEHK's listing-related functions and responsibilities
- Review and recommend changes to the Listing Rules
- Administer securities legislation relating to listed and unlisted companies
- Recommend changes to laws and regulations to facilitate the development of effective, fair and efficient capital markets
- Review prospectuses of unlisted issuers for authorisation under companies legislation and grant exemptions for prospectuses issued by listed and unlisted issuers
- Administer the Dual Filing regime under the SFO to enhance the quality of disclosure by listing applicants and listed companies

Intermediaries and Investment Products

103 executives and
32 non-executives

- Act as the gatekeeper of the industry, by licensing only those individuals and firms that are fit and proper to conduct regulated activities
- Monitor the financial positions of licensed firms and supervise their business conduct
- Raise the professional standards of intermediaries
- Impose authorisation requirements on the sale of investment products to the Hong Kong public and their advertisements in accordance with product codes and industry standards
- Monitor disclosures and ongoing compliance of investment products
- Carry out policy reforms to enhance investor protection and foster market development

Enforcement

71 executives and
20 non-executives

- Monitor trading of Hong Kong's stock and derivative markets and inquire into irregularities
- Inspect books and records of listed companies if impropriety is suspected
- Enforce laws relating to the securities and futures industry, leveraged foreign exchange trading, and collective investment schemes
- Discipline dishonest, incompetent and financially unstable regulated intermediaries
- Report suspected civil market misconduct to the Financial Secretary
- Suppress illegal or improper trading practices and irregularities relating to collective investment schemes and the provision of advice or other financial services
- Enforce disclosure of interests of substantial shareholders, directors and chief executives of listed companies
- Co-operate with domestic and overseas regulatory bodies in local and overseas investigations

Supervision of Markets

18 executives and
5 non-executives

- Facilitate the development of and encourage participation in the Hong Kong markets
- Strengthen market infrastructure
- Supervise and monitor activities of the exchange controller, exchanges and clearing houses
- Regulate approved share registrars
- Regulate authorised ATS
- Supervise and monitor activities of the independent Investor Compensation Company Limited
- Manage Hong Kong's investor compensation funds

Legal Services and Corporate Affairs*

61 executives and
42 non-executives

- Advise operational divisions on possible breaches of the securities laws
- Advise the Commission in relation to suspected insider dealing
- Advise on the applicability and interpretation of laws under the SFC's purview
- Assist with reform of the laws governing the securities and futures markets
- Prosecute in the Magistrates' Courts for a wide range of regulatory offences
- Handle civil litigation matters involving the SFC, including appeals
- Advise the Takeovers Executive and the Takeovers Panel
- Provide legal, finance, human resources, training, information technology, management and corporate services to the Commission
- Educate investors and handle complaints
- Communicate with stakeholders including the media

Numbers of executives/non-executives refer to permanent established posts.

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

Achievements in 2004-2005	Work in Progress
• Issued consultation conclusions jointly with HKEx on the regulation of sponsors and IFAs • Worked with SEHK on its Code on Corporate Governance Practices and the Corporate Governance Report • Implemented prospectus related amendments in the Companies (Amendment) Ordinance 2004 • Issued a consultation paper to review the Codes on Takeovers and Mergers and Share Repurchases • Issued a consultation paper on proposed amendments to the Securities and Futures (Stock Market Listing) Rules and worked with the Government on giving statutory backing to major listing requirements • Supported the Government regarding its proposals to establish a Financial Reporting Council • Worked with SEHK on its proposal to review its decision-making structure arrangement for listing matters	• Consider proposals to modernise the public offering regime under the Companies Ordinance • Consider responses to the Consultation Paper to amend the Takeovers Code • Consider responses to the Consultation Paper to amend the SMLR and work with the Government on its proposals to make related amendments to the SFO
• Managed down financial risks of the securities industry by requiring brokers to tighten their margin loan credit policy and increase their capital base • Minimised the risks to the market of a few firms by imposing licensing conditions and/or obtaining undertakings • Released a report on mis-selling practices of investment advisers • Survey on fund trading practices, theme inspection and subsequent regulatory action • Published the code on analyst conflicts of interest • Secured a new fidelity insurance scheme for SEHK and HKFE participants • Obtained public support for the proposals to address risks arising from securities margin financing • Smooth migration of licensees to the SFO regime • Facilitated the processing of UCITS III fund applications • Proposed relaxation for overseas investments by SFC-authorised REITs	• Fine tune the licensing framework for industry practitioners • Finalise the public consultation on margin financing reform and devise a balanced policy to enhance investor protection • Conduct theme inspection to examine sponsors' compliance with recently revised Listing Rules and practice notes • Review guidelines on retail hedge funds
• Negotiated a record ex-gratia payment to investors of $255 million by an investment adviser • Reached a record $30 million settlement with a sponsor • First Dual Filing prosecution against a listed company and its director for providing false and misleading information • Substantially concluded five cases before the Insider Dealing Tribunal • Successfully prosecuted 76 entities for various offences, including a record high of nine market manipulators • Concluded 99 disciplinary inquiries and took action against 88 licensees or concerned persons • Referred 31 cases of fraud to the Police • Concluded 553 investigations of which 394 were completed within 12 months	• Target investigations on areas of corporate misgovernance, market crimes and serious misconduct by intermediaries • Conduct inspections into listed companies and continue 14 listed companies inspections • 112 cases subject to disciplinary proceedings, 10 cases awaiting hearing in the Courts and two before Insider Dealing Tribunal • Strengthen domestic and international co-operation, especially against cross-border fraudulent activities
• Authorised three Automated Trading Services providers • Completed the comprehensive review of HKEx's fees and charges • Monitored the development and launch of advanced market infrastructure under SCEFI recommendations including DCASS and IP Account service • Consulted the public on the level and the funding of the ICF and the operation of the investor compensation arrangements • Consulted the public on the disclosure of interests regime • Facilitated the launch of H-shares Index Options and the enhancement of the stock options market • Revised the SFC Market Contingency Plan and assisted in the set up of a backup site for the SFC • Participated in a successful market contingency rehearsal co-ordinated by the Government • Commenced legislative drafting for enabling a scripless market	• Introduce legislation to enable a scripless market and an operational model for consultation • Work with HKEx to facilitate the introduction of new products and services, such as callable bull/bear contracts, and to review reduction of minimum spreads and position limits • Monitor HKEx's work on its network consolidation project • Introduce legislative amendments for a levy triggering mechanism for the ICF • Monitor ICC's implementation of the claims handling procedures • Follow up on the consultation conclusions on the disclosure of interests regime • Further enhance the Market Contingency Plan, provide contingency information on website, and complete the Business Continuity Planning Guidelines
• Worked with the Government on maintenance of the SFO and formulated amendments to its subsidiary legislation on statutory backing for listing requirements, disclosure of interests and other matters • Conducted a significant number of successful prosecutions for a wide range of regulatory offences • Successfully opposed an application for leave to apply for judicial review against the Commission • Managed budget prudently and achieved a $169 million surplus • Established an off-site backup office • Gained external recognition of human resources and training policies and procedures • More secure and convenient remote connection solutions for office system access • Introduced more application and network services for FinNet users • New investor education TV and radio programmes, university credit courses • Revamped the SFC website and the eIRC • Active participation in community work and voluntary service	• Work on legislative initiatives to ensure policy aims are fulfilled and to address market needs and reforms • Refine subsidiary legislation in the light of market developments • Launch the new Staff Investment Recording System • Introduce assessment tools for staff development and recruitment • IT infrastructure upgrade related to email, application server and corporate database, and explore solutions for document management, interactive form submission and enterprise resource planning • Investor education campaigns on mis-selling of financial products, analyst conflicts of interest and financial planning • Further upgrade of websites including a text only version for visually impaired users • New edition of the glossary of financial terms

Performance Comparisons

	2004-2005	2003-2004	2002-2003	1994-1995
Market				
Hong Kong markets benefit from economic recovery				
MAIN BOARD				
Number of listed companies*	**891 (+4%) [+68%]#**	856 (+5%)	817	530
Market capitalisation ($ billion)*	**6,506.1 (+14%) [+215%]**	5,690.5 (+68%)	3,377.6	2,067.9
Average daily market turnover ($ billion)	**15.5 (+14%) [+343%]**	13.6 (+116%)	6.3	3.5
Funds raised through IPOs ($ billion)	**80.9 (+11%) [+518%]**	72.6 (+52%)	47.7	13.1
Hang Seng Index (points)*	**13,517 (+7%) [+57%]**	12,682 (+47%)	8,634	8,588
GROWTH ENTERPRISE MARKET (Launched in 1999)				
Number of listed companies*	**205 (+7%) [N/A]**	192 (+14%)	168	N/A
Market capitalisation ($ billion)*	**65.3 (-17%) [N/A]**	79.0 (+54%)	51.4	N/A
Average daily market turnover ($ million)	**66 (-65%) [N/A]**	190 (+40%)	136	N/A
Funds raised through IPOs ($ billion)	**0.9 (-76%) [N/A]**	3.8 (-32%)	5.6	N/A
S&P/HKEx GEM Index (points)*	**936 (-24%) [N/A]**	1,237 (+33%)	927	N/A
Finances and Staff				
Financial position improves with increased turnover				
Income ($ million)	**625.4 (+13%) [+154%]**	551.1 (+63%)	338.4	245.8
Moderate increase in expenses despite new challenges				
Expenses including depreciation ($ million)	**456.3 (+7%) [+124%]**	425.7 (+7%)	396.8	203.5
Staff turnover (%)	**12 (+67%) [+3%]**	7.2 (-18%)	8.8	11.6
Steady permanent establishment level				
Permanent established posts*				
– excluding dual filing	**383 (+2%) [+62%]**	374 (+4%)	361	237
– including dual filing [1]	**406 (+4%) [N/A]**	392 (+5%)	373	N/A
Strong mix of professionals				
Number of lawyers, accountants and CFAs*	**182 (+5%) [N/A]**	173 (+14%)	152	dna
Better staff skills				
Number of training programmes	**320 (+39%) [N/A]**	231 (-12%)	263	dna
Training man-day per employee	**5.5 (+22%) [N/A]**	4.5 (+12%)	4	dna
Corporate Finance				
More applications handled under the Companies Ordinance and the SFO				
Total number of CO applications	**244 (+107%) [N/A]**	118 (+188%)	41	dna
Total number of applications for exemption under section 309 of the SFO	**529 (+15%) [+714%]**	460 (+59%)	290[2]	65[2]
Total number of applications for authorisation under section 105 of the SFO	**52 (+940%) [N/A]**	5 (-50%)	10[3]	dna
Transactions handled under the Codes on Takeovers and Mergers and Share Repurchases				
Total number of transactions handled	**251 (-36%) [+135%]**	393 (+15%)	341	107
Total number of major transactions (general and partial offers, whitewashes, off-market and general offer repurchases)	**62 (-32%) [+265%]**	91 (+18%)	77	17
Other applications	**189 (-37%) [+110%]**	302 (+14%)	264	90
More new listing applications to SEHK				
Total number of listing applications to SEHK [1]	**122 (+4%) [N/A]**	117	N/A	N/A
Intermediaries and Investment Products				
More newcomers amid market recovery				
Applications for SFC licence	**4,915 (+32%) [-39%]**	3,732 (-18%)	4,555	7,996[4]
Applications to conduct new regulated activity	**12,275 (+61%) [N/A]**	7,634	N/A	N/A
Total number of SFC licences	**22,726 (+11%) [+51%]**	20,510 (-22%)	26,411	15,025
Focused inspections				
Routine inspections (cases)	**142 (-17%) [-24%]**	171 (+23%)	139	188
Special inspections (cases)	**28 (-7%) [+833%]**	30 (+88%)	16	3
Prudential meetings	**62 (-18%) [N/A]**	76 (-12%)	86	N/A
Breaches noted from completed inspections	**740 (-9%) [+70%]**	810 (+59%)	510	435
More authorised investment products				
Authorised collective investment schemes*	**2,553 (+6%) [+129%]**	2,414 (-2%)	2,457	1,115
Investment funds increase in value				
NAV of authorised unit trusts and mutual funds (US$ billion) [5]	**551 (+3%) [+867%]**	534 (+56%)	342	57

	2004-2005		2003-2004	2002-2003	1994-1995
Enforcement					
More successful prosecutions					
New investigations (cases)[6]	**501 (-59%)**	**[+131%]**	1,223 (+213%)	391	217
Successful prosecutions[7]	**76 (+27%)**	**[+230%]**	60 (+62%)	37	23
Unsuccessful prosecutions	**6 (N/A)**	**[N/A]**	0 (-100%)	7	0
Disciplinary inquiries conducted	**209 (+25%)**	**[+771%]**	167 (+2%)	163	24
Actions against licensees	**88[8] (+13%)**	**[+340%]**	78 (-7%)	84	20
Supervision of Markets					
Bigger compensation pool					
Total NAV of all compensation funds ($ million)*	**1,506 (+17%)**	**[+235%]**	1,286 (+28%)	1,001	449
NAV of Investor Compensation Fund ($ million)[9]*	**1,456 (+51%)**	**[N/A]**	962	N/A	N/A
NAV of Unified Exchange Compensation Fund ($ million)[9]*	**49 (-85%)**	**[-88%]**	324 (-63%)	872	416
NAV of Commodity Exchange Compensation Fund ($ million)*	**0.3 (0%)**	**[-99%]**	0.3 (-99%)	129	33
Reaching Out					
eIRC and corporate website revamped					
eIRC's average daily hit rate (hits)	**47,896 (+52%)**	**[N/A]**	31,434 (+21%)	25,896	N/A
Corporate website's average daily hit rate (hits)	**337,258 (-2%)**	**[N/A]**	345,739 (+30%)	266,590	N/A
Investor complaints ease off					
Enquiries	**4,523 (-16%)**	**[+281%]**	5,382 (+35%)	3,982	1,188
Complaints	**1,214 (-3%)**	**[+372%]**	1,252 (+31%)	959	257
Complaints referred to operational divisions	**701 (-1%)**	**[+1,013%]**	708 (+23%)	576	63
Complaints leading to investigations	**154 (-4%)**	**[+1,183%]**	161 (-1%)	163	12
Press releases issued	**289 (+7%)**	**[+398%]**	270 (-10%)	299	58
Consultation and Guidelines					
Consultation papers issued	**9 (+50%)**	**[+200%]**	6 (-70%)	20	3
Consultation conclusions issued	**5 (-38%)**	**[+400%]**	8 (-78%)	37	1
Codes and guidelines issued	**3 (-40%)**	**[+200%]**	5 (-86%)	36	1

* Figures as at financial year-end.

( ) denotes % change from the previous year. [ ] denotes % change from 1994-1995. "N/A" denotes Not Applicable. "dna" denotes Data Not Available.

1. The SFC began to review listing applications under the Dual Filing regime from 1 April 2003.
2. Applications under Securities (Disclosure of Interests) Ordinance.
3. Applications under section 4(2)(g) of the Protection of Investors Ordinance.
4. This included 2,568 applications for licence to conduct leveraged forex activities for the first time upon the commencement of the Leveraged Foreign Exchange Trading Ordinance on 1 September 1994.
5. Net Asset Value (NAV) as at 31 December 2004, 2003, 2002 and 1994.
6. The figure 1,223 in the year 2003-2004 was an aberration because of the introduction of the new disclosure of interests requirements. As the market appears to have adjusted to the new requirements, the total number of cases has reverted to approximately closer to previous level.
7. Prosecutions include cases of market manipulation, cold calling, FRR breaches, failing to assist SFC investigations, unlicensed activities, disclosure of interests breaches, illegal short selling and others.
8. The figure includes disciplinary actions and settlements with no statutory sanction imposed but alternative action agreed, e.g. payment of money to the Government.
9. NAV of ICF increased partly because of asset transfer from UECF.

Significant Events 2004-2005

2004

1 April

The SFC secured a better fidelity insurance scheme for SEHK participants and a new scheme for HKFE participants.

12 May

The SFC published its Annual Report 2003-2004.

(From left) SFC EDs Mr Alan Linning, Mrs Alexa Lam, Chairman Mr Andrew Sheng and Mr Ashley Alder introduce the Annual Report at a press conference.

17-20 May

An SFC delegation participated in the 29th Annual Conference of IOSCO in Amman, Jordan, during which Mr Andrew Sheng was appointed Chairman of the IOSCO Technical Committee.

Dr Bassam Saket (left), Executive Chairman of Jordan Securities Commission, is welcomed by Mr Sheng at the SFC exhibition booth in Amman.

25 May

The SFC signed a Letter of Intent (LOI) with Indonesia's Ministry of Finance Capital Market Supervisory Agency (Bapepam) on the establishment of regulatory co-operation relating to investment funds.

15 June

The SFC issued a restriction notice on Charles Schmitt & Associates Limited following suspected misappropriation of assets of a fund. The SFC later obtained a Court judgement for appointing an administrator of its CEO's property.

29 July

The Financial Secretary re-appointed Mr Raymond Kwok as an SFC NED for two years, effective from 1 August 2004.

17 August

The SFC settled disciplinary proceedings against Towry Law (Asia) HK Limited by severely reprimanding it for failings related to two unauthorised hedge funds. Towry Law offered ex-gratia payments of $255 million to over 1,000 investors.

22 September

The SFC successfully prosecuted Huafeng Textile International Group Limited and a director for providing false or misleading information, in the first prosecution under Dual Filing.

28 September

The SFC released a consultation paper on proposed measures to strengthen the regulatory framework for brokerage firms involved in securities margin financing.

19 October

The SFC and HKEx released consultation conclusions on the regulation of sponsors and independent financial advisers.

21 October

The Financial Secretary re-appointed Mr Alan Linning as ED of Enforcement for two years, effective from 1 November 2004, and agreed that Mr Peter Au-Yang, ED and COO, be redeployed to double-up as ED of Corporate Finance following the departure of Mr Ashley Alder.

3 November

The SFC published guidelines to address analyst conflicts of interest. The guidelines took effect on 1 April 2005.

5 November

The SFC launched its revamped corporate website and eIRC, with better contents and features.

8 November

The Insider Dealing Tribunal ordered disgorgement, penalties and costs amounting to $250 million by four insider dealers involved in the case of Siu Fung Ceramics Holdings Limited.

23 November

The SFC was awarded the status of Approved Continuing Professional Development Employer by ACCA and accepted as an ACCA Accredited Employer. It was also awarded the Good People Management Award 2004 by the Labour Department in December.

良好人事管理獎 2004
GOOD PEOPLE MANAGEMENT AWARD

24 November

The SFC signed a LOI with Thailand's Securities and Exchange Commission on the establishment of regulatory co-operation relating to investment funds.

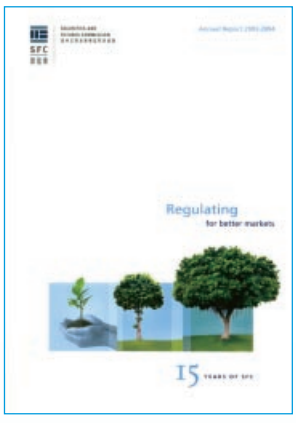
25 November

The SFC signed a MOU with the Philippine Securities and Exchange Commission on mutual assistance and exchange of information.

Mr Sheng exchanges the MOU with Mrs Fe B. Barin, Chairperson of the Philippine SEC.

25 November

Our Annual Report 2003-2004 won the Platinum Award in HKICPA's Best Corporate Governance Disclosure Awards 2004. It also won the Silver Award in the Best Annual Report Awards 2004 organised by the Hong Kong Management Association in December.



26 November

The SFC published guidelines to recommend disclosure of securities related fees and charges under standardised categories.

30 November

The SFC issued a consultation paper on a review of the Codes on Takeovers and Mergers and Share Repurchases.

17 December

In the first joint disciplinary action with HKEx against a sponsor for withholding information, the SFC settled an action against Oriental Patron Asia Limited and an executive with each agreeing not to act as sponsors for five and nine months respectively.

22 December

The SFC issued a consultation paper on the Investor Compensation Fund and proposed suspending the investor compensation levies when the fund assets reach $1.4 billion.

31 December

The Financial Secretary appointed Mr Eddy Fong, Mr Kenneth Kwok and Professor Liu Pak Wai as SFC NEDs with effect from 1 January 2005, succeeding Mr Thomas Brian Stevenson, Mr Daniel Fung and Ms Anna Wu.

2005

7 January

The Government and the SFC issued consultation papers to enhance the regulation of listing, by empowering the SFC to make rules to prescribe major listing requirements.

20 January

The SFC issued a consultation paper on proposed amendments to the disclosure of interests regime under Part XV of the SFO.

27 January

The SFC announced that ICEA Capital Limited had agreed to pay $30 million to settle a disciplinary action regarding its role as the sponsor of Euro Asia Agricultural (Holdings) Company Limited.

23 February

The SFC released a report on a theme inspection of investment advisers, which identified some unsatisfactory selling practices.

The SFC's investor leaflet Questions to Ask When Seeking Investment Advice.

25 February

The Financial Secretary re-appointed Mrs Alexa Lam as ED of Intermediaries and Investment Products for three years, effective 1 March 2005.

30 March

The SFC issued a consultation paper on proposals to relax the geographical restriction on investments by SFC-authorised REITs.

31 March

The two-year transitional period for intermediaries to migrate to the single licensing regime under the SFO ended, with a high percentage of migration.

We Educate

We educate investors to protect their own interests. Investor education provides investors with the tools and knowledge to make informed decisions. An informed investor is also the best defence against fraud. Intermediary education raises the professionalism and integrity of practitioners, which is also important for building investors' confidence in the Hong Kong markets. Last year, we continued to get the investor education messages across to the public through TV, radio, newspapers, the Dr Wise's Column, and our investor resources website. Our seminars reached more than 6,300 people. In the following two pages, we review our investor education work in the past years.

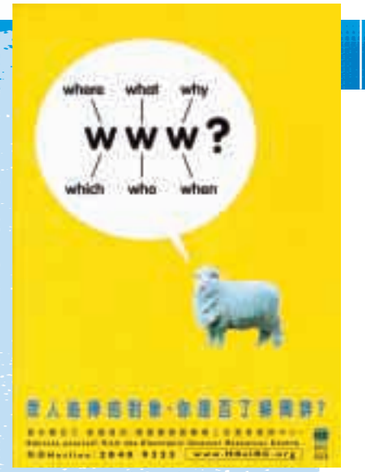
信
Information 信息,
Confidence 信心

Investor Education and the SFC

The SFC is committed to educating and communicating with investors. Let's take a look at our activities over the years.

Investor Education

Knowledge is an investor's safety net. We help investors to invest wisely by understanding the markets, investment risks, and their rights and obligations. We run campaigns on new products and market malpractices.



Since 1996 when the SFC began its investor work proactively, we have rolled out 64 TV episodes of drama and documentary, 194 radio segments, 613 feature articles in the print media, and five CD-ROM/VCDs. We have had six TV Announcements in the Public Interest (API) with different creative concepts. Over 1.8 million copies of investor brochures of 70 titles have been distributed.

Investor Information

We encourage investors to "get the facts before they invest". We started the Electronic Investor Resources Centre (eIRC) website in 2000. With the latest revamp last November, the eIRC has over 710 links to 470 websites of education resources, market information, regulators, exchanges and intermediaries. It carries over 300 feature articles, 79 video and audio clippings, 148 hot investor questions, 40 interactive games, the Alert List, a monthly e-newsletter with 5,300 subscribers and a teachers corner.

Investor Alert

Fraudsters use various tricks to dupe unwary investors. In 2000, we published an Alert List to name suspected boiler rooms. It has been expanded to include scam websites and phishes to caution investors. There are 238 blacklisted entities.

We even build our own scam websites on the eIRC to illustrate how typical boiler rooms and scam websites work. The Smart Investor Awards encourage the public to report financial scams - 12 citizens have been awarded so far.

Investor Communications

We answer investors' questions and listen to their complaints. Investors can call our Investor Hotline (Tel: 2840 9333) or reach us by mail, fax, email or filling in the on-line form on the eIRC.

We organise outreach activities to meet secondary and tertiary students, civil servants, and the elderly. Since 2000, we have organised 80 workshops for secondary school teachers, attracting over 4,400 enrolments.

Investor Surveys

We have conducted four surveys on retail investors since 1996 to help plan our investor education job.

Looking forward, we will continue to explore new channels to effectively communicate with investors and to proactively launch education programmes in line with market development and investor needs.

Corporate Finance

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 consultation conclusions jointly with HKEx on the regulation of sponsors and independent financial advisers
- Worked with SEHK on its Code on Corporate Governance Practices and the Corporate Governance Report
- Implemented prospectus related amendments in the Companies (Amendment) Ordinance 2004
- Issued a consultation paper to review the Codes on Takeovers and Mergers and Share Repurchases
- Issued a consultation paper on proposed amendments to the Securities and Futures (Stock Market Listing) Rules and worked with the Government on giving statutory backing to major listing requirements
- Supported the Government regarding its proposals to establish a Financial Reporting Council
- Worked with SEHK on its proposal to review its decision-making structure for listing matters

[This Chapter Is About]

- Takeovers matters
- Prospectus regime review
- Enhancement of corporate governance
  - Revision of Listing Rules
  - Regulation of sponsors
  - Public Shareholders Group
- Upholding standards
  - Dual Filing
  - Enhancing the regulation of listing
  - Quality of financial reporting
  - Review of the SEHK's decision-making structure for listing matters

Investors First

Year 2 undergraduate Mr Kalvin Lou has not invested before, but is interested in the financial markets.

Ms Olivia Fung finds online trading convenient and user-friendly.

First-time investor Mr Walter Leung has recently subscribed for shares in an IPO.

What We Do

- Administer the Codes on Takeovers and Mergers and Share Repurchases;
- Raise standards of investor protection and corporate governance;
- Oversee the SEHK's listing-related functions and responsibilities;
- Review and recommend changes to the Listing Rules;
- Administer securities legislation relating to listed and unlisted companies;
- Recommend changes to laws and regulations to facilitate the development of effective, fair and efficient capital markets;
- Review prospectuses of unlisted issuers for authorisation under companies legislation and grant exemptions for prospectuses issued by listed and unlisted issuers; and
- Administer the Dual Filing regime under the SFO to enhance the quality of disclosure by listing applicants and listed companies.

Mr Peter Au-Yang (centre), ED of Corporate Finance, explains the Takeovers Code review at a media briefing. Accompanying him are Mr Brian Ho, Senior Director, and Ms Gail Humphryes, Director.

What We Did

Takeovers Matters

The Takeovers Executive administers all takeovers transactions relating to public companies under the Codes on Takeovers and Mergers and Share Repurchases. The Codes are designed to ensure fair treatment for shareholders who are affected by takeovers, mergers and share repurchases. The Executive comments on takeovers announcements and documents, gives rulings and interpretations under the Codes, 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 resolved at an early stage.

The Executive believes it is important to keep the Codes up-to-date with market developments and international practices in order to ensure all shareholders are treated equally. A review of the Codes was conducted in consultation with the Takeovers Panel, taking into account the Executive's experience in its day-to-day administration of the Codes and comments from market practitioners.

A consultation paper proposing amendments to the Codes was published in November 2004. The public consultation ended in March 2005 and elicited 12 responses. We aim to publish the consultation conclusions in the second half of 2005.

During the year, the Takeovers and Mergers Panel met four times to consider Code amendments.

Corporate Finance

Takeovers Executive Sanctioned GP NanoTechnology Group Limited and its Directors

On 18 October 2004, the Executive publicly censured GP Nano and seven directors (Mr Fung Chiu, Mr Lian En Sheng, Mr Ong Hong Hoon, Mr Chow Chun Kwong, Mr Chiang Chi Kin, Stephen, Mr Siu Siu Ling, Robert and Mr Feng Hui Liu). The Executive also imposed a 24-month "cold shoulder order" on Fung and Lian denying them direct or indirect access to the securities markets. The sanctions were imposed under section 12.3 of the Introduction to the Codes.

The background concerned a voluntary offer for GP Nano by Right Field Holdings Limited, which posted an offer document to shareholders of GP Nano on 10 September 2003. Despite repeated requests by the Executive to do so, GP Nano and its directors never issued an offeree circular to shareholders in response to the offer, on the pretext that GP Nano was in financial difficulties and that the offer was unsolicited and unappealing. The Executive ruled that GP Nano and all its seven directors at the time had breached a fundamental requirement under the Takeovers Code, denying shareholders and the investing public access to GP Nano's latest corporate and financial information, a board recommendation and advice of an independent financial adviser with respect to the offer.

The Executive imposed more severe sanctions on Fung and Lian to reflect the fact that they initiated and led the company's decision not to issue the response circular whereas the remaining directors collectively and individually failed to take any action to prevent the breach.

Prospectus Regime Review

The commencement of the prospectus-related amendments in the Companies (Amendment) Ordinance 2004 in December 2004 completed the second phase of a project to improve the public offering regime. The first phase, completed in May 2003, involved the issuance of guidelines and class exemptions by the SFC to facilitate securities offerings. Major reforms in the second phase included 12 new exemptions from the prospectus regime, a new advertising regime for public offers and increased scope for use of the SFC's exemption power.

In the second half of 2004-2005, we began the third phase of the market development project. This involves an overall review of the regime, having regard to equivalent legislation in leading overseas jurisdictions. The principal purpose is to modernise the regime. We hope to consult the public on our recommendations in mid-2005.

Enhancement of Corporate Governance

Revision of Listing Rules

We had worked closely with the SEHK on the Code on Corporate Governance Practices for listed companies, the prescribed Corporate Governance Report and the related Listing Rules changes. They came into effect in January 2005. Issuers are required to report compliance and explain any non-compliance with the Code in the annual report for the accounting period commencing on 1 January 2005.

Regulation of Sponsors

We received 129 responses to the Joint Consultation Paper on the Regulation of Sponsors and Independent Financial Advisers (IFAs) issued in May 2004. There was strong market consensus for the SFC, as the statutory regulator, to be responsible for assessment of eligibility, continuing supervision, discipline and enforcement of the conduct of corporate finance advisers who act as sponsors and IFAs; whereas the SEHK, as the market operator, should continue to be responsible for implementation and administration of the Listing Rules requirements, including the practice note on due diligence.

In October 2004, we published the consultation conclusions and the Listing Rules amendments jointly with the SEHK. The amendments clarified what the SEHK and the SFC expect of sponsors and IFAs. Firms not meeting the regulators' expectations must improve their compliance arrangements or face regulatory consequences. We will also consider introducing specific eligibility criteria for sponsor or IFA work into the existing licensing regime. (see chapter on Intermediaries and Investment Products for details).

Public Shareholders Group

The Public Shareholders Group is a standing committee under section 8 of the SFO to provide investors' views on issues relating to shareholders' rights and interests. The Group consists of 13 members: retail and institutional investors, professionals, market commentators, advocates of investors' rights, an academic and a Consumer Council representative.

During the year, members met eight times to discuss various issues and advise on regulatory proposals. They have assisted the SFC in performing its functions more effectively. Topics discussed include:

- regulation of sponsors and IFAs;
- SEHK's proposal regarding Main Board companies' publication of announcements in newspapers;
- SFC's and SEHK's enforcement policies;
- a review of the disclosure of interests law;
- a review of the Investor Compensation Fund;
- statutory backing for important listing requirements; and
- SEHK's proposed new structure for listing decision-making.

Upholding Standards

Dual Filing

Under the Dual Filing regime, which took effect on 1 April 2003, listing application materials and listed company announcements are filed with the SEHK and, via the SEHK, the SFC.

The Dual Filing Advisory Group, a standing committee established under section 8 of the SFO, advises us on treatment of cases and policy issues under the regime. During the year, in anticipation of more Dual Filing work pursuant to proposals to enhance regulation of listed companies, we expanded the Group to 12 members by appointing three more members. The Group met three times in 2004-2005.

As part of our efforts to ensure transparency, the SFC published quarterly updates on the implementation of Dual Filing. In 2004-2005, we received 122 new listing applications and commented on 64 of them. Of these 64 applications, 26 remained active as at 31 March 2005, 33 had lapsed or been rejected or withdrawn, and five had been listed. There was a marked increase in the number of applications with planned offer size of over $100 million (88 of such cases as compared to 54 cases in 2003-2004). Our average response time was seven working days.

The SFC continues to focus on the quality, not quantity, of disclosure by listing applicants and listed companies. We identify and comment on major disclosure issues at the beginning of the listing process. The Dual Filing Advisory Group has endorsed this approach.

During the year, we identified disclosure concerns including: unusual or undisclosed relationships between a listing applicant and its suppliers or customers, heavy reliance on a few distribution agents, and acquisition or disposal of significant business shortly before the listing application. After consultation with the Dual Filing Advisory Group regarding one application, we advised the SEHK that we would exercise our power to object to the listing, and the application subsequently lapsed. We will continue to work closely with the SEHK to ensure that Dual Filing operates smoothly and the interests of investors are sufficiently protected.

In addition, we have worked with other divisions of the SFC on cases arising from deficient disclosure in both listing applications and listed company announcements. For example, the SFC successfully completed the first prosecution under Dual Filing for the provision of false and misleading information, against a listed company and its director.

Corporate Finance

Enhancing the Regulation of Listing

Following the Government's March 2004 Consultation Conclusions on Proposals to Enhance the Regulation of Listing, the Government and the SFC separately consulted the public in January 2005 on proposals to give statutory backing to major listing requirements.

The Government proposed amendments to the SFO to enable the SFC to make rules and prescribe important listing requirements and continuing obligations of listed companies. It also consulted on the proposed sanctions for breaches:

- civil sanctions by the SFC against issuers, directors and officers, including civil fines of up to $5 million on issuers and directors;
- civil sanctions by the Market Misconduct Tribunal against issuers, directors and officers, including civil fines of up to $8 million on issuers and directors; and
- criminal prosecution.

The Commission supports the Government's proposals, including the proposal to empower the SFC to impose fines. Civil fines would enable the SFC to take swift action to uphold its regulatory objectives of maintaining a fair and transparent market and protecting investors. However, the Commission is concerned that a maximum fine of $5 million for the SFC and $8 million for the Market Misconduct Tribunal (MMT) may not be adequate to address serious cases. The Commission has submitted to the Government that more realistic fining levels of up to $10 million for the SFC and unlimited fines for the MMT should be considered. In order for Hong Kong to have a credible regulatory regime of international standard, the SFC needs to have the power to impose civil fines in amounts that the listed sector will take seriously and consider a deterrent so as to encourage compliance with the Securities and Futures (Stock Market Listing) Rules (SMLR).

The Commission has also written to the Legislative Council's Panel on Financial Affairs before the Panel's meeting on 4 April 2005 to discuss the proposals to give statutory backing to major listing requirements. We pointed out in the Note to the Panel that it is essential for the SFC to have power to impose civil fines to enable the SFC to tailor regulatory action proportionately to misconduct. Reliance on the MMT fines alone would deny the SFC a key enforcement tool. Without the power to levy fines, the SFC may be compelled to refer a large number of cases to the MMT, which is not equipped to deal with a high volume of cases or to process them at the speed required for the proper regulation of the listed sector.

The accompanying SFC consultation proposed amendments to the SMLR to codify important listing requirements covering the following three areas:

- disclosure of price-sensitive information and specific events;
- disclosure/publication of annual and periodic reports, including annual and interim accounts; and
- disclosure of, and shareholders' approval for, notifiable transactions and connected transactions.

The SFC consultation period ended on 31 March 2005. We believe that the Government's and the SFC's proposals are a major step forward in our continuing effort to strengthen backend enforcement action against false or misleading disclosure and non-disclosure. The proposed measures would bring Hong Kong's listing regulatory regime further into line with international markets. We will continue to work with the Government and the SEHK to develop the proposals further in the light of responses received. The SFC is committed to improving the quality of the Hong Kong market.

Quality of Financial Reporting and Regulation of Auditors

The Government published a Consultation Paper on Legislative Proposals to Establish Financial Reporting Council (FRC) in February 2005. The proposed FRC would oversee an Audit Investigation Board (AIB) and a Financial Reporting Review Committee (FRRC). The AIB would investigate suspected irregularities concerning auditors, while the FRRC would look into suspected non-compliance of listed company accounts and financial statements with legal and accounting requirements.

The Government, the SEHK, the Hong Kong Institute of Certified Public Accountants and the SFC have agreed to fund the FRC on an equal share basis. Each will contribute $2.5 million per annum in the first three years of the FRC's existence, plus a one-off contribution of up to $2.5 million as a reserve.

Review of the SEHK's Decision-Making Structure for Listing Matters

The Listing Division discussed with us its proposals to revise the SEHK's decision-making structure for listing matters. HKEx issued a consultation paper on its proposals in February 2005.

Matters Handled by Corporate Finance

Types of application	2004-2005	2003-2004
Applications for listing on the SEHK	122	117
Codes on Takeovers and Mergers and Share Repurchases		
General and partial offers under the Takeovers Code	24	43
Privatisations	3	7
Whitewash waiver applications	32	34
Other applications under the Takeovers Code	184	301
Off-market and general offer repurchases	3	7
Other applications under the Share Repurchases Code	5	1
Total	251	393
Executive's Statements		
Sanctions imposed with parties' agreement[1]	1	1
Takeovers and Mergers Panel		
Meetings for review of the Takeovers and Share Repurchases Codes	4	0
Statements issued by the Panel[2]	0	1
Companies Ordinance (CO) and Securities and Futures Ordinance (SFO)		
Applications for exemption under Section 309 of the SFO	529[3]	460[4]
Applications for authorisation under Section 105 of the SFO	52	5
Applications for authorisation to register prospectuses under the CO in respect of unlisted shares and debentures	114	49
Applications for exemption from the CO prospectus content requirements for prospectuses in respect of shares and debentures	130[5]	69[5]

1. Pursuant to paragraph 12.3 of the Introduction to the Codes on Takeovers and Mergers and Share Repurchases.
2. Pursuant to paragraph 16.1 of the Introduction to the Codes on Takeovers and Mergers and Share Repurchases.
3. Each certificate issued can include more than one warrant or structured product. 1,394 warrants listed, 4 equity-linked instruments and 10 debt instruments were listed during the year.
4. Each certificate issued can include more than one warrant or structured product. 1,007 warrants listed, 7 equity-linked instruments, 2 debt instruments and 2 shares issued were listed during the year.
5. Each certificate issued can include more than one CO exemption.

Intermediaries & Investment Products

Our mission is to safeguard investor interests and work in partnership with the industry to facilitate market development.

[Achievements]

- Prudential regulation
  - Managed down financial risks of the securities industry by requiring brokers to tighten their margin loan credit policy and increase their capital base
  - Minimised the risks to the market of a few firms by imposing licensing conditions and/or obtaining undertakings
  - Secured a new fidelity insurance scheme for SEHK and HKFE participants
  - Obtained public support for the proposals to address risks arising from securities margin financing
- Conduct supervision
  - Released a report on mis-selling practices of investment advisers
  - Survey on fund trading practices, theme inspection and subsequent regulatory action
  - Published the code on analyst conflicts of interest
- Smooth migration of licensees to the SFO regime
- Facilitate the market to develop new products
  - Facilitated the processing of UCITS III fund applications
  - Proposed relaxation of geographical restriction on overseas investments by SFC-authorised REITs
- Operational work
  - Granted 4,743 new licences and approved 8,346 migration applications
  - Inspected 170 firms and conducted 62 prudential meetings
  - Authorised 302 new Collective Investment Schemes

[This Chapter Is About]

- An overview of licensees, the securities industry and authorised investment products
- Safeguarding investor interests
  - Regulatory action
  - Enhancing investor protection
  - Raising professional standards
- Market facilitation
  - Facilitating intermediaries
  - Product facilitation
- Operational functions
  - Licensing
  - Supervision
  - Investment products authorisation

Investors First

Ms Franki Yip has attended the SFC's teachers workshop for several years to learn more about investing.

Mr Kwok Kin Wai has won our Smart Investor Awards twice with his reports of financial scams.

Retiree Mr Kung Kam Ho has been a stock investor for almost 30 years.

What We Do

- Act as the gatekeeper of the industry, by licensing only those individuals and firms that are fit and proper to conduct regulated activities;
- Monitor the financial positions of licensed firms and supervise their business conduct;
- Raise the professional standards of intermediaries;
- Impose authorisation requirements on the sale of investment products to the Hong Kong public and their advertisements in accordance with product codes and industry standards;
- Monitor disclosures and ongoing compliance of investment products; and
- Carry out policy reforms to enhance investor protection and foster market development.

How We Help Investors

Our primary objective is to protect investors and reduce systemic risks to the market. We recognise that investors expect licensed persons to be fit and proper, adopt high standards and act in the investors' best interests.

To achieve this, the Division has an ongoing risk based supervision programme of intermediaries. We prioritise our resources towards resolving regulatory issues that have significant market impact, which may result in a contagion effect or substantial investor losses. By exercising both prudential and conduct supervision to identify and reduce risks as far as possible, we try to promote high standards amongst practitioners because investors rely heavily on the practitioners' skills, integrity and professionalism. In addition, we constantly review our codes and guidelines to assist market practitioners and facilitate new products for Hong Kong's financial market.

Firms may still fail due to market volatility and business risks. With this in mind, our aim is to ensure that such firms, as far as possible, make an orderly exit and minimise any adverse impact on the investing public and the reputation of Hong Kong as an international financial centre. We also emphasise the ongoing role senior management play to properly manage the business risk of their firms.

Over the last five years, our focus and first priority was on managing down the margin financing risks of brokers. Thorough measures have been put in place and rigorously enforced to manage down the financial risks of brokers, subject to the implementation of measures to reduce the pooling and re-pledging risks in margin financing.

We are now at a stage where the brokerage industry is more financially sound, so going forward, we are refocusing our attention on intermediary conduct issues especially those relating to investment advisers, sponsors and fund managers. In this year, we have undertaken cross-sector activities covering fund managers, brokers, investment advisers and corporate finance advisers. These activities include theme inspections and investor surveys in order to examine whether there are any gaps in the compliance standards of intermediaries and the applicable regulatory requirements.

Intermediaries & Investment Products

What We Did

An Overview of Licensees, the Securities Industry and Authorised Investment Products

Over the last five years, we have managed down the risks to the industry by requiring firms to strengthen their credit policies and where necessary, increase their capital base, in order to provide an adequate buffer against market shocks or loan shortfalls. This is shown in the improvement of average margin loan collateral coverage from 3.8 times to 4.6 times and the increase in capital of the whole industry by 54% to $77 billion.

The market recovery and various market facilitation measures taken by the SFC have benefited the industry and industry practitioners. Over the past year, we have seen an 89% increase in net profit of the industry as a whole, a 35% increase in personnel wage costs for the industry and an 11% increase in employment as defined by the number of licensed persons from 20,510 a year ago to 22,726.

Number of Licensees
As at 31 March 2005 (Figures as at 31 March 2004 in brackets) — Table 1

	Corporations		Representatives		Responsible Officers		Total		% Change
SEHK Participants	394	(448)	7,613	(7,390)	1,146	(1,130)	9,153	(8,968)	2%
HKFE Participants	113	(122)	377	(404)	54	(45)	544	(571)	-5%
SEHK and HKFE Participants	11	(5)	549	(217)	61	(24)	621	(246)	152%
Non-Participants	714	(723)	10,150	(8,750)	1,544	(1,252)	12,408	(10,725)	16%
Grand Total	**1,232**	**(1,298)**	**18,689**	**(16,761)**	**2,805**	**(2,451)**	**22,726**	**(20,510)**	**11%**

Financial and Market Highlights of the Securities Market — Table 2

	As at 31/12/2004	As at 31/12/2003
Total number of securities dealers & securities margin financiers	663	673
Total number of active clients[1] (-10%)	685,827	759,042
	HK$ million	HK$ million
Total assets (+22%)	331,613	271,800
Total shareholders' fund (+21%)	76,990	63,431
Period from 1 January 2004 to 31 December 2004		
Total value of transactions (+59%)	16,620,090	10,456,801
Net securities commission income (+37%)	18,225	13,329
Net profit (+89%)	12,828	6,788

1. The drop in the number of active clients was primarily due to the surrender of the licence by a major licensed corporation that was formerly an exempt dealer. That corporation's dealing activities are now done within its banking operations, which are regulated by the HKMA.

Number of Authorised Collective Investment Schemes — Table 3

	As at 31/03/2005	As at 31/03/2004
Unit trusts and mutual funds	1,942	1,872
Investment-linked assurance schemes	177	160
Pooled retirement funds	37	37
MPF master trust schemes	45	46
MPF pooled investment funds[1]	274	255
Others[2]	78	44
Total[3]	**2,553**	**2,414**

1. There are 118 funds included in this category that are offered both as retail unit trusts as well as pooled investment funds for MPF purpose.
2. Other schemes comprised 68 equity-linked deposits, 9 paper gold schemes and 1 REIT.
3. During the year, 302 products were newly authorised for offer to the public in Hong Kong, while 163 products were withdrawn.

Our market facilitation measures include granting capital rule modifications, hence allowing more efficient deployment of capital by licensed corporations. We also assisted them to capitalise on emerging business opportunities by speedy processing and approval of subordinated loans as a partial substitute for regulatory capital. Last year, we approved 40 subordinated loans worth nearly $5 billion, most of which were applied to enable the licensed corporations to carry out more IPO business.

The single licensing regime provides flexibility for industry participants to carry out various regulated activities under one licence. We provided them with guidance on licensing procedures through circulars, seminars and meetings with industry associations.

On product authorisation, we have a number of firsts. We are one of the first jurisdictions in the world to approve the sale of hedge funds to local retail investors. Last year we authorised three retail hedge funds, bringing the total to 13 with an aggregate net asset value of US$1.174 billion - an increase of 190% compared to the previous year.

We are the first regulator in the Asia Pacific region to have issued interim measures to facilitate the processing of UCITS III funds, which include a fast track procedure for funds that do not significantly change their investment policies. Up to 31 March 2005, we had authorised 384 UCITS III funds, representing over 82% of the applications received. Last year, we authorised the first ETF tracking an A-share index and proposed the relaxation of overseas investments for authorised REITs.

All these achievements are the result of our collective work over the last few years. They have reduced the overall levels of risk to investors in addition to facilitating industry development. Going forward, our focus will be less on monitoring the industry as a whole, and more on targeting individual risky firms and addressing conduct issues using a risk-based approach.

Safeguarding Investor Interests

Regulatory Action

Examination of Investment Advisers' Compliance Standards

We have been monitoring cases of mis-selling of financial products to investors in Hong Kong by investment advisers both in Hong Kong and overseas. In order to formulate an appropriate regulatory response, we conducted a theme inspection on a good mix of 15 licensed investment advisers, focusing on their selling practices and assessing their compliance with the relevant rules and regulations.

Based on the inspection findings and SFC's other investigations, we released the Report on Selling Practices of Licensed Investment Advisers in February 2005. We reminded all licensed investment advisers that they should adhere closely to the standards of conduct expected of them. We will further study some of the disclosure and investor protection issues identified in the report.

Review of Fund Managers' Business Practices

In tandem with global regulatory trends to discourage inappropriate market timing and late trading practices of fund managers, the SFC released the Report of the Survey on Fund Trading Practices in July 2004. It was the first such report published by a securities regulator in Asia.

The findings indicated that although market timing was not a widespread phenomenon in Hong Kong, our market is not immune to approaches by market timers who wish to exploit arbitrage opportunities through market timing and late trading activities, and that local fund managers are aware of the relevant issues.

In an inspection, supervision staff noted that First State Investment (Hong Kong) Limited (FSIL), being an investment manager and a Hong Kong Representative of the First State Global Umbrella Fund PLC, forwarded trades from two hedge funds to the Fund's overseas administrator for processing after normal trading hours. This action

Intermediaries & Investment Products

amounted to a technical breach of the dealing deadlines in the Fund's prospectus. In February 2005, FSIL settled the case with the SFC, without admission of fault or liability, by making financial arrangements to the affected parties and stepping up its internal controls and monitoring systems. We have reminded fund managers to ensure that appropriate measures are in place to monitor and prevent improper practices.

Misappropriation of Assets from an Unauthorised Hedge Fund

In June 2004, upon becoming aware that client assets were possibly being misappropriated from a hedge fund that was advised by Charles Schmitt & Associates Limited (CSAL), we issued a restriction notice to CSAL and obtained an injunction from the Court to preserve the assets in a timely manner. Shortly thereafter, the SFC obtained a court judgment to appoint an administrator for the property of the CEO of CSAL, Mr Charles Schmitt, in order to further protect the assets of the firm's clients. The fund was not SFC-authorised.

Compensation for Fund Investors

The Code on Unit Trusts and Mutual Funds sets out the circumstances under which investors should be compensated in the case of pricing errors that involve administrative errors on fund valuation or pricing. Last year, we investigated 37 cases of pricing errors and, in all cases, required the responsible fund managers to rectify the situation and enhance their internal controls. We required compensation be made to the funds and the investors involved in 28 cases.

Enhancing Investor Protection

Fit and Proper Licensees

Investors expect their financial needs to be served by professional and qualified persons and firms that meet the SFC's fit and proper standard. Those who do not meet this standard will not be licensed. During the past year, 84 licensing applications were withdrawn because they failed to meet our licensing requirements. We imposed specific licensing conditions on 1,918 new licensees to ensure that investors' interests and market integrity were adequately protected. We also revoked 38 bankrupt persons' licences as such individuals are not fit and proper to deal with investors.

Improving Transparency of Fees and Charges

We issued Guidelines on Disclosure of Fees and Charges Relating to Securities Services in November 2004 to supplement the Code of Conduct. The fees and charges are to be put in six categories and disclosed. The Guidelines came into effect in January 2005, placing investors in a better position to understand the fee structures of firms and thereby enhancing transparency and fair competition.

More Comprehensive Fidelity Insurance for Brokers

We successfully secured a better fidelity insurance scheme for 2004-2005 in partnership with an industry working group and by way of tender. This scheme offers an additional layer of protection to the clients of SEHK and HKFE participants. It was the first such scheme for HKFE participants. SEHK participants saved 35% in premiums compared with a year ago.

Raising Professional Standards

Addressing Analyst Conflicts of Interest

We published a code to address the issue of analyst conflicts of interest in November 2004. Taking into consideration IOSCO's guidelines, international developments and local market characteristics, the code aims to remove, reduce and manage conflicts faced by analysts and their firms. The code only came into effect in April 2005 to allow firms sufficient time to establish the necessary compliance systems.

Securities Margin Financing Reform

To provide more effective investor protection and to strengthen the overall regulatory framework for brokerage firms, the SFC released for public

consultation Proposed Measures To Address Risks Arising From Securities Margin Financing in September 2004. There are two principal measures, namely imposing a limit on the re-pledging of margin clients' collateral and adjusting the haircut percentages applied to margin clients' collateral under the Securities and Futures (Financial Resources) Rules.

All respondents generally accepted the rationale of the reform, which is to enhance investor protection. We provided a status report to the Legislative Council Panel on Financial Affairs in December 2004.

Enhancing Regulation of Sponsors and IFAs

We engaged an independent research centre to gather a comprehensive picture of the investing public's views on the regulation of listing sponsors. The investor survey findings report, released in March 2005, showed that:

- respondents have a fair understanding of a sponsor's role in the listing process;
- respondents are almost unanimous that sponsor standards need to be raised; and
- the majority of the respondents consider that the sponsor firm's internal controls and systems, human and organisational resources including staff competence and experience, are important factors affecting sponsor standards.

The findings will assist the SFC in formulating an enhanced regulatory framework for sponsors and Independent Financial Advisers (IFAs). We will consult the public on a specific set of eligibility criteria for sponsors and IFAs in 2005.

Anti-Money Laundering Initiatives

In order to meet operational changes and the latest international standards, we have comprehensively reviewed our anti-money laundering guidelines and plan to consult the public on proposed revisions in 2005. We issued 17 advisory circulars during the year to alert licensed corporations to persons designated by international bodies as terrorists.

Market Facilitation

Facilitating Intermediaries

Smooth Migration of Licensees to the New Licensing Regime under the SFO

At the end of the two-year transitional period on 31 March 2005, 96% of the firms registered under the previous regime had applied to migrate into the new regime in order to continue their business. The remainder had orderly exited the industry. Various initiatives were taken during the past year to ensure an orderly transition. We issued three circulars and seven letters to the intermediaries and obtained assistance from industry associations in reminding the licensees to meet the deadline. To ensure that investor interests are safeguarded, we also:

- approached 172 firms to understand their concerns and migration strategies;
- monitored the return of client assets by firms not migrating;
- informed the public about the progress of the migration, and advised investors to enquire about their intermediary's migration status and make alternative arrangements concerning their assets where necessary; and
- published in the public register the migration status of each intermediary.

Specialist Team for Hedge Fund Managers Applications

In light of the rapid growth of the hedge fund management industry, we set up a focus team in October 2004 to process applications and manage issues involving hedge fund managers to facilitate their applications. We had received 13 licence applications, of which seven had been approved.

Intermediaries & Investment Products

Others

We facilitated market development by flexibly applying our regulations. We approved 40 applications for subordinated loans and granted 59 modifications and waivers of certain regulatory requirements to intermediaries. We also approved four applications for associated entities to conduct other business in cases where we believed that investor protection would not be compromised.

To keep pace with industry development and foster better investor protection, we issued a consultation paper proposing amendments to Schedule 5 to the SFO. The proposals aimed to fine-tune the legal definitions of certain regulated activities, including asset management, dealing in securities, advising on securities and advising on futures contracts.

Product Facilitation

Processing of UCITS III Funds

Beginning from 2004, a major policy initiative has been the processing of UCITS III funds. UCITS III is a new set of regulations issued by the European Union (EU) Commission governing funds domiciled in the EU member states. Since many SFC authorised funds are domiciled in European jurisdictions, such as Luxembourg and Ireland, they are required to convert to meet the new EU regulations.

Up to 31 March 2005, we had authorised 384 UCITS III funds (including conversions), representing over 82% of the UCITS III fund applications received. We formulated interim measures with the fund industry, which include a fast track procedure for processing funds that meet all the necessary requirements and do not intend to significantly change their investment policies.

We also initiated an investor education programme to inform investors of the new investment flexibility offered under UCITS III funds. As a start, we issued FAQs in March 2005 to help investors understand the basic information about UCITS III funds.

Authorisation of REIT

During the past year, we licensed the first REIT management company and authorised the company's REIT, namely the Link REIT, which attracted about $280 billion in its Hong Kong public offering. While the offering of the Link REIT lapsed, all application monies (from about 510,000 investors) were refunded in a timely and orderly manner.

Overseas Investments for REITs

Following the publication of the Code on REITs in July 2003, a Taskforce on Overseas Real Estate Investments by Real Estate Investment Trusts was set up to study the regulation of overseas property investments by SFC-authorised REITs.

A public consultation paper was issued in March 2005 to lift the geographical restrictions on overseas investment by REITs and to give concrete guidance on the application of the Code principles to overseas property investments, with an emphasis on the competency of the management company, its due diligence and disclosures.

Fund Investments in Overseas REITs

Separately, as we recognise the growing importance of listed REITs as a separate asset class for investment, we consulted the public in February 2005 on a proposal to allow all SFC-authorised schemes to invest in listed REITs in accordance with the existing investment limits applicable to listed securities.

Review of Hedge Funds Guidelines

We intend to review the Guidelines on Hedge Funds and publish a consultation paper in the first half of 2005. We aim to clarify certain regulatory requirements, such as the assessment of the fund managers' experience, and to enhance disclosure standards among retail hedge funds.

Operational Functions

Licensing

In the second year of the SFO regime, the number of licence applications increased by 32% to 4,915 (Table 4). This could be attributed to the increased number of applications for fast tracked provisional licence from 1,511 in 2003-2004 to 2,477 in 2004-2005. Similar to previous years, dealing in securities accounted for the largest number of applications, followed by advising on securities.

Last year, we approved specialised courses to facilitate the re-entry by former practitioners who had left the industry for three to eight years. These courses are conducted by the Hong Kong Securities Institute (HKSI) for securities and futures, and the Vocational Training Council for leveraged foreign exchange. They serve as an alternative to taking licensing exams or attending five Continuous Professional Training (CPT) hours for each year of absence from the industry.

In addition, we approved the Hong Kong Polytechnic University's Management and Executive Development Centre and the Hong Kong Capital Markets Association as new CPT providers. Licensed persons now have a wider range of institutions to undergo CPT to enhance their technical knowledge and professional expertise. We also assisted the HKSI in implementing measures to improve its Licensing Examinations without lowering competence standards.

Applications for Licence/Regulated Activity
For the period from 1 April 2004 to 31 March 2005 (Previous year's figures in brackets)

Table 4

Applications	Business Corporations		Individuals: Representatives		Individuals: Responsible Officers		Total		%Change
	Licence		Licence		Licence		Licence		
Received	119	(61)	4,429	(3,396)	367	(275)	4,915	(3,732)	32%
Approved	110	(46)	4,316	(2,962)	317	(243)	4,743	(3,251)	46%
Refused	0	0	0	0	0	0	0	0	0%
Withdrawn	2	(11)	70	(117)	12	(16)	84	(144)	-42%
	Regulated Activity		Regulated Activity		Regulated Activity		Regulated Activity		%Change
Received	185	(118)	9,874	(5,673)	663	(619)	10,722	(6,410)	67%
Approved	160	(90)	9,706	(4,995)	550	(512)	10,416	(5,597)	86%
Refused	0	0	0	0	0	0	0	0	0%
Withdrawn	6	(32)	104	(218)	25	(33)	135	(283)	-52%

Intermediaries & Investment Products

Statistical Information on Securities Market [1]

5 Table

	As at 31/12/2004	As at 31/12/2003
Total number of active cash clients[2, 3]	609,281	687,802
Total number of active margin clients[2]	76,546	71,240
Balance Sheet	HK$ million	HK$ million
Cash in hand and at bank[4]	110,176	88,209
Amounts receivable from margin clients[5]	17,158	15,327
Amounts receivable from clients and other dealers arising from dealing in securities	65,357	63,261
Proprietary positions	77,777	55,189
Other assets	61,145	49,814
Total assets (+22%)	**331,613**	**271,800**
Amounts payable to clients and other dealers arising from dealing in securities	124,739	109,517
Total borrowings from financial institutions	56,264	36,786
Short positions held for own account	26,552	24,510
Other liabilities	47,068	37,556
Total shareholders' fund	76,990	63,431
Total liabilities and shareholders' fund (+22%)	**331,613**	**271,800**

	12 months to 31/12/2004	12 months to 31/12/2003
Profit and loss	HK$ million	HK$ million
Total value of transactions[6]	16,620,090	10,456,801
Net securities commission income	18,225	13,329
Gross interest income	2,555	2,034
Net profit on proprietary trading	1,494	1,565
Other income[7]	29,354	18,804
Total overheads and interest expense[8]	(38,800)	(28,944)
Net profit (+89%)	**12,828**	**6,788**

1. The above data were extracted from the monthly Financial Returns submitted in accordance with the Securities and Futures (Financial Resources) Rules by securities dealers and securities margin financiers.
2. Active clients are clients for whom the licensed corporation is required to prepare and deliver monthly statements of account in respect of the relevant reporting month in accordance with Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules.
3. The drop in number of active cash clients was primarily due to the surrender of the licence by a major licensed corporation that was formerly an exempt dealer.
4. Cash in hand and at bank includes trust monies held on behalf of clients amounting to $49,305 million (2003: $41,126 million).
5. 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 31/12/2004	As at 31/12/2003
4.6	4.2

6. The value of transactions includes trading in equities and bonds both in Hong Kong and overseas.
7. Other income mainly comprises corporate finance income, fund management income, net profit/loss on proprietary trading, inter-company charges and others.
8. Total overheads include salary and staff benefits paid to non-commission based staff of licensed corporations. Commission paid to account executives and others has been netted off with commission income to arrive at the net securities commission income.

	12 months to 31/12/2004 ($ million)	12 months to 31/12/2003 ($ million)
Salary and staff benefits	19,786	14,634

Supervision

By flexibly applying the regulatory tools under the SFO, we worked with a number of firms to improve their capital adequacy and liquidity, and raise their professional standards.

We inspected 170 firms and carried out 62 prudential meetings.

During our inspections, we identified various breaches of rules and regulations and required the firms to take prompt rectification measures (Table 6).

Inspections are conducted not only as a means of detecting breaches, but also to help intermediaries maintain and raise their standards. Thus, while breaches of criminal provisions in the SFO and serious misconduct will be referred to the Enforcement Division for investigation and further action, we issue letters of deficiencies in cases of less serious and technical infractions of rules and regulations.

We have also been working with targeted intermediaries to find ways to strengthen their financial positions and internal controls, as well as to rectify improper business practices. Discussions with senior management to focus their attention on addressing our concerns have yielded positive results in most cases.

To enhance the transparency of financial information about the securities industry, we published the Quarterly Financial Review of the Securities Industry and the Half-Yearly Financial Stability Report. These regular publications provide useful analyses on the overall financial performance of the securities industry.

Breaches by Licensed Corporations Noted During SFC Inspections

Table 6

Nature of Breaches	Total Number of Breaches 2004-2005	2003-2004
Failure to comply with Financial Resources Rules	17	38
Failure to safekeep client securities	32	34
Failure to maintain proper books	20	21
Failure to safekeep clients' money	25	33
Unlicensed dealing & other registration issues	20	14
Breach of licensing condition	4	3
Breach of requirements of contract notes/statements of account/receipts	48	72
Failure to make filing/notification	5	3
Breach of margin requirements	6	8
Marketing malpractices	3	4
Illegal short selling of securities	1	2
Breach of Code of Conduct	280	253
Breach of Code on Unit Trusts & Mutual Funds	2	0
Breach of Corporate Finance Adviser Code of Conduct	6	2
Breach of Fund Manager Code of Conduct	16	18
Non-compliance with anti-money laundering guidelines	10	30
Breach of other rules and regulations of the Exchanges	7	5
Internal control weaknesses	201	226
Others	37	44
Total	**740**	**810**

Intermediaries & Investment Products

As part of ongoing education, we reminded our intermediaries in a circular to comply with the telephone-recording requirement. In addition, we issued 26 circulars about current industry issues such as ways to combat fake websites, advice to firms offering IPO financing, alerts regarding fraudulent activities targeting brokerage firms, and issues relating to anti-money laundering and combat of terrorist financing.

Investment Products Authorisation

As at 31 March 2005, the total number of SFC authorised investment products available to the public stood at 2,553, a 5.8% increase from last year's 2,414. While standard bond and equity funds still comprised the bulk of the funds population, specialised investment products such as guaranteed funds remained popular over the past year.

At the year-end, there were 309 authorised guaranteed funds, compared to 244 a year ago. The SFC authorised three more hedge funds during the year, bringing the total to 13, with an aggregate net asset value of US$1.174 billion, an increase of 190% compared to the previous year.

Issuers are required to seek our approval on any advertisements or marketing materials of authorised products before they are issued to the public. In the past year, we authorised 5,981 product advertisements.

Amidst positive market sentiment and improved investment environment, the aggregate net asset value of all authorised unit trusts and mutual funds rose 3.2% during the year to US$551 billion as at 31 December 2004 (Table 7). Funds authorised in Hong Kong continued to show a strong international flavour (Table 8).

We have closely monitored the recent development of retail funds that offer exposure to the A-share market in China. The first ETF tracking an A-share index was authorised in November 2004. Up to 31 March 2005, the SFC had authorised six equity funds with an investment policy to participate in the A-share market, most of which investing indirectly in A-shares via equity-linked investments issued by QFIIs.

The annual Fund Management Activities Survey was conducted in early 2004. Unlike previous years where the survey covered only licensed corporations that were engaged in asset management or advisory business, we invited, for the first time, authorised financial institutions to report on their asset management and other private banking activities. The survey found that total assets under management or advice in the fund management business in Hong Kong amounted to about $3 trillion as at the end of 2003.

Authorised Unit Trusts and Mutual Funds as at 31 March 2005

Table 7

	Number	%	Total NAV* (US$ million)	%
Bond	303	17	112,486	20.4
Equity	884	50	272,962	49.5
Diversified	111	6	38,433	7.0
Money Market	56	3	94,540	17.2
Fund of Funds	76	4	4,813	0.9
Index	19	1	7,362	1.3
Guaranteed	309	17	18,403	3.3
Hedge	13	1	1,174	0.2
Other specialised#	7	1	1,046	0.2
	1,778	100	551,219	100
Umbrella structures	164			
No. of Authorised Funds	**1,942**			

* Net Asset Value as at 31 December 2004
\# Includes: Futures & Options Funds & Leveraged Funds

Origin/Net Asset Value of Authorised Unit Trusts and Mutual Funds as at 31 March 2005

Table 8

	Umbrella Number	Sub-funds Number	Single Funds Number	Total Number	%	Total NAV* (US$ million)	%
Hong Kong	15	55	31	101	5.2	8,355.4	1.5
Luxembourg	54	826	10	890	45.8	361,825.3	65.6
Ireland	43	312	16	371	19.1	110,225.0	20.0
Guernsey	3	32	1	36	1.9	2,843.5	0.5
United Kingdom	2	38	8	48	2.5	30,448.2	5.5
Other Europe	0	0	8	8	0.4	6,481.8	1.2
Bermuda	2	22	8	32	1.6	2,732.8	0.5
British Virgin Islands	5	12	9	26	1.3	1,928.6	0.4
Cayman Islands	39	332	50	421	21.7	24,933.6	4.5
Others	1	1	7	9	0.5	1,445.1	0.3
No. of Authorised Funds	**164**	**1,630**	**148**	**1,942**	**100**	**551,219.3**	**100**

* Net Asset Value as at 31 December 2004 (excluding "umbrella funds")

Enforcement

Our mission is to protect investors and uphold the integrity of the Hong Kong markets by deterring unlawful or improper activities through effective surveillance and enforcement.

[Achievements]

- Negotiated a record ex-gratia payment to investors of $255 million by an investment adviser
- Reached a record $30 million settlement with a sponsor
- First Dual Filing prosecution against a listed company and its director for providing false and misleading information
- Substantially concluded five cases before the Insider Dealing Tribunal
- Successfully prosecuted 76 entities for various offences, including a record high of nine market manipulators
- Concluded 99 disciplinary inquiries and took action against 88 licensees or concerned persons
- Referred 31 cases of fraud to the Police
- Concluded 553 investigations of which 394 were completed within 12 months

[This Chapter Is About]

- Surveillance
  - Unusual price movements and trading
  - Market trading practices
  - Disclosure of interests
- Investigations
  - Listed companies
  - Market misconduct including insider dealing and market manipulation
  - Cold calling
  - FRR breaches
  - Failing to assist investigations
  - Unlicensed activities
  - Disclosure of interests
  - Others
- Discipline
  - Disciplinary priorities
  - Workload and penalty trends
  - Appeals
  - Settlements
- Co-operation with other law enforcement agencies and regulators

Investors First

Lingnan University's Ms Lina Chau has taken a credit course on financial investing jointly offered by the SFC and the university.

Mr Chan Sum, 82, is a winner of a phone-in quiz in the Invest Wisely for Seniors radio programme.

Engineer Mr Leung Man Yan has shifted his investment focus from stocks to funds, as he is looking for a more stable return.

What We Do

- Monitor the trading of Hong Kong's stock and derivative markets and inquire into irregularities;
- Inspect books and records of listed companies if impropriety is suspected;
- Enforce laws relating to the securities and futures industry, leveraged foreign exchange trading, and collective investment schemes;
- Discipline dishonest, incompetent and financially unstable regulated intermediaries;
- Report suspected civil market misconduct to the Financial Secretary;
- Suppress illegal or improper trading practices and irregularities relating to collective investment schemes and the provision of advice or other financial services;
- Enforce disclosure of interests of substantial shareholders, directors and chief executives of listed companies; and
- Co-operate with domestic and overseas regulatory bodies in local and overseas investigations.

What We Did

In 2004-2005, we saw a considerable increase in the number of cases being dealt with under the SFO and more sanctions being imposed under the SFO as we concluded cases that predated 1 April 2003.

We continued to prioritise areas which would have the greatest impact on our statutory objectives and our duty to protect investors. Our record achievements this year confirmed that approach. At the same time, we maintained high standards of forensic work and procedural fairness.

Our priorities for investigations were to combat corporate misgovernance, market misconduct and delinquent intermediaries. On discipline, our priorities were sponsors, investment advisers, fund managers and serious conflicts of interest.

Surveillance

Unusual Price Movements and Trading

Our Surveillance Department is responsible for monitoring day-to-day trading in Hong Kong's securities and futures markets. With the help of sophisticated computer systems, we identify and inquire into unusual price and turnover movements.

In cases of suspected market manipulation, insider dealing or dissemination of false or misleading information, we obtain trading details from brokers to conduct preliminary assessments. We surf the Internet to detect possible unlicensed dealing, unauthorised advertising of investment services, or other abnormal financial activities. Our daily surveillance programme also actively monitors the media for reports of improper activities. Suspicious activities are reported to the Investigation Department.

Where we suspect there is a possible false or misleading announcement and if the situation warrants, we will recommend the suspension of trading in a listed company on the SEHK. During the year, we exercised this power twice. One of the stocks remains suspended while the other has resumed trading after making a clarification announcement.

Enforcement

In addition, there were 280 other trading suspensions owing to unusual price or volume movements. Two of them were directed by HKEx because the management could not be contacted for clarification of potentially price sensitive matters. These matters are subject to further investigation. The other suspensions were requested by the companies concerned following inquiries by HKEx or the SFC. These suspensions were usually lifted on the day after the companies released news which might have an impact on their stocks, or statements that they were unaware of the reason for the unusual movements.

During the year, we conducted 142 inquiries into untoward share price and volume movements in which we sought trading records from brokers. On many occasions our early inquiries explained the untoward movements or stopped the potentially improper trading activities. Nevertheless, 40 cases were subject to full investigation.

Market Trading Practices

In early 2004, we investigated unusual trading activities relating to share placements of listed companies. We found that some placing agents might have acted inappropriately when testing market response to a pending placement. Specifics including the amount of money to be raised and the indicative price level of the placement shares were revealed to selected clients during trading hours, while the actual placing exercise commenced after the close of the market. This privileged information allowed the recipients to benefit in trading the concerned securities and created an unequal market. We inquired into eight such cases. Two cases are still under investigation. The rest were concluded with no further action. In May 2004, we issued a press release reminding market practitioners of the importance of maintaining an equally informed market and to avoid passing potential insider information while conducting their placement activities.

2004-2005 witnessed an explosive growth in the level of activity in the derivative warrants market. We looked into allegations about possible market manipulative activities by issuers. While some complaints reflected a lack of understanding by retail investors about the characteristics of warrants, particularly those of an exotic nature, we identified cases where an abnormally high level of day trading activity by individuals did not appear to be driven by profit motives. This called into question whether these trades were to create a false appearance of active trading. In July 2004, the SFC reminded investors to exercise caution in choosing derivative warrants.

We also looked into the Macau concept stocks frenzy in the second half of 2004. We focused on market manipulation and false or misleading company announcements. We initiated 24 inquiries involving 23 listed companies. Most cases are still under consideration.

Disclosure of Interests

HKEx refers late filings of disclosure of interests to the SFC. From time to time, while conducting other inquiries, we may identify cases of failure to disclose. These breaches are assessed on a case-by-case basis. Where relevant information has been disclosed publicly, the transaction usually will not attract any further SFC action. Minor and first time offenders are usually warned. Serious cases may be prosecuted.

In the second year of implementing the SFO, both listed companies and investors had become more

familiar with the disclosure requirements. The number of late filings dropped from 6,608 in 2003-2004 to 4,185 last year. During the year, disclosure failures that warranted full investigation also dropped from 36 cases to 30 cases.

Investigations

Last year, we continued 546 investigations from 2003-2004. Another 501 new cases were opened as a result of information from sources including the public, other law enforcement agencies, HKEx and foreign regulators. Out of these 1,047 cases handled, 553 were concluded and the remaining 494 were subject to continuing investigations, hearings or prosecutions.

Listed Companies

We reported in 2003-2004 that we were considering seeking orders under section 214 of the SFO (including orders disqualifying directors) in two company investigations. We discontinued one case because of Police action against the company. Our action against the other is imminent. Meanwhile, we are taking legal advice on seeking section 214 orders in a case that came to light last year.

Altogether we investigated 23 cases involving listed companies in 2004-2005, including 11 cases carried forward. Five cases were referred to the Police for further investigation (one of which simultaneously under SFC investigation). As a result of one such referral the Police searched a listed company, Tungda Innovative Lighting Holdings Limited and its senior management, which the media widely reported. Three cases were referred to HKEx, and two were written off.

During the year, we successfully prosecuted a listed company and its director for providing false or misleading announcement to the public (Table 1). We have a similar matter before the Courts and are taking legal advice as to whether we have sufficient evidence to prosecute in another case.

Successful Prosecutions – Provision of False or Misleading Information — Table 1

Case	Defendants	Date of Conviction	No. of Summonses Involved	Fine ($)	Costs of Investigation Awarded($)
1	Cai Yang Bo	22.09.04	1	50,000	28,000
	Huafeng Textile International Group Ltd	22.09.04	1	50,000	
Total:2 entities		**2**	**2**	**100,000**	**28,000**

Market Misconduct

Our determination to combat market misconduct is evidenced by both the number of matters heard by the Insider Dealing Tribunal (IDT) and the number of successful market manipulation prosecutions during the year.

In addition to the cases we prosecuted, the Police Commercial Crime Bureau was successful in securing a three-month custodial sentence for a person found guilty in the District Court of manipulating Wing Lee Holdings Limited shares. This case was referred by the SFC to the Police.

In the coming year, the ICAC will be prosecuting parties involved in the alleged manipulation of Shanghai Land Holdings Limited shares. Our staff have provided significant assistance in terms of data analysis and will give expert evidence in the trial.

Enforcement

Insider Dealing

In 2004-2005, the IDT substantially completed five hearings relating to Firstone International Holdings Limited, Chinney Alliance Holdings Limited, HKCB Bank Holdings Company Limited/Lippo China Resources Limited/Lippo Limited, Gilbert Holdings Limited and Siu Fung Ceramics Holdings Limited. However, the final findings in respect of HKCB Bank/Lippo China Resources/Lippo and Gilbert are awaited and there are outstanding matters to be concluded in respect of Siu Fung Ceramics (Table 2).

In the Firstone inquiry, four persons were found to be insider dealers. They were ordered to pay penalties, disgorge profits and pay costs totalling $16.1 million. They were banned from being directors of any listed company for two to five years. One of them appealed against the penalty and the date of appeal hearing will be fixed this year.

An insider dealer in the Chinney case was ordered to pay penalties etc totalling $3.8 million and banned for four years. Rulings on the other two concluded cases are expected in the coming year.

In the Siu Fung inquiry, the IDT held that the company's former chairman and four related persons had engaged in insider dealing. Penalties, profits disgorgement and costs amounting to $250 million were imposed on four of the insiders.

In 2004-2005, the IDT commenced an additional two inquiries, namely Asian Orient Holdings Limited and Easy Concepts International Holdings Limited. These hearings continue. The hearing of four more inquiries might take place in the coming year.

We investigated 11 cases carried forward and three new cases. We referred two cases to the Financial Secretary for consideration of the appointment of an IDT. We concluded four cases with no further action and investigations continued in the remaining eight cases.

Market Manipulation

We are encouraged by the successful prosecution of eight people and one company in the Courts for manipulating the shares of MUI Hong Kong Limited (Case 1 in Table 3), Fortuna International Holdings Limited (Case 2), Fujikon Industrial Holdings Limited (Case 3), Tern Properties Co Limited (Case 4), Tradeeasy Holdings Limited (Case 5) and Sino Technology Investment Limited (Case 6). The record nine convictions compared to seven in the previous year.

Penalty Ordered by IDT on Insiders

Table 2

Case	Insider Dealers	Shares of Listed Company	Date of Judgement	Disgorgement of Profit ($)	Penalty ($)	Cost ($)	Bar from Being a Director
1	Huang Xiao Jiang James	Firstone International Holdings Ltd	08.07.04	3,219,981.71	3,219,981.71	2,161,588.77	5 years
	Chiu Yuen Man*			379,647.89	2,371,341.41	1,080,794.39	3 years
	Chow Kar Chun Eddie			–	1,404,426.95	720,529.59	3 years
	Kwan Lai Sheung			687,846.56	687,846.56	720,529.59	2 years
	4 entities		**Total**	**4,287,476.16**	**7,683,596.63**	**4,683,442.34**	
2	Lee Siu Fung	Siu Fung Ceramics Holdings Ltd	08.11.04	69,870,530	139,741,060	9,185,356	5 years
	Chan Kwong Tat			–	13,925,337	2,296,339	1 year
	Lisa Lam Lai San*			1,910,297	1,910,297	2,296,339	1 year
	William Lam Chun Ming*			1,910,297	1,910,297	2,296,339	1 year
	Tai Hon Leung Henry*				to be ordered		
	5 entities		**Total**	**73,691,124**	**157,486,991**	**16,074,373**	
3	Lau Chung Yin	Chinney Alliance Holdings Ltd	24.12.04	1,318,486	700,000	1,800,000	4 years
	1 entity		**Total**	**1,318,486**	**700,000**	**1,800,000**	
Total: 10 entities				**79,297,086.16**	**165,870,587.63**	**22,557,815.34**	

* Under appeal

Successful Prosecutions – Market Manipulation Table 3

Case	Defendants	Date of Conviction	No. of Summonses Involved	Fine ($)/Penalty	Costs of Investigation Awarded($)
1	Chung Man Keung	09.06.04	10	2-month imprisonment suspended for 2 years and a fine of $20,000	21,959
2	Han Sze Chao Richard	28.07.04	1	25,000	29,276
	Super Glory International Ltd	28.07.04	1	25,000	
3	Wong Pui Ming	01.09.04	1	2-month imprisonment, suspended for 2 years and a fine of $5,000	10,000
	Ho Sze Man	15.09.04	1	10,000	20,000
	Yuen Kim Shing	15.09.04	1	10,000	20,000
4	Chow Lung On	01.11.04	1	15,000	15,226
5	Leung Tung Wa	15.11.04	1	5,000	44,390
6	Wan Wai Chi	24.02.05	5	120 hours of community service	15,941
Total: 9 entities			22	115,000	176,792

We are confident that a comparable number of cases will be heard in 2005-2006. We have three cases awaiting trial or judgment and another five awaiting legal advice and clearance to prosecute. One of these cases relates to attempted manipulation of the pre-opening price of index futures.

All these offences took place before the introduction of the SFO. The SFO has introduced harsher penalties. It is also encouraging to note that the Magistrate in the Fujikon case warned one defendant that he would have been jailed if he had not pleaded guilty.

Market Misconduct Tribunal

The SFO introduced an alternative civil route, via a Market Misconduct Tribunal (MMT), to deal with all types of market misconduct including insider dealing. Legal advice is being sought on two cases where we think a referral to the MMT is warranted. Investigations have been completed in four others where a referral will also be considered.

Accordingly, we are optimistic that the MMT can commence hearing its first case in the coming year. Nevertheless, we will follow the criminal route of prosecution where there is sufficient evidence and prosecution is in the public interest.

Cold Calling

Cold calling is prohibited so investors are not pressured into trading. Often clients recruited by such means complain of having been obliged to depend upon the advice of the Account Executive who persuaded them, on the basis of incomplete information, to open and lock more contracts than was necessary. We prosecuted three people for hawking of futures contracts (Table 4). Subject to legal advice, there may be six more prosecutions, and disciplinary actions.

Successful Prosecutions – Hawking of Futures Contracts Table 4

Case	Defendants	Date of Conviction	No. of Summonses Involved	Fine ($)	Costs of Investigation Awarded($)
1	Shiu Yau Wah	21.04.04	1	5,000	10,000
2	Lam Shuk Kuen Mean	30.09.04	3	7,500	8,158
	Lau Chun Kwok	30.09.04	2	5,000	8,363
Total: 3 entities			6	17,500	26,521

Enforcement

FRR Breaches

Four persons and four companies were prosecuted for Financial Resources Rules (FRR) related breaches (Table 5). They provided false or misleading information to the SFC or failed to notify the SFC of liquid capital deficiencies. Two persons were sentenced to suspended imprisonment.

Successful Prosecutions – FRR Breaches

Table 5

Case	Defendants	Date of Conviction	No. of Summonses Involved	Fine ($)/ Penalty	Costs of Investigation Awarded($)
1	Pacific Pearl Securities Ltd	02.04.04	2	12,100	–
	Cheng Kwok Cheung	02.04.04	2	3-month imprisonment, suspended for 2 years	–
	Pacific Pearl Futures Ltd	02.04.04	1	16,000	–
	Yung Ki Cheong	02.04.04	2	2-month imprisonment, suspended for 1 year	81,747
2	Upbest Investment Co Ltd	14.06.04	5	25,000	59,213
	Choy Ye King Andy	14.06.04	3	6,000	–
3	Evergreen Securities Ltd	16.06.04	5	20,000	14,295
	Cheng Hok Wai	16.06.04	5	20,000	
Total: 8 entities			25	99,100	155,255

Failing to Assist Investigations

Two persons were convicted of failing to co-operate with SFC investigations (Table 6). People hindering SFC investigations undermine our effort to curb illicit activities that threaten Hong Kong's markets. The SFC will not hesitate to prosecute these offenders.

Successful Prosecutions – Failing to Assist Investigations

Table 6

Case	Defendants	Date of Conviction	No. of Summonses Involved	Fine ($)	Costs of Investigation Awarded($)
1	Xu Li	08.09.04	4	40,000	3,000
2	Wan Wai Chi Katherine	30.09.04	3	30,000	12,296
Total: 2 entities			7	70,000	15,296

Unlicensed Activities

During the year, 12 people and two companies were prosecuted for different types of unlicensed activities, including aiding or abetting (Table 7).

Successful Prosecutions – Unlicensed Activities

Table 7

Case	Defendants	Date of Conviction	No. of Summonses Involved	Fine ($)	Costs of Investigation Awarded($)
Unregistered Dealing in Margin Financing					
1	Wong Chung Ling	06.04.04	1	12,000	12,560
	1 entity		**1**	**12,000**	**12,560**
Unregistered Dealing in Securities					
1	Cheung Tak Shun Dickson	28.10.04	1	2,500	5,000
2	Chang Kit Sun Lama	12.11.04	1	2,500	10,700
	2 entities		**2**	**5,000**	**15,700**
Unregistered Investment or Corporate Finance Advising					
1	CSF Consultancy Ltd	07.05.04	1	4,000	–
	Chan Wing Chuen Freeman	07.05.04	2	10,000	–
2	Chiang Chip Man Andrew	01.09.04	1	5,000	5,000
	Lai Dick Wai	01.09.04	1	5,000	5,000
3	Wong Lee Chun	10.11.04	1	3,000	12,601
4	Tsoi Leung Po	06.01.05	1	2,000	2,540
5	MCC Capital Consulting Ltd	10.03.05	1	5,000	13,131
	7 entities		**8**	**34,000**	**38,272**
Unlicensed Forex Trader					
1	Yip Sheung Chi	01.09.04	1	8,000	10,000
2	Tsang Wai Lin	13.12.04	2	60,000	–
	2 entities		**3**	**68,000**	**10,000**
Unauthorised Advertisement					
1	Ko Wai Yu	14.10.04	2	10,000	4,500
2	Li Ping Hei Benjamin	10.11.04	1	5,000	12,601
3	Tsoi Leung Po	06.01.05	7	14,000	17,785
	3 entities		**10**	**29,000**	**34,886**
Total: 14 entities			24	148,000	111,418

Disclosure of Interests

In 2004-2005, 17 people and 13 companies were prosecuted for material breaches (Table 8). We issued 154 warning letters for minor and inadvertent breaches.

Successful Prosecutions – Disclosure of Interests

Table 8

Case	Defendants	Date of Conviction	No. of Summonses Involved	Fine ($)	Costs of Investigation Awarded($)
1	Value Partner Ltd	07.04.04	4	16,000	29,225
2	Deng Chi Yuan	07.04.04	11	55,000	6,967
3	Leung Kin Man Kenny	23.06.04	2	5,000	10,000
4	Page Louis	23.06.04	2	5,000	6,542
5	Mong Man Wai William	30.08.04	2	5,000	13,578
6	Cheung Choi Chuen	01.09.04	2	7,000	3,500
7	Choo Yeow Ming Summers Overseas Ltd	01.09.04 01.09.04	4 4	4,000 4,000	13,339
8	Ng Kwok Kuen	22.09.04	6	15,000	8,000
9	Yeung Ka Sing Carson	27.09.04	14	43,000	7,398
10	Lee Shi Tat Caric	30.09.04	2	3,000	8,112
11	South China Holdings Ltd South China Industries Ltd South China Industries (BVI) Ltd Wah Sing International Holdings Ltd Man Wah Trading Ltd	07.10.04 07.10.04 07.10.04 07.10.04	4 2 2 2 4	8,000 4,000 4,000 4,000 8,000	12,991 – – – –
12	Wong Man Hung Patrick	14.10.04	4	10,000	5,000
13	Lo Wai Shing Felix	28.10.04	1	5,000	38,177
14	Tsui Muk Lan	28.10.04	9	18,000	16,033
15	Sky Victory Ltd Siu Wai Keung	09.11.04 09.11.04	1 2	2,000 4,000	– 10,000
16	SinoPac Capital Ltd	25.11.04	6	12,000	10,000
17	Kuk Po Shun	25.11.04	4	10,000	4,500
18	Shu Kwan Long	16.12.04	2	4,000	9,500
19	Modern World Resources Ltd	24.02.05	4	10,000	3,500
20	Leung King Keung Lee Wing Ngai	03.03.05 03.03.05	2 8	4,000 22,000	10,821 17,094
21	Linefan Technology Holdings Ltd	10.03.05	2	2,000	4,479
22	China Conservational Power Holdings Ltd	24.03.05	12	9,000	9,765
23	Montgomery Properties Holding Ltd	31.03.05	3	9,000	21,000
Total: 30 entities			127	311,000	279,521

Others

A licensed corporation and its responsible director were prosecuted for pledging clients' securities without their approval. A person and a company were prosecuted for unauthorised investment promotion and three persons for short selling. Three persons were prosecuted for providing false or misleading representation in applications for SFC licences, and a company for issuing share subscription forms without a prospectus (Table 9).

Successful Prosecutions – Others

Table 9

Case	Defendants	Date of Conviction	No. of Summonses Involved	Fine ($)/ Penalty	Costs of Investigation Awarded($)
Pledging Clients' Securities without Obtaining Clients' Prior Approval					
1	Victory Securities Co Ltd	31.03.05	2	5,000	5,547
2	Kou Kuen Katerine	31.03.05	2	5,000	5,546
	2 entities		**4**	**10,000**	**11,093**
Breach of Protection of Investors Ordinance					
1	CSF Consultancy Ltd	07.05.04	1	6,000	–
	Chan Wing Chuen Freeman	07.05.04	1	80 hours of community service	–
	2 entities		**2**	**6,000**	
Short Selling					
1	Wong Chi Wai	25.08.04	9	54,000	10,560
2	Suen Chi Keung	15.09.04	15	75,000	12,917
3	Fung Wing Kwong	10.03.05	2	10,000	9,152
	3 entities		**26**	**139,000**	**32,629**
Provision of False or Misleading Representations in application for an SFC license					
1	Wong Chi Cheong	12.05.04	1	5,000	5,000
2	Yuen Pak Kan	03.02.05	1	10,000	9,000
3	He Zhao Danny	03.02.05	1	10,000	10,000
	3 entities		**3**	**25,000**	**24,000**
Issue Application Forms for Shares in a Company without a Prospectus					
1	Delta Asia Securities Ltd	03.02.05	1	15,000	8,000
	1 entity		**1**	**15,000**	**8,000**
Total: 11 entities			36	195,000	75,722

Enforcement

During the year, the SFC successfully prosecuted 76 entities in total. There were six acquittals after trial.

Discipline

Intermediaries play a crucial role in Hong Kong's financial markets. It is essential that they are honest, efficient and financially sound. We take tough disciplinary actions against those who put their clients' interests and market integrity at risk.

Disciplinary Priorities

Last year we made sponsors, investment advisers, fund managers and serious conflicts of interest our priorities. We achieved notable results in each area with some record outcomes.

Sponsors of listed companies are gatekeepers who help ensure that only suitable companies are listed and that the disclosure of information to investors is adequate. Recent failures by listed companies focused public attention on the role of sponsors.

During the year, the SFC concluded action against ICEA Capital Limited, the sponsor of Euro Asia Agricultural (Holdings) Company Limited. In a landmark settlement, ICEA paid $30 million without admission of liability, and agreed to an internal control review.

In the first joint disciplinary action with HKEx against a sponsor, the SFC settled an action against Oriental Patron Asia Limited and Mr Rabo Leung Chin Sing with each agreeing not to act as sponsors for five and nine months respectively.

Two more cases against sponsors, including one significant action, will likely be concluded in 2005-2006.

Investment advisers play an increasingly important role in helping investors manage their wealth. However, recent events suggest that some are not discharging their role competently.

We settled disciplinary action against Towry Law (Asia) HK Limited with Towry Law promising to make record $255 million ex-gratia payments to clients whom they had advised to invest in two failed hedge funds. We also reprimanded Towry Law. We concluded a settlement with another investment adviser for mis-selling mutual funds, which resulted in a three-year suspension effective on 15 April 2005.

Fund managers help channel investors' savings, providing diversified investment opportunities as an alternative to direct investment in equities and other products. They are entrusted with vast sums of money. We have increasingly focused on fund managers' compliance failings in line with global attention on the issue.

We reprimanded Asia Insurance (Pensions Fund) Limited and Bank Consortium Trust Company Limited for failures to abide by fund investment restrictions and to monitor compliance with those restrictions, respectively. We suspended the licence of a responsible officer of Asia Insurance, Mr Wong Kok Ho, for four weeks.

We also settled allegations against fund manager First State Investments (Hong Kong) Limited of compliance failings that might have facilitated late

trading. First State agreed to make ex-gratia payments to the funds concerned and waived fees without admission of liability. These were relatively technical breaches and we warned the industry that we would take harsher action in more serious cases.

Licensees occupy a position of trust with their clients. We expect them to avoid conflicts of interest and put the interests of their clients first in the event of a conflict. Some licensees ignored these cardinal rules.

We settled with Ms Irene So Wai Yin, who surrendered her licence for five years. She had failed to disclose enough information to clients when borrowing from them for her firm's parent company, which was in financial trouble. We suspended the licence of Mr Eric Wong Wing Fai for 18 months for front-running research reports he issued. This was the first such enforcement action in Hong Kong. We will take action in a similar case this year.

We have sought to use our resources more efficiently by exercising regulatory balance, taking a tougher approach towards more serious cases and a flexible approach towards less serious ones.

We have done this in three ways. First, we have been more flexible in settlements (see discussion later in this chapter). Second, we issued private warnings, where we thought that the public interest did not demand formal punishment, so we could show a degree of leniency while still sending a message that conduct was wrong. Lastly, we have begun to meet with licensees in appropriate cases where penalties are fairly standard, before we decide to take formal disciplinary action. We hope to dispose of these cases more quickly by encouraging rational settlement negotiations where the parameters for settlement are more predictable for us and defendants.

Workload and Penalty Trends

Even in the face of a record number of appeals and some very complex cases, we maintained the existing case load.

In 2004-2005, we conducted 209 disciplinary inquiries. Of these, we concluded 99 cases, disciplined 78 entities. We entered into settlements without formal sanctions with 10 licensees, of which four were settled with voluntary payments. We also took disciplinary actions against 28 licensees which were eventually concluded with no formal sanction imposed, although 15 of them received private warnings.

In addition, we started disciplinary action against four deemed licensees who left their firms before the action ended. Under the SFO transitional provisions, these people lost their licences and we have no jurisdiction over them. However, they must answer our concerns and satisfy us that they are fit and proper if they re-apply for a licence.

We continued the previous year's trend to impose higher penalties, and we increasingly used the new sanctions available under the SFO, in particular fines. We suspended more licensees and suspensions were generally longer.

We revoked two licensees, one of them we also banned him for 10 years. We banned another licensee for life. We accepted the surrender of a

Enforcement

licence and an undertaking not to re-apply for five years. We suspended 37 licences. We reprimanded and fined nine licensees amounts between $14,000 and $375,000. We reprimanded 29 licensees and privately warned 48, including the 15 mentioned above and those whom we warned without initiating formal disciplinary inquiries. Table 10 highlights the most significant actions.

We will keep the level of penalties under review to ensure that they secure appropriate regulatory outcomes by remaining proportionate, protective and dissuasive.

Appeals

During the year, the Securities and Futures Appeals Tribunal (SFAT) received a record 18 appeals against SFC disciplinary actions and five appeals were carried forward from last year. The SFAT heard eight of these cases. Two appeals were withdrawn by the appellant and seven appeals were settled before a full hearing.

Of the eight cases decided by the SFAT, it dismissed three appeals. In five appeals, the SFAT accepted our findings of fact but reduced the penalties, substantially in three appeals and only slightly in the other two.

At the end of the year, we awaited the decision in one appeal and five appeals were awaiting full hearing, though four of these appeals were related and to be heard together. Among the appeal settlements, two were effective on 15 April 2005.

In total, the SFAT upheld our decision to discipline eight licensees. The withdrawal of two appeals and settlement of seven with acceptable settlements suggest that we are getting our disciplinary decisions generally right. Out of the 15 appeals decided or settled, there were substantial penalty reductions in only three cases. As the majority of appeals were decided by the presiding judge and independent lay members, the results indicate a satisfactory degree of outside acceptance of our findings of fact and penalties.

The SFAT was designed to decide appeals quickly and is doing so. Its predecessor, the Securities and Futures Appeals Panel, never heard this number of appeals or decided them so fast. Given the SFAT's speed of decision and the simplicity of procedures, it is proving an inexpensive means of challenging decisions, with individuals appearing unrepresented in a number of appeals, but still capably arguing their cases with the SFAT's assistance.

The SFAT gives useful guidance on how it decides appeals. In two appeals, it stated that the SFC had flexibility to adjust penalties to suit changing circumstances and should not be bound by previous penalties which were too low by present standards. The SFAT also confirmed that SFC disciplinary decisions should have a deterrent effect and that it would give less weight to mitigating factors than was the case in criminal sentencing. Lastly, the SFAT indicated that repeat offenders should be punished more harshly.

During the year, some commentators expressed doubt over the SFAT's function as an effective check and balance on SFC's disciplinary powers, in part because they suggested that the SFAT only reviewed the SFC's procedure and not the merits of cases. They suggested a need for greater industry participation in the disciplinary process.

A review of the SFAT's decisions should dispel these notions. The SFAT is reviewing the merits of decisions. It has, on one occasion, held a full *de novo* hearing (i.e. it heard the case anew). It is also

Significant Actions

10 Table

Case	Registrants	Date of Action	Misconduct	Action/ Settlement/ SFAT Decision
1	Raphael Blot	13.05.04	Alleged use of schemes to circumvent the then placing requirements of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Ltd.	SFC originally decided to suspend Blot for six months. Blot appealed to the SFAT and was granted leave for judicial review. The proceedings were withdrawn as part of a settlement that Blot consented to pay the SFC, on a without admission of liability basis, $750,000. The SFC withdrew its decision to suspend Blot.
2	Chow Yuk Wah	21.05.04	Pledging clients' shares to a bank for personal loan without clients' consent; sold the shares and misappropriated the sales proceeds.	Revocation.
3	Wong Wing Fai Eric	02.08.04	Failure to avoid a conflict of interests and breaching staff dealing policy.	SFAT upheld the SFC's decision for a 18-month suspension.
4	Towry Law (Asia) HK Ltd	17.08.04	Failed to conduct sufficient due diligence into the two hedge funds managed by third parties; sold the two funds to clients whose investment objectives and risk tolerance did not match with the two funds; failed to conduct proper enquiries into circumstances surrounding the two funds which indicated problems; failed to advise clients when the funds had problems.	Severe reprimand and Towry Law, without admission of liability, agreed to make ex-gratia payments to clients amounted to 80% – 90% of the capital invested, which totalling $255 million.
5	Cheung Kwok Chiu Kris	10.11.04	Without exercising due skill, care and diligence, mishandled clients' assets and lied to the SFC.	Ban for life from the industry.
6	Oriental Patron Asia Ltd	17.12.04	Withholding material information from HKEx when acting as sponsor to a listing applicant to the Growth Enterprise Market; failed to properly guide and advise the listing applicant with due care and skill.	Removed from HKEx's approved list of sponsors under the GEM subject to certain exceptions and agreed not to act as a sponsor under the Main Board for five months.*
7	Leung Chin Sing Rabo (Principal Supervisor of Oriental Patron)	17.12.04	ditto	Voluntarily withdrew from acting as a Principal Supervisor of Oriental Patron and agreed not to perform or carry out any activities in relation to any GEM or Main Board listing applicant or listed issuer for nine months.*
8	Tong On Jimmy	23.12.04	Charged as much as $33 million worth of cash clients' securities to a bank as security for an overdraft facility; gave the SFC documents containing inaccurate information during investigation.	SFC originally decided to revoke Tong. Tong appealed to the SFAT. The proceedings were withdrawn as part of a settlement that Tong ceased business, surrendered his license and undertook never to re-apply for a license.
9	ICEA Capital Ltd	27.01.05	Allegedly not exercising due skill, care and diligence in the course of performing its duties as the sponsor for the listing of Euro Asia Agricultural (Holdings) Co Ltd.	A payment of $30 million without admission of liability.
10	Lau Hing Hung Joie	28.01.05	Impersonating a client to open an account; conducted trading without the client's knowledge and consent; lied to the SFC.	SFAT upheld the SFC's decision for revocation and a 10-year ban from the industry.
11	So Wai Ying Irene	01.03.05	Failing to avoid a conflict of interests and did not act in the best interests of her clients.	SFC originally decided to revoke So. So appealed to the SFAT. The proceedings were withdrawn as part of a settlement that So surrendered her license and undertook not to re-apply for five years.

* Joint action between the HKEx and the SFC

Enforcement

willing to interfere with SFC penalties and findings. In most cases, the SFAT sits with market representation; it can sit with the judge alone only if the appellant agrees. The SFAT is acting as an effective check and balance on the SFC, as intended.

To further enhance transparency, in September 2004, we issued a plain language booklet on the disciplinary process. The booklet, Disciplinary Proceedings at a Glance, is given to defendants and is also available on our website and at the SFC.

Settlements

During the year, we settled with four licensees with voluntary payments to the Government in exchange for suspensions. The amounts were $40,000, $195,000, $750,000 and $30 million. In two of these settlements, the licensee did not admit fault.

Separately, we settled with two licensees making ex-gratia payments to investors affected by their alleged conduct without the licensees admitting fault.

Settlements are common in many markets. However, there was local concern about the practice.

It is worth noting that we have always settled disciplinary actions. We have settled without admissions of fault before and also settled with non-statutory disciplinary outcomes, such as compensation, surrender of licences, undertakings not to engage in certain conduct or promises to keep certain undertakings. None of these settlements were controversial.

The SFO made two relevant changes to our disciplinary powers. It gave us the power to fine and an express power to settle, including by taking any appropriate actions as long as we believe it is in the public interest to do so. There may be cases where suspension is too harsh while a reprimand is too light. In many of the cases before the SFO, we had to propose a suspension or other penalty, even though we think a fine would have been ideal.

We have used the new powers to give penalty flexibility to defendants in pre-SFO cases where a fine would have been preferred to suspension. We settled and they made voluntary payments. These settlements bridge the gap between the old law and the SFO, nothing more.

We must satisfy ourselves that it is in the public interest before we settle. Only senior SFC officers can decide to settle and they must do so in accordance with internal procedures. We will not settle with a payment if dishonesty is involved or we consider the licensee poses a continuing risk to the public such that a suspension is more appropriate.

In all cases, the payment that we have agreed upon is proportionate to the initially proposed suspension taking into account the circumstances of the case. We only agree to monetary penalties if we believe they achieve the same protective and deterrent effect as the result we would be able to achieve in the event of the licensees appealing against our proposed actions. The practice will become less common as the number of transitional pre-SFO cases dwindles.

Co-operation with Other Law Enforcement Agencies and Regulators

We maintain close contact with other local enforcement agencies and our Mainland and overseas counterparts to tackle international financial crime and misconduct.

During the year, we referred 31 cases to the Police for further action. We continued to work closely with the Commercial Crime Bureau and the ICAC in cases involving corporate fraud, corruption and market manipulation. Furthermore, two officers from the ICAC were seconded to the Division for three months to exchange expertise and share experiences. Similar secondment will take place in the coming year.

We also place emphasis on international regulatory co-operation such as information sharing and cross-border investigation. The SFC has 34 bilateral or multilateral co-operation arrangements with regulatory bodies around the world. We are one of the signatories to the IOSCO Multilateral Memorandum of Understanding (MMOU).

Regulation of Mainland Corporations

In recent years, there has been an influx of Mainland corporations seeking to list on the Hong Kong market. This has required us to step up our working relationship with the CSRC to deal with cross-border enforcement issues involving Hong Kong listed companies based in the Mainland. The CSRC has been willing to help us to the extent it can.

However, the SFC cannot exercise its statutory power under the SFO over entities or individuals in the Mainland. We are forced to rely on voluntary co-operation from witnesses, suspects and companies located in the Mainland. This represents a significant impediment to effective enforcement of the law.

The SFC has drawn this issue to the attention of the CSRC and the HKSAR Government. In addition, we are working closely with HKEx in tackling the problem by strengthening the regulation of listing and sponsors, and promoting disclosure and transparency.

Supervision of Markets

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

[Achievements]

- Authorised three Automated Trading Services providers
- Completed the comprehensive review of HKEx's fees and charges
- Monitored the development and launch of advanced market infrastructure under SCEFI recommendations including the DCASS and Investor Participant Account service
- Consulted the public on the level and the funding of the Investor Compensation Fund and the operation of the investor compensation arrangements
- Consulted the public on the disclosure of interests regime
- Facilitated the launch of H-shares Index Options and the enhancement of the stock options market
- Revised the SFC Market Contingency Plan and assisted in the set up of the backup site for the SFC
- Participated in a successful market contingency rehearsal co-ordinated by the Government
- Commenced legislative drafting for enabling a scripless market

[This Chapter Is About]

- Facilitating market development
  - Encouraging product innovation and enhancement
  - Authorisation of Automated Trading Services
  - Review of HKEx's fees and charges
  - Review of the disclosure of interests regime
- Strengthening financial infrastructure
  - Rollout of DCASS
  - HKEx's network consolidation project
  - Implementation of SCEFI initiatives (scripless market, IP Account, Settlement Instruction matching)
- Market contingency planning
- Investor compensation
  - Managing compensation funds and processing claims
  - Review of the Investor Compensation Fund levy and claim limit
- Market research

Investors First

Housewife Ms Susana Wong says she only invests in unit trusts and mutual funds.

Mr David Xia De Liang surfs the Internet often to obtain financial and investment information.

Mr Chong Kin Wah, a secondary school teacher, holds stocks for long term investment.

What We Do

- Facilitate the development of and encourage participation in the Hong Kong markets;
- Strengthen market infrastructure;
- Supervise and monitor activities of the exchange controller, exchanges and clearing houses;
- Regulate approved share registrars;
- Regulate authorised ATS;
- Supervise and monitor activities of the independent Investor Compensation Company Limited; and
- Manage Hong Kong's investor compensation funds.

What We Did

Facilitating Market Development

Encouraging Product Innovation and Enhancement

The SFC assisted HKEx in widening its product range, enhancing its markets and streamlining the regulatory requirements for various products:

- Following the successful launch of the Hang Seng China Enterprises Index (H-shares Index) Futures contract in December 2003, the HKFE introduced the H-shares Index Options contract in June 2004. Six market makers were appointed by HKFE to provide liquidity for the contract. The open interest of H-shares Index Options contract quickly exceeded 10,000 contracts in just a few months.
- The SFC is working with HKEx on the proposed launch of callable bull/bear contracts.
- HKEx implemented a number of measures to enhance the competitiveness of the stock options market. These included the reduction of the strike price intervals, allowing market makers to fulfil their obligations by providing continuous quotations, and the reduction of the standard trading tariff of Tier 1 stock options contracts.
- In response to the market, in August 2004 HKEx published a consultation paper on the reduction of minimum trading spreads by two phases. HKEx's view is that a reduction of minimum trading spreads would increase stock market competitiveness, improve market efficiency and enhance market liquidity. Based on the results of the consultation, HKEx is planning to implement Phase 1 in 2005. Under Phase 1, about 20 stocks with share price over $30 will have their minimum trading spreads reduced. The SFC is considering HKEx's proposal.
- To cope with the recent growth of the market, HKEx discussed with the SFC on the possibility of raising the prescribed position limit for HSI Futures and Options contracts, unchanged since August 1999. HKEx also proposed to increase the prescribed position limits for Stock Options contracts and H-shares Index Futures and Options contracts. The SFC will continue to work with HKEx to review the prescribed limits.
- In November 2004, Hong Kong Securities Clearing Company Limited (HKSCC) introduced a settlement agent model. Under this model, a Settlement Agent may operate a CCASS Participant's CCASS terminal in the Settlement Agent's offices. The SFC worked closely with HKEx to ensure that the infrastructure and procedures were in place, and approved the HKSCC rule amendments.

Authorisation of Automated Trading Services (ATS)

During the year, we authorised three ATS providers, bringing the total number of authorised ATS to eight – seven overseas exchanges and entities and one local subsidiary of an international information provider. Particulars of the authorised entities and their authorisation conditions are listed on the Register of ATS on the SFC website.

Supervision of Markets

As at the year-end, the SFC was processing one application from a local company and considering submissions from an entity as to whether it needs to be authorised to provide ATS in Hong Kong.

Review of HKEx's Fees and Charges

Fees charged by HKEx in its capacity as a recognised exchange controller, by SEHK and HKFE in their capacities as recognised exchange companies and by the clearing houses in their capacities as recognised clearing houses must be specified in their respective rules and approved by the SFC.

In March 2005, a comprehensive fees review was completed. HKEx proposed a number of changes to its fee structure. These include the elimination of HKSCC's scrip fee in two phases, a reduction in HKSCC's minimum stock settlement fees for exchange trades and settlement instructions (SI) transactions, the elimination of HKSCC's SI input fee, a reduction of the SEHK Options Clearing House Limited's and HKFE Clearing Corporation Limited's accommodation charges for utilised non-cash collateral, abolition of HKCC and SEOCH's interest retention rates on margin deposits and the rebate of interest to participants at the prevailing bank savings deposit rate on cash margin deposits, the introduction of a new deposit fee by HKSCC and replacement of HKSCC's custody fee, dividend and debt securities interest collection service fee and corporate action service fee with a single custody fee.

Some of the changes will be implemented forthwith while others will be implemented with the scripless market proposals. The SFC will consider the requisite HKEx rule amendments.

Even during the review, many fees had been reduced or abolished: abolishing the requirements and charges for registration of SEHK participants; abolishing processing fees for certain HKFE applications; and a reduction of the derivative warrant listing fees. In January 2005, the SFC also approved fee reductions for network charges to AMS/3 users as a result of HKEx's network consolidation project, and the abolition of the DCASS Standard Instruction Input/Processing Fee.

Review of the Disclosure of Interests Regime

When the SFO commenced in 2003, the Government and the SFC committed to review the Part XV disclosure of interests regime at an appropriate time. We began the review last year after the SFO had been implemented for one year. The SFC first asked selected market participants if Part XV met its policy objectives. We also consulted on any need to update the law in light of market demands and developments. As a result, we identified some principal issues for public consultation. On 20 January 2005, the SFC issued a Consultation Paper on the Review of the Disclosure of Interests Regime under Part XV of the SFO.

Principal areas of the consultation include disclosure forms and codes; disclosure of security interests; simplification of the de minimis exception; situations which should be caught as a change in nature of interests; and proposed changes in certain specialist areas. The consultation paper also contains proposed technical changes to address business practices or for more consistent applications of the law.

The consultation ended in February and 24 submissions were received. The SFC is preparing the conclusions and will continue to work with the Government to draft amendments to Part XV.

Strengthening Financial Infrastructure

Rollout of DCASS

The Derivatives Clearing and Settlement System (DCASS) was successfully launched in April 2004. It provides enhanced clearing and settlement functions for index futures and options, stock options and other derivatives market products. It integrates with the derivatives trading system HKATS (Hong Kong Futures Automated Trading System) under a common network infrastructure.

With DCASS, exchange participants can clear their derivatives transactions with their counterparts in a more reliable, robust and seamless electronic

platform. The system allows greater flexibility for exchange participants to connect with their back office systems to achieve clearing automation, improve operational efficiency and facilitate straight-through-processing. We had worked closely with HKEx and participants in various tests, rehearsals and contingency planning before the launch to ensure that the system was stable and reliable.

HKEx's Network Consolidation Project

HKEx is operating several networks that facilitate access to the core equity and derivatives systems for trading and clearing (i.e. AMS/3, CCASS/3, HKATS and DCASS), as well as the market data feed system. The four networks were built separately over the years and exchange participants have had to install different circuits to access different markets through the separate networks.

In October 2004, HKEx announced its plan to consolidate the four major networks into one single SDNet, or the Securities and Derivatives Network. It aims to improve service reliability, enable the consolidation of communication lines, allow for lower line rental charges and better scalability, and streamline network management. The first phase of consolidation started in early 2005. We will monitor the progress to ensure a successful rollout to the market.

Implementation of SCEFI Initiatives

Work Towards a Scripless Market

Following public consultations by the SFC in 2002 and HKEx in 2003 on the proposals and a model for a scripless securities market, HKEx issued its conclusions in May 2004. It proposed a revised Issuer Register Model and a progressive implementation approach.

The proposed model enables shares to be issued and transferred electronically. Key features are as follows:

- As at present, there will continue to be a single register of members for each listed company to be maintained by an approved share registrar on behalf of the issuer.
- Dematerialisation will be optional. Investors may continue to hold certificates, or may hold shares in uncertificated form on the register of members. This means the register will consist of both certificated and uncertificated shareholdings.
- As at present, HKSCC will continue to operate on a nominee basis and investors holding shares deposited in CCASS through brokers and custodians will continue to be beneficial owners.

HKEx has proposed adopting the changes progressively depending on market demand. In essence, dematerialisation would begin with the CCASS Depository, then gradually be made an option for other registered shareholders with eventual establishment of electronic linkages between CCASS and share registrars' systems.

Upon SFC's recommendation, HKEx and the Federation of Share Registrars have formed a working group to draft an implementation plan and devise an operational model as proposed by HKEx. The SFC has worked closely with the working group. We concentrate our efforts on the legislative changes to enable a scripless market, and have been working closely with the Financial Services and the Treasury Bureau (FSTB) on the legislative proposals.

Enhancing HKEx's Investor Participant (IP) Account Service

During the year, the SFC approved CCASS Rules amendments to enable HKSCC to enhance its IP Account service. HKSCC introduced the following in August 2004: (a) improved communication (e.g. allowing instructions by phone and via the Internet; providing SMS messages on account activities that require investor participants' actions); (b) improved access (allowing self-assigned user ID and password); and (c) simplified procedures for stock transfer if it does not involve money settlement.

In the second quarter of 2005, the SFC will work with HKSCC to introduce additional enhancement including an optional Investor SI on-hold mechanism for Broker Participants and allowing individual or joint IPs to appoint a third party to attend company meetings.

Supervision of Markets

Enhancing the Settlement Instruction (SI) Matching Process in CCASS

The SFC has been working with HKSCC to enhance the SI matching process in CCASS. In October 2004, HKSCC introduced enhancements to automate the pre-matching process through which brokers and custodian banks for institutional investors can confirm with their counterparts SI details by phone, fax or email before inputting them into CCASS.

Market Contingency Planning

In early 2004, the SFC participated in a very successful market contingency rehearsal co-ordinated by the FSTB. Nine organisations including Government departments, regulators and market operators participated in the rehearsal. The rehearsal was to test the responses to a range of high impact scenarios relating to the financial services area including those with cross-market implications.

To reflect the recent developments of the securities and futures markets in Hong Kong and overseas, the SFC revised its Market Contingency Plan last year. New contingency scenarios were added and a project team was established to carry out in-depth analyses on these scenarios.

We wish to provide useful information on market contingency and business continuity planning to market participants and the general public through the SFC website. A Contingency Information section will be available in mid-2005.

The SFC is drafting Business Continuity Planning Guidelines for intermediaries. Last year, we gave two presentations on the growing importance of business continuity planning to over 100 staff of Exchange Participants.

In October 2004, a permanent SFC backup office was established in rented premises in a building in Kowloon. In the event of evacuation or the SFC offices becoming inaccessible or uninhabitable, an external Co-ordination Centre will be set up in the backup office for monitoring of the market.

Investor Compensation

Managing Compensation Funds and Processing Claims

As at 31 March 2005, the net asset value (NAV) of the Unified Exchange Compensation Fund (UECF) and the Commodity Exchange Compensation Fund (CECF) were $49.12 million and $0.27 million respectively. During the year, compensation payments totalling $2.85 million were made from the UECF to 42 claimants in respect of the default of C.A. Pacific Securities Limited (CAPS), Lawsons Securities Company, and Ying Kit Stock Company Limited. The claimants have received, or will receive, the amount allowed by the SEHK up to $150,000 per claimant under the agreed compensation arrangement. No payments were made from the CECF during the year.

The SFC has been working with the liquidators of CAPS and HKEx on the asset distribution to claimants. Up to 31 March 2005, the UECF has paid out compensation amounts of about $300 million to the claimants of CAPS. As of 31 March 2005, the UECF has recovered assets of net value around $108 million from the liquidators as a result of its subrogation rights, excluding $31.8 million being the return of the paid compensation amounts from claimants who opted to receive allocated shares.

During the year, the UECF and CECF have transferred assets of about $995 million and $108 million respectively to the new Investor Compensation Fund (ICF). The net asset size of ICF was $1.46 billion as at 31 March 2005. The ICF provides extended coverage to all investors transacting through licensed intermediaries dealing in HKEx's products, including securities and futures dealers, registered institutions under the Banking Ordinance and securities margin financiers.

The Commission has been regulating and monitoring the operations of the Investor Compensation Company Limited (ICC) since its inception in 2003. We will continue to assist the ICC in enhancing its operational procedures, claims

handling process, public awareness, corporate governance and technical infrastructure.

During the year, ICC received four claims. There were six outstanding claims at the year-end.

Review of the Investor Compensation Fund Levy and Claim Limit

The new ICF is mainly funded by transfers from the two old compensation funds (i.e. UECF and CECF), and by a 0.002% levy on securities transactions executed on SEHK and also $0.5 ($0.1 for smaller size contracts) contract levy on futures transactions executed on HKFE.

At the time of the passage of the Securities and Futures (Investor Compensation – Levy) Rules through the Legislative Council in December 2002, the Government undertook to review the size of the ICF, in light of its operational experience and prevailing circumstances.

According to an SFC consultation paper last December, with $1.4 billion in asset and estimated annual expenditure and compensation of $60 million, the ICF would become self-funding if an investment rate of return of 4.3% can be achieved in the long run.

In order not to accumulate amounts beyond what is necessary for the ICF and to reduce the burden on investors, the SFC proposed an automatic levy triggering mechanism. Under the proposal, the current investor compensation levies would be suspended if the NAV of the ICF exceeds $1.4 billion. The levies would be imposed if the NAV falls below $1 billion, which is the minimum prudent level which the ICF should maintain in order to cover its potential obligations.

The consultation paper examined the adequacy of the current $150,000 per investor limit, first adopted in 1998, and concluded that the limit, which has provided a similar level of coverage to that in and since 1998, should be maintained.

The consultation paper also reviewed three suggestions to improve the existing procedures in handling broker defaults (i.e. for the ICF to advance funds to liquidators for the purpose of facilitating the return of clients' shares pledged by a broker to a bank as security for a loan; to give power to liquidators to sell securities and distribute money; and use of ICF funds to pay for an administrator). It concluded that they should not be pursued because the suggestions would introduce additional financial exposure to the ICF, involve alterations to the existing individual proprietary rights of investors in securities held by brokers and have implications for the current law dealing with trust property and insolvency.

We received 12 submissions at the end of the consultation period in February 2005. Most of the respondents supported the SFC's recommendations. The SFC published the conclusions on 31 March 2005. We are working with the FSTB to amend the rules.

Market Research

The SFC conducts research on developments in the securities and futures markets of Hong Kong and major overseas economies. We monitor market and industry performance. Apart from providing support to the Commission to achieve our regulatory objectives by analysing information and identifying the latest trends, we provide timely information to the Government.

To better communicate with market participants and investors and to share with them industry knowledge, we launched a new research paper series, namely Profile of Exchange-traded Securities and Derivative Products in Hong Kong, on our website during the year. The SFC has continued to work with other regulators and academia on the publication of the SFC Quarterly Bulletin, in which we publish some of our research work and report our assessment of the financial stability of the securities market and industry.

Legal Services

[Achievements]

- Worked with the Government on maintenance of the SFO and formulated amendments to its subsidiary legislation on statutory backing for listing requirements, disclosure of interests and other matters
- Advised on possible breaches of the securities laws
- Conducted a significant number of successful prosecutions for a wide range of regulatory offences
- Successfully opposed an application for leave to apply for judicial review against the Commission

[This Chapter Is About]

- The Securities and Futures Ordinance
- Prosecutions and appeals
- Legal support for the Commission's work
- Legal advice and assistance in policy initiatives

What We Do

- Advise operational divisions on possible breaches of the securities laws;
- Advise the Commission in relation to suspected insider dealing;
- Advise on the applicability and interpretation of laws under the SFC's purview;
- Assist with reform of the laws governing the securities and futures markets;
- Prosecute in the Magistrates' Courts for a wide range of regulatory offences;
- Handle civil litigation matters involving the SFC, including appeals;
- Advise the Takeovers Executive and the Takeovers Panel; and
- Provide general in-house legal advice and support.

What We Did

The Securities and Futures Ordinance

We continued to work with the Government on the maintenance of the SFO to consider if the provisions continue to meet the policy objectives and whether any of its provisions or the subsidiary legislation made under it should be updated in view of market developments. The ongoing review will result in the Securities and Futures (Amendment) Bill 2005 proposed by the FSTB and various amendment rules.

The Bill will include the amendments required for the new statutory framework to implement the Government's proposals to enhance the regulation of listing. The Government's proposals went out for public consultation in January 2005, when the SFC also consulted on proposed amendments to the Securities and Futures (Stock Market Listing) Rules. We formulated the amendments to codify the more important listing requirements.

The Securities and Futures (Amendment) Bill 2005 will be introduced to the LegCo.

During the year, the SFC also consulted on proposed amendments to the disclosure of interests regime. The proposals aim to reduce compliance burden while preserving transparency.

Both SFC consultations have closed and we will study the responses before refining the proposed legislative changes.

Prosecutions and Appeals

We continued to advise on evidence and prosecute a wide range of offences in the Magistrates' Courts under section 388 of the SFO and the old securities-related ordinances. These offences include short selling, market manipulation, unlicensed investment advising, breach of disclosure requirements, providing false or misleading information and failing to assist SFC investigations.

During the year, there was a further increase in prosecutions handled by the prosecution team of the Division. There was also an increasing trend for persons to be prosecuted by the Commission for providing false or misleading information as more of this activity seemed to be occurring.

We successfully prosecuted a company for holding itself out on its website as carrying on a business of advising on corporate finance, in contravention of section 114 of the SFO. We anticipate more prosecutions involving unlicensed activities via websites because more individuals give investment advice online these days.

In our continuing effort to prosecute persons for not co-operating in inquiries, two individuals were convicted of failing to comply with notices issued by the SFC under section 33(4) of the repealed

Legal Services

Securities and Futures Commission Ordinance (by virtue of the transitional provisions in Schedule 10 to the SFO) to attend interviews in connection with investigations into short selling and market manipulation. They were fined and ordered to pay the SFC's investigation costs.

First Prosecution under Dual Filing

In one of the successful prosecutions, Huafeng Textile International Group Limited and its director Mr Cai Yang Bo were convicted of providing false or misleading information. It was the first prosecution under Dual Filing (which came into effect with the SFO).

It was found that, in response to an enquiry from HKEx on 23 July 2003 about untoward movements in the price and trading volume of Huafeng shares during that morning, Huafeng issued an untrue announcement later in the day stating that the board of directors of the company was not aware of any reasons for the untoward movements. However, the fact is that on 23 July 2003, Cai sold 25.6 million Huafeng shares owned by him and other Huafeng directors. The sale of shares had caused untoward movements in the price and trading volume of Huafeng shares on that day. Cai had received confirmation of the sale on 23 July 2003 but did not disclose the sale to Huafeng until 25 July 2003.

Owing to Cai's delay in disclosing the sale, Huafeng had to issue a clarification announcement on 25 July 2003. This announcement was itself misleading and for that reason Huafeng had to issue a second clarification announcement on 31 July 2003.

Legal Support for the Commission's Work

In June 2004, the SFC applied successfully to the High Court for a mareva injunction to prevent Mr Charles Schmitt, CEO of Charles Schmitt & Associates Limited, from dealing with any assets he held or controlled. We also obtained an order for the appointment of an administrator of his property, in connection with suspected misappropriation of client assets. This was the first exercise of the Commission's power to seek such court orders under section 213 of the SFO.

We provided legal advisers to the Takeovers and Mergers Panel and the Takeovers Executive in relation to disciplinary proceedings.

Legal Advice and Assistance in Policy Initiatives

One of our main functions is to provide legal advice to the SFC's operational and support divisions. During the year, we advised on matters including:

- legal issues arising from the review of the handling of broker defaults and the operation of the investor compensation arrangements;
- legal issues arising from the liquidations of Chark Fung Securities Company Limited and Forluxe Securities Limited;
- legal and practical issues arising from the migration to the new licensing regime in the run up to the deadline of 31 March 2005;
- the draft legislation to enable the creation of a scripless securities market in Hong Kong;
- the prospectus-related amendments in the Companies (Amendment) Ordinance 2004; and
- all aspects of the Commission's decision-making process including the exercise of our investigative, disciplinary and intervention powers.

We also provide general legal support to the Commission in relation to employment matters, insurance, and other commercial contracts and agreements.

SFC Successfully Opposed An Application for Leave to Apply for Judicial Review

In April 2004, the SFC commenced disciplinary proceedings against Berich Brokerage Limited for alleged misconduct. The SFC wrote to Berich proposing to take certain disciplinary action.

Berich lodged a complaint against two employees of the SFC and the SFC commenced an internal inquiry. In August 2004, following the completion of the internal inquiry, the SFC informed Berich that its complaint could not be substantiated. In October 2004, the SFC concluded its disciplinary proceedings and informed Berich of its decision.

Berich immediately appealed the SFC's disciplinary decision to the Securities and Futures Appeals Tribunal (SFAT). Less than two weeks later, Berich also made an *ex parte* application to the Court for leave to apply for judicial review of the SFC's decision to dismiss its complaint against the two employees. The SFC sought to intervene in Berich's application and the Judge gave leave to the SFC to attend the hearing of Berich's application to render whatever assistance the Court deemed necessary.

Mr Justice Hartmann heard the application in January 2005. In his judgment he stated that "judicial review being an exceptional remedy and a discretionary one... should be the remedy of last resort". It was "a collateral process" which "unless restrained within permissible boundaries, may result in a proliferation of proceedings when one set of proceedings would be entirely adequate". In addition, he observed that the existence of "an effective alternative remedy" was accorded even greater weight where, as here, "relevant legislation lays down a comprehensive system of appeals procedure guaranteeing that alternative remedy".

The Judge ruled that "the judicial review process should not be allowed to supplant the normal statutory appeal procedure" before the SFAT. He refused to grant leave to Berich to apply for judicial review as "there clearly exists a comprehensive statutory appeal procedure available to the applicant, one which is capable of giving to it the remedy it has sought".

The Judge "saw no reason to agree to the applicant being entitled to pursue a collateral action in this court, one which would, for no material purpose, add to the costs of the litigants, place an extra burden on this court and go to the public expense". He awarded costs against Berich in view of its failure to disclose that it was also in the process of pursuing an alternative remedy of appeal to the SFAT.

Corporate Affairs

[Achievements]

- Managed budget prudently and achieved a $169 million surplus
- Established an off-site backup office
- Gained external recognition of human resources and training policies and procedures
- More secure and convenient remote connection solutions for office system access
- Introduced more application and network services for FinNet users
- New investor education TV and radio programmes, university credit courses
- Revamped the SFC website and the eIRC
- Active participation in community work and voluntary services

[This Chapter Is About]

- Finances and administration
- Human resources and training
- Technology support
- Investor education and communications
- Reaching stakeholders
- Care for the community

What We Do

- Provide finance, human resources, training, information technology, management and corporate services to the Commission;
- Educate investors and handle complaints; and
- Communicate with stakeholders including the media.

This chapter covers the work of the departments of Finance and Administration, Human Resources, Training and Development, Information Technology, Investor Education and Communications, and Corporate Communications.

What We Did

Finances and Administration

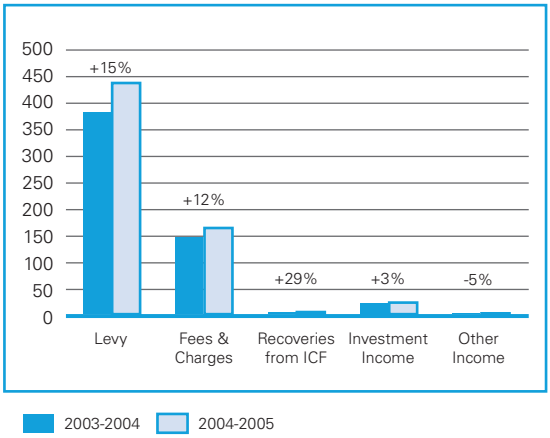
Financial Highlights

Benefiting from the economic recovery, there were increases in all income sources. Total revenue for 2004-2005 increased by 13% or $74 million to $625 million ($551 million in 2003-2004).

Levy income, our primary source of revenue, increased by 15% or $55 million to $435 million ($380 million) as the average daily market turnover surged to $16.8 billion ($14.6 billion). For income purpose, the turnover figure includes the amount of new fund raisings, which also attract transaction levy.

Fees and charges income rose by 12% or $17 million to $162 million ($145 million) due to increase in market activities.

Breakdown of SFC Revenue ($ million)



During the year, we continued to manage our budget prudently and spent only on areas where additional resources were considered necessary to improve market quality. Total expenditure was $456 million ($426 million), $13 million higher than the approved budget. Compared to a year ago, expenditure was 7% or $30 million higher, mainly because of the staff variable pay awarded to address the high staff turnover.

As a result, the SFC achieved a surplus of $169 million for 2004-2005 as compared with the projected surplus of $4 million for 2004-2005 and the $125 million surplus recorded in 2003-2004. Our reserves at the end of March 2005 stood at $860 million, equivalent to 1.7 times of estimated expenditure (including depreciation) of $508 million for 2005-2006.

Our budget for 2005-2006 forecasts an operating surplus of $5 million. In March 2005, the Financial Secretary under the delegated authority from the Chief Executive approved the budget.

At the end of March 2005, the total NAV of the Investor Compensation Fund, the Unified Exchange Compensation Fund and the Commodity Exchange Compensation Fund was $1.51 billion.

Office Expansion and Backup Office

Following the Government's issuance in March 2004 of its consultation conclusions on enhancing listing regulation, last July the SFC moderately expanded its Chater House offices by renting half an extra floor at favourable terms of the existing lease. This was to accommodate the projected manpower increase required to cope with the additional functions under the Government's proposal to enhance listing regulation.

Last October, we established a backup office in Kowloon as a business recovery measure so that our contingency team has a first port of call to carry on essential business in the event of exigency.

In compliance with the new statutory Occupational Safety and Health Regulation, new office chairs were acquired for all staff with a view to enhancing work conditions.

Corporate Affairs

Human Resources and Training

Staff and Remuneration

There were 406 permanent established posts and eight temporary established posts. Separately, provision was made for 24 temporary staff and 14 Executive Trainees.

As at 31 March 2005, there were 431 staff, comprising 390 regular staff filling the permanent established posts and 41 temporary staff. Total staff number was 416 a year ago.

A total of 182 SFC staff, representing 42% of all staff, held professional qualifications. During the year, overall staff turnover increased from 7.2 % to 12.02%.

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.

Financial Secretary Mr Henry Tang (left) presents the Good People Management Award to COO Mr Peter Au-Yang.

- In his current employment contract, the Chairman's annual remuneration package comprises a fixed pay of $6,750,000 and a performance-related variable pay of up to $337,500. The fixed pay is constant throughout the contract period and the variable pay is awarded annually on performance basis. The Chairman has voluntarily waived all his variable pay in his preceding and current contracts. His total emoluments (including retirement benefits) during the year amounted to $6,800,000.

- The average of the total emoluments (including retirement benefits and leave pay) of the other five Executive Directors during the year amounted to $4,317,000. This comprised average fixed pay of $3,581,000, average performance-related variable pay of $440,000, and average retirement benefits and leave pay of $296,000.

- The average of the total emoluments (including retirement benefits) of the seven serving Senior Directorate Grade Staff during the year amounted to $3,005,000. This comprised average fixed pay of $2,571,000, average performance-related variable pay of $390,000, and average retirement benefits of $44,000.

Human Resources Policies and Procedures

A revised Personnel Manual, which includes Grievance Procedures, Disciplinary Procedures and Equal Employment Opportunities Policy, came into effect on 1 April 2004. A revised Code of Conduct and the staff investment policy took effect on 1 February 2005 and 1 April 2005 respectively.

In December 2004, the SFC won the Labour Department's Good People Management Award

2004. We are amongst the 19 winners chosen from 374 organisations and companies. The award recognises the Commission's sound and comprehensive people management policies and practices. It is also recognition of the Commission's consistent achievements and continuous commitment to being a good employer.

Training and Development

We allocated more resources to training and development activities as the Commission's finances improved. We provided more customised workshops to colleagues. During the year, we organised for executives of all levels 320 programmes covering industry topics, management, language and information technology.

A team-building workshop in progress.

There were in-depth workshops on derivatives, financial fraud and financial statement analysis by external consultants. Sharing sessions were given by local and overseas market experts and senior staff including the Chairman and Executive Directors. Training on management subjects like leadership, inter-personal and communication skills, presentation skills, emotional intelligence was organised. In addition, some training was tailor-made for individual departments. These included outdoor team-building workshops and language workshops. We also organised Open Space programmes which are workshops for executives to enhance internal communications and encourage free exchange of ideas.

We have secondment arrangements with many other organisations. Locally, we seconded two staff to the Hong Kong Monetary Authority (HKMA) during the year. Eight staff were seconded to the CSRC while we received four CSRC secondees. Two staff were seconded to the UK's Financial Services Authority and two to the Australian Securities and Investments Commission.

In addition, seven staff attended short courses in the US, UK and the Asia Pacific region. To learn more about the Shenzhen securities markets and to strengthen contact with our counterparts in China, about 60 staff visited Shenzhen in early 2005.

A friendly badminton match with colleagues of the Shenzhen Stock Exchange after a study visit to the Shenzhen securities market.

Corporate Affairs

In November 2004, the Association of Chartered Certified Accountants (ACCA) awarded the Commission the status of Approved Continuing Professional Development Employer. We are the first employer in Hong Kong and the first financial regulator in Asia to acquire this status. At the same time, we became the first financial regulator in Asia to be named an ACCA Accredited Employer. The awards are recognition of the quality of our training and development support for staff. For SFC employees who are ACCA members, they are deemed to have met the accounting body's CPD requirements.

Staff Welfare and Employee Relations

We continued to promote staff relations and communications. In addition to social activities like in-house staff lunches and a barbeque, divisions received subsidies to organise recreational activities for their staff to foster team spirit.

A squash team was formed last year and an inter-divisional bowling competition was held. After work practice for basketball, soccer, badminton, table tennis and squash were arranged. Externally, our soccer and basketball teams competed in the Public Organisation Challenge League and Supervisory Cup respectively, with the HKMA, HKEx, the Mandatory Provident Fund Schemes Authority and Hong Kong Mortgage Corporation, etc.

The SFC Basketball Team celebrates a win in the Supervisory Cup Basketball Competition 2004.

Technology Support

Our IT strategy is to support the Commission's business operations in a secure and cost effective manner. We use viable and proven technology to continuously enhance our operational efficiency, and work with other market players to help strengthen Hong Kong's financial infrastructure.

Internal IT Development and Enhancement

A secure remote access IT solution was implemented in May 2004 to enable staff to access SFC systems when they are away from the office. We have also issued senior executives with

About 80 staff and their families enjoy a barbeque outing in Yuen Long.

portable wireless devices since April 2004 to read and write emails while on the go.

To strengthen information security, we implemented dual-factor authentication and single sign-on for SFC system logon in May 2004. The various remote system accesses have been integrated and are protected by security token, with a quality performance close to that in an office environment. We are also studying to consolidate the log records of various system platforms to better monitor our corporate network and system environment.

On IT infrastructure enhancement, a Storage Area Network System Project aimed to improve system efficiency, availability and recovery capability was completed in October 2004. We target to finish in 2005 three large-scale projects to improve system performance and reliability. They are related to the SFC's email system, application server and corporate database.

On knowledge management and work process improvement, we handled over 1,700 requests by colleagues to build or enhance databases and work systems. We are exploring different IT solutions for document management, interactive form submission and enterprise resource planning that would help enhance information sharing and collaboration within the Commission and facilitate submission of information by practitioners and the public.

FinNet

FinNet is a secure private business-to-business financial network to support the financial communities in Hong Kong in conducting electronic transactions and information delivery. At present, major users include financial regulators, HKEx, local banks, and securities and derivative intermediaries.

FinNet introduced dual network carriers (i.e. the network is provided by two telecom service providers simultaneously) in June 2004 to provide more network connection choices to the FinNet participants. Two community-wide banking applications were launched on FinNet during the year for the local banking sector. They are the Commercial Credit Reference Agency service offered by Dun and Bradstreet, and the File Transfer Service offered by Hong Kong Interbank Clearing Limited.

Investor Education and Communications

We continued to educate different sectors of the community on investment related issues through innovative initiatives.

We joined the Radio Television Hong Kong (RTHK) to produce a nine-episode Cantonese drama, All about Stock Investing, to discuss hot investor topics such as IPO investing, pooling risk of margin accounts, corporate governance and shareholder activism. The programme debuted on TVB and ATV in June 2004 and re-ran on FirstVision of New World First Bus and Cable TV after receiving positive response. The series is now available on VCDs for free distribution to the public.

Another TV series advised investors how to protect themselves from product mis-selling. The 10-episode Cantonese documentary-drama series,

Corporate Affairs

Foundations in Wealth Management, examined investment advisory services and key features of niche products, including specialised funds, investment-linked assurance schemes and structured products. It was broadcast on Cable TV in November 2004 and is also available on VCDs. Investors can also view it on the Electronic Investor Resources Centre (eIRC).

For the first time, the SFC partnered with the RTHK and The Salvation Army to tailor-make a programme targeting citizens aged 50 or above. The 12 radio segments, Invest Wisely for Seniors, was aired on RTHK Channel 5 from September to December 2004. Market experts appeared as guests to discuss wide-ranging topics on stock, fund and bond investments.

Also for the first time, the SFC partnered with Lingnan University to run a credit-based course. The Craft of Financial Investing helped undergraduates of all disciplines understand the market infrastructure and investment activities. The course attracted 160 students.

The eIRC was revamped in November 2004. All investor related materials were relocated from the SFC corporate website to the eIRC, making it an all-in-one investor portal with comprehensive investor education and alert materials. New functions have been introduced to facilitate information search and navigation. We have also changed to an easy-to-remember URL (www.eirc.hk).

Warning investors of financial scams remains a top priority. In view of an increase in reports, we alerted the public to phishing scams, which imitate financial institutions to entice recipients to provide personal information.

We posted 90 entities on the Alert List of unlicensed overseas companies, suspected boiler rooms and scam websites during the year, bringing the total to 238 entities. Besides, we presented 13 Smart Investor Awards to members of the public for their reports on financial scams.

As part of our thematic campaigns, we published two leaflets to educate investors on securities services related fees and charges, and the key questions to ask when seeking investment advice. These publications were supplemented by on-line feature articles and interactive games. We published the monthly Dr Wise's Column, plus a special issue in November. The Column covered concept stocks, REITs, derivative warrants, bonds, sponsors, settlements of disciplinary cases, etc.

During the year, we organised 64 seminars, reaching over 6,300 people. For instance, two rounds of workshops for secondary school teachers attracted a record 2,200 enrolments. We gave talks on retirement financial planning to employees of members of the Employers' Federation of Hong Kong. We also talked to civil servants due for retirement, professional bodies, secondary school students and the general public.

Investor Enquiries and Complaints Handling

During the year, we received 4,523 investor enquiries (5,382 in 2003-2004). We handled 1,214 complaints (1,252).

All public complaints received are tabled at the Complaints Control Committee, which conducts preliminary assessments and determines whether further action is necessary. The Committee comprises senior executives of various departments. The Committee referred 701 cases to operational divisions for further assessment, while 154 cases were investigated by the Enforcement Division.

Statistics of Public Complaints — 1 Table

Nature of complaints	2004-2005	2003-2004
Conduct of licensed intermediaries or registered institutions	381 (+0.3%)	380
Listing related matters & disclosure of interests	367 (-16%)	436
Market misconduct	162 (-23%)	211
Financial products	41 (+46%)	28
Other financial activities	228 (+30%)	175
Miscellaneous	35 (+59%)	22
Total	**1,214 (-3%)**	**1,252**

Reaching Stakeholders

The SFC actively engages stakeholders in the development of its regulatory policies and keeps the public informed of its activities.

The mass media is an important partner in communicating our work and policies to the stakeholders including the public. During the year, we issued 289 press releases (270 in 2003-2004). Our senior executives gave 43 interviews (32) to local, Mainland and international news organisations. We held 13 press conferences or briefings (11) to announce new policies and discuss our work. We handled 1,405 media enquiries (1,486).

We meet journalists on formal occasions as well as socially like this Spring Dinner in February 2005.

SFC's corporate website (www.sfc.hk) is a valuable source of information for practitioners, investors, and other users. More than 3,700 people subscribed to the Update Alert service to get emails of new information. We re-designed the corporate website and improved its contents and features last November (see overleaf). With easier navigation, visitors can generally reach the information needed with fewer clicks. The average number of hits per day for the past year fell 2% to 337,258, after reaching a peak of 446,277 hits per day last August. The upgrade has significantly improved the usability of the website in accordance with industry standards.

Corporate Affairs

Securities and Futures Commission Web Page (www.sfc.hk)

Build your briefcase to directly access frequently visited pages

Clearer navigation with nine modified main sections

Useful information tailor-made for nine user groups

Access to the Electonic Investor Resources Centre

See the latest news and policies

The most recent publications at-a-glance

One click to licensees and products registers

Quick access to SFC codes and guidelines

Electronic Investor Resources Centre Web Page (www.eirc.hk)

Send us enquiries or complaints easily through simple forms

One click to subscribe for monthly e-newsletter and email alerts of eIRC updates

Check blacklisted firms and websites, and win the Smart Investor Awards

Numerous reference materials for teachers to discuss in class

Find out the upcoming events in the calendar

Brochures, feature articles and FAQs on topical areas

Play and learn through interactive games

Tune in to SFC investor video and audio programmes

We received 3,673 pubic enquiries (3,872 in 2003-2004), of which 1,729 were made to the enquiry email (enquiry@sfc.hk). Full replies were given within four days in 88% of the email enquiries.

SFC's annual report continued to be recognised for its overall performance and disclosure. The Annual Report 2003-2004 won the Platinum Award in the Hong Kong Institute of Certified Public Accountants' Best Corporate Governance Disclosure Awards 2004 (Public Sector/Not-for-Profit Organisations category) and the Silver Prize in the Hong Kong Management Association's Best Annual Reports Awards 2004 (Non-profit Making and Charitable Organisations category).

Our regular publications are available online: the monthly SFC Enforcement Reporter and the bi-monthly newsletter SFC Alert inform the market of our enforcement actions and work in general; the Quarterly Report updates our financial position and regulatory work; and the Quarterly Bulletin.

Last May, we published the third edition of the English-Chinese Glossary of Securities, Futures and Financial Terms. A CD-ROM was also produced. The glossary is popular among professionals and the academia. More than 4,000 copies of the three editions of the glossary have been sold or distributed.

Throughout the year, we continued to receive visitors from local, Mainland and overseas regulators and financial institutions who want to learn more about the SFC in general or to discuss specific subjects.

Care for the Community

We continued to support community and charitable projects. We participated in the Community Chest Green Day and the Dress Casual Day. We raised $350,000 for victims of the tsunami tragedy in South Asia.

Our volunteers team, the Commission Possible Volunteers Group, organised four activities reaching out to 180 elderly and children, with active participation and generous donations from staff and their families.

These activities included a reading day for children of the Home of Love in Shamshuipo, Mid-Autumn Festival home visits to the elderly in the Eastern District, a Fun Fun Christmas Day for children at the Caritas Mutual Aid Centre for Single Parent Families, and a Chinese New Year visit to the St. Mary's Home for the Aged.

The elderly at a home for the aged receive red packets from an SFC staff in the Chinese God of Fortune costume.

In addition, individual Commission staff also devote their own time to other voluntary community services such as Civil Aid Service and Oxfam.

Cross-Border Regulatory Co-operation

[This Chapter Is About]

- SFC's involvement in IOSCO
- Partnership with other regulators
- Combating money laundering
- Co-operation with Mainland China
- CEPA II
- Promoting international standards

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.

What We Did

The SFC does its best to contribute to the global efforts to enhance the quality and effectiveness of market regulation. We work closely with our counterparts worldwide and play an active role in the work of the International Organization of Securities Commissions (IOSCO). During the year, we further strengthened these ties.

We have 34 bilateral or multilateral co-operation arrangements with regulatory bodies around the world.

The SFC will host the 31st IOSCO Annual Conference in Hong Kong in 2006. This is the Conference logo.

IOSCO

IOSCO is the pre-eminent forum for international co-operation among securities regulators and is recognised as the international standard setter for the securities sector.

In May 2004, SFC Chairman Mr Andrew Sheng led a delegation to the Annual Conference of IOSCO in Amman, Jordan. During the conference, Mr Sheng was elected as the Chairman of the IOSCO Technical Committee for a two-year term. The SFC also set up an exhibition booth with poster display, videocast and souvenirs to promote the attractiveness and advantages of Hong Kong. Hong Kong will be hosting the IOSCO Annual Conference in June 2006. Preparation has started and a provisional conference website has been launched.

The Technical Committee successfully held its inaugural Technical Committee Conference in New York in October 2004 that has given IOSCO much greater visibility in the international financial

markets. The theme was Regulators and the Global Marketplace. The event was well attended by industry, academia, international financial institutions, and regulators from around the world.

In December 2004, IOSCO published the Code of Conduct Fundamentals for Credit Rating Agencies (CRAs). They represent a global, converged view of specific mechanisms CRAs can use to protect their analytical independence, eliminate or manage conflicts of interest, and appropriately handle confidential information shared with them by issuers.

The Code Fundamentals aim to promote investor protection by safeguarding the integrity of the rating process. CRAs are expected to incorporate the contents into their own code of conduct. The SFC actively participated in the Chairmen's Task Force of the Technical Committee which was responsible for developing the Code Fundamentals.

In March 2005, the Technical Committee released its Report on Strengthening Capital Markets Against Financial Fraud following an in-depth study of recent financial scandals involving large, global companies, including the discovery in December 2003 of financial improprieties at Parmalat S.p.A. in Italy.

The Technical Committee Task Force had looked into the regulatory issues exposed by these scandals. The Report outlines the issues and the action plan, including a description of priority work designed to rectify the most pressing concerns. The Report also sets out two overarching operational priorities for IOSCO's future: (1) promoting implementation of existing international standards and principles; and (2) improving the abilities of securities regulators to co-operate with each other in enforcing existing securities laws and regulations. The Financial Stability Forum welcomed the report and the timely action taken by IOSCO to address the issues identified by the Task Force.

Multilateral Memorandum of Understanding

Adopted in May 2002, the IOSCO MMOU allows full investigatory co-operation among signatory jurisdictions. Hong Kong is one of the 26 signatories.

During the year, one more country signed the MMOU. Four more countries have committed themselves to changing their laws so they can become signatories. We sit on the committees that vet applications to the MMOU and monitor compliance with it.

Standing Committees under the IOSCO Technical Committee

The Corporate Finance Division participates in the Standing Committee on Multinational Disclosure and Accounting (SC1), which monitors and comments on international developments in accounting and auditing standards and drafts IOSCO standards relating to disclosure matters.

During the year, we continued to play an active role in SC1's Auditing Subcommittee and Accounting Subcommittee. We participated in the drafting of and responded to a survey on regulation and oversight of auditors. We reviewed and

Cross-Border Regulatory Co-operation

prepared comments on a consultation paper on proposed constitutional changes to the International Accounting Standards Committee Foundation and attended the Foundation's public hearing in Tokyo in July 2004. We also commented on International Standards on Auditing issued by the International Audit Assurance Standards Board and on International Financial Reporting Standards issued by the International Accounting Standards Board.

The Supervision of Markets Division participates in the Standing Committee on the Regulation of Secondary Markets (SC2). During the year, SC2 studied issues on transparency of corporate bond markets and error trade policies adopted by exchanges. We provided inputs to the reports on these issues and also responded to survey questionnaires on exchange demutualisation.

During the year, the Task Force on Securities Settlement Systems, which was jointly established by IOSCO and the Committee on Payment and Settlement Systems (CPSS), released a report to set out comprehensive standards for risk management of central counterparties for both securities and derivatives markets. We participated in the Task Force to formulate the standards.

The Intermediaries and Investment Products Division participates in the Standing Committee on the Regulation of Market Intermediaries (SC3). During the year, we assisted SC3 in soliciting and collating responses from local intermediaries on a survey of their outsourcing activities. We commented on the draft principles on outsourcing of financial services for market intermediaries.

In February 2005, SC3 issued the survey results and principles, which provide a flexible and practical approach that will assist firms in determining the steps to take when considering outsourcing activities.

The Enforcement Division participates in the Standing Committee on Enforcement and Exchange of Information (SC4). SC4 promotes mutual assistance among securities regulators to combat cross-border financial crimes and misconduct. SC4 is working on enforcement issues relating to gaps in international co-operation, international asset freezing, cross-border boiler rooms and cold calling, and the Internet.

To close the gaps in the global network of co-operating regulatory authorities, IOSCO has opened a confidential dialogue with jurisdictions whose ability or willingness to engage in enforcement co-operation with other regulatory authorities has been uncertain. The objective is to ascertain whether there are any obstacles in these jurisdictions to implementing the IOSCO principles on enforcement co-operation and information exchange, and to encourage and assist them to join the IOSCO MMOU. It is SC4's major task in the coming year.

The Intermediaries and Investment Products Division also participates in the Standing Committee on Investment Management (SC5). In particular, we responded to a survey by SC5 on market timing and explained our regulatory practice regarding the governance of collective investment schemes. We also shared with SC5 members the regulatory framework for retail

hedge funds, including practical matters encountered in the course of reviewing hedge fund applications and the types of hedge funds that we have authorised to date.

Partnership with Other Regulators

Co-operative Agreements

The SFC was very active in bilateral regulatory co-operation last year. We signed a Letter of Intent (LOI) with Indonesia's Ministry of Finance Capital Market Supervisory Agency (Bapepam) in May 2004 and a similar one with the Securities and Exchange Commission of Thailand in November 2004. In April 2005, we signed a third one with the Sri Lanka Securities and Exchange Commission.

Under the LOIs, the signatories agree to strengthen regulatory co-operation and work together with the objective of achieving the cross-border trading of mutually acceptable investment products in each other's markets.

SFC Chairman Mr Andrew Sheng (left) and Mr Tairachai Phuvanatnaranubala, Secretary-General of the Securities and Exchange Commission of Thailand sign the Letter of Intent.

Mr Herwidayatmo (left), Chairman of the Bapepam, presents a souvenir to SFC Chairman Mr Andrew Sheng after the LOI signing in Jakarta, Indonesia.

In November 2004, we signed a MOU with the Philippine Securities and Exchange Commission. The MOU establishes a framework for mutual assistance and facilitates the exchange of information to enable better regulation and enforcement of the securities laws and regulations of Hong Kong and the Philippines.

Enforcement Related Assistance

In general, requests for enforcement related assistance made to the SFC involve getting public information such as company information, land title information, address checks and information about licensees. We also receive many requests for non-public information such as intelligence information about licensees or listed companies and for investigatory assistance. Investigatory assistance requests usually relate to bank records or information of subscribers to telephone lines.

Cross-Border Regulatory Co-operation

During the year, we arranged for overseas regulators interviews with suspects or witnesses in Hong Kong in three cases, all under legal compulsion. With our assistance, criminal charges were laid in one of the cases in a foreign country.

Last year, we received 47 requests for enforcement-related assistance: 13 were requests for investigatory assistance involving the SFC in the exercise of its statutory powers; and 34 were requests for information. On the other hand, we made seven requests to overseas regulators.

In respect of licensing-related matters, the SFC received 140 requests from overseas regulatory authorities and made 668 requests.

Requests for Regulatory Co-operation

	2004-2005		2003-2004		2002-2003	
	In	Out	In	Out	In	Out
Enforcement-related requests for investigatory assistance	13	4	11	4	13	14
Enforcement-related requests for information	34	3	35	2	28	6
Licensing-related requests for information	140	668*	103	383	200	451
Total	**187**	**675**	**149**	**389**	**241**	**471**

* More licensing-related requests were made to overseas regulators because there were more licence applicants from overseas and Mainland China.

Combating Money Laundering

We continued to actively participate in the Financial Action Task Force on Money Laundering (FATF), an inter-governmental body which develops and promotes policies to combat money laundering. We seek to ensure that the SFC's Guidance Note on Prevention of Money Laundering and Terrorist Financing is in line with the FATF recommendations.

We also participated in the International Conference – Creating Global Partnership and Synergy in the Fight Against Money Laundering held in Hong Kong in February 2005. SFC delegates delivered a presentation to discuss the role of the securities sector in preventing money laundering, and exchanged experiences in tackling money laundering with renowned speakers and experts from overseas, the Mainland and the local business sector.

Co-operation with Mainland China

Through the Memorandum of Regulatory Co-operation (MORC), the SFC, CSRC, HKEx, and the Shanghai and Shenzhen stock exchanges meet regularly to discuss regulatory issues and policies. The SFC hosted the 32nd MORC meeting in Hong Kong last June, and attended the 33rd meeting in Hainan in January 2005.

As part of the MORC meetings, divisional colleagues met their CSRC counterparts for in-depth discussions on regulatory developments in Hong Kong and the Mainland, surveillance, enforcement and other cross-border issues.

CEPA II

The CEPA II arrangement was announced by the Central People's Government and the HKSAR Government in August 2004. Under this arrangement, SFC licensed firms which satisfy the requirements of the CSRC will be allowed to set up joint venture futures brokerage companies in the Mainland. Hong Kong firms may have up to 49% of the shareholding. CEPA II gives Hong Kong firms the advantage of early access to the developing Mainland futures market.

Promoting International Standards

On 1 March 2005, the SFC co-hosted with the HKMA a forum on Global Trends of XBRL and the Implications to Hong Kong's Regulatory Reporting Environment. XBRL stands for eXtensible Business Reporting Language and is an evolving global standard for the electronic communication of business and financial data. XBRL facilitates standardisation in the processing of accounting information, hence increasing efficiency, reducing error and permitting automatic verification in the handling of financial data.

The forum attracted 150 participants from government agencies, regulators, stock exchanges, banks, and market experts of the local financial sector. XBRL pioneers from the US, Mainland China and Japan provided instructive updates on the development of XBRL in overseas markets. The SFC will explore the use of XBRL in Hong Kong with the Government, regulatory authorities and users of financial information.

Market experts and regulators from the US, Japan, the Mainland and Hong Kong discuss development of XBRL.

Securities and Futures Commission

[Auditors' Report To The Securities And Futures Commission (the SFC)]

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

We have audited the financial statements on pages 93 to 109 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 requires the directors to prepare financial statements which 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 solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

Basis of opinion

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Institute of Certified Public 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 directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the SFC's and the group's circumstances, consistently applied and 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 affairs of the SFC and of the group as at 31 March 2005 and of the group's 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

4 May 2005

[Consolidated Income and Expenditure Account]

For the year ended 31 March 2005

(Expressed in Hong Kong dollars)

	Note	2005	2004
		$'000	$'000
Income			
Levies		**435,442**	380,336
Fees and charges		**162,325**	144,591
Investment income	5	**21,894**	21,310
Recoveries from Investor Compensation Fund		**4,066**	3,162
Other income	6	**1,654**	1,749
		625,381	551,148
Expenses			
Staff costs and directors' emoluments	7	**357,479**	328,818
Premises			
rent		**20,573**	18,561
other		**12,972**	14,151
Other expenses	8	**42,626**	37,001
		433,650	398,531
Depreciation		**22,670**	27,206
		456,320	425,737
Surplus for the year		**169,061**	125,411
Accumulated surplus brought forward		**648,184**	522,773
Accumulated surplus carried forward		**817,245**	648,184

We have not prepared a separate statement of changes in equity as the surplus for the year would be the only component of such a statement.

The notes on pages 97 to 109 form part of these financial statements.

Securities and Futures Commission

[Consolidated Balance Sheet]

At 31 March 2005

(Expressed in Hong Kong dollars)

	Note	2005	2004
		$'000	$'000
Non-current assets			
Fixed assets	9(a)	**25,258**	34,037
Held-to-maturity debt securities	10	**550,407**	66,329
		575,665	100,366
Current assets			
Held-to-maturity debt securities	10	**294,398**	579,802
Bank deposits		**69,656**	75,781
Debtors, deposits and prepayments		**58,181**	58,101
Cash at bank and in hand		**1,692**	2,182
		423,927	715,866
Current liabilities			
Fees received in advance		**36,675**	34,788
Creditors and accrued charges		**30,765**	22,198
		67,440	56,986
Net current assets		**356,487**	658,880
Total assets less current liabilities		**932,152**	759,246
Non-current liabilities	12	**72,067**	68,222
Net assets		**860,085**	691,024
Funding and reserves			
Initial funding by Government	14	**42,840**	42,840
Income and expenditure account		**817,245**	648,184
		860,085	691,024

Approved and authorised for issue by the Commission on 4 May 2005 and signed on its behalf by

Andrew L T Sheng
Chairman

Eddy C Fong
Non-executive Director

The notes on pages 97 to 109 form part of these financial statements.

[Balance Sheet]

At 31 March 2005

(Expressed in Hong Kong dollars)

	Note	2005	2004
		$'000	$'000
Non-current assets			
Fixed assets	9(b)	**25,012**	33,597
Held-to-maturity debt securities	10	**550,407**	66,329
		575,419	99,926
Current assets			
Held-to-maturity debt securities	10	**294,398**	579,802
Bank deposits		**69,656**	75,781
Debtors, deposits and prepayments		**57,845**	57,877
Cash at bank and in hand		**945**	962
		422,844	714,422
Current liabilities			
Fees received in advance		**36,675**	34,788
Creditors and accrued charges		**29,451**	20,366
		66,126	55,154
Net current assets		**356,718**	659,268
Total assets less current liabilities		**932,137**	759,194
Non-current liabilities	12	**72,052**	68,170
Net assets		**860,085**	691,024
Funding and reserves			
Initial funding by Government	14	**42,840**	42,840
Income and expenditure account		**817,245**	648,184
		860,085	691,024

Approved and authorised for issue by the Commission on 4 May 2005 and signed on its behalf by

Andrew L T Sheng
Chairman

Eddy C Fong
Non-executive Director

The notes on pages 97 to 109 form part of these financial statements.

Securities and Futures Commission

[Consolidated Cash Flow Statement]

For the year ended 31 March 2005

(Expressed in Hong Kong dollars)

	2005	2004
	$'000	$'000
Cash flows from operating activities		
Surplus for the year	**169,061**	125,411
Adjustments for:		
Depreciation	**22,670**	27,206
Investment income	**(21,894)**	(21,310)
(Profit)/loss on disposal of fixed assets	**(40)**	60
	169,797	131,367
Increase in debtors, deposits and prepayments	**(444)**	(28,515)
Increase in fees received in advance	**1,887**	3,231
Increase in creditors and accrued charges	**7,813**	3,628
Increase in non-current liabilities	**3,845**	19,242
Net cash generated from operating activities	**182,898**	128,953
Cash flows from investing activities		
Interest received	**35,539**	24,908
Held-to-maturity debt securities bought	**(802,250)**	(264,721)
Held-to-maturity debt securities redeemed	**590,296**	39,000
Fixed assets bought	**(13,154)**	(28,978)
Fixed assets sold	**56**	9
Net cash used in investing activities	**(189,513)**	(229,782)
Net decrease in cash and cash equivalents	**(6,615)**	(100,829)
Cash and cash equivalents at beginning of the year	**77,963**	178,792
Cash and cash equivalents at end of the year	**71,348**	77,963

Analysis of the balance of cash and cash equivalents:

	2005	2004
	$'000	$'000
Bank deposits	**69,656**	75,781
Cash at bank and in hand	**1,692**	2,182
	71,348	77,963

[Notes to the Consolidated Financial Statements]

For the year ended 31 March 2005

(Expressed in Hong Kong dollars)

1. Status and principal activities

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

2. Income

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

(a) 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

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

Basis of preparation

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

Basis of consolidation

Subsidiaries are those enterprises controlled by the SFC. Control exists when the SFC has the power, directly or indirectly, to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities. We include the financial statements of subsidiaries in the consolidated financial statements from the date that control commences until the date that control ceases. We eliminate all material intragroup balances and transactions in preparing the consolidated financial statements.

3. Significant accounting policies (cont'd)

Recognition of income

Levies We record levies from The Stock Exchange of Hong Kong Limited and Hong Kong Futures Exchange Limited 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; and (b) the amortisation of premiums or discounts on purchases of held-to-maturity debt securities using the effective interest rate method.

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 (see the accounting policy in respect of "impairment" on page 100). We charge depreciation to the income and expenditure account on a straight-line basis over the estimated useful lives of the fixed assets. 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

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

Investments

We state our investments in debt securities, which we intend and are able to hold to maturity, at amortised cost less any provisions for impairments (see the accounting policy in respect of "impairment" on page 100). 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.

3. Significant accounting policies (cont'd)

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 International Accounting Standard 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 recognise exchange gains and losses on translation in the income and expenditure account.

Other receivables

We state other receivables at their cost less impairment losses (see the accounting policy in respect of "impairment" on page 100).

Cash and cash equivalents

Cash and cash equivalents comprise cash balances and bank deposits.

Other payables

We state other payables at their cost.

Investment in subsidiaries

We state an investment in a subsidiary at cost less any impairment losses in the balance sheet.

3. Significant accounting policies (cont'd)

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.

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.

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 SFO exempts the SFC from Hong Kong taxes.

5. Investment income

	2005	2004
	$'000	$'000
Interest income	**35,174**	28,730
Amortisation of premium on held-to-maturity debt securities	**(13,786)**	(7,480)
Amortisation of discount on held-to-maturity debt securities	**506**	60
	21,894	21,310

6. Other income

	2005	2004
	$'000	$'000
Investigation costs awarded	**1,003**	462
Sale of SFC publications	**397**	459
Profit on disposal of fixed assets	**40**	–
Exchange gain	**–**	699
Others	**214**	129
	1,654	1,749

7. Staff costs and directors' emoluments

	2005	2004
	$'000	$'000
Salaries and allowances	**337,502**	308,206
Retirement benefits	**10,093**	10,781
Medical and life insurance	**9,464**	9,484
Overtime pay	**420**	347
	357,479	328,818

The total number of staff as at 31 March 2005 was 434, comprising 393 regular staff (390 for SFC and 3 for Investor Compensation Company Limited) and 41 temporary staff (at 31 March 2004: the total number of staff was 419, comprising 385 regular staff and 34 temporary staff).

Securities and Futures Commission

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

Directors' emoluments included in the above comprised:

	2005	2004
	$'000	$'000
Fees	**1,638**	1,603
Salaries and other emoluments	**25,981**	25,666
Variable pay	**2,200**	1,298
Retirement benefits	**203**	223
	30,022	28,790

Included in the directors' emoluments were fees of $1,638,000 (2003/2004: $1,603,000) paid to the independent non-executive directors during the year.

Directors' emoluments fell within these ranges:

	2005	2004
	No. of directors	No. of directors
$0 to $1,000,000	**10**	8
$2,500,001 to $3,000,000	**–**	1
$3,000,001 to $3,500,000	**1**	–
$4,000,001 to $4,500,000	**2**	3
$4,500,001 to $5,000,000	**1**	1
$5,500,001 to $6,000,000	**1**	–
$6,500,001 to $7,000,000	**1**	1
	16	14

The aggregate remuneration of the five highest paid individuals in 2004/2005, representing the emoluments of five executive directors, was $25,327,000 (2003/2004: $24,360,000 for five executive directors).

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

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 fixed 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 $32,000 (2004: $80,000).

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 $1,287,000 (2004: $773,000) and the amount so forfeited available at the balance sheet date was $13,000 (2004: $61,000).

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

	2005	2004
	$'000	$'000
Training and development	**4,328**	2,569
Legal and professional services	**12,269**	7,780
Legal costs recovered/release of provision for legal costs	**(2,643)**	(1,500)
Information and systems services	**18,418**	16,416
Auditors' remuneration	**258**	221
General office and insurance	**6,054**	5,859
SCEFI (Steering Committee on the Enhancement of Financial Infrastructure)	**293**	3,534
External relations	**3,020**	2,062
Loss on disposal of fixed assets	**–**	60
Exchange loss	**629**	–
	42,626	37,001

Securities and Futures Commission

9. Fixed assets

(a) The Group

	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 2004	30,563	8,770	104,710	20,263	1,456	165,762
Additions	5,290	960	4,459	3,198	–	13,907
Disposals	(641)	(154)	(583)	(2,513)	–	(3,891)
At 31 March 2005	35,212	9,576	108,586	20,948	1,456	175,778
Depreciation						
At 1 April 2004	16,897	6,391	88,352	18,629	1,456	131,725
Charge for the year	8,597	987	11,083	2,003	–	22,670
Written back on disposals	(639)	(154)	(583)	(2,499)	–	(3,875)
At 31 March 2005	24,855	7,224	98,852	18,133	1,456	150,520
Net book value						
At 31 March 2005	10,357	2,352	9,734	2,815	–	25,258
Net book value						
At 31 March 2004	13,666	2,379	16,358	1,634	–	34,037

9. Fixed assets (cont'd)

(b) The SFC

	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 2004	30,233	8,738	104,710	19,972	1,456	165,109
Additions	5,266	960	4,459	3,193	–	13,878
Disposals	(641)	(154)	(583)	(2,513)	–	(3,891)
At 31 March 2005	34,858	9,544	108,586	20,652	1,456	175,096
Depreciation						
At 1 April 2004	16,787	6,385	88,352	18,532	1,456	131,512
Charge for the year	8,479	981	11,083	1,904	–	22,447
Written back on disposals	(639)	(154)	(583)	(2,499)	–	(3,875)
At 31 March 2005	24,627	7,212	98,852	17,937	1,456	150,084
Net book value						
At 31 March 2005	10,231	2,332	9,734	2,715	–	25,012
Net book value						
At 31 March 2004	13,446	2,353	16,358	1,440	–	33,597

Securities and Futures Commission

10. Held-to-maturity debt securities

The Group and the SFC

			2005	2004
			$'000	$'000
Maturing after one year				
In the second to third years	–	unlisted	**209,538**	22,518
	–	listed outside Hong Kong	**340,869**	43,811
			550,407	66,329
Maturing within one year	–	unlisted	**119,965**	187,907
	–	listed outside Hong Kong	**174,433**	391,895
			294,398	579,802
			844,805	646,131
Cost at 31 March	–	unlisted	**329,503**	210,425
	–	listed outside Hong Kong	**515,302**	435,706
			844,805	646,131
Market value at 31 March	–	unlisted	**327,653**	218,053
	–	listed outside Hong Kong	**510,122**	437,051
			837,775	655,104

11. Investments in subsidiaries

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

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

The objective of ICC is to facilitate the administration and management of the Investor Compensation Fund established under the SFO.

Both companies are wholly owned subsidiaries of the SFC. As at 31 March 2005, the investments in subsidiaries, which is stated at cost less any impairment losses, amounted to $2.2. The balance is too small to appear on the balance sheet which is expressed in thousands of dollars.

FinNet has not commenced operation. The balance sheet of FinNet as at 31 March 2005 and the income and expenditure account for the year were immaterial. Therefore, we have not accounted for its result in the consolidated financial statements.

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

12. Non-current liabilities

The Group and the SFC

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

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 2005. Therefore we do not provide an ageing analysis of 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.

Securities and Futures Commission

15. Capital commitments

Capital commitments outstanding at 31 March 2005 not provided for in the financial statements were as follows:

	2005	2004
	$'000	$'000
Authorised and contracted for	**12,413**	11,015
Authorised but not contracted for	**8,801**	11,353

16. Commitment to pay rents for offices

In addition to the operating lease for the SFC's office premises for 10 years starting 1 July 2003, we have entered into a new operating lease with the same landlord for additional office space for a period of 9 years starting 1 July 2004. Both leases are 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 respective lease agreement.

At 31 March 2005 the minimum amount we are committed to pay in rent for our offices up to 30 June 2008 is as follows:

	The Group		The SFC	
	2005	2004	**2005**	2004
	$'000	$'000	**$'000**	$'000
Payable next year	**30,278**	14,648	**29,980**	14,350
Payable in one to five years	**69,578**	86,483	**69,491**	86,098
Payable in more than five years	**–**	–	**–**	–
	99,856	101,131	**99,471**	100,448

During the year ended 31 March 2005, $20,573,000 was recognised as an expense in the income and expenditure account in respect of operating leases (2004: $18,561,000). 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 (UECF), the Commodity Exchange Compensation Fund (CECF), the Investor Compensation Fund (ICF), Securities Ordinance (Chapter 333) - Dealers' Deposits Fund, Commodities Trading Ordinance (Chapter 250) - Dealers' Deposits Fund and Securities Ordinance (Chapter 333) - Securities Margin Financiers' Security Fund. We have the following significant related party transactions during the year:

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

(b) matters disclosed in note 19.

18. 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 to the US dollar, the SFC was not exposed to significant foreign exchange risk.

19. 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 UECF. 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.

Investor Compensation Fund

[Report of the Investor 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 2005.

1. Establishment of the Investor Compensation Fund (the Fund)

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

2. Financial results

The Committee presents the financial results which are set out in the financial statements on pages 112 to 121.

3. Members of the Committee

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

Mr. Peter Au-Yang	[appointed on 1 April 2005]
Mr. Mark Dickens, JP	[resigned on 31 March 2005]
Mr. Paul Chow Man Yiu, JP	[resigned on 20 September 2004]
Mr. Gerald Greiner	[appointed on 20 September 2004]
Mrs. Alexa Lam	
Ms. Anna H Y Wu, SBS, JP	

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, KPMG, being eligible, offer themselves for re-appointment.

On behalf of the Committee

Peter Au-Yang
Chairman

4 May 2005

[Auditors' Report To The Securities And Futures Commission (the SFC)]

We have audited the financial statements of the Investor Compensation Fund (the Fund) established under Part XII of the Securities and Futures Ordinance set out on pages 112 to 121 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 Securities and Futures 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 solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

Basis of opinion

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Institute of Certified Public 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, consistently applied and 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 as at 31 March 2005 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

4 May 2005

Investor Compensation Fund

[Income and Expenditure Account]

For the year ended 31 March 2005

(Expressed in Hong Kong dollars)

	Note	2005	2004
		$'000	$'000
Income			
Net investment income	3&5	**28,668**	4,643
Levy from the SEHK	3&6	**163,914**	144,177
Levy from the HKFE	3&7	**13,279**	10,340
		205,861	159,160
Expenses			
ICC expenses	8	**4,066**	4,434
Auditors' remuneration		**55**	50
Bank charges		**947**	55
Professional fees		**1,539**	12
Exchange difference		**383**	–
Sundry expenses		**1**	–
		6,991	4,551
Surplus		**198,870**	154,609
Accumulated surplus brought forward		**154,609**	–
Accumulated surplus carried forward		**353,479**	154,609

The notes on pages 116 to 121 form part of these financial statements.

[Balance Sheet]

At 31 March 2005

(Expressed in Hong Kong dollars)

	Note	2005	2004
		$'000	$'000
Current assets			
Debt securities	9	**1,182,665**	174,286
Equity securities		**122,409**	–
Other receivable		**384**	–
Interest receivable		**13,731**	1,656
Due from ICC		**1,111**	1,778
Levy receivable from the SEHK		**16,434**	16,415
Levy receivable from the HKFE		**1,283**	1,163
Fixed and call deposits with banks		**81,663**	766,964
Cash at bank		**37,295**	13
		1,456,975	962,275
Current liabilities			
Accounts payable and accrued charges		**818**	66
Net current assets		**1,456,157**	962,209
Net assets		**1,456,157**	962,209
Representing:			
Compensation fund			
Contributions from UECF	10	**994,718**	699,640
Contributions from CECF	10	**107,960**	107,960
Accumulated surplus		**353,479**	154,609
		1,456,157	962,209

Approved and authorised for issue by the Securities and Futures Commission (the SFC) on 4 May 2005 and signed on its behalf by

Andrew L T Sheng
Chairman of the SFC

Eddy C Fong
Non-executive Director of the SFC

The notes on pages 116 to 121 form part of these financial statements.

Investor Compensation Fund

[Statement of Changes in Equity]

For the year ended 31 March 2005

(Expressed in Hong Kong dollars)

	Note	2005	2004
		$'000	$'000
Compensation Fund balance as at 1 April		**962,209**	–
Surplus for the year		**198,870**	154,609
Contributions from UECF	10	**295,078**	699,640
Contributions from CECF	10	**–**	107,960
Compensation Fund balance as at 31 March		**1,456,157**	962,209

The notes on pages 116 to 121 form part of these financial statements.

[Cash Flow Statement]

For the year ended 31 March 2005

(Expressed in Hong Kong dollars)

	2005	2004
	$'000	$'000
Cash flows from operating activities		
Surplus for the year	**198,870**	154,609
Net investment income	**(28,668)**	(4,643)
Exchange difference	**383**	–
Increase in levies receivable	**(139)**	(17,578)
Decrease/(increase) in accounts receivable	**667**	(1,778)
Increase in accounts payable and accrued charges	**752**	66
Net cash from operating activities	**171,865**	130,676
Cash flows from investing activities		
Purchase of debt securities	**(2,729,479)**	(218,378)
Purchase of equity securities	**(99,990)**	–
Sale or maturity of debt securities	**1,692,647**	43,000
Sale of equity securities	**278**	–
Interest received	**21,582**	4,079
Net cash used in investing activities	**(1,114,962)**	(171,299)
Cash flows from financing activities		
Contributions received from UECF	**295,078**	699,640
Contributions received from CECF	**–**	107,960
Net cash from financing activities	**295,078**	807,600
Net (decrease)/increase in cash and cash equivalents	**(648,019)**	766,977
Cash and cash equivalents at beginning of the year	**766,977**	–
Cash and cash equivalents at end of the year	**118,958**	766,977

Analysis of the balance of cash and cash equivalents:

	2005	2004
	$'000	$'000
Fixed and call deposits with banks	**81,663**	766,964
Cash at bank	**37,295**	13
	118,958	766,977

Investor Compensation Fund

[Notes to the Financial Statements]

For the year ended 31 March 2005

(Expressed in Hong Kong dollars)

1. Purpose, limitation and principal activity

The Securities and Futures Ordinance (SFO) provides for the establishment of the Investor Compensation Fund (the Fund) to compensate investors who suffer a loss due to the default of an intermediary in relation to trading of products on Hong Kong Exchanges and Clearing Limited. The defaulting intermediary must be licensed or registered with the Securities and Futures Commission (SFC) for dealing in securities, futures contracts or securities margin financing.

The SFC is primarily responsible for the administration and management of the Fund in accordance with Section 238 of the SFO, but has transferred some functions to the Investor Compensation Company Ltd. (ICC) under Section 80 of the SFO. ICC is thus responsible for receipt, determination and payment of valid claims against the Fund in respect of defaults of intermediaries occurring on or after 1 April 2003. Upon making payment to a claimant, the SFC is subrogated to the claimant's right against the defaulter.

Pursuant to Section 244 of the SFO, the Chief Executive in Council has by order set the maximum amount of compensation at $150,000 per claimant for a single default in relation to securities traded at the Stock Exchange of Hong Kong Limited (SEHK) or futures contracts traded at the Hong Kong Futures Exchange Limited (HKFE).

If amounts owed to claimants against the Fund exceed the Fund's net assets, the SFC would apportion compensation payments to claimants as provided in the Securities & Futures (Investor Compensation-Claims) Rules. The SFC would pay unpaid claim amounts when funds became available in the Fund.

2. Money constituting the Fund

The Fund mainly consists of the amounts paid from the two existing compensation funds, the Unified Exchange Compensation Fund (UECF) and the Commodity Exchange Compensation Fund (CECF). The SFC will also pay into the Fund any remaining balance in the Securities Dealers' Deposits Fund and the Commodities Dealers' Deposits Fund after repaying the dealers' deposits and any money due to the registered dealers in accordance with Section 76(11) of Schedule 10 of the SFO.

Other sources of money for the Fund include the levies chargeable on securities traded on the SEHK and futures contracts traded on the HKFE, and returns earned on the investment of the Fund.

3. Significant accounting policies

Basis of preparation

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

3. Significant accounting policies (cont'd)

Recognition of income

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

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

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 on translation in the income and expenditure account.

Investments

We classify our investments as current assets and state these investments 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 published closing prices or quoted bid prices at the balance sheet date. We account for purchases and sales of debt securities and equity securities on the settlement date. For those debt securities committed at the balance sheet date but not yet settled, we recognise their changes in value as income and other receivable in the income and expenditure account and balance sheet respectively

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.

We calculate the recoverable amount of the Fund's investments in 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.

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 if we had not recognised any impairment loss.

3. Significant accounting policies (cont'd)

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 for which the SFC or ICC has published a notice calling for claims pursuant to Section 3 of the Securities and Futures (Investor Compensation-Claims) Rules. The provision covers all such claims received up to the date on which the financial statements are approved by the SFC.

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

Other payables

We state other payables at cost.

Contingent liability

Unless the probability of outflow of economic benefits is remote, we disclose obligations 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 to 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.

4. Taxation

The interest and profits on investment earned by the Fund are not subject to profits tax under Section 14 of the Inland Revenue Ordinance.

5. Net investment income

	2005	2004
	$'000	$'000
Interest income from bank deposits and debt securities	**20,080**	4,254
Realised gain on disposal of equity securities	**44**	–
Realised loss on redemption/disposal of debt securities	**(2,252)**	–
Gain on revaluation of equity securities	**22,632**	–
(Loss)/gain on revaluation of debt securities	**(11,836)**	389
Net investment income	**28,668**	4,643

6. Levy from the SEHK

From 1 April 2003, the Fund received a levy chargeable under Part 2 of the Securities and Futures (Investor Compensation-Levy) Rules at 0.002% of every leviable SEHK transaction.

7. Levy from the HKFE

From 1 April 2003, the Fund received a levy chargeable under Part 3 of the Securities and Futures (Investor Compensation-Levy) Rules at $0.5 per leviable HKFE contract except for Mini-Hang Seng Index Futures Contracts, Mini-Hang Seng Index Options Contracts, Stock Futures Contracts and Options on Stock Futures Contracts, all of which are chargeable at $0.1 per contract.

8. ICC expenses

The SFC formed the Investor Compensation Company Limited (ICC) in September 2002 to perform functions on behalf of the Fund in relation to the compensation to investors and other functions under Part III and Part XII of the SFO. The Fund is responsible for funding the establishment and operation of ICC. For the year ended 31 March 2005, ICC incurred cost of $4,066,000 for its operation (2004: $4,434,000).

Investor Compensation Fund

9. Debt securities

	2005	2004
	$'000	$'000
Listed outside Hong Kong	**654,186**	90,028
Unlisted	**528,479**	84,258
	1,182,665	174,286

During the year, the Fund purchased from the UECF debt securities of total nominal value of HK$61 million at market prices.

10. Contributions from UECF and CECF

Under Sections 74(2) and 75(2) of Schedule 10 of the SFO, the SFC may pay into the Fund such sum of money from the UECF and the CECF as it considers appropriate after 1 April 2003. Upto 31 March 2005, the SFC paid $994,718,000 and $107,960,000 into the Fund from the UECF and the CECF respectively.

11. Related party transactions

We have related party relationships with the SFC, the ICC, the SEHK, the HKFE, the UECF and the CECF. During the year, there were no significant related party transactions other than those disclosed in the financial statements (refer to notes 6 to 10).

12. Financial instruments

Financial assets of the Fund comprise debt securities and pooled fund. The underlying investments of the pooled fund mainly include equity securities.

(i) Credit risk

The Fund's investment policy only allows the Fund to invest in pooled funds, fixed rate dated securities or in bank deposits. Other than those holdings of pooled funds and fixed rate dated securities issued by the US Treasury and multilateral agencies with AAA credit rating, the policy limits the Fund's exposure to each organisation and each country to not more than 15% and 20% of the Fund's total investments 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 have US dollar foreign exchange exposure. As the HK dollar is pegged with the US dollar, the Fund was not exposed to significant foreign exchange risk.

(iii) Market risk

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

13. Contingent liabilities

As at the date of this report, the Fund has received claims against four intermediaries. The validity of these claims is under investigation. We have not made any provision for these claims. The maximum contingent liability of the Fund to these claims is $900,000 (2004: $450,000).

Unified Exchange Compensation 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 2005.

1. Establishment of the Unified Exchange Compensation Fund (the Fund)

Part X of the repealed Securities Ordinance (Chapter 333) established the Fund. However, when the Securities and Futures Ordinance (SFO) and its subsidiary legislation came into effect from 1 April 2003, a new single investor compensation fund (ICF) was formed to ultimately replace the Fund and the Commodity Exchange Compensation Fund. After reserving sufficient money in the Fund to meet claims against it and its other liabilities, the SFC will eventually transfer the remaining balance of the Fund to the ICF.

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

2. Financial results

The Committee presents the financial results which are set out in the financial statements on pages 124 to 134.

3. Members of the Committee

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

Mr. Peter Au-Yang	[appointed on 1 April 2005]
Mr. Mark Dickens, JP	[resigned on 31 March 2005]
Mr. Paul Chow Man Yiu, JP	[resigned on 31 March 2005]
Mr. Eddy C Fong, SBS, JP	[appointed on 1 April 2005]
Mr. Gerald Greiner	[appointed on 1 April 2005]
Mrs. Alexa Lam	
Mr. David M Roberts	
Mr. T Brian Stevenson, SBS	[resigned on 31 March 2005]

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, KPMG, being eligible, offer themselves for re-appointment.

On behalf of the Committee

Peter Au-Yang
Chairman

28 April 2005

[Auditors' Report To The Securities And 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 124 to 134 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 solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

Basis of opinion

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Institute of Certified Public 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, consistently applied and 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 as at 31 March 2005 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

28 April 2005

Unified Exchange Compensation Fund

[Income and Expenditure Account]

For the year ended 31 March 2005

(Expressed in Hong Kong dollars)

	Note	2005	2004
		$'000	$'000
Income			
Net investment income	3&5	**955**	8,687
Transaction levy	3	**–**	(4)
Compensation refund from claimants		**–**	31,810
Recoveries	3&7	**14,673**	107,899
Provision for compensation reversed	3&10	**5,202**	3,799
		20,830	152,191
Expenses			
Auditors' remuneration		**37**	37
Bank charges		**29**	110
Professional fees		**23**	138
Sundry expenses		**2**	54
		91	339
Surplus for the year		**20,739**	151,852
Accumulated deficit brought forward		**(13,284)**	(165,136)
Accumulated surplus/(deficit) carried forward		**7,455**	(13,284)

The notes on pages 128 to 134 form part of these financial statements.

[Balance Sheet]

At 31 March 2005

(Expressed in Hong Kong dollars)

	Note	2005	2004
		$'000	$'000
Current assets			
Debt securities	6	**–**	160,985
Equity securities received under subrogation	7	**7,793**	7,251
Interest receivable		**36**	2,024
Fixed and call deposits with banks		**47,028**	167,407
Cash at bank		**52**	215
		54,909	337,882
Current liabilities			
Accounts payable and accrued charges	8	**4,291**	4,522
Provision for compensation	3&10	**1,492**	9,545
		5,783	14,067
Net current assets		**49,126**	323,815
Net assets		**49,126**	323,815
Representing:			
Compensation fund			
Contributions from the SEHK		**46,100**	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 surplus/(deficit)		**7,455**	(13,284)
		1,043,844	1,023,455
Contributions to Investor Compensation Fund	14	**(994,718)**	(699,640)
		49,126	323,815

Approved and authorised for issue by the Securities Compensation Fund Committee on behalf of the Securities and Futures Commission on 28 April 2005 and signed on its behalf by

Peter Au-Yang	**Alexa Lam**	**Eddy C Fong**
Chairman	*Committee Member*	*Committee Member*

The notes on pages 128 to 134 form part of these financial statements.

Unified Exchange Compensation Fund

[Statement of Changes in Equity]

For the year ended 31 March 2005

(Expressed in Hong Kong dollars)

	Note	2005	2004
		$'000	$'000
Compensation Fund balance as at 1 April		**323,815**	871,603
Surplus for the year		**20,739**	151,852
Contributions refunded to the SEHK		**(350)**	–
Contributions to Investor Compensation Fund	14	**(295,078)**	(699,640)
Compensation Fund balance as at 31 March		**49,126**	323,815

The notes on pages 128 to 134 form part of these financial statements.

[Cash Flow Statement]

For the year ended 31 March 2005

(Expressed in Hong Kong dollars)

	2005	2004
	$'000	$'000
Cash flows from operating activities		
Surplus for the year	**20,739**	151,852
Net investment income	**(955)**	(8,687)
Decrease in levy receivable	**–**	5,607
Increase in equity securities received under subrogation	**(542)**	(7,251)
Decrease in provision for compensation	**(8,053)**	(21,083)
Decrease in accounts payable and accrued charges	**(231)**	(68)
Net cash from operating activities	**10,958**	120,370
Cash flows from investing activities		
Debt securities redeemed	**90,500**	220,000
Debt securities sold	**67,763**	166,824
Interest received	**5,665**	20,364
Net cash from investing activities	**163,928**	407,188
Cash flows from financing activities		
Contributions refunded to the SEHK	**(350)**	–
Contributions to Investor Compensation Fund	**(295,078)**	(699,640)
Net cash used in financing activities	**(295,428)**	(699,640)
Net decrease in cash and cash equivalents	**(120,542)**	(172,082)
Cash and cash equivalents at beginning of the year	**167,622**	339,704
Cash and cash equivalents at end of the year	**47,080**	167,622

Analysis of the balance of cash and cash equivalents:

	2005	2004
	$'000	$'000
Cash at bank	**52**	215
Fixed and call deposits with banks	**47,028**	167,407
	47,080	167,622

Unified Exchange Compensation Fund

[Notes to the Financial Statements]

For the year ended 31 March 2005

(Expressed in Hong Kong dollars)

1. Purpose, limitation and principal activity

The Fund provides compensation to investors who suffer a loss due to the default of an exchange participant of the Stock Exchange of Hong Kong Limited (SEHK). Part X of the 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.

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

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

2. Money constituting the Fund

Before 1 April 2003, the SEHK was required to 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 (2004: 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 received before the SFO became effective from 1 April 2003.

3. Significant accounting policies

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

Basis of preparation

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

Recognition of income

Net investment income Net investment income comprises (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 recognise recoveries pursuant to Section 118 of the Securities Ordinance as income to the Fund and recoveries re-distributed to claimants as expenses. We record recoveries received and re-distributed 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 compensation payments up to the amount of $8,000,000 for each default to be charged to the contribution from the SEHK.

3. Significant accounting policies (cont'd)

Investments

As we have prepared the financial statements on a break-up basis, we classify our investments in debt securities as current assets and 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 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.

We calculate the recoverable amount of the Fund's investments in 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.

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 if we had not recognised any impairment loss.

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.

3. Significant accounting policies (cont'd)

Other payables

We state other payables at cost.

Contingent liabilities

Unless the probability of outflow of economic benefits is remote, we disclose obligations as contingent liabilities 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 to 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.

4. Taxation

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

5. Net investment income

	2005	2004
	$'000	$'000
Interest income from bank deposits and debt securities	**3,110**	14,463
Loss on revaluation of debt securities	**(2,155)**	(5,776)
Net investment income	**955**	8,687

Unified Exchange Compensation Fund

6. Debt securities

			2005	2004
			$'000	$'000
Maturing after one year				
In the second to third years	–	unlisted	–	–
After three years	–	unlisted	–	44,995
			–	44,995
Maturing within one year	–	unlisted	–	115,990
			–	160,985

During the year, the Fund sold debt securities of nominal value HK$61 million to the ICF at market price.

7. Equity securities and recoveries

In relation to the share distribution from C.A. Pacific Securities Ltd. and C.A. Pacific Finance Ltd., the liquidators had advised SFC that shares were allocated to the Fund under its subrogation rights, subject to paying a processing fee to the liquidators. The Fund arranged to liquidate the shares as far as possible. The Fund recognised as recoveries the sale proceeds and the remaining shares at market value as of 31 March 2005 after deducting relevant processing fees and charges for collecting and selling the securities received.

8. Accounts payable and accrued charges

Accounts payable and accrued charges comprised mainly compensation payment re-established for those cheque payments that were not cleared over six months from the cheque issuing date and accrued auditors' remuneration.

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 46 trading rights having been transferred during the six months to 31 March 2005 (2004: 19 trading rights had been transferred during the six months to 31 March 2004). The SEHK also advised the SFC of two trading rights having been relinquished in July 2004. In respect of these two relinquished trading rights and five trading rights that had been relinquished in November 2003, the SFC had refunded deposits of total $350,000 during the year to the SEHK.

10. Provision for compensation

	2005	2004
	$'000	$'000
Balance brought forward	**9,545**	30,628
Less : Amount paid during the year	**(2,851)**	(17,284)
Add : Net provision reversed	**(5,202)**	(3,799)
Balance carried forward	**1,492**	9,545

We maintain provision for claims in respect of three SEHK exchange participants for which the SEHK has published a notice calling for claims. The maximum liabilities of the Fund in respect of these three defaulted cases exceed the normal $8 million limit provided by Section 109(3) of the Securities Ordinance.

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 2005, 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 $71,562,000 to the Fund as follows:

	2005
	$'000
Compensation paid up to the $8 million limit as set out in Section 109(3) of the Securities Ordinance	**99,091**
Less : Recoveries received for compensation paid up to $8 million	**(27,554)**
Add : Recoveries re-distributed to claimants	**16,385**
Less : Replenishments from the SEHK	**(16,360)**
Net amount the SFC may request the SEHK for replenishment	**71,562**

Under Section 74(3) of 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.

Unified Exchange Compensation Fund

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. Contributions to Investor Compensation Fund

When the SFO and its subsidiary legislation came into effect from 1 April 2003, a new single investor compensation fund (ICF) was formed to ultimately replace the Fund and the Commodity Exchange Compensation Fund. Under Section 74(2) of Schedule 10 of the SFO, the SFC may after 1 April 2003 pay into the ICF, which came into operation after 1 April 2003, such sum of money from the Fund as it considers appropriate. Total contributions paid into the ICF upto 31 March 2005 amounted to $994,718,000.

15. Related party transactions

We have related party relationships with the ICF, 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 6, 9, 11, 12 and 14).

16. Financial instruments

The Fund had Hong Kong dollar deposits with banks only and, as a result, was not subject to significant interest rate, foreign exchange and credit risk.

17. Contingent liabilities

As at the date of this report, the SEHK has received claims against seven exchange participants. The validity of these claims is under investigation by the SEHK. 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 $56 million (2004: $64 million).

Commodity Exchange Compensation 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 2005.

1. Establishment of the Commodity Exchange Compensation Fund (the Fund)

Part VIII of the repealed Commodities Trading Ordinance (Chapter 250) established the Fund. However, when the Securities and Futures Ordinance (SFO) and its subsidiary legislation came into effect from 1 April 2003, a new single investor compensation fund (ICF) was formed to ultimately replace the Fund and the Unified Exchange Compensation Fund. After reserving sufficient money in the Fund to meet claims against it and its other liabilities, the SFC will eventually transfer the remaining balance of the Fund to the ICF.

Part VIII of the repealed Commodities Trading Ordinance remains effective in respect of the operation of the Fund to the extent described in Section 75 of Schedule 10 of the SFO.

2. Financial results

The Committee presents the financial results which are set out in the financial statements on pages 137 to 143.

3. Members of the Committee

The members of the Committee during the year ended 31 March 2005 and up to the date of this report were:

Mr. Peter Au-Yang	[appointed on 1 April 2005]
Mr. Mark Dickens, JP	[resigned on 31 March 2005]
Mr. Lawrence Fok	[resigned on 31 May 2004]
Mr. Eddy C Fong, SBS, JP	[appointed on 1 April 2005]
Mr. Gerald Greiner	[appointed on 21 June 2004]
Mrs. Alexa Lam	
Mr. T Brian Stevenson, SBS	[resigned on 31 March 2005]
Mr. Calvin Tai	

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, KPMG, being eligible, offer themselves for re-appointment.

On behalf of the Committee

Peter Au-Yang
Chairman

28 April 2005

Commodity Exchange Compensation Fund

[Auditors' Report To The Securities And 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 137 to 143 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 solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

Basis of opinion

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Institute of Certified Public 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, consistently applied and 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 as at 31 March 2005 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

28 April 2005

[Income and Expenditure Account]

For the year ended 31 March 2005

(Expressed in Hong Kong dollars)

	Note	2005	2004
		$'000	$'000
Income			
Net investment income	3&5	**2**	731
Expenses			
Auditors' remuneration		**25**	37
Bank charges		**1**	21
Professional fees		**9**	22
Sundry expenses		**1**	2
		36	82
(Deficit)/surplus for the year		**(34)**	649
Accumulated surplus brought forward		**108,262**	107,613
Accumulated surplus carried forward		**108,228**	108,262

The notes on pages 141 to 143 form part of these financial statements.

Commodity Exchange Compensation Fund

[Balance Sheet]

At 31 March 2005

(Expressed in Hong Kong dollars)

	Note	2005	2004
		$'000	$'000
Current assets			
Fixed and call deposits with banks		**488**	524
Cash at bank		**4**	5
		492	529
Current liabilities			
Accounts payable and accrued charges	6	**224**	227
Net current assets		**268**	302
Net assets		**268**	302
Representing:			
Compensation fund			
Accumulated surplus		**108,228**	108,262
Contributions to Investor Compensation Fund	7	**(107,960)**	(107,960)
		268	302

Approved and authorised for issue by the Futures Compensation Fund Committee on behalf of the Securities and Futures Commission on 28 April 2005 and signed on its behalf by

Peter Au-Yang	**Alexa Lam**	**Eddy C Fong**
Chairman	*Committee Member*	*Committee Member*

The notes on pages 141 to 143 form part of these financial statements.

[Statement of Changes in Equity]

For the year ended 31 March 2005

(Expressed in Hong Kong dollars)

	Note	2005	2004
		$'000	$'000
Compensation Fund balance as at 1 April		**302**	129,013
(Deficit)/surplus for the year		**(34)**	649
Contributions reimbursed to the HKFE		**–**	(21,400)
Contributions to Investor Compensation Fund	7	**–**	(107,960)
Compensation Fund balance as at 31 March		**268**	302

The notes on pages 141 to 143 form part of these financial statements.

Commodity Exchange Compensation Fund

[Cash Flow Statement]

For the year ended 31 March 2005

(Expressed in Hong Kong dollars)

	2005	2004
	$'000	$'000
Cash flows from operating activities		
(Deficit)/surplus for the year	**(34)**	649
Net investment income	**(2)**	(731)
Decrease in levy receivable	**–**	772
Decrease in accounts payable and accrued charges	**(3)**	(25)
Net cash (used in)/from operating activities	**(39)**	665
Cash flows from investing activities		
Debt securities redeemed	**–**	23,000
Debt securities sold	**–**	51,555
Interest received	**2**	2,766
Net cash from investing activities	**2**	77,321
Cash flows from financing activities		
Contributions reimbursed to the HKFE	**–**	(21,400)
Contributions to Investor Compensation Fund	**–**	(107,960)
Net cash used in financing activities	**–**	(129,360)
Net decrease in cash and cash equivalents	**(37)**	(51,374)
Cash and cash equivalents at beginning of the year	**529**	51,903
Cash and cash equivalents at end of the year	**492**	529

Analysis of the balance of cash and cash equivalents:

	2005	2004
	$'000	$'000
Cash at bank	**4**	5
Fixed and call deposits with banks	**488**	524
	492	529

[Notes to the Financial Statements]

For the year ended 31 March 2005

(Expressed in Hong Kong dollars)

1. Purpose, limitation and principal activity

The Fund provides compensation to investors who suffer a loss due to the default of an exchange participant of the Hong Kong Futures Exchange Limited (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.

After the Securities and Futures Ordinance (SFO) and its subsidiary legislation came into effect from 1 April 2003, a new single investor compensation fund (ICF) was formed to ultimately replace the Fund and the Unified Exchange Compensation Fund. After allowing a sufficient sum of money in the Fund to meet claims against it and its other liabilities, the SFC will eventually transfer the remaining balance of the Fund into the ICF. Claims for any defaults occurring after 31 March 2003 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 of the Commodities Trading Ordinance, under Section 75(1) of Schedule 10 of the SFO, Part VIII of the Commodities Trading Ordinance remains effective in respect of the operation of the Fund.

2. Money constituting the Fund

Under the Commodities Trading Ordinance, the HKFE was required to keep deposited with the SFC $100,000 for each holder of HKFE trading rights before 1 April 2003. In December 2003, these deposits were reimbursed to the HKFE according to Section 75(3) of Schedule 10 of the SFO.

Other sources of money for the Fund include a contract levy chargeable on contracts traded on the HKFE before the SFO came into effect on 1 April 2003 and recoveries.

Commodity Exchange Compensation Fund

3. Significant accounting policies

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

Basis of preparation

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

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.

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 to significantly influence in making financial and operating decisions;

(ii) parties that have the ability, directly or indirectly, to control or to 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.

4. Taxation

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

5. Net investment income

	2005	2004
	$'000	$'000
Interest income from bank deposits and debt securities	2	1,474
Loss on revaluation of debt securities	–	(743)
Net investment income	2	731

6. Accounts payable and accrued charges

Accounts payable and accrued charges comprised mainly compensation payment re-established for those cheque payments that were not cleared over six months from the cheque issuing date and accrued auditors' remuneration.

7. Contributions to Investor Compensation Fund

When the SFO and its subsidiary legislation came into effect from 1 April 2003, a new single investor compensation fund (ICF) was formed to ultimately replace the Fund and the Unified Exchange Compensation Fund. Under Section 75(2) of Schedule 10 of the SFO, the SFC may after 1 April 2003 pay into the ICF, which came into operation after 1 April 2003, such sum of money from the Fund as it considers appropriate. As at 31 March 2005, total $107,960,000 were transferred into the ICF from the Fund (31 March 2004: $107,960,000).

8. Related party transactions

We have related party relationships with the ICF, the SFC and the HKFE. During the year, there were no significant related party transactions.

9. Financial instruments

The Fund had Hong Kong dollar deposits with banks only and, as a result, was not subject to significant interest rate, foreign exchange and credit risk.

10. Contingent liabilities

As at the date of this report, there is no outstanding claim against the Fund (2004: nil).

Committees, Panels and Tribunal

[Committees of the SFC]

Advisory Committee

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

Chairman	**Members**	
Andrew L T Sheng, SBS, JP	Ashley Alder (to 22.10.04)	Richard Gnodde (from 01.07.04 to 31.12.04)
	Peter Au-Yang (from 15.11.04)	Stephen C C Hui, JP
	Thaddeus Beczak	Alexa Lam
	Ambrose Cheung	Christine Loh
	Paul Chow, JP	Roger Luk, JP
	Paul Fan, JP	Blair Pickerell (from 01.07.04)
	Eddy C Fong, SBS, JP (to 23.12.04)	Samuel Poon
	Mario Francescotti (to 13.05.04)	Dr. Eden Woon
No of meetings : 4	**Average attendance rate (%) : 85%**	

Takeovers and Mergers Panel

Administers the Code on Takeovers and Mergers.

Chairman	**Members**	
Kevin Westley	Nicholas Allen	Liu Chee-ming
	Jim Baird (from 01.04.04)	David Lui (to 31.03.05)
Deputy Chairmen	Ian Boyce	John Maguire
Clifton Chiu	Malcolm Brown	Gavin Nesbitt
Stephen Clark (from 01.04.04)	Edward W S Cheng (to 31.03.05)	Patricia Shih
Henry H L Fan, SBS, JP	Eddy C Fong, SBS, JP (from 01.01.05)	Frank Slevin
David Graham (from 01.04.04)	Clement Kwok	T Brian Stevenson, SBS (from 01.04.04 to 31.12.04)
Teresa Ko (from 01.04.04)	Angelina Lee, JP	May Tan
	John Lees	Carlson Tong
	Alfred Li	David M Webb
		V-Nee Yeh
No of meetings : 4	**Average attendance rate for Code Review Meeting (%) : 43.3%**	

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.

Chairman
Timothy G Freshwater (to 31.03.04)
Kenneth H W Kwok, SC (from 01.04.04 to 31.12.04)
Angelina Lee, JP (from 22.02.05)

Deputy Chairman
Rajat K Jindal (to 31.03.04)
Teresa Ko (from 22.02.05)
Angelina Lee, JP (from 01.04.04 to 21.02.05)

Members
Nicholas Allen
Jim Baird (from 01.04.04)
Ian Boyce
Malcolm Brown
Edward W S Cheng (to 31.03.05)
Clifton Chiu
Stephen Clark
Henry H L Fan, SBS, JP
Eddy C Fong, SBS, JP (from 01.01.05)
David Graham
Teresa Ko (to 21.02.05)
Clement Kwok
John Lees
Alfred Li
Liu Chee-ming
David Lui (to 31.03.05)
John Maguire
Gavin Nesbitt
Patricia Shih
Frank Slevin
T Brian Stevenson, SBS (from 01.04.04 to 31.12.04)
May Tan
Carlson Tong
David M Webb
Kevin Westley
V-Nee Yeh

No of meeting : 0

Average attendance rate (%) : N/A

Committee on Unit Trusts

Authorises collective investment schemes commonly regarded as mutual funds and unit trusts; imposes conditions on the authorisation of such schemes and grants waivers.

Chairman
Alexa Lam

Full Members
Dr. Au King Lun (from 01.04.04)
Prof. Ka-Keung C Chan
Christina Choi (from 03.01.05)
Vincent Duhamel (to 31.03.05)
Roger Hepper
Stuart Leckie, JP
Dr. York Liao, SBS, JP (from 18.01.05)
George Long (to 31.03.05)
Darren McShane
Alastair Murray
Simon Ng (from 01.04.04)
Tina So (to 21.07.04)
Anna H Y Wu, SBS, JP (to 31.12.04)

Alternate Members
Joseph Ho
David Hughes
Frank Kusse (to 31.08.04)
Blair Pickerell (from 01.04.04)
K K Tse (to 31.03.05)
Scobie Ward (to 31.03.05)

No of meetings : 3

Average attendance rate (%) : 68%

Committees, Panels and Tribunal

Committee on Investment-Linked Assurance and Pooled Retirement Funds

Authorises investment-linked assurance schemes and pooled retirement funds; imposes conditions on the authorisation of investment-linked assurance schemes and pooled retirement funds and grants waivers.

Chairman	Full Members		
Alexa Lam	Rex Auyeung	Terry Lo (to 13.05.04)	
	Desmond Chan	Darren McShane	
	Prof. Ka-Keung C Chan	Alastair Murray	
	Christina Choi (from 03.01.05)	Tina So (to 21.07.04)	
	August Chow (to 16.07.04)	Anna H Y Wu, SBS, JP (to 31.12.04)	
	Angel Hon (from 17.07.04)	**Alternate Members**	
	Richard Ip (from 14.05.04)	Francine Fu	
	Stuart Leckie, JP	Kevin Lee	
	Dr. York Liao, SBS, JP (from 18.01.05)	Simon Ng	
		Oscar Wong	
No of meeting : 0	**Average attendance rate (%) : N/A**		

Committee on Real Estate Investment Trusts

Advises the Commission on general policy matters or regulatory issues that are related to the Code on REITs, the overall market development of REITs, the property or securities market or investment management in Hong Kong or elsewhere, professional practices or guidelines that are involved in the operation of REITs, and fund investment or management in general.

Chairman	Members	
Alexa Lam	Henry Cheong	Alice Law (from 01.09.04)
	Martin Cubbon	C Y Leung, JP
	Eddy C Fong, SBS, JP (to 23.12.04)	Stephen Po
	Roger Hepper	David Richardson
	Heung Shu Fai	Paul Smith
No of meetings : 2	**Average attendance rate (%) : 82%**	

Securities Compensation Fund Committee

Administers the Unified Exchange Compensation Fund (Fund) and regulates its procedures in accordance with Part X of the repealed Securities Ordinance which, under Section 74 of Schedule 10 to the Securities and Futures Ordinance, continues to apply to and in relation to any claim for compensation from the Fund made before 1 April 2003.

Chairman	Members	
Mark Dickens, JP (to 31.03.05)	Paul Chow, JP (to 31.03.05)	David M Roberts
	Alexa Lam	T Brian Stevenson, SBS (to 31.03.05)
No of meeting : 1	**Average attendance rate (%) : 100%**	

Futures Compensation Fund Committee

Administers the Commodity Exchange Compensation Fund (Fund) and regulates its procedures in accordance with Part VIII of the repealed Commodities Trading Ordinance which, under Section 75 of Schedule 10 to the Securities and Futures Ordinance, continues to apply to and in relation to any claim for compensation from the Fund made before 1 April 2003.

Chairman Mark Dickens, JP (to 31.03.05)	**Members** Lawrence K M Fok (to 31.05.04) Gerald Greiner (from 21.06.04)	Alexa Lam T Brian Stevenson, SBS (to 31.03.05) Calvin Tai
No of meeting : 1	**Average attendance rate (%) : 80%**	

Investor Compensation Fund Committee

Administers the Investor Compensation Fund and regulates its procedures in accordance with the Securities and Futures Ordinance.

Chairman Mark Dickens, JP (to 31.03.05)	**Members** Paul Chow, JP (to 20.09.04) Gerald Greiner (from 20.09.04)	Alexa Lam Anna H Y Wu, SBS, JP
No of meeting : 1	**Average attendance rate (%) : 100%**	

Investor Education Advisory Committee

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

Chairman Peter Au-Yang	**Full Members** Allen Y N Cham (from 01.04.04 to 31.03.05) Prof. Chan Ka Lok (from 01.04.04 to 31.03.05) Robert C Chow (to 31.03.05) Lawrence K M Fok Ben M B Kwong (from 01.04.04) Ivy W Y Lai Connie Y H Lau (from 01.04.04) Sandra Lee (from 01.04.04 to 14.11.04)	The Hon Fred W M Li, JP (from 01.04.04 to 31.03.05) Victor C K Ng (from 01.04.04 to 31.03.05) Joseph Y W Pang, JP (from 01.04.04) Howard H P Sou **Alternate Members** Matthew Harrison (from 01.04.04 to 31.03.05) Wong Koon Shing Sally Wong
No of meetings : 3	**Average attendance rate (%) : 92%**	

Committees, Panels and Tribunal

Academic and Accreditation Advisory Committee

Approves industry-based courses and examinations for the purpose of meeting the competence requirement; endorses applications from professional bodies and tertiary institutions as recognised institutions for providing continuous professional training; advises the Commission on areas to study in the context of enhancing Hong Kong's position as an international financial centre; provides input for the development of industry related courses and training programs.

Chairman	**Members**	
Alexa Lam	Prof. Charles D Booth (to 18.02.05)	Albert Thomas Da Rosa, Junior
	Prof. Johannes M M Chan, SC (from 19.02.05)	Stephen C C Hui, JP
	Prof. Chan Ka Lok (from 19.02.05)	Sandra Lee
	Prof. Joseph Y S Cheng (from 19.02.05)	Vincent M K H Lee
	Prof. Stephen Y L Cheung (to 18.02.05)	Prof. Paul B McGuinness (to 18.02.05)
		Derek Shek
		Prof. Raymond W M So
No of meetings : 2	**Average attendance rate (%) : 75%**	

Public Shareholders Group

Advises on issues relating to shareholders' rights and interests.

Chairman	**Members**	
Ashley Alder (to 22.10.04)	Jamie Allen	Vincent Duhamel
Peter Au-Yang (from 23.10.04)	Rex Auyeung	Heung Shu Fai (to 16.06.04)
	Prof. Andrew Chan	David Lui
	Chan Wing Luk	Richard Mak
	The Hon Albert J H Cheng (to 23.11.04)	Douglas J Naismith (from 01.07.04)
	David Cheung	David T K Sun
	Chung Man Wing (from 01.07.04)	David M Webb
No of meetings : 8	**Average attendance rate (%) : 56%**	

SFC Dual Filing Advisory Group

Advises on treatment of cases under the Dual Filing regime and the relevant regulatory provisions, as well as on related policy issues.

Chairman	**Members**	
Members present in each committee meeting will elect a Chairman among themselves at the beginning of that meeting.	Ashley Alder (from 16.11.04)	James Siu (from 16.11.04)
	Dennis Cassidy	Frank J Slevin
	David Cheung (from 16.11.04)	Carlson Tong
	Teresa Ko	Peter P W Tse
	W Gage McAfee	Tony Tsoi
	Mike Scales	V-Nee Yeh
No of meetings : 3	**Average attendance rate (%) : 90%**	

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.

Chairman	**Members**	
Members present in each Committee meeting will elect a Chairman among themselves at the beginning of that meeting.	Thaddeus Beczak Eric Cheng Stephen J Clark Mark Dickens, JP (to 31.03.05) Alexa Lam	Alan Linning Patricia Shih Tina So (to 21.07.04) Carlson Tong V-Nee Yeh
No of meeting : 0	**Average attendance rate (%) : N/A**	

SFC (HKEC Listing) Appeals Committee

Exercises powers and functions equivalent to those of the Stock Exchange's Listing Appeals Committee when real or potential conflicts of interest arise between the interests of HKEx and those of the proper performance of the Stock Exchange's listing functions, the relevant powers and functions may be exercised by the SFC.

Chairman	**Member**	
Members present in each Committee meeting will elect a Chairman among themselves at the beginning of that meeting.	Christopher W C Cheng, GBS, JP Eddy C Fong, SBS, JP (from 01.01.05) Daniel R Fung, SBS, SC, QC, JP (to 31.12.04) Kenneth H W Kwok, SC (from 01.01.05) Raymond P L Kwok	Dr. York Liao, SBS, JP Prof. Liu Pak Wai, SBS (from 01.01.05) Andrew L T Sheng, SBS, JP T Brian Stevenson, SBS (to 31.12.04) The Hon Jasper Tsang Yok Sing, GBS, JP Anna H Y Wu, SBS, JP (to 31.12.04)
No. of meeting : 0	**Average attendance rate (%) : N/A**	

Committees, Panels and Tribunal

Share Registrars' Disciplinary Committee

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

Share Registrars' Disciplinary Appeals Committee

Hears and determines appeals from the Share Registrars' Disciplinary Committee.

Chairman	**Members**	Clifford Levy
Martin Rogers	Nicholas Allen	Mark Lin
	Roger T Best, JP	Teresa Ma
Deputy Chairman	Rebecca Chow	Michael W Scales
Stephen Clark	Henry H L Fan, SBS, JP	T Brian Stevenson, SBS
	David Graham	David T K Sun
	David Halperin	Carlson Tong
	Mark Johnson	Jason Webber
	Teresa Ko	Kevin Westley
	Dr. Bill Kwok	James Wong
	Alan Lee	V-Nee Yeh
No of meeting : 0	**Average attendance rate (%) : N/A**	

Note: Members of the Share Registrars' Disciplinary Appeals Committee for the hearing of each appeal case brought before it consists of members of the Share Registrars' Disciplinary Committee who did not preside or participate in the disciplinary hearing of that case.

[Internal Committees]

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; and considers any other matters referred to it by the Commission.

Chairman	**Member**
Eddy C Fong, SBS, JP (from 17.01.05)	Kenneth H W Kwok, SC (from 17.01.05)
T Brian Stevenson, SBS (to 31.12.04)	Raymond P L Kwok (to 16.01.05)
Deputy Chairman	
Raymond P L Kwok (from 17.01.05)	
Anna H Y Wu, SBS, JP (to 31.12.04)	
No of meetings : 5	**Average attendance rate (%) : 100%**

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	**Members**	
Raymond P L Kwok	Peter Au-Yang	Prof. Liu Pak Wai, SBS (from 29.03.05)
Deputy Chairman	Mark Dickens, JP (to 31.03.05)	Andrew L T Sheng, SBS, JP
Christopher W C Cheng, GBS, JP	Alexa Lam (from 29.03.05)	
No of meeting : 1	**Average attendance rate (%) : 100%**	

Management Committee

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

Chairman	**Members**	
Andrew L T Sheng, SBS, JP	Ashley Alder (to 22.10.04)	Brian Ho
	Peter Au-Yang	Alexa Lam
	Mark Dickens, JP (to 31.03.05)	Alan Linning
	Gerald Greiner (to 16.05.04)	Keith Lui
	Geoffrey Harris	Stephen Po
		Andrew Young
No of meetings : 12	**Average attendance rate (%) : 74%**	

Remuneration Committee

Reviews policy on the structure of staff remuneration 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	**Members**	
Daniel R Fung, SBS, SC, QC, JP (to 31.12.04)	Christopher W C Cheng, GBS, JP (to 31.12.04)	Dr. York Liao, SBS, JP (to 31.12.04)
Dr. York Liao, SBS, JP (from 17.01.05)	Eddy C Fong, SBS, JP (from 17.01.05)	Prof. Liu Pak Wai, SBS (from 17.01.05)
Deputy Chairman	Kenneth H W Kwok, SC (from 17.01.05)	T Brian Stevenson, SBS (to 31.12.04)
Christopher W C Cheng, GBS, JP (from 17.01.05)	Raymond P L Kwok	The Hon Jasper Tsang Yok Sing, GBS, JP
Anna H Y Wu, SBS, JP (to 31.12.04)		
No of meetings : 4	**Average attendance rate (%) : 75%**	

Committees, Panels and Tribunal

[Independent Panels and Tribunal]

Process Review Panel for the Securities and Futures Commission

Reviews and advises the SFC upon the adequacy of the SFC's internal procedures and operational guidelines governing the action taken and operational decisions made by the SFC and its staff in the performance of its regulatory functions, including the receipt and handling of complaints, licensing and inspection of intermediaries, and disciplinary action.

Chairman	**Members**	
Vincent H C Cheng, JP	Prof. Chan Yuk-shee, JP	Kam Pok-man
	Henry Y C Cheong	Edward P C Kwan
	Anthony W K Chow, SBS, JP	Joseph Y W Pang, JP
	The Hon Audrey Y M Eu, SC, JP	Andrew L T Sheng, SBS, JP
	Fong Hup	Dr. York Liao, SBS, JP
		Ian G M Wingfield, GBS, JP

Arbitration Panel under Securities and Futures (Leveraged Foreign Exchange Trading) (Arbitration) Rules

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

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

Securities and Futures Appeals Panel (From 1 June 2004 to 31 May 2006, or until completion of the hearing of the outstanding appeal case)

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

Chairman	**Members**
Alan Hoo, SC, JP	Dannis J H Lee, BBS
	Peter S H Wong
Deputy Chairman	
Patrick P T Fung, SC, FCIArb	

Securities and Futures Appeals Tribunal

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

Chairman

The Hon Mr Justice Stone,
Judge of the Court of
First Instance of
the High Court

Members

Dr. Au King Lun
Roger T Best, JP
Prof. Ka-Keung C Chan
Fong Hup
Shirley Fung
David Graham
Stephen C C Hui, JP
Teresa Ko
Dr. Bill Kwok
Kenneth H W Kwok, SC (to 22.12.04)
Clement K M Kwok
Vincent M K H Lee
Angelina Lee, JP
Roger Luk, JP
David T K Sun
Tang Kwai-Nang, JP
Tse Kam-Keung
Samuel N Tsien
Dr. Michael F S Tsui
Gordon R Ward
Wilfred W S Wong

Consultations, Codes and Guidelines

The following were published in 2004-2005:

Consultation Papers : 9

August 2004	1. Consultation Paper on the Proposed Repeal of Certain Class Exemptions made under section 38A(2)/342A(2) of the Companies Ordinance
September 2004	2. Consultation Paper on the Proposed Measures to Address Risks Arising from Securities Margin Financing
November 2004	3. Consultation Paper on a Review of the Codes on Takeovers and Mergers and Share Repurchases
December 2004	4. Consultation Paper on the Review of the Level and Funding of the Investor Compensation Fund, Broker Defaults since 1998 and the Operation of the Investor Compensation Arrangements
January 2005	5. Consultation Paper on Proposed Amendments to the Securities and Futures (Stock Market Listing) Rules
January 2005	6. Consultation Paper on the Review of the Disclosure of Interests Regime under Part XV of the SFO
February 2005	7. Consultation Paper on Proposed Amendments to Schedule 5 of the SFO
February 2005	8. Consultation Paper on Investments in REITs by Collective Investment Schemes Authorised under the Code on Unit Trusts and Mutual Funds
March 2005	9. Consultation Paper on Draft Practice Note on Overseas Investments by SFC-Authorised REITs

Conclusions : 5

October 2004	1. Consultation Conclusions on the Regulation of Sponsors and Independent Financial Advisers
November 2004	2. Consultation Conclusions on the Regulatory Framework for Addressing Analyst Conflicts of Interest
November 2004	3. Consultation Conclusions on the Proposed Repeal of Certain Class Exemptions made under section 38A(2)/342A(2) of the Companies Ordinance
November 2004	4. Consultation Conclusions on the Draft Guidelines on Good Disclosure of Securities Services Related Fees and Charges
March 2005	5. Consultation Conclusions on the Review of the Level and Funding of the Investor Compensation Fund, Broker Defaults since 1998 and the Operation of the Investor Compensation Arrangements

Codes & Guidelines : 3

April 2004	1. Guidance Note on Position Limits and Large Open Position Reporting Requirements
November 2004	2. Guidelines to Address Analyst Conflicts of Interest
November 2004	3. Guidelines on Disclosure of Fees and Charges Relating to Securities Services

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A

Accommodation Charges
HKEx's participants must post margin to cover their outstanding obligations. Where non-cash margin (e.g. Exchange Fund Notes, US Treasury Bills or Notes) is posted, HKEx imposes an accommodation charge on participants based on the value of the margin deposited. The accommodation charges applied by HKCC and SEOCH are 1.2% and 2% respectively.
– *p.68*

Advisory Committee
– *pp.15, 144*

Association of Chartered Certified Accountants (ACCA)
An international accountancy body based in UK.
– *pp.28, 80*

Audit Committee
– *pp.15, 150*

Australian Securities and Investments Commission (ASIC)
An independent Australian government body responsible for regulating financial markets, securities, futures and corporations. It is also responsible for consumer protection in superannuation, insurance, deposit taking and credit.
– *p.79*

Automated Trading Services (ATS)
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.24, 66*

Automatic Order Matching and Execution System, the Third Generation (AMS/3)
A new generation of securities trading infrastructure developed by HKEx that connects investors, Stock Exchange Participants, other market participants and the central market through eCommerce facilities.
– *p.68*

B

Backup Office, SFC
– *pp.25, 70, 76*

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.82*

Budget, SFC
– *pp.3, 76*

Budget Committee
– *pp.16, 151*

C

Callable Bull/Bear Contracts
A type of derivative product that tracks the performance of the underlying asset on an almost one to one basis. They expire on a fixed date and must be called (i.e. early terminated) by issuers when the price of the underlying (auto-matched price at any time during trading hours) reaches the call price (i.e. barrier level).
– *pp.25, 67*

Central Clearing and Settlement System (CCASS)
HKEx's clearing and settlement system for its cash market.
– *p.67*

Chief Executive, HKSAR
– *pp.10, 14*

Chief Operating Officer (COO)
– *pp.5, 11, 28, 78*

China Securities Regulatory Commission (CSRC)
The authorised department under the State Council that governs the securities and futures markets of China.
– *pp.65, 79, 90*

Closer Economic Partnership Arrangement (CEPA)
An agreement between the Central People's Government and the HKSAR Government to strengthen trade and investment co-operation and promote joint development.
– *p.86*

Codes of Conduct for Persons Licensed by or Registered with the SFC (Code of Conduct)
– *p.49*

Codes on Takeovers and Mergers and Share Repurchases
– *pp.24, 26 ,29, 34, 154*

Commercial Crime Bureau (CCB)
A bureau of the Hong Kong Police that investigates serious and complex commercial fraud; computer crime; and the counterfeiting or forgery of currency, coinage, credit cards, other commercial instruments and travel and identity documents.
– *p.55*

Committee on Payment and Settlement System (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.88*

Commodity Exchange Compensation Fund (CECF)
The fund that provides compensation to investors who suffered a loss due to the default of an Exchange Participant of the Hong Kong Futures Exchange Limited before implementation of the SFO.
– *pp.70, 77*

Companies (Amendment) Ordinance 2004
– *pp.25, 34*

Index

Complaints Control Committee
– p.83

Companies Ordinance
– pp.25, 26, 36, 154

Conflicts of Interest, Analysts
– pp.25, 44

Consumer Council
– p.37

Continuous Professional Training (CPT)
The systematic maintenance, improvement and broadening of knowledge and skills to enable individual SFC licensees carrying on regulated activities to perform their duties competently and professionally.
– p.47

Corporate Governance
– pp.4, 14, 24, 34

Custody Fee
– p.68

D

Dematerialisation
The conversion of paper certificates to electronic holdings.
– p.69

Derivatives Clearing and Settlement System (DCASS)
The new clearing and settlement system launched by HKEx for its derivatives market.
– pp.25, 66

Director of Audit
– p.18

Directors of the Commission
– p.10

Disciplinary Actions
– p.57

Disclosure of Interests
– pp.24, 27, 29, 52, 66, 72

Dual Filing
The arrangement that came into effect with the SFO, under which all corporate disclosure and listing application materials are filed with both the SEHK and the SFC. The SFC can exercise its enforcement powers against persons issuing false or misleading corporate information.
– pp.4, 24, 28, 34, 52

Dual Filing Advisory Group
The Dual Filing Advisory Group is a standing committee established under section 8 of the SFO to advise the SFC on treatment of cases and policy issues under the Dual Filing regime.
– pp.37, 148

E

Electronic Investor Resources Centre (eIRC)
An SFC operated website to provide investors with educational information on investments and regulations.
– pp.25, 27, 28, 32, 76

Equity-Linked Investments
– p.50

European Union (EU)
A family of democratic European countries. Its Member States have set up common institutions to which they delegate some of their sovereignty so that decisions on specific matters of joint interest can be made democratically at European level.
– p.46

Exchange Traded Fund (ETF)
Basically index funds that are listed and traded on exchanges just like stocks.
– p.50

Executive Directors (EDs)
– pp.10, 14, 28

Extensible Business Reporting Language (XBRL)
A language for the electronic communication of business and financial data.
– p.91

F

Federation of Share Registrars
The Federation approved by the SFC under Section 12 of the Securities and Futures (Stock Market Listing) Rules. Its members are approved share registrars under the Securities and Futures (Stock Market Listing) Rules.
– pp.8, 69

Financial Action Task Force on Money Laundering (FATF)
An inter-governmental body which sets standards, and develops and promotes policies, both at national and international levels, to combat money laundering and terrorist financing.
– p.90

Financial Reporting Council (FRC)
An independent statutory body proposed by the Government to strengthen the regulatory regime for the accounting profession in Hong Kong.
– pp.25, 34

Financial Secretary, HKSAR
– pp.5, 10, 14, 28, 77

Financial Services and the Treasury Bureau (FSTB)
– pp.20, 69, 73

Financial Services Authority (FSA)
An independent organisation responsible for regulating financial services in the UK. It is the single statutory regulator responsible for the authorisation and supervision of deposit taking, insurance and investment business.
– p.79

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.
– pp.25, 76

Financial Stability Forum
An international Forum that promotes financial stability through information exchange and international co-operation in financial supervision and surveillance.
– p.87

G

Gross Domestic Product (GDP)
– p.3

Growth Enterprise Market (GEM)
– p.26

H

H-shares Index Futures
– p.67

H-shares Index Options
– p.66

Hang Seng Index (HSI)
– pp.3, 26

Hay Report
The report by the consultant Hay Group Limited on a study of the remuneration packages of senior executives of selected statutory and other bodies. The study was commissioned by the HKSAR Government in 2002 to provide guidelines to individual organisations for them to adjust or refine their remuneration polices and arrangements.
– p.78

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 organizational structure, among other characteristics.
– p.43

HKFE Clearing Corporation Limited (HKCC)
– p.68

Hong Kong Exchanges and Clearing Limited (HKEx)
– pp. 4, 8, 25, 28, 54, 80

Hong Kong Futures Automatic Trading System (HKATS)
The electronic trading system for HKEx derivatives market.
– p.68

Hong Kong Futures Exchange Limited (HKFE)
– pp.25, 40, 67

Hong Kong Institute of Certified Public Accountants (HKICPA)
The statutory licensing body of accountants responsible for the regulation of accountancy profession in Hong Kong.
– pp.29, 39, 80

Hong Kong Monetary Authority (HKMA)
– pp.42, 79

Hong Kong Mortgage Corporation (HKMC)
– p.80

Hong Kong Securities Clearing Company Limited (HKSCC)
– p.67

Hong Kong Securities Institute (HKSI)
– p.47

Hong Kong Special Administrative Region (HKSAR)
– pp.10, 14, 65, 91

I

Independent Commission Against Corruption (ICAC)
– pp.19, 55

Independent Financial Advisers (IFAs)
– pp.25, 28, 36, 44

Insider Dealing Tribunal (IDT)
– pp.28, 52

Interest Retention Rates
HKEx's participants must post margin to cover their outstanding obligations. Where the margin posted by participants is cash, HKEx invests the margin. Some of the interest is returned to the participants after deducting the retention rate of 1.2% (HKCC) or 2% (SEOCH) from the respective benchmark interest rate.
– p.68

International Accounting Standards Board (IASB)
An independent, privately-funded accounting standard-setter based in London, UK. It is committed to developing, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require transparent and comparable information in general purpose financial statements.
– pp.18, 88

Index

International Organization of Securities Commissions (IOSCO)
The pre-eminent forum for international co-operation among securities regulators. IOSCO is recognised as the international standard setter for the securities sector.
– pp.4, 28, 44, 86

Investment Advisers
– pp.25, 40

Investor Compensation Company Limited (ICC)
An independent investor compensation company established under the SFO to manage the new compensation fund and process claims.
– pp.8, 24, 70

Investor Compensation Fund (ICF)
– pp.29, 66, 77

Investor Participant Account (IP Account)
A depository account for safekeeping investors' stocks, that gives them legal protection and control over their shareholdings. Both individual and corporate investors may open stock accounts in CCASS and become Investor Participants.
– pp.25, 66

L

Legislative Council (LegCo)
– pp.18, 38, 44, 73

Letter of Intent (LOI)
– pp.4, 28, 89

Listing Rules
– pp.24, 34

M

Management Committee
– p.17

Mandatory Provident Fund (MPF)
– p.42

Mandatory Provident Fund Schemes Authority (MPFA)
– p.80

Margin Financing
– pp.4, 25, 28, 40

Market Misconduct
– p.52

Market Misconduct Tribunal (MMT)
– pp.38, 57

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.90

Memorandum of Understanding (MOU)
Co-operative arrangements or agreements the SFC signed with other local or international organisations.
– pp.4, 29, 89

Minimum Spread
The minimum allowable change in price of securities traded on SEHK.
– pp.25, 67

Multilateral Memorandum of Understanding (MMOU)
The multilateral MOU that enhances the level of IOSCO members' co-operation and information exchange to combat cross-border frauds and other securities violations, and improve their ability to enforce securities regulation worldwide.
– pp.65, 87

N

Net Asset Value (NAV)
– pp.26, 70, 77

Non-Executive Directors (NEDs)
– pp.5, 10, 14, 28

O

Ombudsman
– p.19

P

Part XV, SFO
– pp.29, 68

Performance Pledges
– p.14

Phishing
The act of sending an email to a user falsely claiming to be an established legitimate enterprise in an attempt to scam the user into surrendering private information that will be used for identity theft.
– pp.33, 82

Police
– p.52

Position Limit
– p.67

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.19, 152

Prosecutions
– p.55

Public Shareholders Group
A standing committee under section 8 of the SFO to provide investors' views on issues relating to shareholders' rights and interests.
– pp.15, 34, 148

Q

Qualified Foreign Institutional Investors (QFII)
Foreign fund management institutions, insurance companies, securities firms, and other asset management companies meeting the requirements under the QFII Regulation which have been approved by the CSRC and have obtained an investment quota from the State Administration of Foreign Exchange.
– p.50

R

Radio Television Hong Kong (RTHK)
– p.81

Real Estate Investment Trusts (REITs)
Collective investment schemes constituted as a trust that invest primarily in real estate with the aim to provide returns to holders derived from the rental income of the real estate.
– pp.4, 25, 29, 40

Remuneration Committee
– p.16

S

Scrip Fee
The registration and transfer fee, commonly referred to as "scrip fee", is in essence a cost to use HKSCC's depository service. It is based on the increase of the aggregate holdings in board lots of a security in a participant's account since the previous date on which the fee was collected. The fee is a flat rate of $1.50 per Board Lot for collection on book-close dates and corporate action effective dates and $0.75 for deemed book close dates.
– p.68

Scripless Market
A scripless securities market provides the enabling environment for straight-through-processing, eliminates the risks associated with paper scrip, reduces the cost of ownership transfer and enhances the processing efficiency of securities transactions.
– pp.25, 66, 74

Securities and Derivatives Network (SDNet)
– p.69

Securities and Exchange Commission, Thailand
– pp.29, 89

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.
– pp.19, 62

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.19, 62, 75

Securities and Futures Commission Ordinance (SFCO)
– p.74

Securities and Futures (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.
– pp.27, 44, 52

Securities and Futures Ordinance (SFO)
– pp.2, 14, 23, 24, 26, 29, 35, 40, 68

Securities and Futures (Stock Market Listing) Rules (SMLR)
– pp.25, 38, 73, 154

SEHK Options Clearing House Limited (SEOCH)
– p.68

Settlement, Disciplinary Actions
– pp.4, 52

Settlement Instruction (SI) Input Fee
The SI input fee covers the input and moving of scrip (i.e. by book-entries) from one CCASS participant to another (usually a result of trading). The current fee is $1.
– p.68

Severe Acute Respiratory Syndrome (SARS)
– p.5

Shanghai Stock Exchange
– p.90

Share Registrars
– pp.8, 24, 67

Shenzhen Stock Exchange
– pp.79, 90

Sponsors, Listing
– pp.4, 25, 28, 34, 41, 154

Staffing
– p.78

Steering Committee on the Enhancement of Financial Infrastructure (SCEFI)
The committee set up in 1999 to recommend improvements to the financial infrastructure of Hong Kong's securities and futures industry.
– pp.25, 66

Index

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.24, 34, 40, 53

Stock Options
– p.66

Stock Settlement Fees for Exchange Trades and Settlement Instructions (SI)
SI transactions are transactions settled in CCASS between two participants as a result of the input of an SI by each participant. SI transactions include broker-custodian, stock borrowing and lending, stock pledging transactions and portfolio movements of securities. Exchange Trades are transactions effected on SEHK. HKSCC charges 0.002% of the gross value of each Settlement Instruction Transaction or Exchange Trade, subject to a minimum of $2 and a maximum of $100 for each SI transaction or Exchange Trade.
– p.68

Strike Price Interval
The smallest difference between two consecutive strike prices of an options series.
– p.67

T

Takeovers and Mergers Panel
– pp.35, 144

U

Undertakings for Collective Investment in Transferable Securities III (UCITS III)
A new set of regulations issued by the EU Commission governing funds domiciled in the EU member states. UCITS III comprises a new EU Product Directive and a new Management Directive adopted in 2001 (effective in February 2002) updating the UCITS I directive with a view to enhancing a "European fund passport system". Key changes include the expansion of the investment powers of funds and the use of financial derivatives for investment purposes.
– pp.25, 40

Unified Exchange Compensation Fund (UECF)
The fund that provides compensation to investors who suffered a loss due to the default of an Exchange Participant of the SEHK before implementation of the SFO.
– pp.70, 77

Unit Trust and Mutual Funds
– p.42

V

Vocational Training Council
– p.47

W

Website, SFC
– pp.25, 28, 67, 76

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