



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



Investors First

05-06
Annual Report

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.

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

Investors First

The theme of this year's Annual Report is "Investors First" – the same theme as last year's. The continuation of this important message shows our determination to put the interest of investors first in the performance of our functions. Investors, like consumers, will only be attracted to a market that is well regulated and where firm and fair enforcement action will be taken against malpractice. The regulatory environment should facilitate innovation, and allow educated investors to make informed choices from a wide range of products.



Chairman's Statement

This Statement Is About

- The challenges ahead
- "Investors First"
- Initiatives in 2005-06
- The market and the SFC's financial results
- A year of hard work

This is my first Chairman's Statement. It is a great honour for me to serve the SFC as its fifth Chairman.

I was appointed Executive Director, in charge of the Supervision of Markets Division, in June 2005. As former Chairman, Mr Andrew Sheng, left the SFC after seven years of exemplary service, I was appointed by the HKSAR Chief Executive as Chairman with effect from 1 October.

The challenges ahead

As I assumed my position last October, I set out my mission as follows: to consolidate the SFC's position as a leading securities regulator internationally and help Hong Kong excel as an international financial centre and a premier fund raising centre for the region.

In the following months, I have had the opportunity to consider with my colleagues how that can be achieved. We must fully understand the challenges the SFC and the Hong Kong market face, and ready ourselves to respond.



At the end of March 2006, we published a document on the regulatory challenges and risks in the next three years and the necessary SFC strategic responses. The document, suitably entitled “Regulatory Challenges and Responses”, provides the SFC with timely guidance on how it prioritises and performs its regulatory functions within the statutory objectives under the Securities and Futures Ordinance.

One of our most immediate tasks is the organisation of the Annual Conference of the International Organization of Securities Commissions (IOSCO). In June, the SFC will for the first time host the Annual Conference. Several hundred securities regulators and market practitioners from more than 100 jurisdictions will converge on Hong Kong to tackle the most current securities regulatory challenges.

“Investors First”

In analysing the environment in which we operate and the challenges, and indeed in our daily work, we constantly remind ourselves of the importance of the interest of investors. An avid reader will have noticed that the theme of this year’s Annual Report is “Investors First”; these are the same words that appeared in last year’s report. The continuation of this theme demonstrates the value we attach to this objective.

The strategic plan identifies four main challenges and 21 initiatives to address them. The four challenges, in short, relate to:

- improving standards of corporate governance and behaviour;
- tackling risks arising from complex and structured products, and mis-selling to retail investors;
- addressing the consequences of a market or economic downturn if and when that happens; and
- keeping Hong Kong at the forefront of international financial markets and promoting regulatory best practice.

By allocating appropriate resources to the initiatives, and with the support of the Government, market practitioners and the public, I am confident that we can meet those challenges. Some of the projects have been ongoing and are reviewed in the section below and other parts of this Annual Report.

Initiatives in 2005-06

The SFC’s role may be expressed in four disciplines:

Regulate, Enforce, Facilitate and Educate. We will in the following pages discuss the philosophy behind these four areas of work and last year’s achievements in more details. Some of the more notable work progress:

To Regulate, we

- formulated a Six-Point Plan to strengthen the derivative warrants market and investor education
- reviewed the disclosure of interests requirements

- secured public support for securities margin financing reform
- proposed tighter regulation of sponsors
- continued work on statutory backing for important listing requirements

To Enforce, we:

- successfully prosecuted 72 companies and people for various offences
- took disciplinary action against 98 companies and people
- excluded a sponsor from the listings market for 13 months for due diligence failure
- banned an analyst for five years for conflicts of interest
- substantially concluded three cases before the Insider Dealing Tribunal

“By using our resources appropriately, and with the support of the Government, market bodies, market practitioners and the public, we can confidently meet the regulatory challenges in the next few years.”

Chairman's Statement

- identified 18 cases of suspect warrants market activities for investigation
- investigated 27 cases involving listed companies
- assisted the Court in a successful ICAC prosecution of a high profile market manipulation case
- referred 24 cases to the Police

To Facilitate market development, we:

- authorised the Link REIT, the first listed REIT in Hong Kong
- authorised the first bond index-tracking ETFs in Asia
- approved HKEx's launch of Callable Bull/Bear Contracts
- proposed enhancements to the securities offering prospectus regime
- signed regulatory co-operative agreements with eight jurisdictions
- reviewed the investor compensation levy collection mechanism, resulting in levy exemption since last December
- supported Government's proposal to reduce the transaction levies

To Educate, we:

- reminded investors that "Before you invest, ask the right questions"
- produced new television and radio commercials
- re-launched the investor website as InvestEd with stronger content
- surveyed retail investors, in particular warrant investors, to gauge levels of knowledge and understanding

In the following two parts, I will cover our financial results and the most valuable asset of the SFC, its staff. There is also a new chapter on Staff of the Commission in this Annual Report.

The market and the SFC's financial results

The Hong Kong stock market remained buoyant during 2005-06, despite the uncertainties arising from higher oil prices and interest rates. The Hang Seng Index advanced 17%. The rally was supported by a solid 7.3% GDP growth in 2005 and improving economic fundamentals. Mainland's revaluation of RMB in July 2005 and the move to a more market-based exchange rate system sustained investors' interest in Mainland shares listed in Hong Kong. The gains of the Hong Kong stock market were in line with the performance of major equity markets abroad.

During 2005-06, the average daily turnover of the stock market amounted to \$21.5 billion, 38% higher than the year before.

The China dimension has become increasingly important to the development of the Hong Kong stock market. During the year, the H-shares Index (HSCEI) and the red chips index (HSCCI) rose 39.9% and 42.9% respectively.

Last year, 70 IPOs raised \$171.4 billion (61 IPOs raising \$81.7 billion in 2004-05). Of this, \$142.9 billion (83%) was contributed by Mainland companies, the largest being China Construction Bank's \$71.6 billion. In terms of the total equity funds raised, Hong Kong was ranked fourth in the world after New York, London and Toronto.

As of the end of March 2006, 1,141 companies were listed on the stock exchange with a total market capitalisation of \$9,416 billion, rising 43% from last year. Hong Kong was eighth by market capitalisation amongst world stock exchanges.

Trading of futures and options was active, with a total of 29.5 million contracts traded during 2005-06, 47% higher than the year before.

The brokerage industry is financially more sound, with total shareholders' fund at \$80 billion at the end of 2005, 6% higher than a year ago. The aggregate net asset value of all SFC authorised unit trusts and mutual funds also rose 21% to US\$668 billion.

The SFC's primary source of income is transaction levy. In 2005-06, levy income increased by 41% over a year ago to \$613 million. Together with increases in fees and charges and investment incomes, we recorded total revenue of \$852 million.

We continued to spend carefully. Total expenditure was \$497 million. As a result, the SFC achieved a surplus of \$355 million, lifting the reserves at the end of March 2006 to \$1.2 billion.

A year of hard work

Many achievements of the SFC last year were owing to the leadership of the former Chairman. I would like to pay tribute to Mr Sheng for his tremendous contributions to the SFC and the financial community in Hong Kong as a whole. He has left behind an efficient and respected organisation and a professional, dedicated team. Mr Sheng was Chairman of the IOSCO Technical Committee before stepping down as SFC Chairman, and he has placed Hong Kong more firmly in the league of leading securities regulators of the world.

I have assumed the role of executive Chairman under the existing legal provisions of the SFO. At the time of writing, the Securities and Futures (Amendment) Bill 2005, introduced by the HKSAR Government in April 2005, is being considered by the Legislative Council. Under the proposed changes, the Government will be creating the new post of CEO and at the same time designating the Chair as non-executive.

While 2005-06 was a year of considerable achievements, it also was one of hard work. Personally I am grateful for the staff's dedication and, as with any responsible employer, the SFC considers it appropriate to recognise the staff's contribution by making a variable pay award. The Remuneration Committee in March approved using 12% of the 2005-06 revised Remuneration Budget for this purpose.

We have also reviewed fixed pay, in particular taking account of market comparisons and the need for staff retention to ensure the SFC operates effectively. We have used 3% of the 2006-07 proposed Remuneration Budget for fixed pay adjustment to eligible staff with effect from 1 April 2006. This follows a freeze on fixed pay since 2001.

Our volunteers' team has done some worthy social services, which the members themselves have enjoyed tremendously. A new section in the chapter of Corporate Governance discusses the SFC's social responsibility.

Finally, I would like to express my gratitude to the NEDs, our advisers and partners in the various committees, groups and panels, the legislature, the Government, the market, the media and all other people who have steadfastly stood by the SFC.

Martin Wheatley
Chairman

Whom, What and How We Regulate

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
- Monitor licensees' financial soundness and compliance with ordinance, codes, guidelines, rules and regulations
- Handle misconduct complaints against licensees
- Investigate and take action against misconduct

Investment products offered to the public

- Set standards for the authorisation and regulation of investment products
- Authorise investment products offered to the public and their promotion (including advertisements and marketing materials)

Listed companies

- Approve changes to the Listing Rules
- Monitor announcements and vet listing application materials under the Dual Filing regime
- Administer the Codes on Takeovers and Mergers and Share Repurchases
- Consider requests for exemptions from prospectus requirements under the Companies Ordinance
- Enquire into listed companies' suspected prejudicial or fraudulent transactions or provision of false or misleading information to the public

Hong Kong Exchanges and Clearing Ltd (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

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 Ltd (ICC)

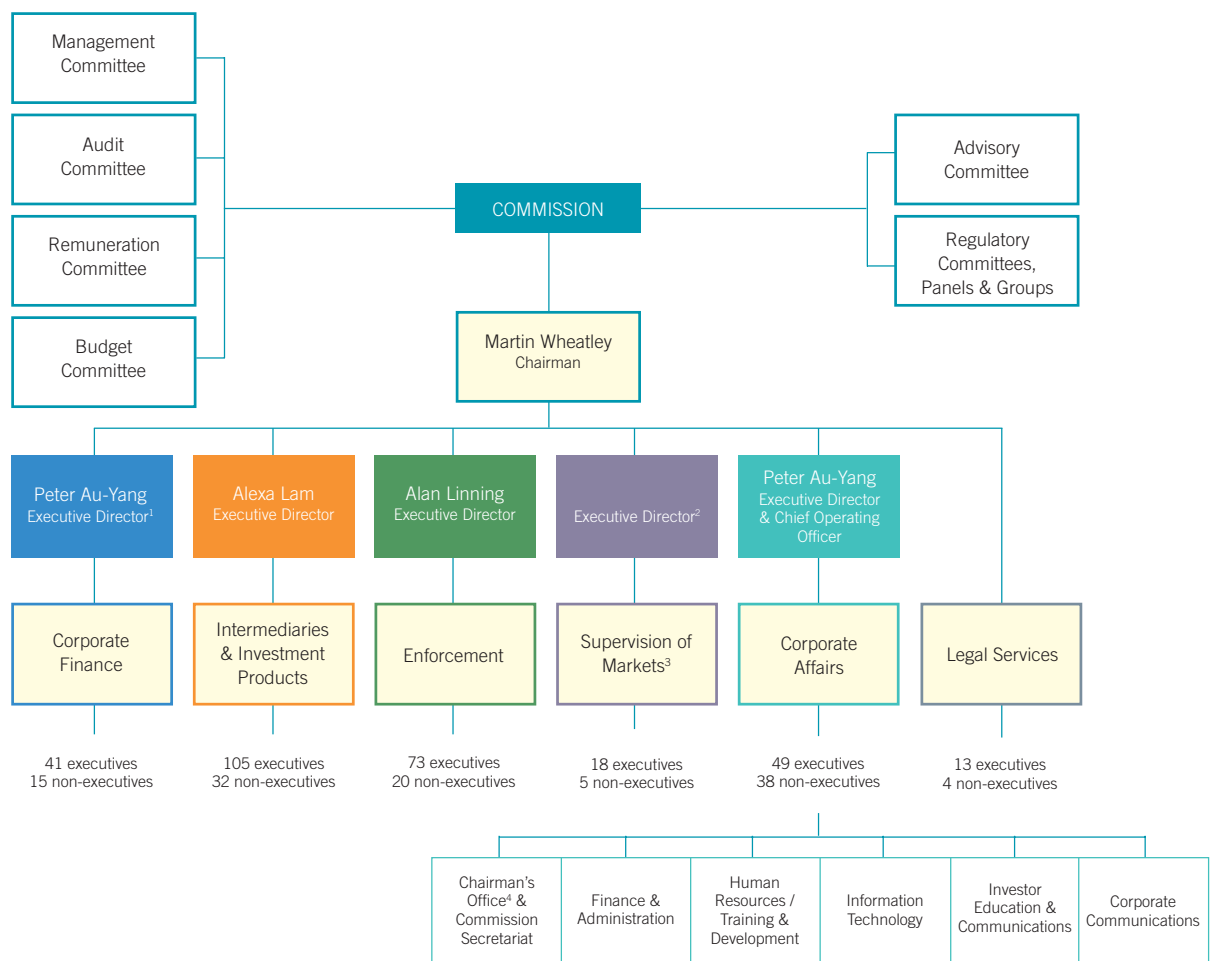
- Recognise the ICC as an independent compensation company
- Approve the rules and any amendment of rules of the ICC
- Require the ICC to prepare and regularly submit financial statements, auditors' report and other documents to the SFC

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 Peter Au-Yang has doubled up as Executive Director of Corporate Finance and Chief Operating Officer since 23 October 2004.
2. The post was vacant as of 31 March 2006. It was previously taken up by Mr Martin Wheatley from 6 June 2005, before his appointment as Chairman from 1 October 2005.
3. Including Research Department.
4. Including China Policy Team.
5. Numbers of executives/non-executives refer to permanent established posts as of 31 March 2006.

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 2006, the Commission consisted of 11 Directors, of whom four were Executive Directors and seven were Non-Executive Directors. Last year the Commission met on 14 occasions.

Executive Directors



Martin Wheatley

Chairman

(From 1 October 2005. Current appointment expires on 30 September 2008.)

Executive Director of Supervision of Markets Division, SFC (June-September 2005); Member, HKEx Listing Nominating Committee; Deputy Chief Executive, London Stock Exchange (2001-2004); Board Member, London Stock Exchange (1998-2004); Chairman, FTSE International (2000, 2002, 2004); Member, Listing Authority Advisory Committee of the Financial Services Authority of England (2003-2004).

Chairs Advisory Committee (from 1.10.05), Management Committee (from 1.10.05), Futures Compensation Fund Committee (from 21.6.05), Investor Compensation Fund Committee (from 21.6.05) and Securities Compensation Fund Committee (from 21.6.05). Member of Budget Committee (from 1.10.05), SFC (HKEC Listing) Committee (from 6.6.05 to 30.9.05) and SFC (HKEC Listing) Appeals Committee (from 1.10.05).



Andrew L T Sheng, SBS, JP

Chairman

(From 1 October 1998. Appointment expired on 30 September 2005.)

Chartered Accountant; Chairman, IOSCO Technical Committee (2004-2005); 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).

Chaired Advisory Committee (to 30.9.05) and Management Committee (to 30.9.05). Member of Budget Committee (to 30.9.05) and SFC (HKEC Listing) Appeals Committee (to 30.9.05).



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); Member, HKEx Listing Nominating Committee; Member, Hong Kong Trade Development Council Financial Services Advisory Committee; Member, Professional Advisory Board-The University of Hong Kong Faculty of Law's Asian Institute of International Financial Law.

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



Alan Linning

Executive Director, Enforcement Division
(From 1 November 2001. Current appointment ends on 6 June 2006.
On leave from 11 May 2006 to 6 June 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.

Member of 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)); Member, HKEx Listing Nominating Committee.

Chairs Investor Education Advisory Committee and Public Shareholders Group. Member of Advisory Committee, Budget Committee and Management Committee. Chaired Futures Compensation Fund Committee (from 1.4.05 to 20.6.05), Investor Compensation Fund Committee (from 1.4.05 to 20.6.05) and Securities Compensation Fund Committee (from 1.4.05 to 20.6.05).

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, JP**

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

Vice Chairman and Managing Director, Sun Hung Kai Properties Ltd; Chairman, 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.

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

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

(From 15 November 2001. Current appointment expires on 14 November 2007.)

Member, Executive Council; Member, Legislative Council; Advisor, Democratic Alliance for the Betterment and Progress of Hong Kong; School Supervisor, Pui Kiu Middle School; Board Member, Hong Kong Airport Authority; Member, ICAC Complaints Committee; Member, Disaster Relief Fund Advisory Committee; Member, Chinese People's Political Consultative Conference.

Member of Remuneration Committee and SFC (HKEC Listing) Appeals Committee.

**Dr York Liao, SBS, JP**

(From 26 May 2003. Current appointment expires on 25 May 2007.)

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.

Chairs Remuneration Committee. Member of Committee on Investment-Linked Assurance and Pooled Retirement Funds, Committee on Unit Trusts, and SFC (HKEC Listing) Appeals Committee.



Christopher W C Cheng, GBS, JP

(From 15 November 2003. Current appointment expires on 14 November 2007.)

Chairman, USI Holdings Ltd; Chairman, Winsor Properties Holdings Ltd; Chairman, Standing Committee on Judicial Salaries and Conditions of Service; Chairman, Competition Policy Review Committee; Independent Non-Executive Director, NWS Holdings Ltd; Independent Non-Executive Director, New World China Land Ltd; Independent Non-Executive Director, DBS Bank (Hong Kong) Ltd; Independent Non-Executive 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; Chairman, Hong Kong General Chamber of Commerce (2001-2003).

Member of 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; Council Member, Open University of Hong Kong; Member, General Committee of Federation of Hong Kong Industries; Non-Executive Director, Li Ning Company Ltd; Independent Non-Executive Directors, China Resources Power Holdings Company Ltd, Parkson Retail Group Ltd, Tradelink Electronic Commerce Ltd and SUNeVision Holdings Ltd; Partner, PricewaterhouseCoopers (until 2003).

Chairs Audit Committee. Member of Remuneration Committee, Futures Compensation Fund Committee (from 1.4.05), Investor Compensation Fund Committee (from 21.6.05), Securities Compensation Fund Committee (from 1.4.05), SFC (HKEC Listing) Appeals Committee, Takeovers and Mergers Panel, and Takeovers Appeal Committee.



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, Standing Committee on Legal Education and Training (Legal Practitioners 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).

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



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, Independent Commission on Remuneration for Members of the Executive Council and the Legislature of the HKSAR; Member, Manpower Development Committee; Director, Hong Kong Institute for Monetary Research of Hong Kong Monetary Authority; Member, Aviation Development Advisory Committee; Member, Committee on Economic Development and Economic Cooperation with the Mainland-Commission on Strategic Development; Member, Independent Commission on Remuneration Package and Post-office Arrangements for the Chief Executive of the HKSAR.

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

Staff of the Commission

The SFC considers its staff the greatest asset. The Board and senior management welcome and value comments and suggestions from colleagues at all levels. We endeavour to be a caring employer and to make the office an efficient and pleasant work place.

In this chapter, we will discuss:

- Communication
- Remuneration
- Training and development
- Welfare and employee relations

Communication

Throughout the year, we conducted management briefings and sharing sessions to communicate the goals, priorities, and projects of the SFC. The Chairman held staff briefings and regularly sent letters to staff on important issues.

In response to staff comments, we installed better computers and software, extended our business casual wear policy, and re-arranged our working hours so that staff work fewer Saturdays. We are also keeping in view the Government's proposal of a five-day work week.

Last year we conducted an opinion survey to understand staff attitude to their work and identify areas for improvement. Management will shortly share with staff the findings of the survey.

We updated the Employee Handbook to set out more clearly some of our policies and practices, for example on equal opportunities employment, business casual wear, and overtime allowance or other benefits.

Remuneration

Our remuneration policy is to ensure that pay levels are competitive and effective in attracting, retaining and motivating competent staff. We believe only a strong team can effectively discharge our statutory responsibilities. At the year-end, a total of 187 staff, representing 42% of all staff, held professional qualifications.

During the year, overall staff turnover increased from 12% to 12.5%. Turnover at the junior to middle levels was higher, but our turnover was in line with comparable indicators in the financial sector.

A performance based variable pay award was made to staff in 2005-06, equivalent to about an average of 1.4 months of salary. An increase in fixed pay has also been approved effective from 1 April 2006.

Training and development

More resources were allocated for training and development in the past year. We organised 358 training programmes on industry topics, management, language and information technology for all levels of executives. This was a 12% increase from a year ago. The average training time per employee was 25% higher at 6.9 man-days.

There were workshops by external consultants on the new International Financial Reporting Standards (IFRS), advocacy, litigation, new financial products and information technology risk assessment. Sharing sessions were also given by overseas regulators, experienced market practitioners and internal experts.

Placing great importance on management training, we organised leadership, communication, presentation and negotiation skills workshops. Some training programmes were tailor-made for specific departments. An intensive workshop led by Professor Malcolm Sparrow of Harvard University, executive development programme and leadership workshops were organised for senior executives. Language courses were designed for general grade staff.

We continued to offer overseas secondment and training opportunities to staff. A total of 25 colleagues were seconded to the China Securities and Regulatory Commission, the UK's Financial Services Authority, the Australian Securities & Investments Commission and the US Securities and Exchange Commission. 12 staff attended training courses in the US, UK, Canada and the Asia Pacific region.



Professor Malcolm Sparrow led a workshop for senior executives.

The SFC acquired an analytical tool to aid recruitment and help staff better understand their career needs. We have a job rotation system within the SFC to help career and personal development.

We offer job opportunities as Manager Trainee, Executive Trainee, Vacation Trainee and Industrial Places. Last year, we also introduced an internship programme for local university students to work on various SFC projects. Undergraduates from across several universities have joined.

We are pleased that in a survey conducted by Hong Kong Economic Times in September and October 2005, young degree holders rated the SFC as one of the top 10 most popular organisations.

Welfare and employee relations

We facilitate social and sports activities for staff and their families including an annual barbeque and in-house staff gatherings. Divisions receive subsidies to organise recreational activities for their staff to foster team spirit.



Sports activities like yoga classes and inter-divisional badminton competition were held. We also organised bowling competition and table tennis matches with other organisations. SFC was the Champion in the Friendly Badminton Match 2005 with other regulatory and related bodies, while our basketball team won the first runner-up in the Supervisory Cup Basketball Competition 2005. Our soccer team also won the first runner-up in the Public Organization Challenge League 2005.

In a competitive and fast-paced society, many people face tremendous stress due to work or personal matters. Since January 2006, we have appointed professional social workers and clinical psychologists to provide confidential counselling and consultation to staff and their dependents at the cost of the SFC.



Our soccer team consists of staff from all departments.

Corporate Governance and Social Responsibility

As the statutory regulator of the securities and futures markets in Hong Kong, the SFC 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:

- Composition and operation of the Board
- Commission committees
- Conduct standards
- Internal controls
- Independent checks and balances
- Corporate social responsibility
- Performance pledges

Composition and operation of the Board

✓ 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 SFC's executive functions.

The remuneration package of individual Executive Directors (EDs) is determined by the HKSAR Chief Executive (or Financial Secretary under the authority

delegated by the Chief Executive) upon the recommendations of 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 11 Members: four full-time EDs including the Chairman and seven NEDs. During the year, the HKSAR Chief Executive appointed Mr Martin Wheatley as SFC Chairman for a term of three years from 1 October 2005. Mr Wheatley succeeded Mr Andrew Sheng, who has led the Commission as its Chairman for seven years until 30 September 2005. Dr York Liao was re-appointed as an NED for a term of two years from 26 May 2005, while Mr Christopher Cheng and the Hon Jasper Tsang were re-appointed as NEDs for a term of two years from 15 November 2005.

A full-time executive Chairman currently leads the Commission. On 6 April 2005, the Government introduced the Securities and Futures (Amendment) Bill 2005 into the Legislative Council (LegCo) to provide for the separation of the role of the SFC Chairman from that of the executive arm. Under the proposed structure, the Commission will be headed by a Chairman who will focus on leading the Board in setting the Commission's directions and policies, while the executive arm will be headed by a chief executive officer who will be responsible for the day-to-day running of the Commission.

At the time of this report, the Amendment Bill is being scrutinised by the Bills Committee of the LegCo.

✓ How the Commission operates

The Board is fully accountable to the public on the extent to which it fulfils its statutory objectives and functions. The Board meets each month and holds additional meetings as necessary. All important policies and decisions are discussed and approved by the Board. Commission staff attend Board meetings to explain policy proposals, report on important policy proposals, operational matters and regulatory issues. Members also consider the financial position of the Commission and are provided with monthly financial statements. The Chief Counsel attends the Board meetings to advise Members on legal issues.

To play an effective oversight role, the Board has delegated many 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 independent access to the senior management and 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.

We published in March 2006 a document setting out the regulatory challenges that the SFC faces over the next three years. Please see Chairman's Statement for more information. The statement of Regulatory Challenges and Responses is available on the SFC website.

Attendance of Directors at Commission meetings in 2005-06

Number of meetings	14	
Attendance of individual Directors		
Andrew L T Sheng	5	83%
Martin Wheatley	12	100%
Peter Au-Yang	14	100%
Alexa Lam	12	86%
Alan Linning	11	85%
Christopher W C Cheng	14	100%
Eddy C Fong	13	93%
Kenneth H W Kwok	13	93%
Raymond P L Kwok	9	64%
York Liao	11	79%
Liu Pak Wai	12	86%
Jasper Tsang Yok Sing	10	71%
Average attendance of meetings	87%	

The individual attendance rates are based on the respective number of 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 have their respective terms of reference and 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. The Commission committees circulate their minutes and report important issues to the Board regularly.

Corporate Governance and Social Responsibility

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 audit firms are appointed to perform respectively the annual audit and internal control review of the Commission.

During the year, we paid KPMG, our external auditors, \$350,600 for audit-related services and \$180,000 for non-audit related activity involving an IT risk assessment training program. We paid PricewaterhouseCoopers (PwC) \$151,650 for conducting the annual internal control review.

KPMG was also engaged as the external auditors of a number of funds, such as compensation funds that are under the supervision of the Commission directly or indirectly as required by the law. In total, they paid KPMG \$280,700 for annual audits and half yearly interim reviews.

Attendance of Directors at Audit Committee meetings in 2005-06

Number of meetings	4	
Attendance of individual Directors		
Eddy C Fong (Chairman)	4	100%
Raymond P L Kwok (Deputy Chairman)	4	100%
Kenneth H W Kwok	3	75%
Average attendance of meetings	92%	

✔ 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 regarding remuneration of senior management.

The HKSAR Chief Executive (or the Financial Secretary under delegated authority) determines 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 81. We have improved the disclosure by publishing, for the first time, the remuneration on an individual and named basis. 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 2005-06

Number of meetings	3	
<i>Attendance of individual Directors</i>		
York Liao (Chairman)	3	100%
Christopher W C Cheng (Deputy Chairman)	3	100%
Eddy C Fong	2	67%
Kenneth H W Kwok	3	100%
Raymond P L Kwok	2	67%
Liu Pak Wai	3	100%
Jasper Tsang Yok Sing	2	67%
Average attendance of meetings	86%	

✓ 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 2005-06

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

Mr Sheng was a member until 30 September 2005. There was no meeting during his term.

✓ Management Committee

The Management Committee comprises 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. 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 information acquired in the course of duties, confidential.

The Code sets out 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. A new Staff Investment Recording System was implemented during the year to enable staff to input their investment disclosures and update transactions.

Corporate Governance and Social Responsibility

✔ 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.

A quarterly report is made to the Audit Committee providing information on any grievances raised and any decisions taken in respect of them under the Grievances Procedures.

✔ Complaints against SFC 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.

A quarterly report is made to the Audit Committee providing information on any grievances raised and any decisions taken in respect of them under the Grievances Procedures.

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 for the SFC.

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 2000-01.

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 is committed to open communication with our stakeholders and the public. We publish our Quarterly Reports and Annual Report in a timely manner. We report our operations and activities to the public through periodic newsletters, press releases, publications and press conferences. Last year, we introduced new functions and content on our website to make it more accessible and informative to the public and market practitioners, and as part of our corporate governance initiatives.

✓ Internal audit

As a relatively small organisation, we do not have a full-time internal audit unit. Instead, we have appointed PwC 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 fixed assets acquisition and insurance policy, payroll procedures, staff benefits, training and sponsorship approval processes. They

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

The Corporate Finance Division conducted a cross-divisional audit on the fees collection procedures of the Licensing Department during the year. The audit report will be 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. We reviewed the plan in the second half of last year to ensure it remained comprehensive and effective.

During the year, we put the information regarding contingency situations in the form of frequently asked questions on our website to enhance the understanding by the public in this area.

Corporate Governance and Social Responsibility

✔ IT security

We have established an information security framework to manage our IT environment. Under the framework, all staff members are required to attend mandatory information security awareness training. We have also developed an information security policy and established an information security unit.

As a new corporate governance initiative, during the year, we appointed Ernst & Young to perform a security audit on our computer network to identify information security gaps and system control weaknesses. The audit confirmed that our information security framework and security controls procedures have met the level of security standard of a well-controlled organisation.

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 (PRP), the Ombudsman and the Independent Commission Against Corruption (ICAC).

✔ Process Review Panel for the SFC

The Commission's internal procedures for regulating the markets, including procedures for ensuring consistency and fairness, are reviewed on an ongoing basis by the 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 have in place 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 his representative), the Commission's Chairman and an NED of the Commission.

Over the past year, the PRP reviewed various completed cases and advised the Commission upon the adequacy of its internal procedures. These cases covered the following aspects: licensing of intermediaries, authorisation of collective investment schemes, inspection of intermediaries, prudential visit to intermediaries, settlement of disciplinary cases, issuance of warning letters, and dual filing cases.

✔ 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 appointed by the Chief Executive and comprises two other members appointed by the Secretary for Financial Services and the Treasury. There were 17 applications for review lodged with the SFAT during the year: three were determined, three were withdrawn and eleven are in progress. In addition, six cases were carried forward from 2004-05, of which four were withdrawn and two were determined.

Before the establishment of the SFAT, there was an independent Securities and Futures Appeals Panel (SFAP) established under the repealed Securities and Futures Commission Ordinance. The SFAP heard appeals against decisions made by the SFC relating to the registration, regulation and discipline of intermediaries. The SFAP was disbanded upon the conclusion of the last case in 2005-06.

✓ ICAC

The Independent Commission Against Corruption has conducted periodic corruption prevention reviews on the procedures and practices of the Commission since 1990. There was no ICAC review during the year.

✓ 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, Secretary for Financial Services and the Treasury and the Financial Services and the Treasury Bureau regarding its operations and important issues. We are required to consult the Financial Secretary before exercising certain powers.

In addition, according to section 11 of the Securities and Futures Ordinance, 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. This reserve power of the Chief Executive has never been exercised since the establishment of the SFC in 1989.

✓ 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, there were two complaints. The Ombudsman found one of them not substantiated and is dealing with another one.

Anyone who is dissatisfied with the Commission's performance of its functions may take civil action in the Courts against the Commission, by either applying for

judicial review of the Commission's decisions or seeking remedies. There was one application for judicial review against the Commission last year. The applicant was not granted leave by the court to proceed. Details are on page 78.

Corporate social responsibility

We review in this new section of the Annual Report the initiatives or work of the SFC that we believe will make positive social and environmental impact.

✓ Care for the society

SFC staff have formed a volunteers team called the Commission Possible Volunteers Group. Last year, it organised five activities for 230 elderly, children and their family members. These included: a visit to the Hong Kong Heritage Museum with the elderly, an Ocean Park tour with families of South Asian ethnic origin, home visits to the elderly in Wanchai to celebrate the Mid-Autumn Festival, a Christmas party for children and parents in Tai Kok Tsui, and a visit to the Mr & Mrs Lawrence Wong Lutheran Home for the Elderly to celebrate the Chinese New Year. About \$40,000 cash donations were raised from staff to support the activities.



A child received a Christmas present from Santa Claus, played by an SFC staff.



An SFC investigator in the Chinese God of Fortune costume shared the joy with two elderly people.

Corporate Governance and Social Responsibility

From time to time the SFC will upgrade the office computers to enhance efficiency and to meet changing needs. Many replaced computers are in good working condition and suitable for basic office use and Internet connection. The volunteers team is working out a scheme to donate these computers to charitable bodies that are registered with the Social Welfare Department. Further details will be published on the SFC website.

The SFC corporate website (www.sfc.hk) provides a valuable source of information also for market practitioners, investors and other users. Over 3,900 people subscribed to the Update Alert service to get emails of new information. The website drew average daily hits of 390,549 in March 2006, a record since a major revamp in November 2004.

Last August, we further improved the site and introduced a text-only version which enables visually impaired visitors to browse for key information about the SFC. New sections were created to report our upcoming events and latest market contingency arrangements, and to explain our procedures for handling the public's complaints against our staff.

Our website received a Gold Award in the Web Care Award 2005, which was run by the Hong Kong Internet Professional Association to promote no-barrier websites for all users including people with disabilities.



✔ Environment protection

Waste paper, carton boxes and newspapers are collected by building management for recycling on a daily basis. Confidential materials are sealed and collected for recycling by an approved contractor every two months.

Since 2000, the SFC has introduced facilities for internal e-filing, which may cut down the consumption of paper. All our computer printers have a power saving feature and enable double-sided printing. Dispensed laser/ink cartridges are collected by the General Post Office for proper disposal.

We have also been using e-fax for sending or receiving fax. This saves the printing out of a document for conventional transmission. Our fax volume could be substantial, particularly with divisions handling prospectuses.

We are aware of calls by environment friendly groups for shorter IPO prospectuses. The SFC's primary concern is that the public are given all material information to make investment decisions. In our reform proposals for the prospectus regime, published last August, we encourage shorter prospectuses without compromising the availability of more detailed or technical information. We proposed the introduction of a framework permitting information lodged with a central online document repository to be treated as forming part of a prospectus.

We also encourage licensees to submit their monthly financial resources returns electronically. To date, more than 70% of the firms are using e-submission.

We use energy saving light tubes and bulbs. Staff also make sure that appliances and lighting are turned off in the evening or if they will not be used for a long time.

Performance pledges

In discharging our regulatory duties, we pledge to be responsive to the general public, market participants, and intermediaries under our supervision. The following table shows how we met the pledges last year.

Performance pledges			% of cases meeting the pledge in 2005-06
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		99.7% ²
Public complaints			
■ Preliminary response to verbal & written complaints	2 weeks		99.7% ³
Licensing applications			
Processing of licensing applications			
■ Representatives (provisional licence)	7 business days		92% ⁴
■ Representatives (normal licence)	8 weeks		87% ⁴
■ Representatives (responsible officer)	10 weeks		95% ⁴
■ Corporations	15 weeks		93% ⁴
■ Change of accreditation	7 business days		82% ⁴
Modification/waiver and subordinated loan applications			
■ Acknowledgement of receipt upon receiving any application	2 business days		99%
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. One enquiry failed to meet the pledge due to the exceptionally heavy workload when the enquiry was received.
2. Three cases failed to meet the pledge due to the exceptionally heavy workload when the enquiries were received.
3. Three cases failed to meet the pledge due to their complexity. More time was needed to collect information to facilitate assessment.
4. Performance pledges only apply to cases where the applicants had supplied all the required documentation in their applications and satisfied all regulatory requirements.

We Regulate



“Clear rules and regulations help raise quality and standards, hence users’ confidence.”

Regulate

Last year, we

- mapped out measures to strengthen the derivative warrants market
- reviewed the disclosure of interests requirements
- secured public support for securities margin financing reform
- proposed tighter regulation of sponsors
- continued work on statutory backing for important listing requirements



INVESTORS need to be able to rely on markets having strong integrity, on financial products that are sound and clearly explained, and on advisers and intermediaries that have high standards of conduct. We are committed to strong but well-balanced regulation. We will focus on tightening standards of corporate governance and behaviour, on improving the regulation of investment products and on enhancing the standard of intermediaries conduct through vigorous gate keeping and supervision.

Achievements and Work in Progress

CORPORATE FINANCE

41 executives and
15 non-executives

- Administer the Codes on Takeovers and Mergers and Share Repurchases
- Promote 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 and grant exemptions for prospectuses issued by listed and unlisted issuers under companies legislation
- Administer the Dual Filing regime under the SFO to enhance the quality of disclosure by listing applicants and listed companies

INTERMEDIARIES AND INVESTMENT PRODUCTS

105 executives and
32 non-executives

- Act as the gatekeeper 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 investment products offered to the public and their advertisements
- Monitor disclosures and ongoing compliance of authorised investment products
- Develop regulatory platform to facilitate market growth and innovation

Achievements in 2005-06

- Revised the Codes on Takeovers and Mergers and Share Repurchases
 - Issued a consultation paper on possible reforms to the prospectus regime in the Companies Ordinance
 - Analysed responses to the consultation paper on amendments to the Securities and Futures (Stock Market Listing) Rules (SMLR) to give statutory backing to major listing requirements, worked with stakeholders on developing the proposals
 - Supported the Government's proposals to establish a Financial Reporting Council
 - Worked with the SEHK on its proposal to review its decision-making structure for listing matters
 - Reviewed and reported on the SEHK's performance in its regulation of listing matters
-
- Enhanced Hong Kong's position as an asset management hub in Asia: authorised three REITs and Asia's first bond index-tracking ETFs
 - Approved nearly 90% of UCITS III fund applications received
 - Allowed SFC-authorized schemes to invest in listed REITs
 - Fine-tuned the SFO to allow licensed asset managers to provide advice on their own funds without an adviser licence
 - Revised the Hedge Fund Guidelines to increase transparency and recognise a greater scope of experience for fund manager personnel
 - Signed a MOU with the Insurance Authority to enhance regulatory co-operation of insurance-related investment products
 - Proposed measures to tighten regulation of sponsors and compliance advisers
 - Secured public support including that of the Panel on Financial Affairs of LegCo to reform securities margin financing regulation
 - Ring-fenced the operations and client assets of problem licensed firms
 - Revised anti-money laundering regulation to match new international standards

Work in Progress

- Consider responses to the consultation paper on possible reforms to the prospectus regime in the Companies Ordinance
 - Work with the Government, SEHK and market stakeholders to finalise the proposal to give statutory backing to major listing requirements
-
- Finalise the consultation conclusions on the securities margin financing regulation reform
 - Complete the consultation on the regulation of sponsors and compliance advisers
 - Work with the industry to address issues concerning selling practices of investment advisers
 - Keep in view the development of the REIT market in Hong Kong and elsewhere and improve regulations on SFC-authorized REITs
 - Review business continuity arrangement of intermediaries

Achievements and Work in Progress

ENFORCEMENT73 executives and
20 non-executives

- Monitor the trading of Hong Kong's stock and derivative markets and inquire into irregularities
- Monitor reporting of large open positions in futures and options
- 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
- Report suspected market misconduct to the Financial Secretary
- Enforce disclosure of interests of substantial shareholders, directors and chief executives of listed companies
- Discipline dishonest, incompetent and financially unstable regulated intermediaries
- 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 Hong Kong markets
- Strengthen market infrastructure
- Supervise and monitor activities of the exchange controller, exchanges and clearing houses
- Authorise Automated Trading Services providers
- Regulate approved share registrars
- Co-ordinate market contingency planning
- Supervise the Investor Compensation Company and manage investor compensation funds
- Conduct market research

**LEGAL SERVICES
AND CORPORATE
AFFAIRS**62 executives and
42 non-executives

- Provide internal advice on possible breaches of the securities laws, including market misconduct
- 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
- Conduct prosecutions in the Magistrates' Courts for regulatory offences
- Handle civil litigation matters involving the SFC, including appeals
- Advise the Takeovers Executive and the Takeovers Panel
- Provide general in-house legal advice and support
- Provide finance, human resources, training, information technology, management and corporate services to the SFC
- Educate investors and handle complaints
- Communicate with stakeholders including the media
- Co-operate with other regulators

Achievements in 2005-06

- Identified 18 cases of suspect warrants market activities for investigation
- Substantially concluded three cases before the Insider Dealing Tribunal
- Successfully prosecuted 72 companies and people for various offences
- Concluded 84 disciplinary inquiries and took action against 98 companies and people
- Excluded a sponsor from the listings market for 13 months
- Banned an analyst for five years for trading contrary to his research reports
- Assisted the Court in a successful ICAC prosecution of a high profile market manipulation case
- Referred 24 cases to the Police
- Concluded 570 cases of which 427 cases were completed within 12 months

- Approved HKEx rules to launch Callable Bull/Bear Contracts
- Formulated a Six-Point Plan on the derivative warrants market
- Approved HKEx rules to increase the position limits on stock options contracts and to reduce trading spreads
- Approved HKEx rule amendments for the migration of the Securities and Derivatives Network
- Co-ordinated market contingency planning for World Trade Organization's 6th Ministerial Conference and avian flu preparation
- Reviewed the Investor Compensation Fund levy
- Published research reports

- Formulated amendments to the SFO and its subsidiary legislation to address market developments
- Advised on possible breaches of the securities laws
- Conducted a significant number of successful prosecutions
- Organised more staff training and development activities
- Conducted staff opinion survey to enhance communications and improve workplace
- Established a preparatory working group to promote XBRL
- Launched new investor education TV and radio commercials, re-named the IE portal
- Launched text-only version of SFC website
- Won annual report and corporate governance disclosure awards
- Signed regulatory co-operative instruments with eight jurisdictions
- Hosted Joint Forum meeting and business continuity planning meeting for Asian regulators

Work in Progress

- Continue surveillance work and provide expert testimony
- Continue the investigation of 224 cases including two cases of SFO s.214 proceedings and 18 cases on derivative warrants trading
- 20 cases awaiting hearings in the Courts including two market manipulation cases, eight cases before the Insider Dealing Tribunal and two cases eligible for Market Misconduct Tribunal hearings
- 122 cases subject to disciplinary proceedings including four sponsor cases and a number of mis-selling cases

- Enhance the market risk monitoring system and introduce its wider use internally
- Work with HKEx to facilitate the introduction of Callable Bull/Bear Contracts, etc
- Monitor HKEx's network consolidation project
- Work with HKEx to strengthen and enhance the derivative warrants market
- Update the market contingency plan and draft business continuity planning guidelines for market participants

- Work on legislative initiatives to ensure policy aims are fulfilled and to address market needs and reforms, and refine subsidiary legislation
- Make the SFC a better work place and increase training, especially to retain staff
- Review overall information and system architecture to align with new business initiatives and best industry practices
- Work with HKEx on SDNet-FinNet interconnection for CCASS/3 participants
- Explore IT solutions for document management and electronic submission
- Produce a new IE TV series
- Launch a focused IE campaign on pooling risk
- Conduct retail investor surveys on using investment advisers and investment in structured products
- Publish a new edition of the glossary of financial terms

We Enforce



“Malpractice and crimes will not go unnoticed or unpunished.”

EFFECTIVE

regulation needs to be backed by credible enforcement. We have an excellent record of enforcement. We will continue to build our enforcement capability and seek to ensure there is effective deterrence against misconduct and crimes in the securities market. We adjust the intensity of our enforcement actions and concentrate resources more heavily on the important problems.

Enforce

Last year, we

- ✓ concluded 84 disciplinary inquiries and took action against 98 companies and people
- ✓ disciplined a sponsor for due diligence failure
- ✓ banned a securities analyst from the industry for five years for conflicts of interest
- ✓ prosecuted 72 companies and people
- ✓ identified 18 cases of suspect warrants market activities for investigation
- ✓ investigated 27 cases involving listed companies
- ✓ assisted the Court in a successful ICAC prosecution of a high profile market manipulation case
- ✓ referred 24 cases to the Police

Statistical Comparisons

The following table shows certain key market data and statistics of the work of the SFC in the past three years. Figures in brackets are changes from the preceding year. More statistics are available in the Divisional Reports.

	2005-06	2004-05	2003-04
Market activities and transactions			
Number of listed companies on the Stock Exchange Main Board*	940 (+5%)	891 (+4%)	856
Market capitalisation (\$ billion)*	9,331.8 (+43%)	6,506.1 (+14%)	5,690.5
Average daily market turnover (\$ billion)	21.3 (+37%)	15.5 (+14%)	13.6
Total number of listing applications reviewed under Dual Filing	86 (-30%)	122 (+4%)	117
Total number of takeovers and shares repurchases transactions handled ¹	295 (+18%)	251 (-36%)	393
Total NAV of all compensation funds (\$ million)* ²	1,726 (+15%)	1,506 (+17%)	1,286
Licensees and investment products			
Applications for SFC licence	5,704 (+16%)	4,915 (+32%)	3,732
Applications to conduct new regulated activity	13,809 (+12%)	12,275 (+61%)	7,634
Total number of SFC licensees*	25,691 (+13%)	22,726 (+11%)	20,510
Total number of SFC-authorized schemes*	2,667 (+4%)	2,553 (+6%)	2,414
NAV of authorised unit trusts and mutual funds (US\$ billion) [#]	668 (+21%)	551 (+3%)	534

	2005-06	2004-05	2003-04
Enforcement action			
New cases	524 (+5%)	501 (-59%)	1,223
Actions against licensees	98 (+11%)	88 (+13%)	78
Entities successfully prosecuted	72 (-5%)	76 (+27%)	60
Unsuccessful prosecutions	1 (-83%)	6 (N/A)	0
Reaching out			
Press releases issued	279 (-3%)	289 (+7%)	270
Total average daily hit rate of corporate and InvestEd websites	414,099 (+8%)	385,154 (+2%)	377,173
Investor enquiries	4,811 (-6%)	4,523 (-16%)	5,382
Investor complaints	1,091 (-10%)	1,214 (-3%)	1,252
Consultation papers issued	5 (-44%)	9 (+50%)	6
Consultation conclusions issued	8 (+60%)	5 (-38%)	8
Codes and guidelines issued	3 (0%)	3 (-40%)	5
Finances and staff			
Income (\$ million)	851.5 (+36%)	625.4 (+13%)	551.1
Expenses including depreciation (\$ million)	496.9 (+9%)	456.3 (+7%)	425.7
Permanent established posts*	413 (+2%)	406 (+4%)	392

* Figures as at financial year-end.

Net asset value (NAV) as at 31 December 2005, 2004 and 2003.

¹ Including general and partial offers, whitewashes, off-market and general offer repurchases, and other applications.

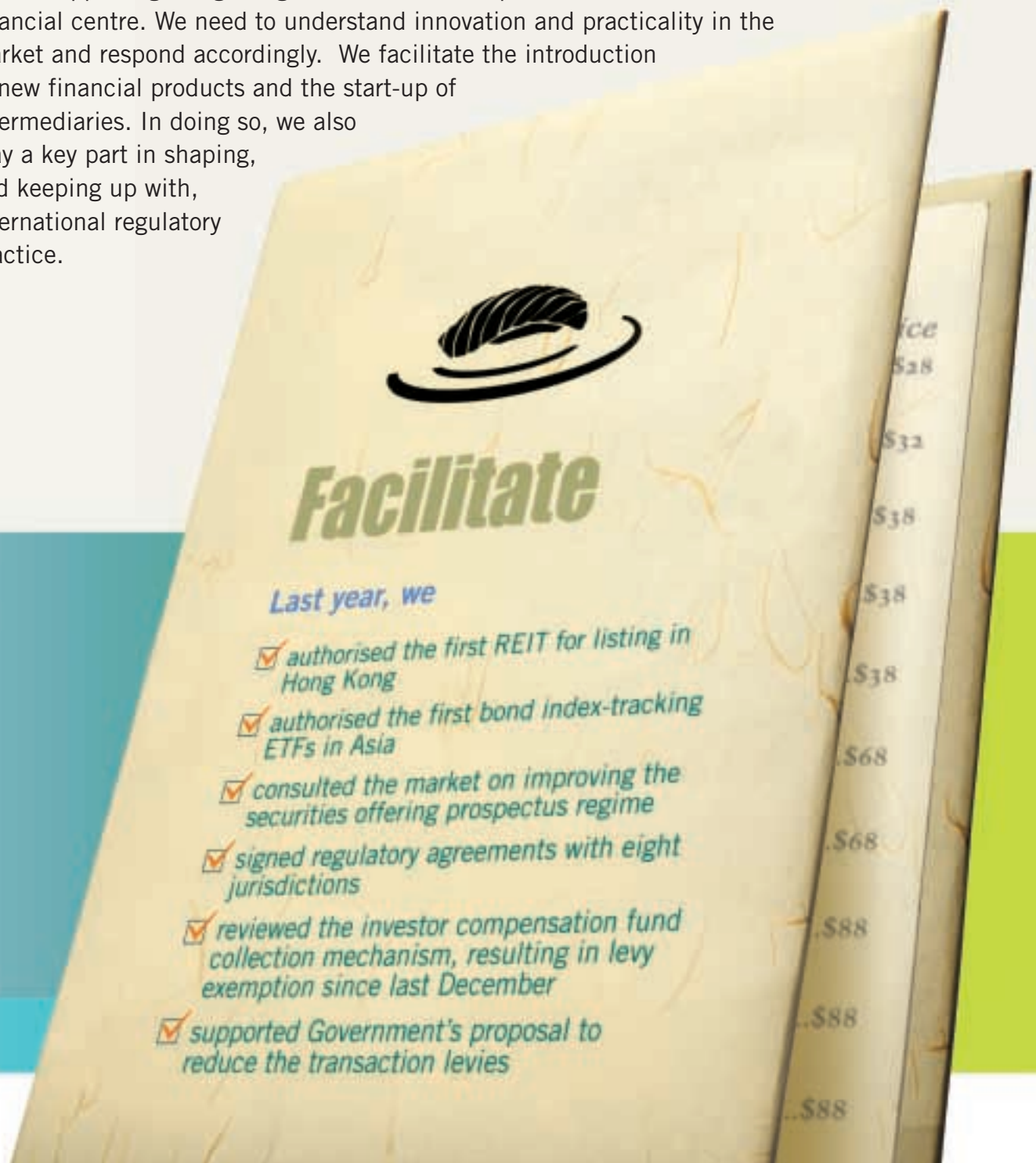
² Including Investor Compensation Fund, Unified Exchange Compensation Fund and Commodity Exchange Compensation Fund.

We Facilitate



“Consumers have greater choice in an efficient environment with well-built infrastructure.”

OUR primary role is to regulate the securities industry. But we also have a role in supporting Hong Kong's continued development as an international financial centre. We need to understand innovation and practicality in the market and respond accordingly. We facilitate the introduction of new financial products and the start-up of intermediaries. In doing so, we also play a key part in shaping, and keeping up with, international regulatory practice.



Significant Events 2005-06

6 April

Former Chairman Mr Andrew Sheng signed Letter of Intent with Dr Dayanath C. Jayasuriya (right), Chairman of the Securities and Exchange Commission of Sri Lanka, on regulatory co-operation at the IOSCO 2005 Annual Conference in Colombo (below). The SFC later signed similar pacts with India's Securities and Exchange Board (26 May), Guernsey's Financial Services Commission (3 June), Malaysia's Securities Commission (15 July) and Jersey's Financial Services Commission (13 September).



22 April

Broadcast a RTHK radio drama series, The Star Analysts' Fans Family.

Amended the Code on Unit Trusts and Mutual Funds to permit investment in listed REITs.

5 May

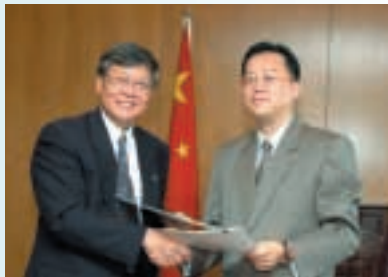
Signed Statement of Intent with the Financial Services Agency of Japan on co-operation.

12 May

Published Annual Report 2004-05, which later won best annual report and disclosure awards.

13 May

Mr Andrew Sheng exchanged Side Letters with Mr Anselmo Teng (right), Chairman of the Monetary Authority of Macau, under an existing Memorandum of Understanding to strengthen regulatory co-operation.



23 May

The Financial Secretary re-appointed Dr York Liao as SFC NED for two years, effective from 26 May 2005.

30 May

The Financial Secretary appointed Mr Martin Wheatley as SFC ED of Supervision of Markets, effective from 6 June 2005.

31 May

Released the consultation conclusions on the review of the disclosure of interests regime.

17 June

Amended the Code on REITs to permit investment in overseas properties.

21 June

Listing of the SFC-authorized ABF Hong Kong Bond Index Fund, Asia's first bond index-tracking ETF.

29 June

Consulted the public on the regulation of sponsors and compliance advisers.

4 July

Securities and Futures Appeals Tribunal upheld SFC decision to suspend a person for negligent advice.

29 August

Consulted the public on possible reforms to the prospectus regime in the Companies Ordinance.

30 September

The HKSAR Chief Executive appointed Mr Martin Wheatley as SFC Chairman for three years, effective from 1 October 2005. The Board of Directors on 20 September passed a vote of thanks to the ex-Chairman Mr Andrew Sheng.



Staff bid farewell to Mr Sheng at a gathering on 23 September 2005.

30 September

Revised the Hedge Fund Guidelines to strengthen assessment of managers and disclosure.

1 October

Certain major revisions of the Takeovers Code took effect.

17 October

The Government published the report on the SFC's 2005 annual review of the Exchange's performance in its regulation of listing matters.

18 October

An individual's suspended jail sentence for market manipulation was activated by the Courts for failing to attend an SFC interview.

27 October

SFC Chairman, Mr Martin Wheatley, visited CSRC Chairman, Mr Shang Fulin (left), in Beijing.

**11 November**

The Financial Secretary re-appointed the Hon Jasper Tsang and Mr Christopher Cheng as SFC NEDs for two years, effective from 15 November 2005.

25 November

Listing of Link REIT, the first REIT authorised by the SFC.

19 December

Investor compensation levies were suspended under a new levy collection mechanism.

20 December

Signed MOU with the Insurance Authority to enhance regulatory co-operation.

21 December

Listing of GZI REIT, the world's first REIT with 100% investment in Mainland properties.

**06****10 January**

The Secretary for Financial Services and the Treasury, Mr Frederick Ma (right), launched the IE month and 2006 IE theme: "Before You Invest, Ask the Right Questions".

**16 January**

Three people including the former general manager of a listed company jailed in ICAC prosecution after SFC staff gave expert evidence on market manipulation. Two other people were jailed earlier.

22 February

Hosted the Business Continuity Planning Meeting for Asian Financial Regulators 2006.

7 March

Jointly with HKEx, sanctioned a listing sponsor and two responsible officers for due diligence failure.

29 March

Published a three-year strategic document, Regulatory Challenges and Responses.

Signed MOU with the Israel Securities Authority to enhance enforcement co-operation.

31 March

Announced the way forward for a Six-Point Plan to enhance the derivative warrants market after public consultation.

We Educate



“Education is the best defence against dishonest behaviour and it is better to start early.”

THE laws of Hong Kong, the statutory objectives of the SFC and our codes and guidelines set the overall regulatory framework. However, well-informed and financially literate investors are the first line of defence against fraud and bad practice. We will continue our strong efforts in investor education and communication.

Educate

Last year, we

- ✓ introduced the theme of "Before you invest, ask the right questions", complete with a new television commercial
- ✓ re-named the investor website InvestEd for a clearer identity and with stronger content
- ✓ surveyed retail investors, in particular warrant investors, to gauge levels of knowledge and understanding
- ✓ attracted 8,000 people to 79 education seminars

MODE D'EM



Mette le ingredienti
dentro de con-
dare a la tua
ricetta di cu-



Prepara
una
cena



Arroia un petit peu,
mais régulièrement.
Te petit cultiver
la réussite
de ta vie...

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

- Revised the Codes on Takeovers and Mergers and Share Repurchases
- Issued a consultation paper on possible reforms to the prospectus regime in the Companies Ordinance
- Analysed responses to the consultation paper on amendments to the Securities and Futures (Stock Market Listing) Rules (SMLR) to give statutory backing to major listing requirements, worked with stakeholders on developing the proposals
- Supported the Government's proposals to establish a Financial Reporting Council
- Worked with the SEHK on its proposal to review its decision-making structure for listing matters
- Reviewed and reported on the SEHK's performance in its regulation of listing matters

This Chapter Is About

- Takeovers matters
- Prospectus related matters
 - Prospectus regime review
 - Prospectus authorisation for unlisted retail structured note issues

- Upholding standards
 - Dual Filing
 - Enhancing the regulation of listing
 - Quality of financial reporting and regulation of auditors
 - Review of the SEHK's decision-making structure for listing matters
 - Review of the SEHK's performance of its regulation of listing matters
 - Regulation of business valuers
- The Public Shareholders Group

What We Do

- Administer the Codes on Takeovers and Mergers and Share Repurchases
- Promote 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 and grant exemptions for prospectuses issued by listed and unlisted issuers under companies legislation
- Administer the Dual Filing regime under the SFO to enhance the quality of disclosure by listing applicants and listed companies

What We Did

Takeovers matters

The Takeovers Executive, comprising staff of the Corporate Finance Division, 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. Following public consultation on proposed code amendments, and in consultation with the Takeovers and

Mergers Panel, we published the consultation conclusions in August 2005. The amended Codes were issued in October 2005.

During the year, the Takeovers and Mergers Panel met two times to consider the public's responses to proposed code amendments.

The SFC criticised the Board of Directors of ITC Corporation Ltd

On 15 November 2005, the SFC publicly criticised the board of directors of ITC for breaching Rule 21.3 of the Takeovers Code, which restricts share dealings and transactions by an offeror and parties acting in concert with it during securities exchange offers.

The background concerned a possible voluntary securities exchange offer to be made by Hanny Holdings Ltd for all shares of Group Dragon Investments Ltd, a company to be established following completion of the group reorganisation of China Strategic Holdings Ltd, which was announced by Hanny on 19 April 2005. As a result an offer period commenced under the Takeovers Code. As ITC held over 20% of the shares in Hanny, it was presumed to be acting in concert with Hanny under the Takeovers Code and hence was subject to the restrictions in Rule 21.3 during the offer period.

On 21 October 2005, a wholly-owned subsidiary of ITC acquired 11 million Hanny shares for \$44 million, increasing ITC's shareholding in Hanny from 20.61% to 25.48%. This acquisition of shares by ITC constituted a breach of Rule 21.3 of the Takeovers Code. The board of directors of ITC admitted the breach and agreed to the SFC issuing the public criticism under section 12.3 of the Introduction to the Codes.

Prospectus related matters

✓ Prospectus regime review

The release in August 2005 of the consultation paper on possible reforms to the prospectus regime in the Companies Ordinance marked the launch of the third and final phase of a project to modernise the regime for public offerings of shares and debentures.



Corporate Finance

The first two phases were completed in May 2003 and December 2004 respectively. The final phase involves an overall review of the public offering regime, and the consultation paper put forward 21 “concept” proposals covering regulatory harmonisation, enhancement of investor protection, pre-deal research reports, and incorporation by reference etc. The consultation ended on 31 December 2005 and we are considering the submissions.

✓ Prospectus authorisation for unlisted retail structured note issues

Under the Companies Ordinance prospectus regime, SFC authorisation is required for prospectuses in respect of unlisted public offerings of shares and debentures.

In 2005-06, we authorised 134 prospectuses in respect of retail structured note issues, representing an 18% increase from 114 prospectuses a year ago. The aggregate issue size represented by retail note issues with an issue date falling within 2005-06 was approximately \$13,137 million.

Our authorisation is also required for any advertisements in relation to retail note prospectuses. We processed 103 applications in 2005-06.

Upholding standards

✓ Dual Filing

Under the Dual Filing regime, which took effect on 1 April 2003, listing application materials and listed company announcements filed with the SEHK are also filed via the SEHK with 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. The Group met once in 2005-06.

In 2005-06, we received 86 new listing applications and issued comments on 41 of them. Of these 41 applications, 13 remained active as at 31 March 2006, 11 had lapsed or been rejected or withdrawn, and 17 had been listed.

70.2% of the total applications were submitted during the first half of 2005-06 (i.e. from April to September), compared to 60.6% in the first half of 2004-05. There was a higher proportion of applications with planned offer size of over \$500 million (41.9% compared to 25.4% in 2004-05). Our average response time was seven working days. To ensure transparency, the SFC publishes quarterly updates on applications.

We continue 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 concerns including deficient disclosure of key factual information relating to the ownership, business and industry of the applicant, and its relationship with related parties, and inconsistencies between the English and the Chinese versions of a prospectus.

After consultation with the Dual Filing Advisory Group regarding one application, we advised the SEHK that we intended to exercise our power to object to the listing. 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.

✓ 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 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.

The SFC supports the Government's proposals, including the proposals to empower the SFC to fine. Civil fines will enable the SFC to take swift action to uphold its regulatory objectives of maintaining a fair and transparent market and protecting investors. The SFC is working with the Government to finalise the proposals.

The 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.

Our consultation ended on 31 March 2005. We have analysed the responses to the consultation and discussed the proposals with the Government, the SEHK and market stakeholders. Discussions are continuing.

We believe these 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. 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 a 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, HKEx, 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. Recently, we have also agreed to double a one-off contribution to \$5 million as contingency funding.

✓ Review of the SEHK's decision-making structure for listing matters

The SEHK consulted the public on a new structure for decision-making on listing matters in February 2005. We worked closely with the SEHK on its proposals.

Subsequent to the consultation period, the SEHK decided to address the proposals in its consultation paper in two phases. In the first phase, the SEHK amended the Listing Rules to increase the number of Listing Committee members to at least 28, cap their term of office to six years, and include more investor representatives on the committee. The SEHK will review the other consultation proposals in phase two.

✓ Review of the SEHK's performance of its regulation of listing matters

Section 21 of the SFO requires the SEHK to ensure, as far as reasonably practicable, an orderly, informed and fair market. Section 5(1)(b)(i) of the SFO requires the SFC to supervise, monitor and regulate the activities carried on by the SEHK. The SEHK and the SFC have agreed in a Memorandum of Understanding signed on 28 January 2003 that the SFC shall periodically review the SEHK's performance in its regulation of listing matters.

The Government recommended, in its March 2004 Consultation Conclusions on Proposals to Enhance the Regulation of Listing, that the SFC prepare annual reports on its reviews of the SEHK's performance in its listing functions and submit them to the Financial Secretary.

Corporate Finance

In the first half of 2005, we reviewed the SEHK's procedures in key listing-related functional areas. We concluded that the procedures in the areas examined were adequate to enable it to discharge its statutory obligation to maintain an orderly, informed and fair market. We also recommended certain areas for improvement to the SEHK for consideration, including ways it can improve the transparency of its policies and practices. A report was published by the Government in October 2005 and is available on the SFC website.

✓ Regulation of business valuers

We are concerned about the standards of business valuations used in financial reporting and have called for better regulation and higher standards of professionals who provide business valuation services to listed companies.

In response to our calls, the Hong Kong Institute of Surveyors, the Hong Kong Society of Financial Analysts and the Royal Institution of Chartered Surveyors formed the Hong Kong Business Valuation Forum in September 2005. The Forum's objectives are to set standards and requirements that each of these professional bodies will apply to its members.

The 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 14 members: retail and institutional investors, market commentators, advocates of investors' rights, academics and a Consumer Council representative.

During the year, members met five 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 independent financial advisers;
- the Government's Financial Reporting Council Bill;
- proposals on possible reforms to the prospectus regime in the Companies Ordinance;
- proposed reforms to the derivative warrants market; and
- SEHK policy issues relating to profit forecasts.

Matters handled by Corporate Finance

Types of application	2005-06	2004-05
Applications for listing on the SEHK	86	122
Codes on Takeovers and Mergers and Share Repurchases		
General and partial offers under the Takeovers Code	34	24
Privatisations	15	3
Whitewash waiver applications	32	32
Other applications under the Takeovers Code	204	184
Off-market and general offer repurchases	5	3
Other applications under the Share Repurchases Code	5	5
Total	295	251
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	2	4
Statements issued by the Panel ²	0	0
Companies Ordinance and Securities and Futures Ordinance		
Exemptions granted under section 309 of the SFO ³	767	529
Authorisations granted under section 105 of the SFO	142	52
Authorisations granted to register prospectuses under the CO in respect of unlisted shares and debentures	134	114
Exemptions granted from the CO prospectus content requirements for prospectuses in respect of shares and debentures	158	130

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

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

3. Each certificate of exemption issued can include more than one warrant or structured product. 2,080 warrants and 8 debt instruments were listed during the year.

Intermediaries & Investment Products

Our mission is to protect investors and uphold market integrity and confidence. We establish a robust regulatory platform, continue to raise standards among our market intermediaries, and provide room and support for market growth and innovation.

Achievements

- Protected investor interests
 - Secured public support including that of the Panel on Financial Affairs of LegCo to reform securities margin financing regulation
 - Ring-fenced the operations and client assets of problem licensed firms
 - Required disclosure in a timely manner of clear, accurate and up-to-date information in the offering documents of authorised investment products
 - Investigated 44 cases of pricing errors and secured compensation to the affected funds/investors in 27 cases

- Enhanced Hong Kong's position as an asset management hub in Asia
 - Developed the Hong Kong REIT market – authorised three REITs with a total market capitalisation of \$42 billion; and relaxed the geographical restriction on overseas investments and gearing ratio of SFC-authorised REITs
 - Authorised Asia's first bond index-tracking ETFs, facilitating the development of a deeper, more liquid and mature bond market in the Asian region; the total net asset value was about US\$1,377 million as at end of 2005

- Allowed SFC-authorised schemes to invest in listed REITs
- Revised the Hedge Fund Guidelines to increase transparency and recognise a greater scope of experience for fund manager personnel
- Approved nearly 90% of UCITS III fund applications received
- Handled more licence applications of non-conventional fund managers (e.g. REITs, hedge funds, etc)
- Fine-tuned the SFO to allow licensed asset managers to provide advice on their own funds without an adviser licence

- Promoted prudential soundness and raising professional standards
 - The securities industry is financially more sound – total shareholders' fund increased to \$80 billion
 - Proposed measures to tighten regulation of sponsors and compliance advisers
 - Signed a MOU with the Insurance Authority to enhance regulatory co-operation of insurance-related investment products
 - Revised anti-money laundering regulation to match new international standards

This Chapter Is About

- Protecting investor interests
- Facilitating business development
- Raising professional standards
- Operational functions
- Impose authorisation requirements on investment products offered to the public and their advertisements
- Monitor disclosures and ongoing compliance of authorised investment products
- Develop regulatory platform to facilitate market growth and innovation

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

What We Did

Our primary objective is to protect investors. 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, our robust licensing regime ensures that only fit and proper persons are licensed to conduct regulated activities. During last year, our licensee base reached a new milestone of 25,000 in November 2005, and the number of licensees as at 31 March 2006 was 13% higher than a year ago at 25,691 (Table 1).

**Table 1 – Number of licensees
As at 31 March 2006 (Figures as at 31 March 2005 in brackets)**

	Corporations		Representatives		Responsible officers		Total	% Change	
SEHK Participants	411	(394)	7,793	(7,613)	1,220	(1,146)	9,424	(9,153)	3%
HKFE Participants	115	(113)	380	(377)	63	(54)	558	(544)	3%
SEHK and HKFE Participants	22	(11)	1,063	(549)	128	(61)	1,213	(621)	95%
Non-Participants	742	(714)	11,974	(10,150)	1,780	(1,544)	14,496	(12,408)	17%
Grand Total	1,290	(1,232)	21,210	(18,689)	3,191	(2,805)	25,691	(22,726)	13%

Intermediaries & Investment Products

We have 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 seek to promote high standards amongst practitioners because investors rely heavily on practitioners' skills, integrity and professionalism.

Our investment product approval and monitoring processes also require that SFC-authorized schemes have the necessary structural safeguards and relevant disclosures for investors to make informed investment decisions. Further, we respond to market developments and, where appropriate, review our codes and guidelines to assist market practitioners and facilitate the introduction of new investment products to the Hong Kong market.

The annual Fund Management Activities Survey found that total assets under management or advice in the fund management business in Hong Kong amounted to about \$3.6 trillion as at the end of 2004, an increase of 23% compared with the previous year.

Protecting investor interests

No regulatory regime can ensure zero failure. Firms may fail due to market volatility and business risks. 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 risks of their firms.

With an intensive risk management programme since 2000, the brokerage industry is financially more sound. Total shareholders' fund of the industry was \$80 billion as of end of 2005. We are now able to focus on intermediary conduct issues, especially those relating to investment advisers, sponsors and fund managers. During the year, we undertook cross-sector supervisory activities covering fund managers, brokers, investment advisers and corporate

finance advisers. These activities included theme inspections to examine whether there are any gaps in the compliance standards of intermediaries and the applicable regulatory requirements.

✔ **Securities margin financing**

Over the past few years, our first priority was managing down the margin financing risks of brokers. Robust measures have been put in place and rigorously enforced. A major piece of the regulatory fabric – specific limits to reduce the pooling and re-pledging risks in margin financing – is in the legislative process. We reported our work status to the Legislative Council in a meeting of the Panel on Financial Affairs in February 2006. Practically all members supported the direction of our proposal. We issued the consultation conclusions on 7 April 2006. Upon implementation, that will provide an effective tool to manage down risks and bring Hong Kong closer to international best practice.

Furthermore, in June 2005, we imposed licensing conditions on a securities firm to ensure that it adopted prudent margin lending practices and strengthened its risk management.

✔ **Safeguard investor interests in cases of fraud and other concerns**

There were some reported cases of misappropriation of client assets by staff of brokerage firms towards the year-end. We required the affected firms to ensure adequate financial resources, take appropriate and timely measures to ascertain and deal with clients' losses and strengthen their internal controls. In addition, we issued a circular on 8 March 2006 to all brokerage firms requiring senior management to take immediate steps to strengthen anti-fraud controls and management supervision. We also reminded investors to stay vigilant.

Some of our licensed firms have group companies overseas whose viability and reputation may adversely impact the local firms. In September 2005, we conducted an onsite inspection of the three licensed firms related to Banco Delta Asia S.A.R.L. (BDA) immediately after BDA was designated as a "primary money laundering concern" by the US Treasury Department, in order to monitor those

firms' financial positions and ensure proper safeguard of clients' interests. We also ensured that those firms took appropriate measures to ring-fence their operations and strengthen their management oversight.

Furthermore, upon the reporting of fraud committed by the chief executive of Refco Inc. in October 2005, we immediately required the two licensed firms under the Refco group in Hong Kong to take measures to contain risk to investors and counterparties.

✓ Proper disclosure in offering documents of authorised investment products

During an inspection, we noted that Allianz Global Investors Hong Kong Ltd (AGI), formerly known as Allianz Dresdner Asset Management Hong Kong Ltd, had failed to change its offering documents regarding the valuation time of four authorised funds after it had effected a change more than four years ago. AGI settled the case with us in July 2005, without admission of liability, by voluntarily making ex-gratia payment to the affected funds, engaging a firm of accountants to independently review its internal control procedures and undertaking to implement all recommendations arising out of the review.

✓ Fund investors compensated for pricing errors

The Code on Unit Trusts and Mutual Funds sets out the circumstances under which investors should be compensated in the case of pricing errors. Last year, we investigated 44 cases of pricing errors. We required the responsible fund managers to rectify the situation and enhance their internal controls in all those cases. Compensation was made by the responsible parties to the funds and the investors concerned in 27 cases.

✓ Thematic review on stockbrokers active in derivative warrants trading

We conducted a thematic review of the trading practices adopted by some stockbrokers that were particularly active in derivative warrants trading. We also continued to monitor these firms to assess the adequacy of their controls over the associated credit and liquidity risks.

Facilitating business development

✓ Intermediaries

✓ Focus licensing team

We set up a focus team in October 2004 to handle the licence applications and answer enquiries of fund managers of non-conventional products, such as hedge funds and REITs. Last year, we received over 30 licence applications from these managers.

✓ Balanced approach to facilitate business development

We facilitate business development by flexibly applying our rules and regulations under circumstances where investor interests would not be compromised. During the year, we granted 68 modifications or waivers in respect of statutory requirements or licensing conditions to 73 licensed persons and applicants. We approved 43 applications for subordinated loans worth about \$13 billion and granted 20 modifications and waivers regarding Securities and Futures (Financial Resources) Rules (FRRs), introducing agents and Securities and Futures (Professional Investor) Rules. We also approved two applications for associated entities to conduct other business.

✓ Fine-tuned scope of regulated activities

Further to a consultation in 2004-05, Schedule 5 to the SFO was amended and came into effect on 6 January 2006. The changes concerned licensing of REIT managers, allowing approved money brokers who represent authorised financial institutions to deal in securities without a dealer licence, and allowing licensed asset managers to provide advice on their own funds without an adviser licence.

✓ Dialogue with the industry

We issued 33 circulars to the industry about anti-fraud controls, business continuity arrangement, prudent risk management, anti-money laundering and combat of terrorist financing, etc. We also gave 50 talks on regulatory issues and industry developments such as REITs, hedge fund, wealth management and selling practices. We posted frequently asked questions and answers on the SFC website to assist practitioners.

Intermediaries & Investment Products

✓ More choices in professional training

We approved the City University of Hong Kong's Department of Economics & Finance as an additional recognised institution for providing Continuous Professional Training (CPT) courses. In addition, we approved the Hong Kong Securities Institute's Professional Diploma in Financial Markets as a recognised industry qualification and local regulatory framework paper towards meeting the licensing competence requirements.

✓ Products

✓ Authorisation of REITs

Following public consultation, the Code on REITs was revised in June 2005 to allow investments in overseas properties and raise the gearing ratio of a REIT from 35% to 45% of total gross assets. The latter was intended to provide REITs with more financial flexibility in making property investments, particularly in overseas jurisdictions due to different tax structures and the need to match assets and liabilities to manage foreign currency exposure.

We introduced a Practice Note on Overseas Investments by SFC-authorized REITs to elaborate on the application of the code provisions in the context of overseas investments.

During the year, we authorised the first three REITs in Hong Kong, namely the Link REIT, which is the biggest REIT IPO to date worldwide; the Prosperity REIT; and the GZI REIT, which is the first REIT with 100% investment in Mainland China properties. As of 31 March 2006, the total market capitalisation of the three REITs amounted to \$42 billion.

In line with our commitment to allow special product features to the extent that they are formulated in a fair and objective manner and in line with prevailing market practice, we have allowed the authorised REITs to incorporate features such as payment of management fees by way of units and the payment of transaction-based fees, namely disposal fees and acquisition fees.

The launch of SFC-authorized REITs sets the stage for the development of a new breed of asset managers, namely REIT managers, thus further augmenting the range of capabilities among the asset managers in Hong Kong. More importantly it paves the way for the development of Hong Kong as a regional REITs hub. Issuers in Asia are likely to choose Hong Kong as the preferred choice, given the breadth and depth of Hong Kong's capital market.

In December 2005, we announced a policy to require that provisions substantially equivalent to those in Part XV (Disclosure of Interests) of the SFO be adopted in trust deeds of REITs. As a result, holders of REIT units are required to submit to the relevant REIT manager and SEHK notifications of interests upon the attainment of the 5% disclosure threshold and other changes thereto in accordance with the relevant trust deed, in the same manner as the disclosure of interests in shares of listed companies.

✓ Asian Bond ETFs

We authorised the first bond index-tracking Exchange Traded Funds (ETFs) in Asia under the Asian Bond Fund (ABF) 2 project. The ABF Hong Kong Bond Index Fund and the ABF Pan Asia Bond Index Fund were both authorised in June 2005, and listed on the SEHK in June and July 2005 respectively. We are pleased to have played a key role in this project as it provides a new class of investments for Hong Kong investors and demonstrates greater regulatory co-operation within the Asian region. ABF2 is phase two of the ABF project, which is an initiative spearheaded by the Executives' Meeting of East Asia and Pacific Central Banks (EMEAP). The impetus for the project is the recognition of a need to develop a deeper, more liquid and mature bond market in the region. As at the end of 2005, the approximate net asset values of these two



The offer of the Link REIT units in November was the world's largest REIT IPO.

bond index funds amounted to US\$275 million and US\$1,102 million respectively.

✓ Processing of UCITS Funds

European based UCITS I funds need to be compliant with the UCITS III requirements at the latest by February 2007. We introduced interim measures in March 2005 to facilitate the changeover of those that are authorised for sale in Hong Kong. As of 31 December 2005, we had approved nearly 90% of the 1,000 plus UCITS III fund applications received. We continued our dialogue with the industry to work out the best possible means to process UCITS III fund applications, in particular those funds with innovative product features.

✓ Review of Hedge Fund Guidelines

With the introduction of our Hedge Fund Guidelines in May 2002, Hong Kong became one of the first jurisdictions to authorise hedge funds for retail distribution. In response to market developments, we conducted a public consultation on the Guidelines in May 2005 with an aim to: adopt a holistic approach to the assessment of hedge fund managers through recognising an expanded scope of experience of fund manager personnel such as proprietary trading; increase transparency of the management company's operations in offering documents; and consolidate and codify regulatory practices. The revised Guidelines took effect on 30 September 2005.

✓ Investment in listed REITs

After public consultation, the Code on Unit Trusts and Mutual Funds was revised in April 2005 so that collective investment schemes authorised under the Code are allowed to invest in listed REITs worldwide.

✓ Streamlining of authorisation process

We aim to be pragmatic in our approach to product authorisation without compromising investors' interests. To this end, fast track procedures were included in the interim measures to facilitate and expedite the processing of UCITS III fund applications which did not intend to use the expanded investment powers. We also clarified that certain notices issued by fund managers to investors which pertain to routine operational and administrative matters would not require our prior approval.

Raising professional standards

✓ Enhancing regulation of sponsors and compliance advisers

We published the Consultation Paper on the Regulation of Sponsors and Compliance Advisers in June 2005. The Consultation Paper proposed to introduce a set of specific eligibility criteria and ongoing obligations for corporate finance advisers who carry out the work of sponsors and compliance advisers. With the objective to raise the overall standards of sponsors and compliance advisers, these specific eligibility criteria and ongoing obligations will be integrated into the existing licensing regime under the SFO.

✓ Regulation of insurance-related investment products

To enhance co-operation, exchange of information and mutual assistance, we signed a MOU with the Insurance Authority in December 2005. Under the MOU, both parties agree to foster closer co-operation in the regulation of insurance-related investment products and the sharing of information of persons who are regulated under the respective supervisory regimes.

✓ Revised anti-money laundering regulation

In order to match the new international standards developed by the Financial Action Task Force on Money Laundering (FATF), we revised the Guidance Note on Prevention of Money Laundering and Terrorist Financing in October 2005. The revised Guidance Note provides



An SFC staff spoke at an anti-money laundering seminar in Hong Kong for compliance officers.

Intermediaries & Investment Products

additional guidance on practical measures that firms are expected to take in order to prevent money laundering and terrorist financing.

The revised Guidance Note has become effective from 30 April 2006. To raise public awareness and help the industry implement it, we have given seminars since November 2005.

✔ Strengthened business continuity arrangement of intermediaries

In view of the threats of business interruption arising from the 6th Ministerial Conference of the World Trade Organization (MC6) in October 2005, we conducted a theme inspection to review the business continuity arrangement of selected firms. We issued two circulars in November 2005, providing practical guidance on measures that firms might take.

We issued another circular in December 2005 to draw intermediaries' attention to the importance of taking reasonable precautions against avian flu to minimise impact on their operations and their clients.

We will continue to review the business continuity arrangement of licensed firms this year.

Operational functions

Market activities have continued to expand and increase in complexity and, with them, regulatory issues. During the

year, we have had to reallocate our staff resources in accordance with our assessment of the risks posed by these issues on investors, and the impact and contagion that such risks would have on the market. We will continue to devote resources in accordance with our risk-based approach in the coming year. This necessarily requires us to keep under constant review our work priorities and our allocation of resources so as to ensure that we dedicate our time and effort to deal with what is important and necessary in a measured manner for the benefit of the market overall. To this end, we have started reviewing our performance pledges with a view to reflecting market changes, investors' needs and our priorities.

✔ Licensing

The number of applications for licence has increased by 16% to 5,704¹ (Table 2). As with previous years, applications for dealing in securities and advising on securities constitute the majority of the new licence applications. However, we saw a significant increase in applications for asset management (54 corporate and 862 individual applications received), demonstrating Hong Kong's advancement as a major international fund management centre.

During the year, 105 applications were withdrawn because they failed to meet the competence requirements. To protect investors and market integrity, we imposed licensing conditions on 2,444 new licensees to ring-fence their scope of activities.

Table 2 – Applications for licence/regulated activity
For the period from 1 April 2005 to 31 March 2006 (Previous year's figures in brackets)

Applications	Business corporations		Individuals		Responsible officers		Total		% Change
	Licence		Licence		Licence		Licence		
Received	113	(119)	5,275	(4,429)	316	(367)	5,704	(4,915)	16%
Approved	108	(110)	5,199	(4,316)	318	(317)	5,625	(4,743)	19%
Refused	0	0	0	0	0	0	0	0	0%
Withdrawn	7	(2)	67	(70)	31	(12)	105	(84)	25%
	Regulated activity		Regulated activity		Regulated activity		Regulated activity		% Change
Received	159	(185)	11,318	(9,874)	499	(663)	11,976	(10,722)	
Approved	155	(160)	11,224	(9,706)	516	(550)	11,895	(10,416)	14%
Refused	0	0	0	0	0	0	0	0	0%
Withdrawn	10	(6)	108	(104)	52	(25)	170	(135)	26%

1. 2,868 applicants also opted for the fast track provisional licence.

✓ Supervision

Benefiting from a 23% increase in the total value of transactions and active fund raising activities, the reported

total operating income of the securities industry increased by 15% in 2005. However, the industry's profitability dropped due to increase in total overheads.

Table 3 – Statistical information relating to the Hong Kong securities market¹

	As at 31/12/2005	As at 31/12/2004
Total number of active cash clients ²	625,775	609,281
Total number of active margin clients ²	72,290	76,546
Balance sheet	(HK\$ million)	(HK\$ million)
Cash in hand and at bank ³	106,798	100,547
Amounts receivable from margin clients ⁴	14,639	15,065
Amounts receivable from clients and other dealers arising from dealing in securities	102,724	64,697
Proprietary positions	96,892	77,134
Other assets	118,124	60,458
Total assets (+38%)	439,177	317,901
Amounts payable to clients and other dealers arising from dealing in securities	155,237	112,728
Total borrowings from financial institutions	102,171	56,264
Short positions held for own account	34,480	26,552
Other liabilities	67,093	46,883
Total shareholders' fund	80,196	75,474
Total liabilities and shareholders' fund (+38%)	439,177	317,901
	12 months to 31/12/2005	12 months to 31/12/2004
Profit and loss	(HK\$ million)	(HK\$ million)
Total value of transactions ⁵	20,367,924	16,608,214
Net securities commission income	18,531	17,610
Gross interest income	4,526	2,354
Other income ⁶	32,811	28,810
Total operating income (+15%)	55,868	48,774
Total overheads and interest expense ⁷	(46,378)	(37,832)
Total operating profit (-13%)	9,490	10,942
Net profit on proprietary trading	1,657	1,540
Net profit (-11%)	11,147	12,482

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

2. Active clients are clients for whom the licensed corporation is required to prepare and deliver monthly statements of account in respect of the relevant reporting month in accordance with the Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules.

3. Cash in hand and at bank includes trust monies held on behalf of clients amounting to \$38,496 million (2004: \$27,345 million).

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

As at 31/12/2005	As at 31/12/2004
4.8	4.9

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

6. Other income mainly comprises corporate finance income, fund management income, inter-company charges and others.

7. Total overheads include salary and staff benefits paid to non-commission based staff of licensed corporations. Commission paid to account executives and others is included in the net securities commission income.

Intermediaries & Investment Products

✓ Risk-based and objective-driven regulatory approach

During the year, we allocated more staff resources to deal with regulatory issues and conduct more focused inspections on a risk-based monitoring approach, including reviews into fund managers, stockbrokers actively trading in derivative warrants and business continuity arrangement of licensed firms.

We inspected 140 firms (109 routine inspections and 31 special inspections) and carried out 21 prudential meetings. We noted 439 rule breaches during our inspections (Table 4). Inspections are conducted not only as a means of detecting breaches, but also to help intermediaries maintain and raise their standards. While breaches of criminal provisions in the SFO and serious misconduct were referred to the Enforcement Division for investigation and further action, we issued letters of deficiencies in less serious cases and technical infractions.

Through our onsite inspections and ongoing monitoring programmes, we worked with certain intermediaries to find ways to strengthen their financial positions and internal controls, and to rectify improper business practices.

Discussions with senior management of those intermediaries yielded positive results in most cases.

✓ Investment products authorisation

As at 31 March 2006, the total number of SFC-authorized investment products stood at 2,667, an increase from the previous year's 2,553 (Table 5). During the year, 355 products were newly authorised, while 241 products were withdrawn.

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. There were 13 authorised hedge funds as at the year-end, with an aggregate net asset value of US\$1.038 billion.

Table 4 – Breaches by licensed corporations noted during SFC inspections

Nature of breaches	Total number of breaches	
	2005-06	2004-05
Failure to comply with Financial Resources Rules	6	17
Failure to safekeep client securities	7	32
Failure to maintain proper books and records	26	20
Failure to safekeep clients' money	26	25
Unlicensed dealing & other registration issues	6	20
Breach of licensing condition	3	4
Breach of requirements of contract notes/statements of account/receipts	20	48
Failure to make filing/notification	1	5
Breach of margin requirements	8	6
Marketing malpractices	2	3
Illegal short selling of securities	2	1
Breach of Code of Conduct	150	280
Breach of Code on Unit Trusts & Mutual Funds	3	2
Breach of Corporate Finance Adviser Code of Conduct	3	6
Breach of Fund Manager Code of Conduct	17	16
Non-compliance with anti-money laundering guidelines	6	10
Breach of other rules and regulations of the Exchanges	9	7
Internal control weaknesses	118	201
Others	26	37
Total	439	740

Issuers are required to seek our prior approval of any advertisements or marketing materials for the public. In the past year, we authorised 6,620 product advertisements.

Amid positive market sentiment and investment environment, the aggregate net asset value of all authorised unit trusts and mutual funds rose 21% during the year to US\$668 billion as at 31 December 2005 (Table 6). Funds authorised in Hong Kong continued to show a strong international flavour (Table 7).

Table 5 – Number of authorised investment products

	As at 31/3/2006	As at 31/3/2005
Unit trusts and mutual funds	1,998	1,942
Investment-linked assurance schemes	197	177
Pooled retirement funds	37	37
MPF master trust schemes	44	45
MPF pooled investment funds*	280	274
Others#	111	78
Total	2,667	2,553

* There are 122 funds included in this category that are offered both as retail unit trusts as well as pooled investment funds for MPF purposes.

Other schemes comprised 97 investment-linked deposits, 11 paper gold schemes and 3 REITs.

Table 6 – Authorised unit trusts and mutual funds as at 31 March 2006

	Number	%	Total NAV* (US\$ million)	%
Bond	318	17.3	147,379	22.1
Equity	916	49.9	356,731	53.4
Diversified	111	6.0	37,650	5.6
Money market	51	2.8	92,574	13.9
Fund of funds	84	4.6	5,528	0.8
Index	28	1.5	8,970	1.3
Guaranteed	309	16.8	16,455	2.5
Hedge	13	0.7	1,038	0.2
Other specialised#	7	0.4	1,260	0.2
	1,837	100	667,585	100
Umbrella structures	161			
No. of authorised funds	1,998			

* Net Asset Value as at 31 December 2005

Includes: Futures & Options Funds & Leveraged Funds

Table 7 – Origin/net asset value of authorised unit trusts and mutual funds as at 31 March 2006

	Umbrella number	Sub-funds number	Single funds number	Total number	%	Total NAV* (US\$ million)	%
Hong Kong	16	59	28	103	5.2	9,374	1.4
Luxembourg	51	906	11	968	48.4	455,702	68.2
Ireland	43	299	8	350	17.5	134,083	20.1
Guernsey	3	33	1	37	1.9	5,109	0.8
United Kingdom	3	39	8	50	2.5	32,133	4.8
Bermuda	1	20	5	26	1.3	2,550	0.4
British Virgin Islands	5	12	9	26	1.3	2,683	0.4
Cayman Islands	38	338	54	430	21.5	24,205	3.6
Others	1	2	5	8	0.4	1,746	0.3
No. of authorised funds	161	1,708	129	1,998	100	667,585	100

* Net Asset Value as at 31 December 2005 (excluding "umbrella funds")

Enforcement

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

Achievements

- Identified 18 cases of suspect warrants market activities for investigation
- Substantially concluded three cases before the Insider Dealing Tribunal
- Successfully prosecuted 72 companies and people for various offences
- Concluded 84 disciplinary inquiries and took action against 98 companies and people
- Excluded a sponsor from the listings market for 13 months
- Banned an analyst for five years for trading contrary to his research reports
- Assisted the Court in a successful ICAC prosecution of a high profile market manipulation case
- Referred 24 cases to the Police
- Concluded 570 cases of which 427 cases were completed within 12 months

This Chapter Is About

- Surveillance
 - Unusual price and volume movements
 - Market trading practices
 - Client identity rule
 - Large open positions and position limits
 - Expert advisory services
- Investigations
 - Listed companies
 - Market misconduct including insider dealing and market manipulation
 - Cold calling
 - Failing to assist SFC investigations
 - Unlicensed activities
 - Disclosure of interests
 - Provision of false or misleading information
- Discipline
 - Disciplinary priorities
 - Workload and penalty trends
 - Appeals and checks and balances
 - Settlements
- Co-operation with other law enforcement agencies

What We Do

- Monitor the trading of Hong Kong's stock and derivative markets and inquire into irregularities
- Monitor reporting of large open positions in futures and options
- 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
- Report suspected market misconduct to the Financial Secretary
- Enforce disclosure of interests of substantial shareholders, directors and chief executives of listed companies
- Discipline dishonest, incompetent and financially unstable regulated intermediaries
- Co-operate with domestic and overseas regulatory bodies in local and overseas investigations

What We Did

During the year, we continued 494 inquiries or investigations from 2004-05. Another 524 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 1,018 cases handled, 570 were concluded and the remaining 448 were subject to continuing inquiries, investigations, hearings or prosecutions.

Surveillance

✓ Unusual price and volume movements

The Surveillance Department monitors 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, which may be signs of market misconduct including insider dealing and market manipulation. We actively monitor media reports for disclosure failures. We also surf the Internet to detect possible unlicensed dealing, unauthorised advertising of investment services, or other abnormal financial activities.

Where we suspect there are possible false or misleading announcements or withholding of material information from the public, we seek clarification from listed companies or recommend suspension of trading of their shares. We have not recommended suspensions in the past year.

In 2005-06, there were 253 trading suspensions due to unusual price or volume movements. 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. HKEx directed one of the suspensions as the management of the company could not be contacted.

In case of suspected market manipulation, insider dealing, dissemination of false or misleading information or other trading malpractices, we will obtain trading details from brokers to conduct preliminary assessments before referring these matters to the Investigation Department.

During the year, we sought trading records from brokers in 162 inquiries into untoward share price and volume movements. On many occasions, our early inquiries stopped potentially improper trading activities. 49 cases were passed to our Investigation Department for further investigation. Of these, eight cases were concluded with the issuance of warning letters, 14 cases were concluded with no further action, and 27 cases were still under investigation.

Enforcement

✔ Market trading practices

During the year, we conducted 32 inquiries into activities in the derivative warrants market, including possible false trading, fixing of the settlement price during the expiry process, non-compliance with the liquidity provider obligations and illegal short selling of warrants. We concluded 14 cases with no further action. 18 cases were still being investigated.

✔ Client identity rule

Under this rule, intermediaries are required to provide information relating to the ultimate beneficiaries of clients trading through them within two business days of our request. If they fail to comply, they may be required by the SFC to cease accepting orders from the clients concerned and be subject to disciplinary action. In 2005-06, we requested 11 intermediaries to cease trading for 18 clients. Four of these requests were subsequently lifted after we were satisfied that the intermediaries concerned would comply with the rule in the future.

✔ Large open positions and position limits

During the year, there were 11 cases relating to reporting violations and position limits breaches. Four cases were written off, with warning letters issued in three instances. The others were under review or being investigated.

✔ Expert advisory services

In 2005-06, we provided expert advisory services in 32 SFC investigations and three investigations conducted by other law enforcement agencies. In addition, we gave expert evidence before the Courts or the Insider Dealing Tribunal (IDT) on six occasions.

Investigations

During the year, we opened 252 new cases and continued investigation in 224 cases brought forward from 2004-05.

✔ Listed companies

A petition was made to the Courts seeking a SFO section 214 order to disqualify a former director. This matter will be heard in the coming year. Similar action in another case to disqualify five directors is at an advanced stage.

We investigated 27 cases involving listed companies in 2005-06, including 14 cases brought forward. We referred seven cases to the Police, ICAC, HKEx or Hong Kong Institute of Certified Public Accountants. Five cases were concluded with no further action.

✔ Market misconduct

In combating market misconduct, we continued to work closely with other law enforcement agencies including the Police Commercial Crime Bureau and the ICAC.

The high-profile manipulation of Shanghai Land Holdings Ltd shares case was heard during the year. The former general manager of the company, Ms Mo Yuk Ping, and four others were convicted for manipulating the shares of Shanghai Land and perverting the course of justice by giving false information to the SFC. They were given custodial sentence of six months to three and a half years.

The conviction followed an ICAC investigation in which considerable assistance was provided by the SFC. The expert evidence given by an SFC officer on the manipulative trades was fully accepted by the Courts. This case is a good example of the excellent co-operation that exists between law enforcement agencies in Hong Kong, and demonstrates that efforts to combat market misconduct extend well beyond the SFC.



Five people jailed in market manipulation case at the District Court in Wanchai.

✓ Insider dealing

The IDT last year released the full decisions of two concluded cases. In the Gilbert Holdings Ltd case (Case 1 in Table 1), it was found that two directors and two people related to them were insiders. In addition to fines and costs totalling \$11.7 million, all four insiders were banned from being directors or taking part in the management of any listed companies for three years.

In the case of HKCB Bank Holding Company Ltd and Hong Kong China Ltd (Case 2), two insiders were banned from being directors of listed companies for five years and ordered to pay fines and costs totalling \$56 million.

The IDT substantially completed one hearing relating to Easy Concepts International Holdings Ltd and Easyknit International Holdings Ltd (Case 3). Five people were found to be insiders. Two of them appealed the findings.

Fewer cases were concluded during the year due to challenges and appeals lodged. In this regard, the constitution of the IDT, the appointments of its members and the IDT's decision not to stay proceedings were challenged in the cases concerning Vanda Systems & Communications Holdings Ltd, Asia Orient Holdings Ltd and Harbour Ring International Holdings Ltd respectively. The applications have now been dismissed and substantial hearings are due to commence this year.

In 2005-06, we investigated eight cases carried forward and 17 new cases. We concluded 10 cases: one of which was referred to HKEx, warning letter or letters of advice were issued to parties concerned in three cases, and six cases were concluded with no further action. We continued investigations in the remaining 15 cases.

Altogether we have eight cases before the IDT, two of which were referred to the IDT during last year.

Table 1
Penalty ordered by IDT on insiders

Case	Insider dealers	Shares of listed company	Date of decision/penalty	Disgorgement of profit/loss avoided (\$)	Penalty (\$)	Cost (\$)	Bar from being a director
1	Wong Wing Wah	Gilbert Holdings Ltd	15.12.05	1,754,541	2,631,812	\$3,648,439 to be paid jointly and severally by the 4 insiders	3 years
	Clarence			—	529,940		3 years
	Hung Shiu Shan			353,293	529,940		3 years
	Wong Man Fu Sunny			110,673	2,219,940		3 years
2	Carlton Poon	HKCB Bank Holding Company Ltd and Hong Kong China Ltd (now renamed Lippo China Resources Ltd)	9.8.05	3,422,158	6,844,316	—	5 years
	Jenny Kong			11,797,939 [^]	23,595,878 [^]		10,543,546 [^]
3	Koon Wing Yee*	Easy Concepts International Holdings Ltd and Easyknit International Holdings Ltd	19.1.06	31,367,553	15,000,000	1,895,044	5 years
	Chan Kin Shing Sonny*			5,090,219	1,500,000	758,017	2 years
	Alan Tsang			442,127	1,000,000	947,522	4 years
	Helena Sum			442,127	500,000	758,017	N/A
	Christina Tsang			589,502	800,000	947,522	N/A
Total: 11 entities				55,370,132	55,151,826	19,498,107	

[^] Liability to pay is joint and several between Carlton Poon and Jenny Kong

* Under appeal

Enforcement

✓ Market manipulation

We successfully prosecuted eight people in the Courts for manipulating the shares of Dynamic Holdings Ltd, EVI Education Asia Ltd, Artel Solution Group Holdings Ltd, Essex Bio-Technology Ltd, Innovis Holdings Ltd and GP Nano Technology Group Ltd (Table 2). One manipulator was sentenced to seven months' imprisonment. One was sentenced to four months' immediate custodial sentence but allowed bail with conditions pending appeal on 11 July 2006. There are four entities awaiting trial.

✓ Market Misconduct Tribunal

The SFO provides for parallel civil and criminal regimes to combat market misconduct. A Market Misconduct Tribunal (MMT) has been set up to build on the work of the IDT by

handling civil cases of all forms of market misconduct in addition to insider dealing, including market manipulation, price rigging and related abuses and the dissemination of false or misleading information about securities or futures contracts.

During the year, we referred one case to the Financial Secretary to consider instituting proceedings before the MMT regarding dissemination of false or misleading information. This matter is under review by the Department of Justice. Currently, we have two other matters that we regard as suitable for referral to the Financial Secretary.

Table 2
Successful prosecutions – market manipulation

Case	Defendants	Date of conviction	No. of summonses involved		Fine (\$)/penalty	Costs of investigation awarded (\$)
1	Zou Yishang	11.4.05	1	4 months' immediate custodial sentence*		56,924
2	Lam Chee Wing Alan	17.6.05	2	3-month imprisonment suspended for 18 months		8,202
3	Tang Shui Fai	29.12.05	2	6-month imprisonment suspended for 2 years and a fine of \$20,000		25,000
4	Lee Sing Wai Stephen	10.1.06	1	7-month imprisonment		10,054
5	Cheung Wan Chiu	12.1.06	1	4-month imprisonment suspended for 3 years and a fine of \$30,000		10,000
6	Ng Hon Chung	21.3.06	1	2-month imprisonment suspended for 12 months		34,433.33
7	Ng Kwok Wing	21.3.06	1	2-month imprisonment suspended for 12 months		34,433.33
8	Cheung Joe Kin Cho	21.3.06	1	2-month imprisonment suspended for 12 months		34,433.33
Total: 8 entities			10		50,000	213,480

* Allowed bail with conditions pending appeal

✔ Cold calling

Unsolicited calls are prohibited in the SFO to protect investors from being pressured into hasty decisions to buy financial products they do not want or cannot afford. We prosecuted nine people in 2005-06 (Table 3).

✔ Failing to assist SFC investigations

Two people were convicted for failing to attend SFC investigation interviews and a third person was convicted for failure to provide assistance in connection with an investigation (Table 4). People who have information relevant to an investigation have a legal duty to attend the SFC's interviews to give complete, accurate and true answers.

Table 3
Successful prosecutions – cold calling

Case	Defendants	Date of conviction	No. of summonses involved	Fine (\$)	Costs of investigation awarded (\$)
1	Chan Man Kit	28.7.05	1	5,000	5,000
	Cheng Chun Fai	28.7.05	2	10,000	6,000
2	Chow Wai Ho	29.9.05	3	7,500	10,000
3	Mak Wing Shun Agnes	10.11.05	2	10,000	15,000
4	Lam Wing Chit	17.11.05	1	5,000	9,975
5	Leung Wing	1.12.05	1	2,000	14,533
6	Chau Sik Ki	24.1.06	1	6,000	4,716
7	Chan Kei	21.3.06	3	15,000	14,420
	Yeung Wan Yiu	21.3.06	3	15,000	14,420
Total: 9 entities			17	75,500	94,064

Table 4
Successful prosecutions – failing to assist SFC investigations

Case	Defendants	Date of conviction	No. of summonses involved	Fine (\$)/penalty	Costs of investigation awarded (\$)
1	Chan Kim Wing	15.4.05	2	30,000	2,248
2	Lee Sing Wai Stephen	7.10.05	1	15,000*	9,380
3	Tan King Yu	8.2.06	1	5,000	2,500
Total: 3 entities			4	50,000	14,128

* Lee was sentenced to 6-month imprisonment because his failure to attend an SFC interview was committed during the time his prison term for another offence was suspended

Enforcement

✔ Unlicensed activities

We will prosecute those who engage in or aid and abet unlicensed activities. Licensees may also face disciplinary action. We prosecuted 16 people and two companies last year (Table 5).

✔ Disclosure of interests

HKEx refers late filings of disclosure of interests to the SFC. We may also detect cases of failure to disclose in our inquiries. Minor and first time offenders are usually warned. Serious cases may result in prosecutions. We have made public our investigation policy since May 2005.

Table 5
Successful prosecutions – unlicensed activities

Case	Defendants	Date of conviction	No. of summonses involved	Fine (\$)/penalty	Costs of investigation awarded (\$)
Unregistered dealing/aiding and abetting					
1	Ng Ka Man	5.5.05	1	3,000	9,671
	Chan Pang	5.5.05	1	3,000	9,671
2	Wong Yuen Sze Angel	29.6.05	1	1,500	13,317
	Lo Po Wah Julie	29.6.05	1	1,500	13,317
3	Ng Kit Fai Paris	22.9.05	3	20,000*	20,000
4	Chiu Chui Yi	9.3.06	1	3,000	10,686
Unlicensed advising on corporate finance					
1	Brodick Capital Ltd	2.6.05	1	10,000	10,000
	Lam Chi Yin Henry	2.6.05	1	10,000	10,000
2	Yam Wang Lap	2.12.05	1	6,000	13,131
Unlicensed investment advising					
1	Ng Yuk Chan Michael	7.7.05	1	3,000	18,138
2	Pang Yin Har	25.8.05	1	5,000	17,560
3	Lam Kwok Fai	8.9.05	1	2,000	9,053
4	Kwan Sok Un Samantha	22.9.05	1	5,000*	5,000
Unlicensed foreign exchange trading/aiding and abetting					
1	Mok Sze Wan	1.9.05	1	5,000	5,000
2	Tan King Yu	8.2.06	1	5,000	2,500
Unregistered asset management					
1	Ming Tak Sang	22.9.05	1	5,000*	5,000
2	Chow Kwok Chung Bruce	10.11.05	1	2-month imprisonment suspended for 1 year and a fine of \$5,000	10,000
	Universal Funds and Asset Management Inc	10.11.05	1	50,000	–
Total: 18 entities			20	143,000	182,044

* Amount of fine was paid to the SFC as investigation costs

In the third year of operation of the SFO, investors became more familiar with their disclosure obligations. This is evident from a 10% decrease in late filings HKEx referred to us, from 4,185 in 2004-05 to 3,766 in 2005-06.

Last year, 16 people and 15 companies were prosecuted (Table 6). 91 warnings were issued. 16 cases were still under investigation.

Table 6
Successful prosecutions – disclosure of interests

Case	Defendants	Date of conviction	No. of summonses involved	Fine (\$)	Costs of investigation awarded (\$)
1	Lee Fung Hong (Cheung's) Forex Dealers Ltd	14.4.05	4	10,000	3,000
	Luk Hon Sum Peter	14.4.05	4	6,000	2,000
2	Lee Eng Chhong	5.5.05	2	2,000	5,439
3	Mo Shikang	26.5.05	4	20,000	8,393
	Rhythorth Ltd	26.5.05	2	10,000	—
4	Lin Ko Ming	30.6.05	2	10,000	782
5	Brilliant Path Ltd	8.7.05	1	3,000	11,492
6	Wang Li Hua	4.8.05	10	30,000	18,709
7	Wong Tin Sang	25.8.05	2	3,000	10,699
	Bioleader Ltd	25.8.05	2	3,000	—
8	Chu Yat Lam	6.10.05	13	13,000	2,265
9	TingKong-RexCapital Holdings Ltd	13.10.05	6	18,000	8,718
	Rexcapital Partners Inc	13.10.05	6	18,000	8,718
	Tees Corp	13.10.05	6	18,000	8,718
10	Chan Lai Keung	3.11.05	10	20,000	3,000
11	China Northern Enterprises Investment Fund	3.11.05	4	12,000	—
	Yau Chung Hong	3.11.05	4	8,000	17,000
12	Power Assets Enterprises Ltd	9.11.05	2	5,000	—
	Gouw Kar Yiu Carl	9.11.05	2	6,000	3,584
	Gouw San Bo Elizabeth	9.11.05	2	4,000	3,585
13	Raymond Dennis Neoh	10.11.05	2	5,000	—
	Upflow Holdings Ltd	10.11.05	2	10,000	22,000
14	Bava Ashraf Akathoottu	22.12.05	6	12,000	5,000
15	Wong Kam Yim	29.12.05	1	3,000	5,000
16	Everbest Investments Ltd	26.1.06	4	8,000	15,000
	Yu Chiu Wo	26.1.06	4	8,000	5,000
17	Heritage International Holdings Ltd	10.2.06	2	5,000	2,316
	Coupeville Ltd	10.2.06	2	5,000	2,316
	Dollar Group Ltd	10.2.06	2	5,000	2,316
18	New-Alliance Asset Management (Asia) Ltd	23.2.06	6	12,000	13,876
19	Tsoi Man Chi	23.2.06	2	4,000	9,098
Total: 31 entities			121	296,000	198,024

Enforcement

✔ Provision of false or misleading information

Two people were convicted for misleading the SFC. One person and one company were prosecuted for making reckless and fraudulent misrepresentations respectively in a brochure promoting guaranteed funds (Table 7). They were also prosecuted for holding out as carrying on unlicensed activities.

✔ Others

One person was prosecuted for short selling a warrant through four accounts under his control. One person and one company were prosecuted for Financial Resources Rules (FRR) breaches. They failed to notify the SFC of liquid capital deficiencies (Table 8).

During the year, we successfully prosecuted 72 companies and people in total, four were prosecuted for more than one offence. We offered no evidence against five entities. There was one acquittal after trial.

Table 7
Successful prosecutions – provision of false or misleading information

Case	Defendants	Date of conviction	No. of summonses involved	Fine (\$)/penalty	Costs of investigation awarded (\$)
1	Kong Kwok Yee	29.9.05	1	20,000	11,849
2	Ngai Leung Wai	27.10.05	1	Sentencing adjourned	N/A
3	Chow Kwok Chung Bruce	10.11.05	1	10,000	—
	Universal Funds and Asset Management Inc	10.11.05	1	20,000	—
Total: 4 entities			4	50,000	11,849

Table 8
Other successful prosecutions

Case	Defendants	Date of conviction	No. of summonses involved	Fine (\$)	Costs of investigation awarded (\$)
Short selling					
1	Ha But Yee	30.6.05	16	64,000	20,952
Total: 1 entity			16	64,000	20,952
FRR breaches					
1	Excalibur Futures Ltd	9.6.05	7	35,000	10,000
	Chan Cheung Wah Linus	9.6.05	7	35,000	5,000
Total: 2 entities			14	70,000	15,000

This year, we will continue investigation of the 18 cases on derivative warrants trading as a priority. In addition, we have 20 cases awaiting hearing in the Courts including two market manipulation cases, and eight cases before the IDT.

Discipline

Intermediaries play a crucial role in Hong Kong's financial markets. They must be honest, efficient and financially sound. We take tough disciplinary action against those who put their clients' interests and market integrity at risk.

✔ Disciplinary priorities

Sponsors, investment advisers, fund managers and serious conflicts of interest continued to be our priorities. We made steady progress on these areas in 2005-06 and we intend to keep this focus into the coming year and successfully finish a number of important cases started during the year. We will then review our results and consider adjusting our focus.

Sponsors play a central role in protecting our investors and markets. However, some sponsors have failed to act according to the high standards expected.

During the year, the SFC concluded action against CSC Asia Ltd, which agreed to stop acting as a sponsor for 13 months and to an internal control review. The SFC had identified during an inspection of CSC due diligence failings in two listing applications it sponsored. Two senior executives of CSC, who each supervised one listing, agreed to withdraw from supervising sponsorship activities for eight months.

We took the above action together with HKEx, demonstrating our joint commitment to raising listing standards in Hong Kong. We currently have one significant action against a sponsor carried over from 2004-05 that we expect to conclude shortly, and three more actions pending which we hope to conclude in the coming year.

We intend our actions to send a clear message to sponsors who fail to act to the high standards expected that they will suffer severe economic and reputational consequences by being excluded from the listings market for lengthy periods.

More investors are relying on investment advisers to help manage their assets. We are concerned that many investment advisers do not appear to sufficiently understand their obligations to give investors sound advice. Our largest case involving an investment adviser remains in progress.

During the year, the Securities and Futures Appeals Tribunal (SFAT) decided our case against Mr Andrew Barber. After admitting new evidence that Barber did not produce to the civil courts or to us, the SFAT reduced the SFC's sanction against him but upheld a suspension. The SFAT made clear that investment advisers must ensure their clients understand a product sold to them and that it is reasonably suitable for them, even if promotional material contains warnings and other information that the clients read. The SFAT also held that an investment adviser cannot avoid liability for advice given by designating a client "execution only". Barber appealed the SFAT's decision to the Court of Appeal and the SFC appealed in response. We are waiting for the Court's decision.

The SFC also took action against three investment advisers for failing to supervise staff properly etc. The SFC reminds the industry that employers and management must ensure only competent, licensed staff advise clients. As noted in our recently released Regulatory Challenges and Responses document, we wish to raise standards among advisers and ensure they meet their obligations.

We also have a number of cases against other investment advisers pending that we aim to conclude in the coming year.

Enforcement

We hope that our enforcement action, together with the clarification of standards expected of investment advisers and a programme of inspections by our Intermediaries and Investment Products Division, will improve conduct and lead to better advice for investors.

Last year, we continued our watch on fund managers' compliance failings. We settled allegations of compliance failings by fund manager Allianz Global Investors Hong Kong relating to the non-disclosure of changes in the valuation time of certain funds.

We are reassured that we have not yet discovered serious failings in Hong Kong's fund management industry and by the responsible attitude of those fund managers that we have found failings with. We will keep monitoring activities and take harsher action against more serious failings.

We expect licensees to avoid conflicts of interest and will severely punish those who fail to put clients' interest first. We banned Mr Wong Wing Fai Eric from the market for five years for trading contrary to research he prepared for traders in the firm that employed him. In 2004-05, we suspended him for 18 months for front running his research reports. We punished him more severely for being a repeat offender.

✔ Workload and penalty trends

In 2005-06, we conducted 206 disciplinary inquiries. Of these, we concluded 84 cases, and took action against 98 companies and people. We commenced disciplinary proceedings against five licensees which ended with no further action taken.

Last year, penalties have been consistent with the previous two years, after we raised them in 2003 on the commencement of the SFO.

Now, three years after the SFO commenced, more of our cases are being run under the SFO with the newer sanctions available.

We fined 26 licensees last year. We also accepted voluntary payments in settlements from 10 licensees. Fines and payments ranged from \$30,000 to \$1.4 million for companies and \$6,000 to \$400,000 for individuals. We fined about \$6.6 million in total.

We consider that a fine and a public reprimand are often appropriate penalties for failings which are negligent but not too serious and which do not warrant the removal of an individual or entity from the market.

We banned more licensees – six people for three months to five years. Previously, when a licensee surrendered their licence, we could not punish them. We can now fine people who have surrendered their licences or ban them from re-applying for a period or forever.

We suspended 36 licensees for periods up to three years and accepted three voluntary undertakings not to conduct regulated activities for up to 13 months.

We reprimanded 51 licensees with 33 reprimands being imposed with other sanctions, and privately warned 54 licensees.

It has been three years since the SFO came into force. Early in 2006-07, we will review the level of penalties against some comparable foreign markets to determine whether they should be increased. Our goal is to ensure that penalties secure appropriate regulatory outcomes by remaining proportionate, protective and dissuasive.

Table 9 highlights the most significant disciplinary actions.

Table 9
Significant actions

Case	Registrants	Date of action	Misconduct	Action/settlement/SFAT decision
1	Berich Brokerage Ltd	18.4.05	Failure to comply with undertakings to the SFC and other internal control failures.	As the result of a settlement, Berich paid \$1,400,000 and the SFC publicly reprimanded Berich.
2	Chung Tin Ming	18.4.05	Window-dressing of FRR returns by effecting fund transfers between margin client accounts to understate a particular client's margin shortfall.	As the result of a settlement, SFC suspended Chung for 2 years.
3	Han Sze Chao Richard	3.10.05	Market manipulation.	As the result of a settlement, SFC suspended Han for 18 months.
4	Lam Ho Chu	7.10.05	Failure to detect suspicious transactions executed through his company.	Suspension for 9 months.
5	Kung Chiu Nam Edmond	16.11.05	Providing misleading information to SFC and lending account to another licensee for personal use.	Suspension for 20 months.
6	Wong Wing Fai Eric	28.11.05	Conflicts of interest resulting from trading substantial amounts of securities which were the subject matter of the research reports prepared for traders in the firm.	As the result of a settlement, the SFC banned Wong from re-entering the industry for 5 years.
7	Hooray Securities Ltd	14.12.05	Breaches of Anti-Money Laundering Guidelines, FRR, Code of Conduct, and lack of internal controls.	As the result of a settlement, SFC reprimanded Hooray and fined it \$700,000.
8	Wong Tak Yuen Adrian	20.2.06	Facilitating an unlicensed person to impersonate his brother (a licensee) to engage in unlicensed activities.	As the result of a settlement, SFC banned Wong from re-entering the industry for 3 years.
9	Ng Hung Yu	22.2.06	Providing false information at an SFC interview, allowing clandestine and unauthorised third party orders and operating discretionary accounts without written authorisations.	Banned from re-entering the industry for 2 years and 9 months.
10	CSC Asia Ltd	7.3.06	Failure to comply with Code of Conduct in relation to due diligence work and preparation of prospectuses and submissions to HKEx.	As the result of a settlement, CSC undertook not to act as a sponsor for any new listing application on both the Main Board and the GEM Board for 13 months. CSC agreed to commission an accounting firm to conduct a comprehensive review of its operations and procedures.*
11	Chiu Chi Kin Andrew	7.3.06	ditto	As the result of a settlement, Chiu undertook not to act as principal supervisor of CSC for any new listing application for 8 months.*
12	Tang Ho Wai Howard	7.3.06	ditto	As the result of a settlement, Tang undertook not to act as principal supervisor of CSC for any new listing application for 8 months.*

* Joint action between HKEx and the SFC

Enforcement

✓ Appeals and checks and balances

During the year, the SFAT received appeals from 14 entities against SFC disciplinary actions and six were carried forward from 2004-05. The SFAT decided four of these cases. Five appeals were settled before full hearings.

Of the four appeals decided by the SFAT, two were dismissed and the penalty in the other two was reduced. No appellant was acquitted. Extraordinary mitigating factors reduced the suspension in one case from eight to five weeks. In another, the SFAT admitted new evidence that the appellant had not presented previously to two civil courts and to the SFC despite two opportunities to do so. As a result of findings based on the new evidence, the SFAT reduced the suspension from six months to one month.

We await a decision in one appeal already heard and 10 appeals are awaiting full hearing, though some of them are related and will be heard at the same time.

The Securities and Futures Appeals Panel (SFAP), the predecessor of SFAT, made its last decision last year. The SFAP decided, after lengthy legal arguments and hearing some new evidence not put before the SFC, that a public

reprimand instead of a suspension of licence was the appropriate penalty in the case in light of the endorsement of the misconduct by the appellant's supervisor.

We find our appeal record in front of the SFAT encouraging. The fact that only two decisions out of a total of 98 disciplinary decisions made by the SFC in 2005-06 (about 2%) were varied on appeal suggests that the great majority of our decisions were proportionate and either accepted by the defendants or not viewed as realistically appealable. The fact that no appellant has been acquitted and only one costs order was awarded against the SFC (in the SFAP appeal) out of five appeals decided also indicates a level of comfort and acceptance by the appeal tribunals of our findings of fact and that we are making our decisions responsibly.

In making its decisions, the SFAT also made some important statements of principle, including those noted above on investment advisers. On the issue of bringing appeals, the SFAT stated that, in the unusual circumstances that an appeal is plainly meritless, it might increase the SFC's penalty or impose a harsher costs order than usual basis.

To further enhance the transparency of our disciplinary procedures, we revised our plain language booklet on the disciplinary process, *Disciplinary Proceedings at a Glance*. We also issued a public statement of our policy on co-operation by defendants, the *Guidance Note on Co-operation with the SFC*, including through settling cases. On the advice of the Process Review Panel, we have also sought to standardise the audit trail of our justification for settlements. We also gave guidance on how the complex secrecy laws apply to disciplinary actions.



The SFAT website, www.sfat.gov.hk, contains the full text of all determinations or reasons for determination of concluded review cases handed down.

✔ Settlements

The SFC settled with 67 entities (68% of all the entities we disciplined) during the year. Settlements are common in civil and criminal proceedings in both Hong Kong and many foreign markets. The SFO gives the SFC the express power to settle.

In deciding to settle, we aim to balance giving an incentive to defendants to co-operate with the authorities by ending proceedings more quickly and by taking steps they are not obliged to do (e.g. compensating victims), with imposing sanctions that adequately deter and punish.

Last year, more cases were settled. The faster results allowed us to achieve greater investor protection with the same resources. We did this by actively making settlement approaches in suitable cases before starting formal action. We chose to settle only cases where defendants had co-operated in investigations, the facts were relatively clear and the likely penalty was relatively predictable because there were enough previous similar cases.

Settlements without admission of liability were controversial with some a year ago. Noting the public concern, we were more cautious in settling cases without admission. We only settled on a without admission basis with one licensee – a fund manager who had committed minor technical breaches and who had compensated those who may have potentially been disadvantaged, along with other remedial steps. However, we will continue our policy of settling with no admissions in appropriate cases. We firmly believe that, in exceptional circumstances, such settlements can help achieve a satisfactory outcome that would not be otherwise achieved. However, we will rigorously test the justification for such an outcome before concluding a settlement on this basis.

Co-operation with other law enforcement agencies

We keep close contact with other local law enforcement agencies, and overseas and Mainland regulators to tackle international financial crime and misconduct.

In 2005-06, we referred 24 cases to the Police for further action and three cases to the ICAC.

We regularly share intelligence information with, and collect evidence on behalf of foreign regulators.

We sought regulatory assistance from the China Securities Regulatory Commission (CSRC) on five occasions. We also gave the CSRC regulatory assistance on four occasions. Often, however, the CSRC was not able to give us the investigatory assistance we needed to bring enforcement proceedings. The Central People's Government has recently passed amendments to its securities laws enabling the CSRC to provide assistance to non-Mainland regulators. We trust that closer co-operation between the CSRC and the SFC will be possible in the future.

We are making improved co-operation with the CSRC our highest cross-border priority. We will also seek to involve the HKSAR Government more closely in reflecting our concerns to the relevant Mainland authorities.

Supervision of Markets

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

Achievements

- Approved HKEx rules to launch Callable Bull/Bear Contracts
- Formulated a Six-Point Plan on the derivative warrants market
- Approved HKEx rules to increase the position limits on stock options contracts and to reduce trading spreads
- Approved HKEx rule amendments for the migration of the Securities and Derivatives Network
- Co-ordinated market contingency planning for World Trade Organization's 6th Ministerial Conference and avian flu preparation
- Reviewed the Investor Compensation Fund levy
- Published research reports

This Chapter Is About

- Facilitating market development
 - Encouraging new product development
 - Review of the derivative warrants market
 - Position limits and trading spreads
 - Review of the disclosure of interests regime
 - Authorisation of Automated Trading Services providers

- Strengthening market infrastructure
 - HKEx's new network and CCASS services
 - Implementation of market infrastructure enhancement recommendations
 - ETF market making infrastructure
- Co-ordinating market contingency planning
- Monitoring investor compensation
 - Compensation funds and Investor Compensation Company
 - Review of the Investor Compensation Fund levy
- Market research

What We Do

- Facilitate the development of and encourage participation in Hong Kong markets
- Strengthen market infrastructure
- Supervise and monitor activities of the exchange controller, exchanges and clearing houses
- Authorise Automated Trading Services providers
- Regulate approved share registrars
- Co-ordinate market contingency planning
- Supervise the Investor Compensation Company and manage investor compensation funds
- Conduct market research

What We Did

Facilitating market development

✓ Encouraging new product development

We worked closely with HKEx and the market to widen the product range available to investors and to ensure proper regulation of new products.

During the year, we discussed with HKEx its plans and measures to mitigate risks associated with the launch of Callable Bull/Bear Contracts (CBBCs). CBBC is a structured product that tracks the performance of an underlying asset. It expires at a fixed date or must be called by the issuers when the price of the underlying asset reaches the call price. We consulted potential issuers and the market on concerns regarding the potential liquidity impact of unwinding activities, the snowball effect of several CBBCs with similar call prices and the potential risk of market manipulation around a call event. The SFC emphasised to HKEx the importance of a proper monitoring system and contingency plans to address these concerns.

In October 2005, HKEx proposed to initially limit the underlying assets of CBBCs to the five most liquid stocks, Hang Seng Index, H-shares Index, overseas indices, commodities and currencies. HKEx also committed to implementing a surveillance programme to detect rules breaches, a monitoring system to track market activities and contingency measures to mitigate the risks under extreme market situations. We approved the proposals in November.

We will continue working with HKEx in its effort to educate market participants and the public, implement the systems and roll out the products.

With the growing demand for ETFs, in addition to the ETFs on the Asian Bond Fund 2, we also worked with HKEx and market participants to facilitate the launch of the Hang Seng FTSE/Xinhua China 25 ETF during the year.

The SFC worked with HKEx on the FTSE/Xinhua China 25 Index Futures and Options contracts, which were launched in May 2005. The underlying index tracks the 25 largest H-shares and red chips listed in Hong Kong.

✓ Review of the derivative warrants market

In August 2005, the SFC carried out a review of the derivative warrants market. We issued a Six-Point Plan in November 2005 to strengthen the regulatory regime and enhance investors' understanding, and invited the public to comment. In March 2006, we announced how we will proceed with the proposals to:

- tighten the liquidity provider provisions;
- facilitate further issues and identical issues of existing derivatives warrants to help alleviate price anomalies and enhance market competition;
- ban commission rebates and other incentive schemes offered by issuers;
- issue new marketing guidelines;
- require the use of plain language and summaries in listing documents; and
- enhance investor education and information dissemination.

Many of the proposals will require changes to the Listing Rules. We are working with HKEx to bring the proposals before the Listing Committee as early as possible.

Supervision of Markets

✔ Position limits and trading spreads

The SFC approved HKEx's proposal to increase the position limits on stock options contracts from 10 February 2006. The SFC will work with HKEx to review the position limits on the HSI and H-shares Index Futures and Options contracts.

In May 2005, the SFC approved HKEx's rule amendments to reduce trading spreads for securities with share prices above \$30. The new trading spreads became effective on 4 July 2005.

✔ Review of the disclosure of interests regime

In January 2005, the SFC consulted the public on proposed changes to Part XV of the SFO. There was support for most of the proposals including those on the disclosure forms and codes; 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 SFC has been working with the Government on related amendments.

There was however no consensus on the disclosure of share pledges. The SFC has set up a Working Group on Disclosure Requirements for Securities Interests to discuss this issue. The group consists of members from brokers, banks, investment banks, fund managers, listed companies and investors. It held its inaugural meeting last October. The SFC will continue to work with group members on ways to take this forward.

✔ Authorisation of Automated Trading Services providers (ATS)

During the year, we authorised one ATS provider, bringing the total number of authorised ATS to nine – eight 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.

As at the year-end, the SFC was considering four applications from overseas exchanges and one from a local company.

Strengthening market infrastructure

✔ HKEx's new network and CCASS services

The SFC has been working closely with HKEx to ensure the smooth implementation of the Securities and Derivatives Network (SDNet) project, under which the four major networks for its trading and clearing systems (i.e. AMS/3, CCASS/3, HKATS and DCASS) would be consolidated into one network, as well as the robustness and reliability of the network.

After the market rehearsal in August 2005 and the SFC's approval of the rule amendments in September, the first phase of migration for the derivatives trading, clearing and price dissemination networks into the new network was completed in October. The remaining two phases of the SDNet migration, which will cover the securities clearing and trading networks, are scheduled for the second quarter of 2006 and within 2007 respectively. We will monitor the process.

In April 2005, the Hong Kong Securities Clearing Company Ltd (HKSCC) introduced further enhancements to its Investor Participant (IP) Account services, including (i) an optional Investor Settlement Instruction on-hold mechanism for Broker Participants; and (ii) an option to allow individual or joint IPs to appoint a third party to attend company meetings.

HKSCC abolished the initial deposit requirement of \$1,000 when opening an IP Account in CCASS on 1 July 2005 after SFC's approval.

HKEx proposed enhancements to CCASS's nominee services that aim to improve efficiency in corporate announcements, facilitate CCASS participants in processing nominee instructions, reduce participants' costs on cancelling electronic IPO or tender instructions, facilitate distribution of scrip entitlements and improve the voting function for the non-book close period. These enhancements were implemented in early 2006. We will continue to work closely with HKEx in enhancing CCASS's services.

✓ **Implementation of market infrastructure enhancement recommendations**

Since the publication of the Steering Committee on the Enhancement of Financial Infrastructure's recommendations to improve the financial infrastructure in August 2002, most of the recommendations have been successfully implemented. HKEx has also upgraded all its trading and clearing systems in the past five years, which has made Hong Kong one of the most efficient markets in the world, with significant growth in market size.

We will continue to work on the remaining initiatives, such as third party clearing, cross-margining and migration of the existing HKEx trading and clearing networks to SDNet. They will be monitored together with other initiatives under the general mandate of improvement of market infrastructures.

Drafting of the legislative amendments to implement a scripless market in Hong Kong advanced considerably last year. However, the Government and the SFC agreed that

priority should be accorded to the SMLR project and the review of the disclosure of interests regime given their greater importance in strengthening the existing regulatory framework for listed companies.

Additionally, there is no strong demand for or urgency to hasten the implementation of the scripless initiative, as Hong Kong already has one of the highest settlement efficiency rates in the world.

✓ **ETF market making infrastructure**

The SFC approved HKEx's rule amendments to enhance its market making infrastructure for ETFs in May 2005. Amendments that took effect on 1 June 2005 set out new parameters, within which the SEHK may fix specific obligations for each ETF (including when a market maker must provide a quote, the minimum period of time a quote must be maintained by the market maker and the minimum response rate of the market maker). The SEHK will consult the market and the SFC prior to setting the specific obligations.

The Securities and Futures (Levy) Order and the Securities and Futures (Investor Compensation – Levy) Rules provide for the payment of SFC transaction levy and the compensation fund levy for transactions on the SEHK. Currently, there are separate exemptions for pilot programme market makers and ETF market makers as incentives for their taking on additional risk in their market making services. We are proposing housekeeping amendments to substitute exemptions for separate products with one exemption for holders of valid SEHK market making permits, to facilitate SEHK launch of new products with market making facilities.

Supervision of Markets

Co-ordinating market contingency planning

As mentioned earlier, the SFC made preparations last year for any potential impact that the World Trade Organization's MC6 might bring to the markets. A cross-divisional MC6 Task Force co-ordinated contingency measures for the market and within the SFC. We met with HKEx, selected licensed corporations and share registrars that were located near the MC6 conference area to understand their contingency measures. Internally, we raised staff awareness on personal and office safety.

The SFC also took steps to alert staff and stakeholders to the risks of an avian flu and other epidemics. The SFC arranged talks conducted by the Department of Health and doctors from private sector to its staff, representatives from HKEx, Financial Services and the Treasury Bureau (FSTB) and Hong Kong Securities Institute, and to other market participants.

We also discussed with HKEx and share registrars their contingency measures to deal with avian flu.

To ensure that intermediaries meet the standards of business continuity planning, the SFC is drafting a set of best practice guidelines for public consultation.

Monitoring Investor Compensation

☑ Compensation funds and Investor Compensation Company

As at 31 March 2006, the net asset values of the Unified Exchange Compensation Fund (UECF), the Commodity Exchange Compensation Fund (CECF) and the Investor Compensation Fund (ICF) were \$51.26 million, \$0.81 million and \$1.67 billion respectively.

During 2005-06, the UECF paid \$559,566 to nine claimants of Lawsons Securities Company and \$388,320 to seven claimants of C.A. Pacific Securities Ltd.

The UECF and CECF received a recovery amount of \$1,464,218 and \$548,932 from the liquidators of Foreground Securities Co Ltd and Winton Commence Ltd respectively.

The SFC has been regulating and monitoring the operations of the Investor Compensation Company Ltd (ICC) since its inception in 2003. ICC is a wholly owned subsidiary of the SFC and it is charged with the duty to process and determine claims lodged with the ICF. During the year, the ICC received four new claims. As at 31 March 2006, six claims were outstanding.

We assist the ICC in enhancing its operational procedures, claims handling process, public awareness, corporate governance and technical infrastructure.

In March 2006, we recommended changes to enhance administrative efficiency within ICC and improve the working environment for its staff. Currently, ICC has a relatively small operation with only two staff. The streamlining of the structure of the organisation would enable staff to focus more on the critical task of investigating claims. The specific changes that will be implemented in the coming year include:

- to reduce the size of ICC's board from 10 members to five;
- to restructure ICC's Claims Committee so that it is made up of four people from the industry (including at least two brokers), one from HKEx, one from the SFC and four from the ICC board; and

- to incorporate the responsibilities of ICC's other four existing committees (i.e. the Management Committee, Audit Committee, Remuneration Committee and Public Relations and Investor Education Committee) within the restructured board.

To ensure that the changes do not compromise good corporate governance, ICC's board will provide half-yearly status reports to the SFC regarding its operations.

✔ Review of the Investor Compensation Fund levy

We worked with the FSTB to prepare amendments to the Securities and Futures (Investor Compensation – Levy) Rules to provide for an automatic ICF levy triggering and suspension mechanism. The mechanism helps to reduce the transaction costs borne by investors while ensuring that the ICF will be maintained at a level sufficient for potential claims and operating expenses. An exemption notice gazetted by the Government in November 2005 declared that no person is required to pay investor compensation levies on securities and futures transactions on or after 19 December 2005. The suspension will remain in force until the net asset value of the ICF falls below \$1 billion.

Market research

The SFC researches the securities and futures markets of Hong Kong and other major markets. We monitor market developments and industry performance. We conduct research to assist policy formulation, and provide timely information and analysis to the Government.

During 2005-06, we developed a market risk monitoring system, which enables us to better monitor the risks associated with the trading in the securities and derivatives markets and assess how they may affect market stability.

To better communicate with market participants and to share industry knowledge with the public, we published more research papers on topical issues, and enhanced the statistics section on our website. The SFC will continue to work with other regulators and academia on the publication of the SFC Quarterly Bulletin.



Investors have been exempted from paying a 0.002% levy per securities transaction and \$0.5 or \$0.1 per futures contract since 19 December 2005.

Legal Services

Achievements

- Formulated amendments to the SFO and its subsidiary legislation to address market developments
- Advised on possible breaches of the securities laws
- Conducted a significant number of successful prosecutions for regulatory offences

This Chapter Is About

- The Securities and Futures Ordinance
- Prosecutions and appeals
- Legal support for the SFC's work

What We Do

- Provide internal advice on possible breaches of the securities laws, including market misconduct
- 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

- Conduct prosecutions in the Magistrates' Courts for regulatory offences
- Handle civil litigation matters involving the SFC, including appeals
- Advise the Takeovers Executive and the Takeovers Panel
- Provide general in-house legal advice and support

What We Did

The Securities and Futures Ordinance

We continued our review of the SFO to consider if its provisions are effective in meeting the SFC's policy objectives and whether updates are needed to accommodate market developments.

As mentioned in previous chapters, we proposed legislative changes to the Securities and Futures (Investor Compensation – Levy) Rules to provide for an automatic levy collection mechanism. We fine-tuned the legal definitions of certain regulated activities in Schedule 5 to the SFO to meet changing market developments. We worked on proposed legislative amendments to give statutory backing to certain listing requirements.

We also worked with the Government to prepare amendments to the disclosure of interests regime under Part XV.

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 making unsolicited calls (cold calling), short selling, market manipulation, unlicensed investment activities, breach of disclosure requirements, providing false or misleading information, and failing to assist SFC investigations.

Over the year, we conducted a significant number of successful prosecutions. In particular, more individuals were prosecuted for making unsolicited calls.



SFC v Lee Sing Wai Stephen

In June 2002, Lee pleaded guilty in the District Court to a charge of creating a false or misleading appearance of active trading, contrary to sections 135(1)(a) and 139 of the repealed Securities Ordinance (SO), regarding the shares of Gay Giano International Group Ltd. Lee was convicted and sentenced to nine months' imprisonment suspended for three years.

In October 2005, Lee pleaded guilty in the Magistrates' Court to a charge brought by the SFC of failing to attend an SFC interview on 25 September 2003 without reasonable excuse. This offence related to the SFC's investigation into dealings in the shares of Essex Bio-Technology Ltd. Lee was convicted and fined \$15,000. As this offence was committed during the operational period of the suspended sentence imposed by the District Court, the magistrate referred the case back to the District Court to consider whether action should be taken on the breach of the suspended sentence.

Judge Whaley in the District Court subsequently activated the suspended sentence but reduced the original term of imprisonment from nine months to six months. In February 2006, Lee appealed against the activation of the suspended sentence but the court rejected his appeal.

In January 2006, Lee was prosecuted by the SFC for creating a false or misleading appearance of active trading in the shares of Essex, between 14 February 2003 and 31 March 2003. Lee committed this offence during the operational period of the suspended sentence. Lee pleaded guilty and was sentenced to seven months' imprisonment, which the magistrate ordered to run consecutively to the six months' imprisonment Lee was ordered to serve by the District Court. Lee appealed against the sentence on the basis that it was too severe. Mr Justice McMahon heard the appeal on 29 March 2006. Mr Justice McMahon disagreed that seven months' imprisonment was too severe. He stated that the scheme was sophisticated and a relatively large operation which aimed to make a profit by selling shares at artificially high prices. He stated that offences such as these are not merely regulatory or technical but amount to fraud on the investing public. Mr Justice McMahon stated that he agreed with the comments of the magistrate who sentenced Lee, that the scheme hampered the proper practice of share trading on the Unified Exchange and this in turn hampered the reputation of Hong Kong as a significant stock market in the world. Lee's appeal was dismissed.

Legal Services**Legal support for the SFC's work**

In August 2005, the SFC succeeded in its application to the High Court to dismiss an action brought by Mr Ng Yat Chi and Mr Choy Bing Wing. The action alleged, amongst other things, that the SFC had concealed corporate fraud and failed in its duty to suspend certain stocks. The High Court refused Mr Ng leave to continue the action and dismissed his claim. The High Court also found that Mr Choy's claim against the SFC was an abuse of the process of the court and ordered that his statement of claim be struck out and his claim be dismissed. Both Mr Ng and Mr Choy were ordered to pay the SFC's costs on an indemnity basis.

Court vindicates SFC's handling of complaint

Ms Winnie Ho Yuen Ki applied to the High Court in 2005 for leave to seek judicial review of a decision by the SFC. Ms Ho was dissatisfied with the SFC's decision not to investigate a complaint she had raised regarding the affairs of Shun Tak Holdings Ltd. The SFC considered that it did not have jurisdiction to investigate Ms Ho's complaints and, even if it did, could not justify the use of its limited resources, as it would be unlikely to obtain sufficient evidence to take regulatory action. Therefore, the SFC had decided instead to apply its resources to other more significant cases and would continue to do so in future.

Mr Justice Reyes heard and dismissed the application in January 2006. In his judgment he stated that "the SFC's handling of Madam Ho's complaints and its reasons for declining to pursue them further are impeccable. As far as I can see looking at matters as a whole, the SFC has properly and reasonably exercised its discretion on whether or not to pursue such a case".

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:

- interpretation of old securities-related ordinances and the SFO;
- other legislation affecting the SFC such as the Companies Ordinance, the Personal Data (Privacy) Ordinance, the Copyright Ordinance and the Employment Ordinance;
- proposed amendments to SFO subsidiary legislation to address the risks of securities margin financing;
- amendments to the Securities and Futures (Contracts Limits and Reportable Positions) Rules;
- the SFC's procedures, to ensure procedural fairness in the exercise of our powers; and
- all aspects of the SFC's decision-making process including the exercise of our investigative, disciplinary and intervention powers including proceedings under section 214 of the SFO against a former director of a listed company.

Corporate Affairs

Achievements

- Organised more staff training and development activities
- Conducted staff opinion survey to enhance communications and improve workplace
- Established a preparatory working group to promote XBRL
- Launched new investor education TV and radio commercials, re-named the IE portal
- Won annual report and corporate governance disclosure awards
- Signed regulatory co-operative instruments with eight jurisdictions
- Hosted Joint Forum meeting and business continuity planning meeting for Asian regulators

This Chapter Is About

- Financial highlights
- Staffing
- Information technology support
- Investor education and communications

- Reaching stakeholders

Cross-border co-operation

- SFC's involvement in IOSCO
- Co-operative agreements
- Enforcement related assistance
- Co-operation with Mainland China
- Promoting international standards

What We Do

- Provide finance, human resources, training, information technology, management and corporate services to the SFC
- Educate investors and handle complaints
- Communicate with stakeholders including the media
- Co-operate with other regulators

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. Some of the activities are also covered in the chapter on Staffing of the Commission. This chapter concludes on our cross-border regulatory co-operation with other regulators.

Corporate Affairs

What We Did

Financial highlights

Benefiting from the economic recovery, total revenue for 2005-06 increased by 36% to \$852 million (\$625 million in 2004-05). Total expenditure was \$497 million (\$456 million).

As a result, the SFC achieved a surplus of \$355 million for the year 2005-06 as compared with the projected surplus of \$5 million for 2005-06 and the \$169 million surplus recorded in 2004-05. Our reserves at the end of March 2006 stood at \$1.2 billion, equivalent to 2.4 times of estimated expenditure (including depreciation) of \$508 million for 2005-06.

The Financial Secretary proposed a 20% transaction levy cut in his Budget Speech for 2006-07. We forecast an operating surplus of \$25 million in our 2006-07 budget, which was approved by the Financial Secretary under the delegated authority from the HKSAR Chief Executive in March 2006.

Staffing

As at 31 March 2006, there were 413 permanent established posts and eight temporary established posts. Separately, provision was made for 24 temporary staff and 14 Executive Trainees.

There were 441 staff, comprising 395 regular staff filling the permanent established posts and 46 temporary staff. Total staff number was 431 a year ago.

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:

- Executive Directors are not entitled to any other benefits except for retirement benefits, medical and life insurance, and annual leave. All Executive Directors (including the Chairman) are required to obtain prior permission in writing from a committee, comprising all Executive Directors and Non-Executive Directors except the officer concerned, for an employment during a six-month post-termination period if the activities of the new employment have been the subject of any of the statutory functions of the SFC in the period of 12 months before and/or six months after departure.
- During the period 1 April 2005 to 30 September 2005, the annual remuneration package of the ex-Chairman 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 ex-Chairman has voluntarily waived all his variable pay in his contract. His total emoluments (including retirement benefits) during the above period amounted to \$6,202,000.
- The current Chairman's annual remuneration package comprises a fixed pay of \$6,350,000 and a performance-related variable pay component. The fixed pay is constant throughout the contract period and the variable pay is awarded annually on performance basis. For the period 1 October 2005 to 31 March 2006, his total emoluments (including retirement benefits) amounted to \$3,200,000.
- The average of the total emoluments (including retirement benefits) of the four Executive Directors during the year amounted to \$4,028,000. This comprised average fixed pay of \$3,383,000, average performance-related variable pay of \$623,000, and average retirement benefits of \$22,000. The breakdown of total emoluments of individual Executive Directors is in the following table.

Executive Directors	Fixed pay (\$)	Variable pay (\$)	Retirement benefits (\$)	Total (\$)
Alexa Lam	4,000,000	1,000,000	50,000	5,050,000
Alan Linning	4,200,000	525,000	12,000	4,737,000
Peter Au-Yang	4,000,000	663,000	12,000	4,675,000
Martin Wheatley*	1,333,000	303,000	12,000	1,648,000

* as ED-SOM for the period from 6 June 2005 to 30 September 2005

- The average of the total emoluments (including retirement benefits) of the eight Senior Directorate Grade Staff during the year amounted to \$3,123,000. This comprised average fixed pay of \$2,570,000, average performance-related variable pay of \$503,000, and average retirement benefits of \$50,000.

Information technology support

We maintain and enforce the SFO, protect and educate investors, and interact with other regulators to strengthen Hong Kong's financial infrastructure, via the effective use of IT.

As part of "Takeovers Code-Documents on Display" project, an interface between SFC and HKEx websites was established to facilitate market participants to inquire takeovers information at one-stop to enhance transparency.

We enhanced the Licensing System in October to cope with rule amendments. We upgraded the surveillance system jointly used by HKEx and the SFC for better system administration, and acquired a new analysis tool for monitoring trading activities.

We installed a new email firewall to block SPAM, and implemented the latest version of corporate database management system to enable better Chinese language support and detailed audit trails.

We started to develop a new financial resources management system, which will be completed in the third quarter in 2006, to replace the existing accounting system. The system is the first building block towards the Commission-wide implementation of an enterprise resources planning system.

✓ XBRL

To strengthen Hong Kong's financial infrastructure, the SFC in April took the lead to establish a preparatory working group consisting of members from the private and public sector to promote XBRL (eXtensible Business Reporting Language). XBRL is an evolving global standard for faster and more accurate electronic communication of business and financial data. The preparatory working group has been developing an adoption roadmap and identifying pilot applications.

✓ 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. Major users include financial regulators, HKEx, banks, and securities and derivative intermediaries.

In 2005-06, we upgraded our network and infrastructure to improve FinNet's functionality, performance, reliability and security. Fixed line connections grew from 55 to 144, mainly in banking sector. Hong Kong Monetary Authority enabled their secure email access for all authorised banking institutions via FinNet. Hong Kong Interbank Clearing Ltd launched Clearing File Transfer Service for batch payment information exchange with participating banks. The file transfer service will be extended to cheque image transfer in 2006.

Corporate Affairs

Investor education and communications

“Before you invest, ask the right questions” is our investor education (IE) theme in 2006. We encourage investors to ask the right questions about products and services, and advisers’ recommendations to make informed choices.

We designated January 2006 as the IE Month with various activities. We launched a new icon to highlight our IE role, re-named our IE portal, previously known as the Electronic Investor Resources Centre or eIRC, to InvestEd (www.InvestEd.hk). We also introduced lively flash animation videos to complement text information on InvestEd. The average daily hit rate of the revamped portal during January to March 2006 was 103% higher than that in December and was up 123% compared with the same period last year.

We ran new TV and radio commercials featuring a new “Mr Sheep” highlighting the importance of asking the right questions in buying warrants, opening a margin account and seeking investment advice.



For the first time, we invited the Radio Television Hong Kong (RTHK) and The Salvation Army to organise a competition inviting investors to share their investment experiences and lessons learnt. 100 contestants entered the “My Investment Story” competition. The 10 best stories were adapted into radio dramas and newspaper articles.

In September to November 2005, we conducted the Retail Investor Survey 2005 to study retail investors’ participation in and understanding of investment products. According to the survey, about 29% more people had invested in financial products during the past two years but their investment knowledge needed improvement. Over 90% of respondents agreed that the securities industry as a whole should do more investor education.

In early 2006, we conducted the first Warrant Investor Survey to ascertain retail investors’ investment attitude towards derivative warrants, their knowledge of the product and trading results. While most warrant investors considered derivative warrants risky and chose to take the risks, there is a need to enhance investor understanding of this product. We have stepped up our IE through different media, focusing on risk education, clarifying misconceptions and reminding investors to look beyond commercial promotion of warrants.

Other IE initiatives:

- With the RTHK, broadcast of “The Star Analysts’ Fans Family” radio drama series on analyst conflicts of interest
- Exhibition at the Financial World Expo 2005
- Wallet-sized card with key questions investors should ask when considering a financial product, and a leaflet on REITs
- Credit-based courses, guest lectures and “Meet-the-SFC” sessions, some jointly with universities. We organised with The Open University of Hong Kong (OUHK) 15 investor forums, with excerpts carried on Cable TV, TVB Pearl, OUHK website and Hong Kong Economic Journal

Alerting the public to financial scams remains a top priority. We posted 94 entities on the Alert List of unlicensed overseas companies, suspected boiler rooms and scam websites during the year, bringing the total to 332 entities. We enhanced the Alert List by adding a search function. We also presented Smart Investor Awards to six members of the public for reporting scams to us.

During the year, we published over 100 articles in local newspapers and magazines and organised 79 seminars, reaching nearly 8,000 participants.



Hundreds of people were attracted to an SFC-OUHK seminar in December.

✔ Investor enquiries and complaints handling

We received 4,811 investor enquiries (4,523 in 2004-05) and handled 1,091 complaints (1,214).

Following initial screening by the Investor Education & Communications Department, every complaint is tabled to the Complaints Control Committee to decide if further action is appropriate. During the year, the Committee referred 459 (701) cases to operational divisions for further assessment, while 145 cases (183) were investigated by the Enforcement Division.

Statistics of public complaints

Nature of complaints	2005-06	2004-05
Conduct of licensed intermediaries & registered institutions	255 (-33%)	381
Listing related matters & disclosure of interests	364 (-1%)	367
Market misconduct	185 (+14%)	162
Financial products	32 (-22%)	41
Other financial activities	240 (+5%)	228
Miscellaneous	15 (-57%)	35
Total	1,091 (-10%)	1,214

Reaching stakeholders

The SFC constantly engages stakeholders in the development of its regulatory policies and keeps them informed of its initiatives.

The mass media has been an important partner in communicating our work and policies to the stakeholders including the public. During the year, we issued 279 press releases (289 in 2004-05). Our executives gave 45 interviews (43) to local, Mainland and international news organisations. We held 12 press conferences or sharing sessions (13) to announce new policies and discuss our work. We handled 1,061 media enquiries (1,405).



We battled it out with journalists at a bowling tournament in September.

We received 3,836 public enquiries (3,673), of which 1,680 were made online (enquiry@sfc.hk). Full replies were given within four days in 95% of the email enquiries.

Last September, we released the findings of our first Public Perception Survey. Of the 1,375 people interviewed, most understood the SFC's overall responsibilities. The SFC's general performance in fulfilling its statutory objectives was rated 6.5 points out of 10. The survey establishes benchmarks against which we may assess future changes of the public's perceptions and views, and provides us with a background when considering how to more effectively get our messages across.

Corporate Affairs

The Annual Report 2004-05 won the Platinum Award (Public Sector/Not-for-profit Organisations category) in the Hong Kong Institute of Certified Public Accountants' Best Corporate Governance Disclosure Awards 2005, and the Gold Award and the Award for Citation for Achievement in Corporate Governance Disclosure (both in the Non-profit Making and Charitable Organisations category) in the Hong Kong Management Association's Best Annual Reports Awards.



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 regulatory work and financial position; and the Quarterly Bulletin researches on regulatory and market development.

We are updating the content of the English-Chinese Glossary of Securities, Futures and Financial Terms. Its fourth edition will soon be completed to provide investors, market practitioners and other interested parties with a more practical and useful tool.

Throughout the year, we continued to receive visitors from local, Mainland and overseas regulators, financial institutions and enterprises who want to know more about the SFC's work or to discuss specific subjects.

Cross-border regulatory co-operation

The SFC endeavours to contribute to global efforts in enhancing 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). We have 36 bilateral or multilateral co-operation arrangements with regulatory bodies around the world.

✓ IOSCO

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

IOSCO has adopted a timetable for member regulators, which are not yet signatories to the IOSCO Multilateral Memorandum of Understanding (MMOU), to have become or committed to becoming a signatory by 1 January 2010. The IOSCO MMOU is an agreement that allows regulatory co-operation among signatory jurisdictions; Hong Kong is one of them. The SFC plays an active regional role in providing expert assistance through the IOSCO assistance programme to regulatory authority applicants with their applications to join the MMOU.

IOSCO has developed a methodology for jurisdictions to assess the extent to which they comply with the IOSCO Objectives and Principles of Securities Regulation. As part of an IOSCO pilot programme, we helped one jurisdiction to apply the self-assessment methodology.



Hong Kong will host the 31st IOSCO Annual Conference from 5 to 8 June 2006. During the first two days, IOSCO members will hold closed meetings. There will then be public panels where non-IOSCO members may join. The panels will discuss International Financial Reporting Standards (IFRS), regulation of hedge funds, transparency in the bond markets, and the challenges faced by emerging markets in implementing IOSCO standards.

✓ Standing Committees under the IOSCO Technical Committee

Our 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 Sub-committee and Accounting Sub-committee. We participated in the drafting of and responded to a survey on the provision by auditors of non-audit services to audit clients. We also commented on International Standards on Auditing issued by the International Auditing and Assurance Standards Board and on International Financial Reporting Standards issued by the International Accounting Standards Board. We also participated in the Technical Committee's Task Forces on Corporate Governance and Auditing, and responded to the IOSCO's survey on board independence.

Our Supervision of Markets Division participates in the Standing Committee on the Regulation of Secondary Markets (SC2). During the year, SC2 finalised its report on error trade policies adopted by exchanges and published a

consultation report on regulatory issues arising from exchange evolution. We provided inputs to these reports and also responded to a survey on multi-jurisdictional information sharing for market oversight.

Our Intermediaries and Investment Products Division participates in the Standing Committee 3 on Regulation of Market Intermediaries (SC3). We contributed to the conclusion of several SC3's initiatives, notably the Report on Compliance Function at Market Intermediaries. We also conducted a survey of certain local securities firms' policies and procedures in the area of securities offering as part of a SC3 survey initiative, and provided input to other emerging initiatives.

Our Enforcement Division participates in the Standing Committee on Enforcement and the Exchange of Information (SC4). SC4 promotes mutual assistance and the exchange of information among securities regulators. SC4 is working on enforcement issues relating to gaps in international co-operation, international asset freezing, cross-border boiler rooms and Internet frauds. SC4 made good progress in addressing co-operation issues with those jurisdictions whose ability or willingness to engage in enforcement co-operation has been uncertain. Steady progress was also made in international asset freezing.

Our Intermediaries and Investment Products Division participates in the Standing Committee on Investment Management (SC5). We responded to questionnaires by SC5 on hedge funds offered to retail investors, soft commissions and data collection exercise, and contributed our views on best practice standard for market timing, hedge funds offered to retail investors, and governance for

Corporate Affairs

collective investment schemes. We also discussed with SC5 members the top five priorities of each member jurisdiction and distribution related issues on collective investment schemes.

Public documents of the IOSCO are available at www.iosco.org.

✔ Co-operative agreements

During the year, the SFC signed a Letter of Intent (LOI) each with the Securities and Exchange Commission of Sri Lanka, the Securities and Exchange Board of India, the Financial Services Commission of Guernsey, Securities Commission, Malaysia, and Jersey Financial Services Commission.

Under each LOI, the two 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.

We also signed a Statement of Intent concerning co-operation, consultation and the exchange of information with the Financial Services Agency of Japan, exchanged Side Letters with the Monetary Authority of Macau under an existing MOU to strengthen regulatory co-operation, and signed a MOU with the Israel Securities Authority to enhance enforcement co-operation.

✔ Enforcement related assistance

During the year, we received 71 requests for enforcement-related assistance: 18 were requests for investigatory assistance involving the SFC in the exercise of its statutory powers; and 53 were for information. We made 18 requests to overseas regulators.

In respect of licensing-related matters, we received 186 requests from overseas regulatory authorities and made 631 requests.

Requests for regulatory co-operation

	2005-06		2004-05		2003-04	
	In	Out	In	Out	In	Out
Enforcement-related requests for investigatory assistance	18	10	13	4	11	4
Enforcement-related requests for information	53	8	34	3	35	2
Licensing-related requests for information	186	631	140	668	103	383
Total	257	649	187	675	149	389

✔ 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 attended the 34th MORC meeting hosted by HKEx in Hong Kong in August 2005, and the 35th meeting in Shanghai in March 2006.

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.

✔ Promoting international standards

The Group of Thirty (G30), a private and non-profit international group on key economic and monetary affairs, published the Global Clearing and Settlement: A Plan of Action in January 2003, to improve safety and efficiency of the global clearing and settlement process. To monitor and promote implementation of these recommendations in major financial markets, the G30 established a Global Monitoring Committee in early 2004.

The SFC Chairman has taken the role as the regional co-chair for the Asia-Pacific Monitoring Committee. Our Supervision of Markets Division has worked closely with Hong Kong Monetary Authority, HKEx and regulators in Australia, Japan and Singapore to review and assess the

implementation progress in the region. The Global Monitoring Committee will publish a final progress report in May 2006 and be then dissolved as planned. The SFC and the Asia-Pacific Monitoring Committee members have agreed to continue monitoring the implementation in the Asia-Pacific major markets.

In February 2006, we co-hosted a meeting in Hong Kong of the Joint Forum, which was established under the aegis of the Basel Committee on Banking Supervision, IOSCO, and the International Association of Insurance Supervisors, to deal with issues common to the banking, securities and insurance sectors, including the supervision of financial conglomerates.

We also hosted the first Business Continuity Planning Meeting for Asian Financial Regulators in February. About 40 financial regulators from 19 jurisdictions attended the roundtable discussion and shared their experiences and best practices. Speakers were from member organisations of the Joint Forum, Hong Kong Monetary Authority and the SFC. This meeting was held subsequent to the issue of the High-level Principles for Business Continuity paper in December 2005. The seven high-level principles are intended to support international standard setting organisations to improve the resilience of financial systems to major operational disruptions.

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 89 to 106 which have been prepared in accordance with International Financial Reporting Standards.

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 Hong Kong Standards on Auditing 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 2006 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.

KPMG

Certified Public Accountants

Hong Kong

4 May 2006

Consolidated Income and Expenditure Account

For the year ended 31 March 2006
(Expressed in Hong Kong dollars)

	Note	2006 \$'000	2005 \$'000
Income			
Levies		612,512	435,442
Fees and charges		196,677	162,325
Investment income	5	36,278	21,894
Recoveries from Investor Compensation Fund		3,263	4,066
Other income	6	2,753	1,654
		851,483	625,381
Expenses			
Staff costs and directors' emoluments	7	384,227	357,479
Premises			
rent		21,432	20,573
other		13,758	12,972
Other expenses	8	56,563	42,626
Depreciation		20,994	22,670
		496,974	456,320
Surplus for the year		354,509	169,061
Accumulated surplus brought forward		817,245	648,184
Accumulated surplus carried forward		1,171,754	817,245

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 93 to 106 form part of these financial statements.

Securities and Futures Commission

Consolidated Balance Sheet

At 31 March 2006

(Expressed in Hong Kong dollars)

	Note	2006 \$'000	2005 \$'000
Non-current assets			
Fixed assets	9(a)	17,934	25,258
Held-to-maturity debt securities	10	580,962	550,407
		598,896	575,665
Current assets			
Held-to-maturity debt securities	10	617,931	294,398
Bank deposits	11	47,505	69,656
Debtors, deposits and prepayments		96,562	58,181
Cash at bank and in hand	11	2,378	1,692
		764,376	423,927
Current liabilities			
Fees received in advance		52,195	36,675
Creditors and accrued charges		33,343	30,765
		85,538	67,440
Net current assets			
		678,838	356,487
Total assets less current liabilities			
		1,277,734	932,152
Non-current liabilities			
	13	63,140	72,067
Net assets			
		1,214,594	860,085
Funding and reserves			
Initial funding by Government			
	15	42,840	42,840
Income and expenditure account			
		1,171,754	817,245
		1,214,594	860,085

Approved and authorised for issue by the Commission on 4 May 2006 and signed on its behalf by

Martin Wheatley
Chairman

Eddy C Fong
Non-executive Director

Balance Sheet

At 31 March 2006

(Expressed in Hong Kong dollars)

	Note	2006 \$'000	2005 \$'000
Non-current assets			
Fixed assets	9(b)	17,866	25,012
Held-to-maturity debt securities	10	580,962	550,407
		598,828	575,419
Current assets			
Held-to-maturity debt securities	10	617,931	294,398
Bank deposits	11	47,505	69,656
Debtors, deposits and prepayments		96,223	57,845
Cash at bank and in hand	11	1,014	945
		762,673	422,844
Current liabilities			
Fees received in advance		52,195	36,675
Creditors and accrued charges		31,572	29,451
		83,767	66,126
Net current assets			
		678,906	356,718
Total assets less current liabilities			
		1,277,734	932,137
Non-current liabilities			
	13	63,140	72,052
Net assets			
		1,214,594	860,085
Funding and reserves			
Initial funding by Government			
	15	42,840	42,840
Income and expenditure account			
		1,171,754	817,245
		1,214,594	860,085

Approved and authorised for issue by the Commission on 4 May 2006 and signed on its behalf by

Martin Wheatley
Chairman

Eddy C Fong
Non-executive Director

Securities and Futures Commission

Consolidated Cash Flow Statement

For the year ended 31 March 2006

(Expressed in Hong Kong dollars)

	2006 \$'000	2005 \$'000
Cash flows from operating activities		
Surplus for the year	354,509	169,061
Adjustments for:		
Depreciation	20,994	22,670
Investment income	(36,278)	(21,894)
Profit on disposal of fixed assets	(11)	(40)
	339,214	169,797
Increase in debtors, deposits and prepayments	(33,170)	(444)
Increase in fees received in advance	15,520	1,887
Increase in creditors and accrued charges	3,626	7,813
(Decrease)/increase in non-current liabilities	(8,927)	3,845
Net cash generated from operating activities	316,263	182,898
Cash flows from investing activities		
Interest received	34,579	35,539
Held-to-maturity debt securities purchased	(758,117)	(802,250)
Held-to-maturity debt securities redeemed	400,517	590,296
Fixed assets bought	(14,718)	(13,154)
Fixed assets sold	11	56
Net cash used in investing activities	(337,728)	(189,513)
Net decrease in cash and cash equivalents	(21,465)	(6,615)
Cash and cash equivalents at beginning of the year	71,348	77,963
Cash and cash equivalents at end of the year	49,883	71,348

Analysis of the balance of cash and cash equivalents:

	2006 \$'000	2005 \$'000
Bank deposits	47,505	69,656
Cash at bank and in hand	2,378	1,692
	49,883	71,348

Notes to the Consolidated Financial Statements

For the year ended 31 March 2006
(Expressed in Hong Kong dollars)

1. Status and principal activities

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

2. Income

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

- (a) 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 ("IFRSs") (including applicable International Accounting Standards and Interpretations) promulgated by the International Accounting Standards Board ("IASB"). 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 as the measurement basis. The accounting policies have been applied consistently by Group entities.

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

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

Securities and Futures Commission

3. Significant accounting policies (cont'd)

Basis of consolidation

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

Recognition of income

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

<i>Levies</i>	We record levies from The Stock Exchange of Hong Kong Limited and Hong Kong Futures Exchange Limited as income on an accrual basis.
<i>Fees and charges</i>	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.
<i>Investment income</i>	We record investment income as it accrues using the effective interest method. It comprises (a) interest earned on bank deposits and held-to-maturity debt securities; and (b) the amortisation of premiums or discounts on purchases of held-to-maturity debt securities.

Operating leases

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

Employee benefits

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

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 pages 96 and 97). We charge depreciation to the income and expenditure account to write off the costs of fixed assets using the straight-line method over the estimated useful lives as follows:

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

3. Significant accounting policies (cont'd)

Fixed assets and depreciation (cont'd)

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

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

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

Investments

We state our investments in debt securities, which we have positive intention and ability to hold to maturity, initially at fair value and subsequently at amortised cost using the effective interest method less impairment losses, if any (see the accounting policy in respect of "impairment" on pages 96 and 97). We account for purchases and sales of debt securities on the settlement date.

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

Related parties

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

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

Related parties may be individuals (being members of key management personnel, and/or their close family members) or other entities and include entities which are under the significant influence of related parties of the SFC where those parties are individuals, and post-employment benefit plans which are for the benefit of the employees of the SFC or of any entity that is a related party of the SFC. 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 departments and agencies in the financial statements.

3. Significant accounting policies (cont'd)

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 initially at their fair value and thereafter at amortised cost less impairment losses. We review the carrying amount of other receivables at each balance sheet date to determine whether there is objective evidence of impairment. If any such evidence exists, we reduce the carrying amount to the estimated recoverable amount by means of a charge to the income and expenditure account. (See also the accounting policy in respect of "impairment" on pages 96 and 97).

Cash and cash equivalents

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

Other payables

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

Investment in subsidiaries

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

Impairment

Recognition of impairment loss

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

Calculation of impairment loss

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

3. Significant accounting policies (cont'd)

Impairment (cont'd)

Reversals of impairment loss

We reverse an impairment loss in respect of an asset in a subsequent period if the circumstances and events that have objectively linked to the write down or write-off cease to exist and there is persuasive evidence that the new circumstances and events will persist for the foreseeable future. We reverse an impairment loss only to the extent that the asset's carrying amount does not exceed the carrying amount that we should have determined, net of depreciation or amortisation, if we had not recognised any impairment loss.

Provisions and contingent liabilities

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

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

Impact of the newly implemented IFRSs

In December 2003 and March 2004, the IASB approved amendments to a number of existing standards as a result of the Improvements project and issued several new standards. The objectives of the Improvements project were to reduce or eliminate alternatives, redundancies and conflicts with the standards, to deal with some convergence issues and to make other improvements.

As a result, we adopted the newly implemented IFRSs for the financial period starting from 1 April 2005. However, the adoption of these newly implemented IFRSs do not have a significant impact on the financial statements of the Group.

4. Taxation

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

5. Investment income

	2006	2005
	\$'000	\$'000
Interest income	39,790	35,174
Amortisation of premium on held-to-maturity debt securities	(7,429)	(13,786)
Amortisation of discount on held-to-maturity debt securities	3,917	506
	36,278	21,894

Securities and Futures Commission

6. Other income

	2006 \$'000	2005 \$'000
Investigation costs awarded	1,903	1,003
Sale of SFC publications	401	397
Profit on disposal of fixed assets	11	40
Others	438	214
	2,753	1,654

7. Staff costs and directors' emoluments

	2006 \$'000	2005 \$'000
Salaries and allowances	362,898	337,502
Retirement benefits	10,520	10,093
Medical and life insurance	10,382	9,464
Overtime pay	427	420
	384,227	357,479

The total number of staff as at 31 March 2006 was 443, comprising 397 regular staff (395 for SFC and 2 for Investor Compensation Company Limited) and 46 temporary staff (at 31 March 2005: the total number of staff was 434, comprising 393 regular staff and 41 temporary staff).

Directors' emoluments included in the above comprised:

	2006 \$'000	2005 \$'000
Fees	1,638	1,638
Salaries and other emoluments	22,885	25,981
Variable pay	2,491	2,200
Retirement benefits	136	203
	27,150	30,022

Included in the directors' emoluments were fees of \$1,638,000 (2004/2005: \$1,638,000) paid to the independent non-executive directors during the year.

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

Directors' emoluments fell within these ranges:

	2006	2005
	No. of directors	No. of directors
\$0 to \$1,000,000	7	10
\$3,000,001 to \$3,500,000	–	1
\$4,000,001 to \$4,500,000	–	2
\$4,500,001 to \$5,000,000	3	1
\$5,000,001 to \$5,500,000	1	–
\$5,500,001 to \$6,000,000	–	1
\$6,000,001 to \$6,500,000	1	–
\$6,500,001 to \$7,000,000	–	1
	12	16

The aggregate remuneration of the five highest paid individuals in 2005/2006, representing the emoluments of five executive directors, was \$25,512,000 (2004/2005: \$25,327,000 for five executive directors).

Employee benefits

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

(a) ORSO Scheme

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 \$53,000 (2005: \$32,000).

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 \$1,627,000 (2005: \$1,287,000) and the amount so forfeited available at the balance sheet date was \$20,000 (2005: \$13,000).

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

Securities and Futures Commission

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

	2006	2005
	\$'000	\$'000
Training and development	6,709	4,328
Legal and professional services	14,645	12,269
Legal costs recovered	–	(2,643)
Information and systems services	19,528	18,418
Auditors' remuneration	253	258
General office and insurance	5,852	6,054
SCEFI (Steering Committee on the Enhancement of Financial Infrastructure)	4,053	293
External relations	5,107	3,020
Exchange loss	416	629
	56,563	42,626

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 2005	35,212	9,576	108,586	20,948	1,456	175,778
Additions	6	60	8,416	5,188	–	13,670
Disposals	–	(130)	–	(1,604)	–	(1,734)
At 31 March 2006	35,218	9,506	117,002	24,532	1,456	187,714
Accumulated depreciation						
At 1 April 2005	24,855	7,224	98,852	18,133	1,456	150,520
Charge for the year	8,593	814	8,108	3,479	–	20,994
Written back on disposals	–	(130)	–	(1,604)	–	(1,734)
At 31 March 2006	33,448	7,908	106,960	20,008	1,456	169,780
Net book value						
At 31 March 2006	1,770	1,598	10,042	4,524	–	17,934
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
Accumulated 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

Securities and Futures Commission

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 2005	34,858	9,544	108,586	20,652	1,456	175,096
Additions	6	60	8,416	5,121	–	13,603
Disposals	–	(130)	–	(1,604)	–	(1,734)
At 31 March 2006	34,864	9,474	117,002	24,169	1,456	186,965
Accumulated depreciation						
At 1 April 2005	24,627	7,212	98,852	17,937	1,456	150,084
Charge for the year	8,475	808	8,108	3,358	–	20,749
Written back on disposals	–	(130)	–	(1,604)	–	(1,734)
At 31 March 2006	33,102	7,890	106,960	19,691	1,456	169,099
Net book value						
At 31 March 2006	1,762	1,584	10,042	4,478	–	17,866
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
Accumulated 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

10. Held-to-maturity debt securities

The Group and the SFC

			2006	2005
			\$'000	\$'000
Maturing after one year				
In the second to third years	–	unlisted	424,870	209,538
	–	listed outside Hong Kong	156,092	340,869
			580,962	550,407
Maturing within one year				
	–	unlisted	362,760	119,965
	–	listed outside Hong Kong	255,171	174,433
			617,931	294,398
			1,198,893	844,805
Cost at 31 March				
	–	unlisted	787,630	329,503
	–	listed outside Hong Kong	411,263	515,302
			1,198,893	844,805
Market value at 31 March				
	–	unlisted	781,237	327,653
	–	listed outside Hong Kong	406,234	510,122
			1,187,471	837,775

The weighted average effective interest rate of debt securities was 4.17% at 31 March 2006 (2005: 3.24%).

11. Bank deposits and cash at bank

The effective interest rate of bank deposits and cash at bank at 31 March 2006 ranged from 3.9% to 4.2% (2005: 2.1% to 2.33%). These balances matured within one year at both 31 March 2006 and 31 March 2005.

12. 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.

Securities and Futures Commission

12. Investments in subsidiaries (cont'd)

Both companies are wholly owned subsidiaries of the SFC. As at 31 March 2006, 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 operations. The balance sheet of FinNet as at 31 March 2006 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.

13. 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.

14. 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 2006. Therefore we do not provide an ageing analysis of debtors and creditors.

15. Initial funding by Government

The Government provided funds to pay for the SFC's initial non-recurrent and capital expenditure. These funds are not repayable to the Government.

16. Capital commitments

Capital commitments outstanding at 31 March 2006 not provided for in the financial statements were as follows:

	2006	2005
	\$'000	\$'000
Authorised and contracted for	10,471	12,413
Authorised but not contracted for	11,361	8,801

17. 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 2006 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	
	2006 \$'000	2005 \$'000	2006 \$'000	2005 \$'000
Payable next year	31,022	30,278	30,935	29,980
Payable in one to five years	38,555	69,578	38,555	69,491
Payable in more than five years	–	–	–	–
	69,577	99,856	69,490	99,471

During the year ended 31 March 2006, \$21,432,000 was recognised as an expense in the income and expenditure account in respect of operating leases (2005: \$20,573,000).

18. 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. In addition to the transaction and balances disclosed elsewhere in these financial statements, we have the following significant related party transactions.

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

During the year, \$3,263,000 was recovered from ICF for ICC's expenses (2005: \$4,006,000). As at 31 March 2006, the amount due to ICF from ICC was \$1,726,000 (at 31 March 2005: \$1,111,000).

(b) Remuneration of key management personnel

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

19. Financial instruments

Financial assets of the SFC comprise held-to-maturity debt securities, bank deposits, cash at bank and debtors.

(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 in order to manage its credit risk.

(b) Interest rate risk

The SFC's interest bearing assets mainly comprises debt securities and bank balances. Interest rate risk in the SFC's investment portfolio is continuously monitored by management. The effective interest rates and maturity profile of the SFC's interest bearing assets are disclosed in the respective notes to the financial statements.

(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.

20. Non-adjusting post balance sheet event

Pursuant to section 396 of the SFO, the SFC shall consult the Financial Secretary with a view to recommending to the Chief Executive in Council that the rate or amount of levy be reduced if our reserves, after deducting depreciation and all provisions, are more than twice our estimated operating expenses for the financial year. As announced by the Financial Secretary in February 2006, it is proposed that there will be a 20% cut in levy for securities and futures and options contracts. Subject to the necessary legislative procedures, the SFC expects to implement the proposals within 2006.

21. Possible impact of new standard and amendment issued but not yet effective for the annual accounting period ended 31 March 2006

Up to the date of issue of these financial statements, the IASB has issued the following new standard and amendment which are not yet effective for the accounting period ended 31 March 2006 and which have not been adopted in these financial statements. Of these developments, the following relate to matters that may be relevant to the Group's operations and financial statements:

	Effective for accounting periods beginning on or after
IFRS 7, Financial instruments: disclosures	1 January 2007

We are in the process of making an assessment of what the impact of the new standard is expected to be in the period of initial application. So far we have concluded that while the adoption of the new standard may result in new or amended disclosures, it is unlikely to have a significant impact on the Group's results of operation and financial position.

Investor Compensation Fund (the 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 2006.

1. Establishment of 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 109 to 120.

3. Members of the Committee

The members of the Committee during the year ended 31 March 2006 and up to the date of this report were: -

Mr. Martin Wheatley (Chairman)	[appointed on 21 June 2005]
Mr. Gerald Greiner	
Mrs. Alexa Lam	
Ms. Anna H.Y. Wu, SBS, JP	
Mr. Eddy C. Fong, SBS, JP	[appointed on 21 June 2005]
Mr. Peter Au-Yang	[appointed on 1 April 2005 and resigned on 20 June 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

Martin Wheatley

Chairman

4 May 2006

Investor Compensation Fund

Auditors' Report To the Securities & 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 109 to 120 which have been prepared in accordance with International Financial Reporting Standards.

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 Hong Kong Standards on Auditing 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 2006 and of its surplus and cash flows for the year then ended, and have been properly prepared in accordance with International Financial Reporting Standards.

KPMG

Certified Public Accountants

Hong Kong

4 May 2006

Income and Expenditure Account

For the year ended 31 March 2006
(Expressed in Hong Kong dollars)

	Note	2006 \$'000	2005 \$'000
Income			
Net investment income	3&5	73,212	28,668
Levy from the SEHK	3&6	144,983	163,914
Levy from the HKFE	3&6	11,464	13,279
		229,659	205,861
Expenses			
ICC expenses	7	3,263	4,066
Auditors' remuneration		65	55
Bank charges		1,125	947
Professional fees		2,469	1,539
Exchange difference		4,687	383
Sundry expenses		1	1
		11,610	6,991
		218,049	198,870
Surplus			
Accumulated surplus brought forward		353,479	154,609
Accumulated surplus carried forward		571,528	353,479

The notes on pages 113 to 120 form part of these financial statements.

Investor Compensation Fund

Balance Sheet

At 31 March 2006

(Expressed in Hong Kong dollars)

	Note	2006 \$'000	2005 \$'000
Current assets			
Financial assets designated at fair value through profit or loss			
– Debt securities	8	1,357,440	1,182,665
– Equity securities	8	145,608	122,409
Other receivables		–	384
Interest receivable		17,848	13,731
Due from ICC		1,726	1,111
Levy receivable from the SEHK		–	16,434
Levy receivable from the HKFE		–	1,283
Fixed and call deposits with banks	9	152,341	81,663
Cash at bank	9	9	37,295
		1,674,972	1,456,975
Current liabilities			
Accounts payable and accrued charges		766	818
		1,674,206	1,456,157
Net current assets			
		1,674,206	1,456,157
Net assets			
		1,674,206	1,456,157
Representing:			
<u>Compensation fund</u>			
Contributions from UECF	10	994,718	994,718
Contributions from CECF	10	107,960	107,960
Accumulated surplus		571,528	353,479
		1,674,206	1,456,157

Approved and authorised for issue by the Securities and Futures Commission (the SFC) on 4 May 2006 and signed on its behalf by

Martin Wheatley
Chairman of the SFC

Eddy C. Fong
Non-executive Director of the SFC

The notes on pages 113 to 120 form part of these financial statements.

Statement of Changes in Equity

For the year ended 31 March 2006
(Expressed in Hong Kong dollars)

	2006	2005
	\$'000	\$'000
Compensation Fund balance as at 1 April	1,456,157	962,209
Surplus for the year	218,049	198,870
Contributions from UECF	–	295,078
Compensation Fund balance as at 31 March	1,674,206	1,456,157

The notes on pages 113 to 120 form part of these financial statements.

Investor Compensation Fund

Cash Flow Statement

For the year ended 31 March 2006

(Expressed in Hong Kong dollars)

	2006	2005
	\$'000	\$'000
Cash flows from operating activities		
Surplus for the year	218,049	198,870
Net investment income	(73,212)	(28,668)
Exchange difference	4,687	383
Decrease/(increase) in levies receivable	17,717	(139)
(Increase)/decrease in amount due from ICC	(615)	667
(Decrease)/increase in accounts payable and accrued charges	(52)	752
Net cash from operating activities	166,574	171,865
Cash flows from investing activities		
Purchase of debt securities	(3,331,795)	(2,729,479)
Purchase of equity securities	–	(99,990)
Sale or maturity of debt securities	3,146,281	1,692,647
Sale of equity securities	641	278
Interest received	51,691	21,582
Net cash used in investing activities	(133,182)	(1,114,962)
Cash flows from financing activities		
Contributions received from UECF	–	295,078
Net cash from financing activities	–	295,078
Net increase/(decrease) in cash and cash equivalents	33,392	(648,019)
Cash and cash equivalents at beginning of the year	118,958	766,977
Cash and cash equivalents at end of the year	152,350	118,958

Analysis of the balance of cash and cash equivalents:

	2006	2005
	\$'000	\$'000
Fixed and call deposits with banks	152,341	81,663
Cash at bank	9	37,295
	152,350	118,958

Notes to the Financial Statements

For the year ended 31 March 2006
(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

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

Investor Compensation Fund

3. Significant accounting policies (cont'd)

Basis of preparation

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

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

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

Recognition of income

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

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 as it accrues using the effective interest method.

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.

3. Significant accounting policies (cont'd)

Financial Instruments

(i) Initial recognition

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

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

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

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

(ii) Fair value measurement principles

We determine the fair value of financial instruments based on their quoted market prices on a recognised stock exchange or a price from a broker/dealer for non-exchange-traded financial instruments at the balance sheet date without any deduction for estimated future selling costs. Financial assets are priced at current bid prices, while financial liabilities are priced at current asking prices.

(iii) Derecognition

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

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

(iv) Offsetting

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

Investor Compensation Fund

3. Significant accounting policies (cont'd)

Impairment

(i) Recognition of impairment loss

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

(ii) Calculation of impairment loss

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

(iii) Reversals of impairment loss

We reverse an impairment loss in respect of an asset in a subsequent period if the circumstances and events that have objectively linked to the write down or write-off cease to exist and there is persuasive evidence that the new circumstances and events will persist for the foreseeable future. We reverse an impairment loss only to the extent that the asset's carrying amount does not exceed the carrying amount that we would have determined if we had not recognised any impairment loss.

Cash and cash equivalents

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

Other receivables

We state other receivables initially at fair value and thereafter at amortised 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 & 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 initially at fair value and thereafter at amortised cost unless the effect of discounting would be immaterial in which case we state them at cost.

3. Significant accounting policies (cont'd)

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 (being members of key management personnel, and/or their close family members) or other entities and include entities which are under the significant influence of related parties of the Fund where those parties are individuals.

Impact of the newly implemented IFRSs

In December 2003 and March 2004, the IASB approved amendments to a number of existing standards as a result of the Improvements project and issued several new standards. The objectives of the Improvements project were to reduce or eliminate alternatives, redundancies and conflicts with the standards, to deal with some convergence issues and to make other improvements.

As a result, we adopted the newly implemented IFRSs for the financial period starting from 1 April 2005. However, the adoption of these newly implemented IFRSs do not have a significant impact on the financial statements of the Fund.

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

	2006	2005
	\$'000	\$'000
Interest income from bank deposits and debt securities	47,985	20,080
Realised (loss)/gain on disposal of equity securities	(1)	44
Realised gain/(loss) on redemption/disposal of debt securities	5,578	(2,252)
Gain on revaluation of equity securities	24,467	22,632
Loss on revaluation of debt securities	(4,817)	(11,836)
Net investment income	73,212	28,668

Investor Compensation Fund

6. Levy from the SEHK/HKFE

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

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

7. ICC expenses

The SFC formed the 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 2006, ICC incurred cost of \$3,263,000 for its operations (2005: \$4,066,000).

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

	2006 \$'000	2005 \$'000
(a) Debt securities		
(i) Listing status		
Listed – outside Hong Kong	385,850	654,186
Unlisted	971,590	528,479
	1,357,440	1,182,665
(ii) Maturity profile		
– Within one year	695,808	580,646
– After one year but within two years	442,602	295,638
– After two years but within five years	156,279	254,587
– After five years	62,751	51,794
	1,357,440	1,182,665
(iii) The weighted average effective interest rate of debt securities at 31 March 2006 was 4.88% (2005: 3.78%).		
(b) Equity securities		
Unlisted	145,608	122,409

9. Deposits with banks and cash at bank

The effective interest rate of deposits with banks and cash at bank at 31 March 2006, ranged from 3.8% to 4.72% (2005: 1.98% to 2.8%). The balances matured within one year at both 31 March 2006 and 31 March 2005.

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 2006, the SFC paid \$994,718,000 (2005: \$994,718,000) and \$107,960,000 (2005: \$ 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, 7 & 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) Interest rate risk

The Fund's interest bearing assets mainly comprises debt securities and bank deposits. It limits its interest rate risks by investing mainly in fixed rate dated securities. The Fund's bank deposits expose only to short term bank deposit interest repricing risk. We considered that the Fund was not exposed to significant interest rate risk. In respect of its interest bearing assets, their effective interest rates and maturity profile are disclosed in the respective notes to the financial statements.

(iii) 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.

(iv) 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.

Investor Compensation Fund

13. Contingent liabilities

As at the date of this report, the Fund has six outstanding claims in respect of 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 (As at 31 March 2005: \$900,000).

14. Non-adjusting post balance sheet event

Pursuant to Section 75(9) of Schedule 10 of the SFO, after all claims against the CECF have been disposed of and all deposits paid to the CECF under Section 82 of the repealed CTO have been reimbursed to the HKFE, the SFC shall pay the remaining balance of the CECF to the Fund. Section 75(11) of Schedule 10 of the SFO also stipulates that where the SFC is unable to locate a successful claimant within three years from the date their claim was allowed, the money must be paid into the Fund. The three year period started to run from 1 April 2003 and expired on 31 March 2006. As at 31 March 2006, there was an unclaimed balance of \$158,013 payable to 10 claimants. Such balance should be paid into the Fund after the lapse of the three year time barred period on 31 March 2006.

On 3 April 2006, \$932,010 was transferred into the Fund from the CECF, leaving a cash balance of \$51,583 in CECF which will be used to settle all outstanding liabilities of the CECF before winding up.

15. Possible impact of amendments, new standards and interpretations issued but not yet effective for the annual accounting period ended 31 March 2006

Up to the date of issue of these financial statement, the IASB has issued a number of amendments, new standards and interpretations which are not yet effective for the accounting period ended 31 March 2006 and which have not been adopted in these financial statements.

Of these developments, the following relate to matters that may be relevant to the Fund's operations and financial statements:

	Effective for accounting periods beginning on or after
IFRS 7, Financial instruments: disclosures	1 January 2007

We are in the process of making an assessment of what the impact of the new standard is expected to be in the period of initial application. So far it has concluded that while the adoption of them may result in new or amended disclosures, it is unlikely to have a significant impact on the Fund's results of operations and financial position.

Unified Exchange Compensation Fund (the Fund)

Report of the Securities Compensation Fund Committee (the Committee)

The members of the Committee present their annual report and the audited financial statements for the year ended 31 March 2006.

1. Establishment of the Fund

Part X of the repealed Securities Ordinance (Chapter 333) established the Fund. However, when the Securities and Futures Ordinance (SFO) and its subsidiary legislation came into effect from 1 April 2003, a new single Investor Compensation Fund (ICF) was formed to ultimately replace the Fund and the Commodity Exchange Compensation Fund. After 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 123 to 133.

3. Members of the Committee

The members of the Committee during the year ended 31 March 2006 and up to the date of this report were:

Mr. Martin Wheatley (Chairman)	[appointed on 21 June 2005]
Mrs. Alexa Lam	
Mr. Eddy C. Fong, SBS, JP	[appointed on 1 April 2005]
Mr. Gerald Greiner	[appointed on 1 April 2005]
Mr. Roger Lee	[appointed on 1 April 2006]
Mr. Peter Au-Yang	[appointed on 1 April 2005 and resigned on 20 June 2005]
Mr. David M. Roberts	[resigned on 31 March 2006]

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

Martin Wheatley

Chairman

26 April 2006

Unified Exchange Compensation Fund

Auditors' Report To the Securities & Futures Commission (the SFC)

We have audited the financial statements of the Unified Exchange Compensation Fund (the Fund) established under Section 99 of the repealed Hong Kong Securities Ordinance set out on pages 123 to 133 which have been prepared in accordance with International Financial Reporting Standards.

Respective responsibilities of the SFC and auditors

The directors of the SFC are responsible for preparing financial statements of the Fund that 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 Hong Kong Standards on Auditing 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 2006 and of its surplus and cash flows for the year then ended, and have been properly prepared in accordance with International Financial Reporting Standards.

KPMG

Certified Public Accountants

Hong Kong

26 April 2006

Income and Expenditure Account

For the year ended 31 March 2006
(Expressed in Hong Kong dollars)

	Note	2006 \$'000	2005 \$'000
Income			
Net investment income	3&5	1,792	955
Recoveries	3&6	2,384	14,673
Replenishments from the SEHK		1	–
Provision for compensation reversed	3&9	–	5,202
		4,177	20,830
Expenses			
Provision for compensation made	9	2,005	–
Auditors' remuneration		30	37
Bank charges		1	29
Professional fees		10	23
Sundry expenses		2	2
		2,048	91
Surplus for the year		2,129	20,739
Accumulated surplus/(deficit) brought forward		7,455	(13,284)
Accumulated surplus carried forward		9,584	7,455

The notes on pages 127 to 133 form part of these financial statements.

Unified Exchange Compensation Fund

Balance Sheet

At 31 March 2006

(Expressed in Hong Kong dollars)

	Note	2006 \$'000	2005 \$'000
Current assets			
Equity securities received under subrogation	6	721	7,793
Interest receivable		91	36
Fixed and call deposits with banks		57,236	47,028
Cash at bank		14	52
		58,062	54,909
Current liabilities			
Accounts payable and accrued charges	7	4,254	4,291
Provision for compensation	3&9	2,553	1,492
		6,807	5,783
Net current assets			
		51,255	49,126
Net assets			
		51,255	49,126
Representing:			
<u>Compensation fund</u>			
Contributions from the SEHK		46,100	46,100
Excess transaction levy from the SEHK	11	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	12	3,002	3,002
Accumulated surplus		9,584	7,455
		1,045,973	1,043,844
Contributions to Investor Compensation Fund	13	(994,718)	(994,718)
		51,255	49,126

Approved and authorised for issue by the Securities Compensation Fund Committee on behalf of the Securities and Futures Commission on 26 April 2006 and signed on its behalf by

Martin Wheatley
Chairman

Alexa Lam
Committee Member

Eddy C. Fong
Committee Member

Statement of Changes in Equity

For the year ended 31 March 2006
(Expressed in Hong Kong dollars)

	2006	2005
	\$'000	\$'000
Compensation Fund balance as at 1 April	49,126	323,815
Surplus for the year	2,129	20,739
Contributions refunded to the SEHK	–	(350)
Contributions to Investor Compensation Fund	–	(295,078)
Compensation Fund balance as at 31 March	51,255	49,126

The notes on pages 127 to 133 form part of these financial statements.

Unified Exchange Compensation Fund

Cash Flow Statement

For the year ended 31 March 2006

(Expressed in Hong Kong dollars)

	2006	2005
	\$'000	\$'000
Cash flows from operating activities		
Surplus for the year	2,129	20,739
Net investment income	(1,792)	(955)
Decrease/(increase) in equity securities received under subrogation	7,072	(542)
Increase/(decrease) in provision for compensation	1,061	(8,053)
Decrease in accounts payable and accrued charges	(37)	(231)
Net cash from operating activities	8,433	10,958
Cash flows from investing activities		
Debt securities redeemed	–	90,500
Debt securities sold	–	67,763
Interest received	1,737	5,665
Net cash from investing activities	1,737	163,928
Cash flows from financing activities		
Contributions refunded to the SEHK	–	(350)
Contributions to Investor Compensation Fund	–	(295,078)
Net cash used in financing activities	–	(295,428)
Net increase/(decrease) in cash and cash equivalents	10,170	(120,542)
Cash and cash equivalents at beginning of the year	47,080	167,622
Cash and cash equivalents at end of the year	57,250	47,080

Analysis of the balance of cash and cash equivalents:

	2006	2005
	\$'000	\$'000
Fixed and call deposits with banks	57,236	47,028
Cash at bank	14	52
	57,250	47,080

Notes to the Financial Statements

For the year ended 31 March 2006
(Expressed in Hong Kong dollars)

1. Purpose, limitation and principal activity

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

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 repealed 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 repealed 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 repealed Securities Ordinance, under Section 74 of Schedule 10 of the SFO, Part X of the repealed Securities Ordinance remains effective in respect of the operation of the Fund.

2. Money constituting the Fund

Before 1 April 2003, the SEHK was required to keep deposited with the SFC \$50,000 for each SEHK trading right under the repealed Securities Ordinance. When the SFC makes compensation payments out of the deposits, the SFC may require 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 (2005: nil).

Unified Exchange Compensation Fund

2. Money constituting the Fund (cont'd)

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 10; special levy surplus detailed in note 12; 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 ("IFRSs") (including applicable International Accounting Standards and Interpretations) promulgated by the International Accounting Standards Board ("IASB"). 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.

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

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

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 as it accrues using the effective interest method.

Recoveries We recognise recoveries pursuant to Section 118 of the repealed Securities Ordinance as income to the Fund and recoveries re-distributed to claimants as expenses. We record recoveries received and re-distributed when and only when we can virtually certain that the recoveries will be received and paid.

Replenishments by the SEHK We record replenishments from the SEHK pursuant to Section 107 of the repealed Securities Ordinance as income of the Fund on a receipt basis. For the purpose of calculating the amount to be replenished by 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)

Impairment

(i) Recognition of impairment loss

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

(ii) Calculation of impairment loss

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

(iii) Reversals of impairment loss

We reverse an impairment loss in respect of an asset in a subsequent period if the circumstances and events that have objectively linked to the write down or write-off cease to exist and there is persuasive evidence that the new circumstances and events will persist for the foreseeable future. We reverse an impairment loss only to the extent that the asset's carrying amount does not exceed the carrying amount that we would have determined if we had not recognised any impairment loss.

Cash and cash equivalents

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

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 repealed 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 repealed 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.

Accounts payables and accrued charges

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

Unified Exchange Compensation Fund

3. Significant accounting policies (cont'd)

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 (being members of key management personnel, and/or their close family members) or other entities and include entities which are under the significant influence of related parties of the Fund where those parties are individuals.

Impact of the newly implemented IFRSs

In December 2003 and March 2004, the IASB approved amendments to a number of existing standards as a result of the Improvements project and issued several new standards. The objectives of the Improvements project were to reduce or eliminate alternatives, redundancies and conflicts with the standards, to deal with some convergence issues and to make other improvements.

As a result, we adopted the newly implemented IFRSs for the financial period starting from 1 April 2005. However, the adoption of these newly implemented IFRSs do not have a significant impact on the financial statements of the Fund.

4. Taxation

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

5. Net investment income

	2006 \$'000	2005 \$'000
Interest income from bank deposits and debt securities	1,792	3,110
Loss on revaluation of debt securities	–	(2,155)
Net investment income	1,792	955

6. 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 2006 after deducting relevant processing fees and charges for collecting and selling the securities received.

According to the repealed Securities Ordinance, the Fund is under an obligation to refund any excess amount representing the excess of the sale proceeds of recovered assets over the compensation amount. We will proceed to make the refund once the verification process is completed.

7. 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.

8. 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 repealed 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 8 trading rights having been transferred during the six months to 31 March 2006 (2005: 46 trading rights had been transferred during the six months to 31 March 2005).

9. Provision for compensation

	2006	2005
	\$'000	\$'000
Balance brought forward	1,492	9,545
Less: Amount paid during the year	(944)	(2,851)
Add: Net provision made/(reversed)	2,005	(5,202)
Balance carried forward	2,553	1,492

We maintain provision for claims in respect of two SEHK exchange participants for which the SEHK has published a notice calling for claims.

Unified Exchange Compensation Fund

10. Replenishments from the SEHK

Under Section 107 of the repealed 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 2006, the SEHK has replenished \$16,361,000 to the Fund. In compliance with Section 107 of the repealed Securities Ordinance, if no further recoveries were to be collected, the SFC may require the SEHK to further replenish \$70,096,000 to the Fund as follows:

	2006 \$'000	2005 \$'000
Compensation paid up to the \$8 million limit as set out in Section 109(3) of the repealed Securities Ordinance	99,091	99,091
Less: Recoveries received for compensation paid up to \$8 million	(29,019)	(27,554)
Add: Recoveries re-distributed to claimants	16,385	16,385
Less: Replenishments from the SEHK	(16,361)	(16,360)
Net amount the SFC may request the SEHK for replenishment	70,096	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.

11. 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.

12. 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.

13. 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 2006 amounted to \$994,718,000.

14. 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 8, 10, 11 and 13).

15. 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.

16. Contingent liabilities

As at the date of this report, the SEHK has received claims against three 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 repealed 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 \$24 million (2005: \$56 million).

17. Possible impact of amendments, new standards and interpretations issued but not yet effective for the annual accounting period ended 31 March 2006

Up to the date of issue of these financial statement, the IASB has issued a number of amendments, new standards and interpretations which are not yet effective for the accounting period ended 31 March 2006 and which have not been adopted in these financial statements.

Of these developments, the following relate to matters that may be relevant to the Fund's operations and financial statements:

	Effective for accounting periods beginning on or after
IFRS 7, Financial instruments: disclosures	1 January, 2007

We are in the process of making an assessment of what the impact of these amendments, new standards and new interpretations is expected to be in the period of initial application. So far it has concluded that while the adoption of them may result in new or amended disclosures, it is unlikely to have a significant impact on the Fund's results of operations and financial position.

Commodity Exchange Compensation Fund (the Fund)

Report of the Futures Compensation Fund Committee (the Committee)

The members of the Committee present their annual report and the audited financial statements for the year ended 31 March 2006.

1. Establishment of 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.

Pursuant to Section 75(9) of Schedule 10 of the SFO, the SFC shall pay the remaining balance of the Fund to the ICF. We expect that the Fund will be wound up by the end of the first quarter of the financial year 2006/07 after all outstanding liabilities are settled and the remaining cash balance is transferred into the ICF. The details are set out in note 10 to the financial statements.

2. Financial results

The Committee presents the financial results which are set out in the financial statements on pages 136 to 143.

3. Members of the Committee

The members of the Committee during the year ended 31 March 2006 and up to the date of this report were:

Mr. Martin Wheatley (Chairman)	[appointed on 21 June 2005]
Mr. Gerald Greiner	
Mrs. Alexa Lam	
Mr. Calvin Tai	
Mr. Eddy C. Fong, SBS, JP	[appointed on 1 April 2005]
Mr. Peter Au-Yang	[appointed on 1 April 2005 and resigned on 20 June 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

Since the Fund is expected to be wound up by the end of the first quarter of the financial year 2006/07, the retiring auditors, KPMG, have not offered themselves for re-appointment.

On behalf of the Committee

Martin Wheatley

Chairman

26 April 2006

Auditors' Report To the Securities & Futures Commission (the SFC)

We have audited the financial statements of the Commodity Exchange Compensation Fund (the Fund) established under Section 77 of the repealed Hong Kong Commodities Trading Ordinance set out on pages 136 to 143 which have been prepared in accordance with International Financial Reporting Standards.

Respective responsibilities of the SFC and auditors

The directors of the SFC are responsible for preparing financial statements of the Fund that 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 Hong Kong Standards on Auditing 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 2006 and of its surplus and cash flows for the year then ended, and have been properly prepared in accordance with International Financial Reporting Standards.

KPMG

Certified Public Accountants

Hong Kong

26 April 2006

Commodity Exchange Compensation Fund

Income and Expenditure Account

For the year ended 31 March 2006

(Expressed in Hong Kong dollars)

	Note	2006 \$'000	2005 \$'000
Income			
Interest income	3	18	2
Recoveries	3	549	-
		567	2
Expenses			
Auditors' remuneration		20	25
Bank charges		-	1
Professional fees		9	9
Sundry expenses		1	1
		30	36
Surplus/(deficit) for the year		537	(34)
Accumulated surplus brought forward		108,228	108,262
Accumulated surplus carried forward		108,765	108,228

The notes on pages 140 to 143 form part of these financial statements.

Balance Sheet

At 31 March 2006

(Expressed in Hong Kong dollars)

	Note	2006 \$'000	2005 \$'000
Current assets			
Fixed and call deposits with banks		983	488
Cash at bank		1	4
		984	492
Current liabilities			
Accounts payable and accrued charges	5	179	224
Net current assets			
		805	268
Net assets			
		805	268
Representing:			
<u>Compensation fund</u>			
Accumulated surplus		108,765	108,228
Contributions to Investor Compensation Fund	6	(107,960)	(107,960)
		805	268

Approved and authorised for issue by the Futures Compensation Fund Committee on behalf of the Securities and Futures Commission on 26 April 2006 and signed on its behalf by

Martin Wheatley
Chairman

Alexa Lam
Committee Member

Eddy C. Fong
Committee Member

The notes on pages 140 to 143 form part of these financial statements.

Commodity Exchange Compensation Fund

Statement of Changes in Equity

For the year ended 31 March 2006

(Expressed in Hong Kong dollars)

	2006	2005
	\$'000	\$'000
Compensation Fund balance as at 1 April	268	302
Surplus/(deficit) for the year	537	(34)
Compensation Fund balance as at 31 March	805	268

The notes on pages 140 to 143 form part of these financial statements.

Cash Flow Statement

For the year ended 31 March 2006
(Expressed in Hong Kong dollars)

	2006	2005
	\$'000	\$'000
Cash flows from operating activities		
Surplus/(deficit) for the year	537	(34)
Interest income	(18)	(2)
Decrease in accounts payable and accrued charges	(45)	(3)
Net cash from/(used in) operating activities	474	(39)
Cash flows from investing activities		
Interest received	18	2
Net cash from investing activities	18	2
Net increase/(decrease) in cash and cash equivalents	492	(37)
Cash and cash equivalents at beginning of the year	492	529
Cash and cash equivalents at end of the year	984	492

Analysis of the balance of cash and cash equivalents:

	2006	2005
	\$'000	\$'000
Fixed and call deposits with banks	983	488
Cash at bank	1	4
	984	492

Commodity Exchange Compensation Fund

Notes to the Financial Statements

For the year ended 31 March 2006
(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 repealed Commodities Trading Ordinance (CTO) 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.

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 repealed CTO, under Section 75(1) of Schedule 10 of the SFO, Part VIII of the repealed CTO remains effective in respect of the operation of the Fund.

As required by Section 75(4) of Schedule 10 of the SFO, HKFE had published a notice in the newspapers on 2 April 2003 specifying 3 October 2003 as the deadline for lodging any claim for compensation against the Fund in relation to a default occurring before 1 April 2003. No claim had been received before the deadline specified.

2. Money constituting the Fund

Under the repealed CTO, 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.

3. Significant accounting policies

The Fund prepares its financial statements in accordance with International Financial Reporting Standards (“IFRSs”) (including applicable International Accounting Standards and Interpretations) promulgated by the International Accounting Standards Board (“IASB”). 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 we expect that the Fund will be wound up by the end of the first quarter of the financial year 2006/07, 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.

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

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

Recognition of income

Interest income We record interest income as it accrues using the effective interest method.

Recoveries We record recoveries pursuant to Section 95 of the repealed CTO as income to the Fund, when and only when, we can virtually certain that the recoveries will be received.

Cash and cash equivalents

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

Accounts payable and accrued charges

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

Commodity Exchange Compensation Fund

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 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 (being members of key management personnel, and/or their close family members) or other entities and include entities which are under the significant influence of related parties of the Fund where those parties are individuals.

Impact of the newly implemented IFRSs

In December 2003 and March 2004, the IASB approved amendments to a number of existing standards as a result of the Improvements project and issued several new standards. The objectives of the Improvements project were to reduce or eliminate alternatives, redundancies and conflicts with the standards, to deal with some convergence issues and to make other improvements.

As a result, we adopted the newly implemented IFRSs for the financial period starting from 1 April 2005. However, the adoption of these newly implemented IFRSs do not have a significant impact on the financial statements of the Fund.

4. Taxation

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

5. Accounts payable and accrued charges

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

6. 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 2006, a total of \$107,960,000 were transferred into the ICF from the Fund (31 March 2005: \$107,960,000).

7. 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.

8. 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.

9. Contingent liabilities

As at the date of this report, there is no outstanding claim against the Fund (2005: nil).

10. Non-adjusting post balance sheet event

Pursuant to Section 75(9) of Schedule 10 of the SFO, after all claims against the Fund have been disposed of and all deposits paid to the Fund under Section 82 of the repealed CTO have been reimbursed to the HKFE, the SFC shall pay the remaining balance of the Fund to the ICF. Section 75(11) of Schedule 10 of the SFO also stipulates that where the SFC is unable to locate a successful claimant within three years from the date their claim was allowed, the money must be paid into the ICF. The three year period started to run from 1 April 2003 and expired on 31 March 2006. As at 31 March 2006, there was an unclaimed balance of \$158,013 payable to 10 claimants. Such balance will be paid into the ICF after the completion of the three year period on 31 March 2006.

On 3 April 2006, \$932,010 was transferred into the ICF from the Fund, leaving a cash balance of \$51,583. The cash balance will be used to settle all outstanding liabilities, including audit fees. The Committee expects that the Fund will be wound up by the end of the first quarter of the financial year 2006/07 after all outstanding liabilities are settled and the remaining cash balance is transferred into the ICF.

11. Possible impact of amendments, new standards and interpretations issued but not yet effective for the annual accounting period ended 31 March 2006

Up to the date of issue of these financial statements, the IASB has issued a number of amendments, new standards and interpretations which are not yet effective for the accounting period ended 31 March 2006 and which have not been adopted in these financial statements.

Of these development, the following relate to matters that may be relevant to the Fund's operations and financial statements:

	Effective for accounting periods beginning on or after
IFRS 7, Financial instruments: disclosures	1 January 2007

We are in the process of making an assessment of what the impact of these amendments, new standards and new interpretations is expected to be in the period of initial application. So far it has concluded that while the adoption of them may result in new or amended disclosures, it is unlikely to have a significant impact on the Fund's results of operations and financial position.

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

Andrew L T Sheng, SBS, JP
(to 30.9.05)
Martin Wheatley (from 1.10.05)

Members

Peter Au-Yang
Thaddeus Beczak
Henry Chan (from 1.6.05)
Ambrose Cheung
Paul Chow, SBS, JP
Paul Fan, BBS, JP
Stephen C C Hui, JP (to 31.5.05)
Alexa Lam

Christine Loh
Roger Luk, JP (to 31.5.05)
Jack Maisano (from 1.6.05)
Blair Pickerell
Samuel Poon
Peter Sullivan (from 1.6.05)
Ada Tse (from 1.6.05)
Dr. Eden Woon (to 31.5.05)
Yip Lai Shing (to 1.6.05)

No of meetings: 4

Average attendance rate (%) : 81%

Takeovers and Mergers Panel

Administers the Code on Takeovers and Mergers.

Chairman

Kevin Westley

Deputy Chairmen

Clifton Chiu
Stephen Clark
The Hon Henry H L Fan, SBS, JP
David Graham
Teresa Ko

Members

Nicholas Allen
Jim Baird
Ian Boyce
Malcolm Brown
Julia Charlton (from 1.10.05)
Roy Chen (from 1.4.05)
Stephen Cheung (from 1.10.05)
Eddy C Fong, SBS, JP
Herbert Hui, JP (from 1.10.05)
Dr. Bill C P Kwok (from 1.10.05)
Clement Kwok
Angelina Lee, JP
John Lees
Alfred Li (to 31.3.06)
Liu Chee-Ming
Michael Liu (from 1.4.05)

John Maguire
Gavin Nesbitt
Nicholas Norris (from 1.4.05)
Grace Fung Oei (from 1.4.05)
Michael Palin (from 1.10.05)
William Ryback (from 1.4.05)
Patricia Shih
Frank Slevin
May Tan
Gregory Terry (from 1.10.05)
Carlson Tong
David M Webb
Christine Wong (from 1.10.05)
Harold Wong (from 1.10.05)
Kenneth Willman (from 1.10.05)
V-Nee Yeh
Benita Yu (from 1.4.05)

No of meetings: 2

Average attendance rate for code review meeting (%): 62.5%

Takeovers Appeal Committee

Reviews disciplinary rulings of the Takeovers and Mergers Panel at the request of an aggrieved party for the sole purpose of determining whether any sanction imposed by the Panel is unfair or excessive.

<p>Chairman Angelina Lee, JP</p> <p>Deputy Chairman Teresa Ko</p>	<p>Members</p> <p>Nicholas Allen Jim Baird Ian Boyce Malcolm Brown Julia Charlton (from 1.10.05) Roy Chen (from 1.4.05) Stephen Cheung (from 1.10.05) Clifton Chiu Stephen Clark The Hon Henry H L Fan, SBS, JP Eddy C Fong, SBS, JP David Graham Herbert Hui, JP (from 1.10.05) Dr. Bill C P Kwok (from 1.10.05) Clement Kwok John Lees Alfred Li (to 31.3.06) Liu Chee-Ming</p>	<p>Michael Liu (from 1.4.05) John Maguire Gavin Nesbitt Nicholas Norris (from 1.4.05) Grace Fung Oei (from 1.4.05) Michael Palin (from 1.10.05) William Ryback (from 1.4.05) Patricia Shih Frank Slevin May Tan Gregory Terry (from 1.10.05) Carlson Tong David M Webb Kevin Westley Kenneth Willman (from 1.10.05) Christine Wong (from 1.10.05) Harold Wong (from 1.10.05) V-Nee Yeh Benita Yu (from 1.4.05)</p>
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.

<p>Chairman Alexa Lam</p>	<p>Full Members</p> <p>Dr. Au King Lun (to 6.9.05) Prof. Ka-Keung C Chan Christina Choi Roger Hepper Heung Shu Fai (from 1.4.05) Stuart Leckie, JP Dr. York Liao, SBS, JP Darren McShane Alastair Murray</p>	<p>Simon Ng Elisabeth Scott (from 6.9.05) Oscar Wong (from 1.4.05)</p> <p>Alternate Members</p> <p>Joseph Ho David Hughes Sau Kwan (from 1.4.05) Blair Pickerell Ken Sue (from 1.4.05) Alan Yamashita (from 1.4.05)</p>
No of meetings: 2	Average attendance rate (%): 73%	

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 such schemes and grants waivers.

Chairman

Alexa Lam

Full Members

Rex Auyeung
Desmond Chan
Prof. Ka-Keung C Chan
Raymond Chan (from 17.5.05)
Christina Choi
Angel Hon
Richard Ip (to 16.5.05)
Stuart Leckie, JP

Dr. York Liao, SBS, JP

Darren McShane

Alastair Murray

Alternate Members

Francine Fu

Kevin Lee

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

Alexa Lam

Members

F K Au (from 18.4.05)
Henry Cheong
Christina Choi (from 18.4.05)
Susan Chow (from 1.9.05)
Martin Cubbon
Roger Hepper (to 31.8.05)
Heung Shu Fai
Stephen C C Hui, JP (from 1.9.05)

Alice Law

C Y Leung, JP

Alastair Murray (from 17.5.05)

Stephen Po

Paul Smith (to 21.4.05)

David Richardson

T Brian Stevenson, SBS

(from 18.4.05)

Kevin Westley (from 1.9.05)

No of meetings: 2

Average attendance rate (%): 74%

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.

<p>Chairman Peter Au-Yang (from 1.4.05 to 20.6.05) Martin Wheatley (from 21.6.05)</p>	<p>Members Alexa Lam Eddy C Fong, SBS, JP (from 1.4.05)</p>	<p>Gerald Greiner (from 1.4.05) David M Roberts (to 31.3.06)</p>
<p>No of meeting: 1</p>		<p>Average attendance rate (%): 60%</p>

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.

<p>Chairman Peter Au-Yang (from 1.4.05 to 20.6.05) Martin Wheatley (from 21.6.05)</p>	<p>Members Alexa Lam Eddy C Fong, SBS, JP (from 1.4.05)</p>	<p>Gerald Greiner Calvin Tai</p>
<p>No of meeting: 1</p>		<p>Average attendance rate (%): 80%</p>

Investor Compensation Fund Committee

Administers the Investor Compensation Fund and regulates its procedures in accordance with Part XII of the Securities and Futures Ordinance.

<p>Chairman Peter Au-Yang (from 1.4.05 to 20.6.05) Martin Wheatley (from 21.6.05)</p>	<p>Members Alexa Lam Anna H Y Wu, SBS, JP</p>	<p>Gerald Greiner Eddy C Fong, SBS, JP (from 21.6.05)</p>
<p>No of meeting: 1</p>		<p>Average attendance rate (%): 75%</p>

Committees, Panels and Tribunal

Investor Education Advisory Committee

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

Chairman

Peter Au-Yang

Full Members

Lawrence K M Fok (to 31.7.05)

Mark C Fong (from 1.4.05)

Eric W M Fu (from 1.4.05)

Dr. Bill C P Kwok
(from 1.4.05 to 31.3.06)

Ben M B Kwong (to 31.3.06)

Ivy W Y Lai

Connie Y H Lau

Henry M W Law (from 1.8.05)

The Hon Li Kwok Ying, MH
(from 1.4.05 to 31.3.06)

Joseph Y W Pang, JP (to 31.3.06)

Siu Sai Wo (from 1.4.05)

Prof. Raymond W M So
(from 1.4.05)

Howard H P Sou

Alternate Members

Bonnie S Y Chan (from 1.4.05)

Wong Koon Shing

Sally Wong

No of meetings: 3

Average attendance rate (%): 82%

Academic and Accreditation Advisory Committee

Approves industry-based courses and examinations for the purpose of meeting the licensing competence requirements; endorses applications from professional bodies and tertiary institutions as recognised institutions for providing continuous professional training; advises the Commission on areas to study in the context of enhancing Hong Kong's position as an international financial centre; and provides input for the development of industry-related courses and training programs.

Chairman

Alexa Lam

Members

Prof. Johannes M M Chan, SC

Prof. Ka Lok Chan

Prof. Joseph Y S Cheng

Albert Thomas Da Rosa, Junior

Anthony Espina (from 19.2.06)

Stephen C C Hui, JP (to 18.2.06)

Sandra Y M Lee (to 18.2.06)

Vincent M K H Lee (to 18.2.06)

Andreas Mondovits (from 19.2.06)

Derek Shek

Prof. Raymond W M So

Judy Vas (from 19.2.06)

No of meeting: 1

Average attendance rate (%): 100%

Public Shareholders Group

Advises on issues relating to shareholders' rights and interests.

<p>Chairman Peter Au-Yang</p>	<p>Members Jamie Allen Rex Auyeung Prof. Andrew Chan Prof. K C Chan (from 5.12.05) Vincent Chan (from 1.7.05) Chan Wing Luk David Cheung Prof. Stephen Cheung (from 1.7.05)</p>	<p>Chung Man Wing (to 30.6.05) Vincent Duhamel William Kerr (from 1.7.05) Stuart Leckie (from 1.7.05) David Lui (to 30.6.05) Karl Lung (from 1.7.05) Richard Mak (to 30.6.05) Douglas J Naismith (to 30.6.05) David T K Sun (to 30.6.05) David M Webb</p>
No of meetings: 5	Average attendance rate (%): 63%	

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.

<p>Members Ashley Alder Dennis Cassidy David Cheung Teresa Ko (to 31.3.06) W Gage McAfee Mike Scales</p>	<p>James Siu Frank J Slevin Carlson Tong Peter P W Tse (to 31.3.06) Tony Tsoi (to 31.3.06) V-Nee Yeh</p>	
No of meeting: 1	Average attendance rate (%): 66.7%	

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 function may be exercised by the SFC.

<p>Chairman Members present in each committee meeting will elect a Chairman among themselves at the beginning of that meeting</p>	<p>Members Thaddeus Beczak (to 31.3.06) Eric Cheng Christina Choi (from 1.4.05) Stephen J Clark Alexa Lam</p>	<p>Alan Linning Patricia Shih (to 31.3.06) Carlson Tong Martin Wheatley (from 6.6.05 to 30.9.05) V-Nee Yeh</p>
No of meeting: 0	Average attendance rate (%): N/A	

Committees, Panels and Tribunal

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. In such cases, the relevant powers and functions may be exercised by the SFC.

<p>Chairman Members present in each committee meeting will elect a Chairman among themselves at the beginning of that meeting</p>	<p>Members Christopher W C Cheng, GBS, JP Eddy C Fong, SBS, JP Kenneth H W Kwok, SC Raymond P L Kwok, JP Dr. York Liao, SBS, JP</p>	<p>Prof. Liu Pak Wai, SBS Andrew L T Sheng, SBS, JP (to 30. 9.05) The Hon Jasper Tsang Yok Sing, GBS, JP Martin Wheatley (from 1.10.05)</p>
No of meeting: 0	Average attendance rate (%): N/A	

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.

<p>Chairman Martin Rogers</p> <p>Deputy Chairman Stephen Clark</p>	<p>Members Nicholas Allen Roger T Best, JP Rebecca Chow The Hon Henry H L Fan, SBS, JP David Graham David Halperin Mark Johnson Teresa Ko Dr. Bill C P Kwok Alan Lee</p>	<p>Clifford Levy Mark Lin Teresa Ma Michael W Scales T Brian Stevenson, SBS David T K Sun Carlson Tong Jason Webber Kevin Westley James Wong (to 29.11.2005) V-Nee Yeh</p>
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.

<p>Chairman Eddy C Fong, SBS, JP</p> <p>Deputy Chairman Raymond P L Kwok, JP</p>	<p>Member Kenneth H W Kwok, SC</p>
No of meetings: 4	Average attendance rate (%): 92%

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.

<p>Chairman Raymond P L Kwok, JP</p> <p>Deputy Chairman Christopher W C Cheng, GBS, JP</p>	<p>Members Peter Au-Yang Alexa Lam Prof. Liu Pak Wai, SBS</p>	<p>Andrew L T Sheng, SBS, JP (to 30.9.05) Martin Wheatley (from 1.10.05)</p>
No of meeting: 1	Average attendance rate (%): 100%	

Management Committee

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

<p>Chairman Andrew L T Sheng, SBS, JP (to 30.9.05) Martin Wheatley (from 1.10.05)</p>	<p>Members Peter Au-Yang Geoffrey Harris Brian Ho Alexa Lam</p>	<p>Alan Linning Keith Lui Stephen Po Andrew Young</p>
No of meetings: 12	Average attendance rate (%): 77%	

Committees, Panels and Tribunal

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

Dr. York Liao, SBS, JP

Deputy Chairman

Christopher W C Cheng, GBS, JP

Members

Eddy C Fong, SBS, JP

Kenneth H W Kwok, SC

Raymond P L Kwok, JP

Prof Liu Pak Wai, SBS

The Hon Jasper Tsang Yok Sing,
GBS, JP

No of meetings: 3

Average attendance rate (%): 86%

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

Vincent H C Cheng, JP

Members

Prof. Chan Yuk-shee, JP

Henry Y C Cheong

Anthony W K Chow, SBS, JP

The Hon Audrey Y M Eu, SC, JP

Fong Hup

Kam Pok-man

Edward P C Kwan

Joseph Y W Pang, JP

Dr. York Liao, SBS, JP

Martin Wheatley

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

Horace S Y Fan

Deputy Chairman

Patrick Gillot

Members

Justin S C Chan

Eddie C S Tan

Securities and Futures Appeals Panel (From 1 June 2004 to 31 May 2006, or until completion of the hearing of the outstanding appeal cases. The last outstanding case was concluded on 25 January 2006.)

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

Alan Hoo, SBS, SC, JP

Deputy Chairman

Patrick P T Fung, SC FCI Arb

Members

Dannis J H Lee, BBS

Peter S H Wong

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

James W Baird

Roger T Best, JP

Fong Hup

David Graham

Prof. Simon S M Ho

Prof. Richard Y K Ho

Stephen C C Hui, JP

Teresa Ko

Dr. Bill C P Kwok

Clement K M Kwok

Vincent Marshall K H Lee

Angelina Lee, JP

Vernon F Moore, BBS

Joseph Y W Pang, JP

David T K Sun

Tang Kwai-Nang, BBS, JP

Richard J Thornhill

Tse Kam-Keung

Samuel N Tsien

Dr. Michael F S Tsui

Wilfred W S Wong

Henry K C Wu, BBS, JP

Consultations, Codes and Guidelines

The following were published in 2005-06:

Consultation papers: 5	
April 2005	1. Consultation Paper on the Proposed Revised Prevention of Money Laundering and Terrorist Financing Guidance Note
May 2005	2. Consultation Paper on the Review of Chapter 8.7 of the Code on Unit Trusts and Mutual Funds (Hedge Fund Guidelines)
June 2005	3. Consultation Paper on the Regulation of Sponsors and Compliance Advisers
August 2005	4. Consultation Paper on Possible Reforms to the Prospectus Regime in the Companies Ordinance
November 2005	5. A Healthy Market for Informed Investors – A Report on the Derivative Warrants Market in Hong Kong
Conclusions: 8	
April 2005	1. Consultation Conclusions on Investments in Real Estate Investment Trusts by Collective Investment Schemes Authorised under the Code on Unit Trusts and Mutual Funds
May 2005	2. Consultation Conclusions on the Review of the Disclosure of Interests Regime under Part XV of the SFO
June 2005	3. Consultation Conclusions on Draft Practice Note on Overseas Investments by SFC-authorized Real Estate Investment Trusts
August 2005	4. Consultation Conclusions on a Review of the Codes on Takeovers and Mergers and Share Repurchases
September 2005	5. Consultation Conclusions on Proposed Amendments to Schedule 5 to the SFO
September 2005	6. Consultation Conclusions on Consultation Paper on the Review of Chapter 8.7 of the Code on Unit Trusts and Mutual Funds (Hedge Fund Guidelines)
October 2005	7. Consultation Conclusions on the Proposed Revised Prevention of Money Laundering and Terrorist Financing Guidance Note
March 2006	8. Hong Kong's Derivative Warrants Market-the Way Forward Results of the Consultation on the SFC's Six-Point Plan
Codes & guidelines (including amendment parts): 3	
June 2005	1. Revised Code on Real Estate Investment Trusts
September 2005	2. Revised Code on Unit Trusts and Mutual Funds (Hedge Fund Guidelines)
October 2005	3. Revised Codes on Takeovers and Mergers and Share Repurchases

Index

Indices do not include references in the Financial Statements.

A

Advisory Committee

– pp. 7-11, 15, 144

Asian Bond Fund 2 (ABF2) Project

An initiative led by the Executives' Meeting of East Asian and Pacific Central Banks which seeks to promote the development of index bond funds in the regional markets, enhance the domestic as well as regional bond market infrastructure and to develop listed and passively managed bond funds available to retail investors.

– pp. 50, 71

Audit Committee

– pp. 7, 10, 11, 16, 18, 19, 151

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. 6, 28, 72

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. 72

Avian flu

Avian flu (H5N1) is a type of influenza A that mainly infects birds but occasionally affects humans. Avian flu can be transmitted from live birds to people, although transmission between humans is very inefficient. The initial symptoms of avian flu are similar to those of other influenza viruses, including fever, generalized muscle pain, cough and sore throat. However, it is more likely to result in high fever, chest infection, respiratory failure, multi-organ failure, and death.

– pp. 29, 52, 74

B

Boiler Rooms

Frauds in which unscrupulous but plausible salespeople cold call potential investors and use high pressure sales tactics to persuade them to buy real or bogus investments.

– pp. 82, 85

Budget Committee

– pp. 7, 17, 151

Budget Speech

– p. 80

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. 4, 29, 71

Central Clearing and Settlement System (CCASS)

HKEx's clearing and settlement system for its cash market.

– p. 31

Chief Executive, HKSAR

– pp. 2, 8, 14, 16, 20, 21, 28, 36, 80

Chief Executive Officer (CEO)

– pp. 5, 14

Chief Operating Officer (COO)

– pp. 7, 9

China Securities Regulatory Commission (CSRC)

The authorised department under the State Council that governs the securities and futures markets of China.

– pp. 37, 69, 87

Codes of Conduct for Persons Licensed by or Registered with the SFC (Code of Conduct)

– pp. 6, 15, 17, 54, 67

Codes on Takeovers and Mergers and Share Repurchases

– pp. 6, 26, 36, 41, 81, 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. 58

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.

– p. 74

Companies Ordinance

– pp. 6, 27, 36, 41, 42, 154

Complaints Control Committee

– p. 83

Consumer Council

– p. 44

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.

– pp. 50, 148

Corporate Governance

– pp. 3, 5, 14-23, 26, 29, 75, 84, 85

Index

D

De minimis exception

The exception to exclude disclosures by substantial shareholders under Part XV of the SFO for small changes (0.5%) around a whole percentage level.

– p. 72

Derivatives Clearing and Settlement System (DCASS)

The new clearing and settlement system launched by HKEx for its derivatives market.

– p. 72

Director of Audit

– p. 18

Directors of the Commission

– p. 8

Disciplinary Actions

– pp. 67, 68

Disclosure of Interests

– pp. 3, 28, 36, 50, 62, 63, 72, 73, 83, 154

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. 6, 26, 32, 42

Dual Filing Advisory Group

– pp. 42, 149

E

Electronic Investor Resources Centre (eIRC)

An SFC operated website to provide investors with educational information on investments and regulations. The website has been renamed InvestEd.

– p. 82

Exchange Traded Fund (ETF)

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

– pp. 4, 27, 36, 50, 71, 73

Executive Directors (EDs)

– pp. 8, 9, 14, 80

Extensible Business Reporting Language (XBRL)

A language for the electronic communication of business and financial data.

– pp. 29, 81

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.

– p. 6

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. 51

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. 27, 43

Financial Secretary, HKSAR

– pp. 8, 14, 16, 18, 21, 28, 36, 37, 43, 60, 80

Financial Services Agency of Japan

The capital market regulator responsible for ensuring the stability of the financial system in Japan, protection of depositors, insurance policy-holders and securities investors, and smooth finance function.

– pp. 36, 86

Financial Services and the Treasury Bureau (FSTB)

– pp. 20, 21, 37, 74

Financial Services Authority (FSA), UK

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.

– pp. 8, 13

Financial Services Commission of Guernsey

A regulatory body responsible for the supervision of the finance sector and the countering of financial crime and terrorist financing in the Bailiwick of Guernsey.

– pp. 36, 86

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. 29, 81

G

Gross Domestic Product (GDP)

– p. 4

Group of Thirty (G30)

A private and non-profit international group on key economic and monetary affairs.

– p. 87

Growth Enterprise Market (GEM)

– pp. 67, 149

H

H-shares Index Futures

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Hang Seng FTSE/Xinhua China 25 ETF

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Hang Seng Index (HSI)

– pp. 4, 71

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 policies and arrangements.

– p. 80

Hedge Funds

– pp. 49, 51, 54, 85

Hong Kong Exchanges and Clearing Limited (HKEx)

– pp. 4, 6, 8, 9, 29, 37, 43, 57-59, 62, 63, 65, 71-74, 81, 87, 149, 150

Hong Kong Futures Automatic Trading System (HKATS)

The electronic trading system for HKEx derivatives market.

– p. 72

Hong Kong Futures Exchange Limited (HKFE)

– p. 47

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. 43, 58, 84

Hong Kong Institute of Surveyors

– p. 44

Hong Kong Management Association

– p. 84

Hong Kong Monetary Authority (HKMA)

– pp. 8, 11, 81, 87

Hong Kong Securities Clearing Company Limited (HKSCC)

– p. 72

Hong Kong Securities Institute (HKSI)

– pp. 50, 74

Hong Kong Society of Financial Analysts

– p. 44

Hong Kong Special Administrative Region (HKSAR)

– pp. 2, 5, 8, 11, 14, 16, 20, 36, 69, 80

I

Independent Commission Against Corruption (ICAC)

– pp. 4, 10, 20, 21, 29, 37, 58, 69

Independent Financial Advisers (IFAs)

– p. 44

Insider Dealing Tribunal (IDT)

– pp. 3, 58-60, 65

Insurance Authority

The Insurance Authority is appointed pursuant to, and is responsible for administering, the Insurance Companies Ordinance. It is responsible for authorising and regulating insurers, approving and administering a self-regulatory regime for the regulation of insurance intermediaries, to oversee the monitoring, disciplinary and enforcement functions carried out by the self-regulatory bodies.

– pp. 27, 37, 51

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, 85

International Auditing and Assurance Standards Board

– p. 85

International Financial Report Standards (IFRS)

– pp. 14, 85

International Organization of Securities Commissions (IOSCO)

– pp. 3, 5, 36, 84, 86, 87

Internet Professional Association

– p. 22

InvestED

Formerly known as eIRC, an SFC operated portal to provide investors with educational information on investments and regulations.

– pp. 4, 33, 82

Investment Advisers

– pp. 27, 29, 48, 65, 66, 68

Investor Compensation Company Limited (ICC)

– pp. 17, 74

Investor Compensation Fund (ICF)

– pp. 74, 75

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.

– p. 72

Israel Securities Authority

The Israel Securities Authority is Israel's capital markets regulator.

– pp. 37, 86

Index

J

Jersey Financial Services Commission

A statutory body responsible for the supervision of the financial services sector in Jersey, including banking, collective investment funds, insurance business, investment business and trust and company service providers.

– pp. 36, 86

Joint Forum

– pp. 29, 87

L

Legislative Council (LegCo)

– pp. 5, 10, 14, 18, 27, 48

Letter of Intent (LOI)

– pp. 36, 86

Listing Rules

– p. 6, 26, 43, 71

M

Management Committee

– pp. 7-10, 17, 75, 151

Mandatory Provident Fund (MPF)

– pp. 23, 55

Margin Financing

– pp. 3, 6, 27, 48

Market Misconduct

– pp. 6, 28, 57, 58, 60, 83

Market Misconduct Tribunal (MMT)

– pp. 29, 60

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. 87

Memorandum of Understanding (MOU)

Co-operative arrangements or agreements the SFC signed with other local or international organisations.

– pp. 27, 37, 43, 46, 51, 84, 86

Monetary Authority of Macau

A statutory body responsible for policy development and regulation in relation to the monetary, financial, foreign exchange, and insurance markets of Macau.

– pp. 36, 86

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.

– p. 84

N

Non-Executive Directors (NEDs)

– pp. 5, 8, 10, 11, 14-17, 20, 36, 80

O

Ombudsman

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P

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Process Review Panel (PRP)

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Prosecutions

– pp. 4, 28, 29, 33, 37, 57, 60-64, 77

Public Perception Survey

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Public Shareholders Group

– pp. 9, 15, 44, 149

R

Radio Television Hong Kong (RTHK)

– pp. 36, 82

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. 9, 27, 36, 49-51, 82, 146

Remuneration Committee

– pp. 5, 7, 10, 11, 14, 16, 17, 152

Royal Institution of Chartered Surveyors

An international organisation for professionals involved in land, property, construction and environmental issues.

– p. 44

S

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.

– p. 73

Securities and Derivatives Network (SDNet)

– pp. 29, 72

Securities and Exchange Board of India

A regulatory body responsible for the formulation of the securities market policies, regulations and guidelines and implementation, administration and enforcement of the mandate of SEBI Act and rules and regulations in India.

– pp. 36, 86

Securities and Exchange Commission of Sri Lanka

A regulatory body for the securities market in Sri Lanka responsible for ensuring proper disclosure of information in the public offering of securities, financial stability and proper conduct of securities companies, proper performance of various self-regulatory agencies and other institutions related to securities businesses, public compliance with takeover codes, as well as integrity and fairness of the Sri Lankan securities market.

– pp. 36, 86

Securities and Futures Appeals Panel (SFAP)

– pp. 20, 68, 153

Securities and Futures Appeals Tribunal (SFAT)

– pp. 11, 20, 65, 67, 68, 153

Securities and Futures Commission Ordinance (SFCO)

– pp. inside front cover, 20

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. 43, 49, 64, 67

Securities and Futures Ordinance (SFO)

– pp. inside front cover, 3, 8, 14, 26, 41-44, 49-51, 54, 58, 60, 61, 63, 66, 69, 72, 77, 78, 81, 154

Securities and Futures (Stock Market Listing) Rules (SMLR)

– pp. 27, 43, 73

Securities Commission, Malaysia

The central authority responsible for the regulation and development of the securities and futures industries in Malaysia.

– pp. 36, 86

Settlement, Disciplinary Actions

– pp. 20, 67-69

Share Registrars

– pp. 6, 28, 74

Social Responsibility

– pp. 5, 14, 21

SPAM

Unsolicited e-mail, often of a commercial nature, sent indiscriminately to multiple mailing lists, individuals, or newsgroups.

– p. 81

Sponsors, Listing

– pp. 3, 6, 26, 27, 36, 42, 44, 65, 71, 154

Staff

– pp. 4, 5, 12, 13, 15-22, 29, 33, 36, 79-81

Steering Committee on the Enhancement of Financial Infrastructure

The committee set up in 1999 to recommend improvements to the financial infrastructure of Hong Kong's securities and futures industry.

– p. 73

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. 26, 47, 73

Stock Options

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T

Takeovers and Mergers Panel

– pp. 41, 45, 144

Takeovers Executive

– pp. 28, 41, 76

Trading spread

The minimum allowable change in price of securities traded on the SEHK.

– pp. 29, 72

Index**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. 27, 51

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. 33, 74, 147

Unit Trusts and Mutual Funds

– pp. 5, 32, 49, 51, 55, 154

US Securities and Exchange Commission (SEC)

The SEC is a United States government agency having primary responsibility for enforcing the Federal securities laws and regulating the security industry.

– p. 13

W**Website, SFC**

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World Trade Organization’s 6th Ministerial Conference (MC6)

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