



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

Annual Report 2006-07

Investors First

Regulate, Facilitate & Educate



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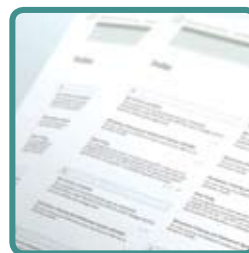


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Investors First

The continued success of our financial services market, a key and growing part of Hong Kong's economy, can be attributed to many factors including effective regulation. Effective regulation allows both local and international market participants to conduct their business in accordance with an accepted and transparent set of rules. This in turn provides investors with confidence when making their investment decisions and thus facilitates greater levels of market activity. We execute our responsibilities under the law through three inter-related activities: Regulation, Facilitation and Education.

Who We Are and What We Do



The continued success of our financial services market, a key and growing part of Hong Kong's economy, can be attributed to many factors including effective regulation. Effective regulation allows both local and international market participants to conduct their business in accordance with an accepted and transparent set of rules. This in turn provides investors with confidence when making their investment decisions and thus facilitates greater levels of market activity.

The financial services market in Hong Kong is made up of a number of different sectors including banking, insurance and securities and futures, together with the many businesses that provide services to these principal sectors. In Hong Kong, the regulation of the financial services sector is shared by a number of different regulators and we at the Securities and Futures Commission (SFC) are responsible for regulating the securities and futures markets.

The SFC is a statutory body, and its functions and powers are set out under Hong Kong law in the Securities and Futures Ordinance (SFO). However, whilst the SFC is accountable to the Government for the performance of its functions, it is an independent securities market regulator – it operates outside of the civil service. Funding is derived directly from levies on stock market transactions or fees charged to market participants and the SFC has made no claim for public funding for over 10 years.

The market participants and the activities they conduct, which are subject to regulation by the SFC fall into three main groups:

- intermediaries such as brokers, investment advisers and investment bankers who must first meet qualifications requirements, under a licensing regime, before dealing in securities or giving investment advice to clients. They must then conduct their business in compliance with ongoing conduct and financial position requirements;
- issuers of securities, including listed companies and investment funds, who are required to comply with certain disclosure and other regulations in order to be able to sell securities to the investing public; and
- market operators such as Hong Kong Exchanges and Clearing Ltd (HKEx) which is directly overseen by the SFC.

In certain areas the SFC shares its regulatory responsibility with other bodies; HKEx is responsible for oversight of certain non-statutory regulations governing listed companies and where licensed banks conduct securities activities the Hong Kong Monetary Authority oversees their ongoing compliance with SFO regulations.

The SFO sets out six statutory regulatory objectives for the SFC. They are:

- i) to maintain and promote the fairness, efficiency, competitiveness, transparency and orderliness of the securities and futures industry;

Who We Are and What We Do

- ii) to promote understanding by the public of the operation and functioning of the securities and futures industry;
- iii) to provide protection for members of the public investing in or holding financial products;
- iv) to minimise crime and misconduct in the securities and futures industry;
- v) to reduce systemic risks in the securities and futures industry; and
- vi) 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.

We execute our responsibilities under the SFO through three inter-related activities:

Regulation

In carrying out our regulatory responsibilities we adopt a philosophy of considering the interest of investors first. However, in establishing and maintaining the regulatory environment we aim to achieve an appropriate balance between facilitating the efficient functioning and continuing development of the securities and futures markets and at the same time providing adequate, but not absolute, protection to investors. In considering what regulations to put in place we also pay close attention to the rules and regulations in other international financial centres to ensure that our regulatory environment is of a similar standard.

In enforcing regulations it is not our aim to identify and prosecute all minor breaches but rather to encourage compliance and good business ethics through the selective sanctioning of malpractices and enforcement action. However, in the most serious cases of abuse or fraud we seek to remove participants from the industry in order to maintain overall market standards and to protect investors.

While we rigorously pursue those who defraud investors we have no legal powers to order an intermediary to pay compensation. However, a separate investor compensation fund exists to compensate investors in cases of broker default and we work closely with this fund to facilitate the processing of relevant claims.

We place considerable emphasis on market monitoring and analysis to detect prohibited trading activities utilising techniques and systems which are some of the most sophisticated in the world. Where insider dealing or other market misconduct is identified we will where appropriate refer cases for prosecution or to the Market Misconduct Tribunal which is an independent tribunal established by the Government and led by a Judge.

We review all applications made by companies seeking a listing on HKEx, to ensure there is full and proper disclosure. For companies that are already listed, we take action against the release of false or misleading information, transactions that harm minority shareholders' interests, or other misconduct involving the companies or their officers. Cases involving fraud are referred to the Police.

Facilitation

We recognise the importance of effective regulation to the success of the financial markets and our role in supporting Hong Kong's continued development as an international financial centre. In the execution of our regulatory functions and in considering market developments and regulatory changes, we therefore aim to achieve a balance between innovation and appropriate levels of investor protection.

In considering the authorisation of new products, and especially structured products, we consider the interest of investors first. However, we also recognise that the provision of additional products can be to the advantage of investors and that it is not our role to create a risk-free market. Innovative investment products are therefore authorised for sale to retail investors provided that the managers and distributors make proper disclosure and have in place sound management and controls.

We also oversee the stock and futures exchanges' introduction of new products, including derivatives, where we are also concerned about the market's ability to handle large volumes, especially in times of volatility. We therefore work with the exchanges to consider the implications of new products for the stability of the market in times of stress and to ensure the adequacy of trading and clearing systems.

Who We Are and What We Do

Each year we have many meetings to help individuals and businesses who want to start business in the financial sector, often in conjunction with other public bodies responsible for attracting investment into Hong Kong.

We actively participate in the international forum of securities regulators, the International Organization of Securities Commissions, which reviews standards and recommends global best practices, to ensure that Hong Kong continues to be recognised as a leading regulator and that we participate in the development of international regulatory standards. We also devote considerable resources to working with the Mainland regulatory authorities. Our efforts here are focused on sharing knowledge with our fellow regulators as well as ensuring that our securities and futures markets are well positioned to participate in the growth being generated by the Mainland economy.

Education

Well-informed and financially literate investors are the first line of defence against fraud and malpractice. We conduct a variety of activities to advise the public of both their rights and responsibilities as investors in the securities and futures markets. We educate investors to allow them to make informed choices especially in the area of new products, structured

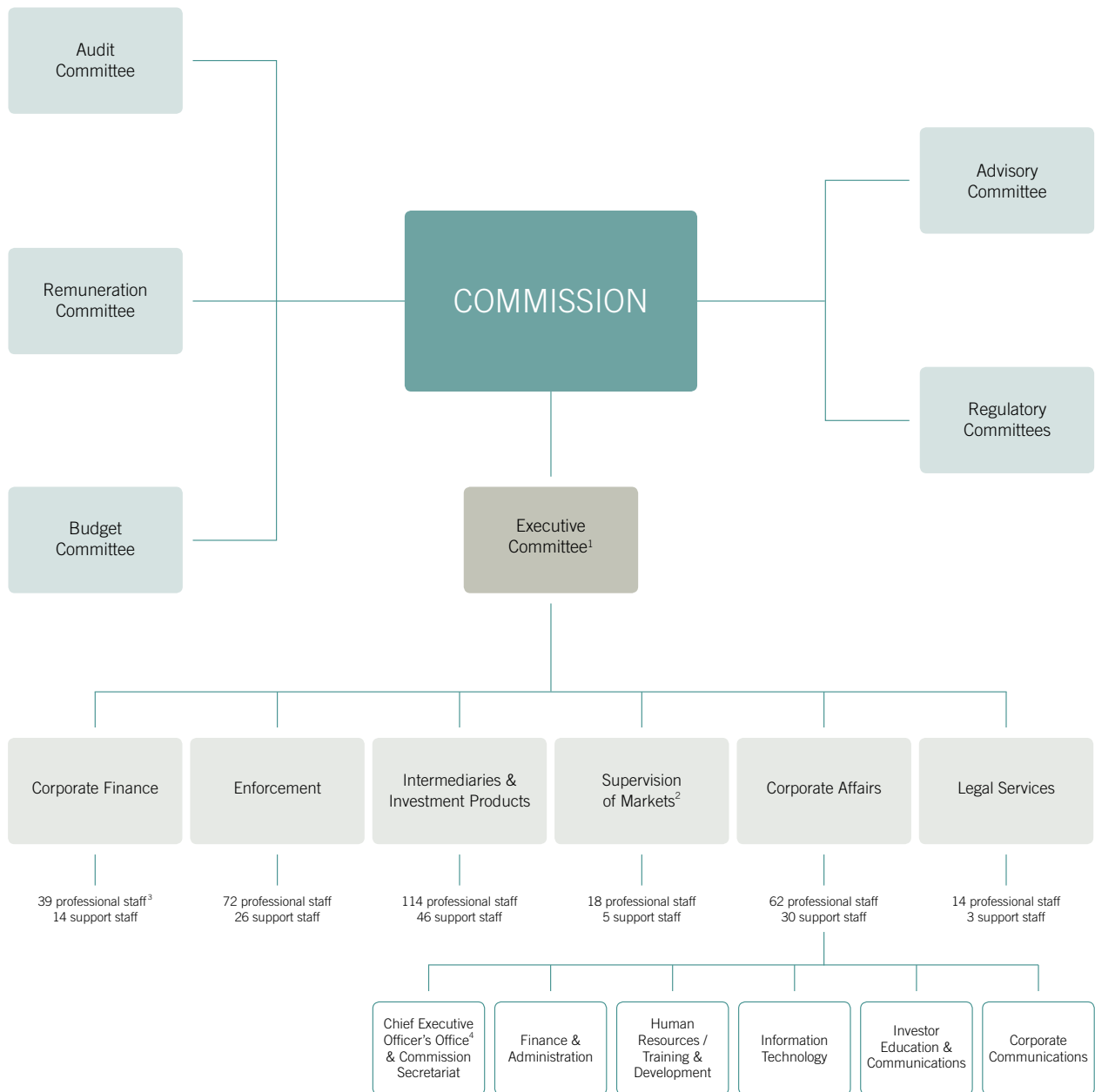
products or areas where potential abuses may occur. We also remind investors of their own responsibility for their investment decisions. In particular they should consider carefully how much risk they can manage and to select investments, from the choices available, that are most suitable for their own risk profile. We also ensure that market participants provide appropriate disclosure of product features and risks when selling to the public thus facilitating informed choices by investors.

Communication with investors is carried out in a variety of formats including our investor website (www.InvestEd.hk), television and radio docudramas, presentations to different sectors of the community, newspaper articles and our own Dr Wise education column. We also collaborate with universities to educate the younger generation regarding responsible investment.

How we are organised

The SFC is divided into four operational divisions: Corporate Finance, Enforcement, Intermediaries and Investment Products, and Supervision of Markets. These operating divisions are supported by the Legal Services and Corporate Affairs divisions. Our structure is outlined on the opposite page.

Who We Are and What We Do



¹ Comprises all Executive Directors and the Chief Counsel, and is chaired by the Chief Executive Officer.

² Including Research Department.

³ Total number of staff was previously split between executive and non-executive grades. For the current year, number of staff has been split between professional and support staff. We believe that the new basis of disclosure provides a more meaningful analysis of our resources. An analysis of total number of staff on these two bases is provided for comparison in footnote 5 under the chapter on Statistical Comparisons.

⁴ Including China Affairs Team.

Directors of the Commission

Under the SFO, there must be no fewer than eight members of the Commission, the majority of which 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 of the Chief Executive. The Commission has a number of statutory functions and also formulates overall policy and strategy. As of 31 March 2007, the Commission consisted of 14 members: the Chairman, seven Non-Executive Directors, and six Executive Directors.

Chairman



Eddy C Fong, SBS, JP

(From 20 October 2006.
Current appointment expires on
19 October 2009.)

SFC: Non-Executive Director (from 1.1.05 to 19.10.06); Certified Public Accountant; Treasurer and Council Member, Open University of Hong Kong; Formerly, partner of PricewaterhouseCoopers; Non-Executive Director, Mandatory Provident Fund Schemes Authority; Non-Executive Director, Exchange Fund Investments Ltd; Non-Executive Director, Hong Kong Mortgage Corporation; Member and Chairman, Finance Committee of the Hong Kong Housing Authority.

Chairs Advisory Committee (from 20.10.06). Member of Remuneration Committee, Process Review Panel for the SFC (from 1.11.06) and SFC (HKEC Listing) Appeals Committee.

Chaired Audit Committee (to 15.1.07) and Investor Compensation Company Ltd (from 8.8.06 to 15.1.07). Member of Futures Compensation Fund Committee (to 26.5.06), Securities Compensation Fund Committee (to 15.1.07), Investor Compensation Fund Committee (to 15.1.07), Takeovers and Mergers Panel (to 19.10.06) and Takeovers Appeal Committee (to 19.10.06).

Non-Executive Directors



Kenneth H W Kwok, BBS, SC

(From 1 January 2005.
Current appointment expires on
31 December 2008.)

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).

Chaired Investor Compensation Company Ltd (from 16.1.07). Member of Audit Committee, Remuneration Committee, SFC (HKEC Listing) Appeals Committee, Securities Compensation Fund Committee (from 16.1.07) and Investor Compensation Fund Committee (from 16.1.07).



Raymond P L Kwok, JP

(From 1 August 1998. Appointment
expired on 31 July 2006.)

Vice Chairman and Managing Director, Sun Hung Kai Properties Ltd; Chairman, SUNeVision Holdings Ltd; Chairman, SmarTone Telecommunications Holdings Ltd; Director, Transport International 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.

Chaired Budget Committee (to 31.7.06). Member of Audit Committee (to 31.7.06), Remuneration Committee (to 31.7.06) and SFC (HKEC Listing) Appeals Committee (to 31.7.06).



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 (2005-2006); 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; Member, Council of the University of Hong Kong; Charter Member, President's Council on International Activities of the Yale University; Chairman, Hong Kong General Chamber of Commerce (2001-2003).

Chairs Budget Committee (from 17.7.06). Member of Remuneration Committee and SFC (HKEC Listing) Appeals Committee.

Directors of the Commission



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; Member, Board of Trustees, California Institute of Technology; Member, Steering Committee on Innovation & Technology; Member, Manpower Development Committee; Council Member, University of Hong Kong.

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



Angelina P L Lee, JP

(From 1 August 2006.
Current appointment expires on
31 July 2008.)

Partner, Woo, Kwan, Lee & Lo; Solicitor; Certified Public Accountant; Non-Executive Director, Mandatory Provident Fund Schemes Authority; Independent Non-Executive Director, Great Eagle Holdings Ltd; Non-Executive Director, Cheung Kong Infrastructure Holdings Ltd; Non-Executive Director, Henderson Land Development Company Ltd; Non-Executive Director, TOM Group Ltd; Chairman, Takeovers Appeal Committee (to 31.7.06); Member, Securities and Futures Appeals Tribunal (2003-2006); Member, Listing Committee, Stock Exchange of Hong Kong Ltd (2000-2006); Member, Standing Committee on Company Law Reform (1991-2003).

Chairs Audit Committee. Member of Budget Committee (from 17.7.06), Remuneration Committee (from 1.8.06), Takeovers and Mergers Panel, Takeovers Appeal Committee (from 1.8.06) and SFC (HKEC Listing) Appeals Committee (from 1.8.06).



The Hon Jasper Y S Tsang, GBS, JP

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

Regular column writer for Ming Pao, Sing Tao Daily and Oriental Daily; Member, Executive Council; Member, Legislative Council; Adviser, Democratic Alliance for the Betterment and Progress of Hong Kong; School Supervisor, Pui Kiu Middle School; Manager, Pui Kiu Primary School; Manager, Pui Kiu College; Board Member, Hong Kong Airport Authority; Member, ICAC Complaints Committee; Member, Disaster Relief Fund Advisory Committee; Member, Chinese People's Political Consultative Conference; Adviser, Tung Wah Group of Hospitals Advisory Board; Adviser, Ryoden Development (China) Ltd.

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



Shengman Zhang

(From 1 January 2007.
Current appointment expires on
31 December 2008.)

Vice Chairman of Global Banking, Chief Operating Officer, Citigroup Corporate and Investment Banking, Asia Pacific; Chairman, Public Sector Group, Citigroup (from 2006); Managing Director, World Bank (1997-2001; 2001-2005); Vice President and Corporate Secretary, World Bank (1995-1997); Executive Director for China, World Bank (1994-1995); various senior positions, The Ministry of Finance, China (1981-1992).

Member of Audit Committee (from 15.1.07), Remuneration Committee (from 1.1.07) and SFC (HKEC Listing) Appeals Committee (from 1.1.07).



Professor Liu Pak Wai, SBS, JP

(From 1 January 2005.
Current appointment expires on
31 December 2008.)

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 of Audit Committee (from 17.7.06), Budget Committee, Remuneration Committee and SFC (HKEC Listing) Appeals Committee.

Directors of the Commission

The Chief Executive Officer leads the executive team. Each of the four operational divisions - Corporate Finance, Enforcement, Intermediaries and Investment Products, and Supervision of Markets - is headed by an Executive Director. The Corporate Affairs Division, which supports the operational divisions, is headed by the Chief Operating Officer.

Executive Directors



Martin Wheatley

Chief Executive Officer

(From 23 June 2006.

Current appointment expires on 30 September 2008.)

SFC: Chairman (from 1.10.05 to 22.6.06) and Executive Director, Supervision of Markets Division (from 6.6.05 to 30.9.05); Member, HKEx Listing Nominating Committee; Deputy Chief Executive, London Stock Exchange (LSE) (2001-2004); Board Member, LSE (1998-2004); Chairman, FTSE International (2000, 2002, 2004); Member, Listing Authority Advisory Committee of the Financial Services Authority of England (2003-2004).

Chairs Executive Committee (from 16.2.07). Member of Budget Committee and SFC (HKEC Listing) Committee (from 23.6.06).

Chaired Advisory Committee (to 19.10.06), Management Committee (to 16.2.07), Futures Compensation Fund Committee (to 26.5.06), Securities Compensation Fund Committee (to 18.9.06) and Investor Compensation Fund Committee (to 18.9.06). Member of SFC (HKEC Listing) Appeals Committee (to 22.6.06).



Peter Au-Yang

Executive Director, Corporate Finance Division and Chief Operating Officer

(From 26 May 2003. Appointment expired 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 (to 25.5.06).

Chaired Investor Education Advisory Committee (to 25.5.06) and Public Shareholders Group (to 25.5.06). Member of Advisory Committee (to 25.5.06), Budget Committee (to 25.5.06) and Management Committee (to 25.5.06).



Brian Ho

Executive Director, Corporate Finance Division

(From 28 August 2006.

Current appointment expires on 27 August 2009.)

SFC: (1992-1994; 1995-present; Senior Director, 2000-2006). Solicitor admitted in Hong Kong in 1988. Member of HKEx Listing Nominating Committee.

Chairs Public Shareholders Group (from 28.8.06). Member of Management Committee (to 16.2.07) and Executive Committee (from 16.2.07).



Paul Kennedy

Executive Director and Chief Operating Officer

(From 16 October 2006.

Current appointment expires on 15 October 2009.)

Chartered Accountant; Certified Public Accountant; KPMG Hong Kong ((1983-2005); Partner 1990-2005); Member, Advisory Committee on Human Resources Development in the Financial Services Sector (from 23.10.06).

Chairs Investor Education Advisory Committee (from 16.10.06). Member of Advisory Committee (from 28.11.06), Budget Committee (from 28.11.06), Management Committee (from 16.10.06 to 16.2.07), Executive Committee (from 16.2.07) and SFC (HKEC Listing) Committee (from 16.10.06). Director of the Investor Compensation Company Ltd (from 17.10.06).

Directors of the Commission



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 Committee on Unit Trusts, Committee on Investment-Linked Assurance and Pooled Retirement Funds, Committee on Real Estate Investment Trusts and Academic and Accreditation Advisory Committee. Member of Advisory Committee, Budget Committee, Management Committee (to 16.2.07), Executive Committee (from 16.2.07), Futures Compensation Fund Committee (to 26.5.06), Securities Compensation Fund Committee, Investor Compensation Fund Committee and SFC (HKEC Listing) Committee.



Keith Lui

Executive Director,
Supervision of Markets
Division

(From 28 August 2006.
Current appointment expires on
27 August 2009.)

SFC: (1991-1994; 1995-present;
Commission Secretary, 2001-2004;
Senior Director, 2002-2006).
Member of HKEx Risk Management
Committee (from 28.8.06).

Chairs Securities Compensation Fund Committee (from 19.9.06) and Investor Compensation Fund Committee (from 19.9.06). Member of Management Committee (to 16.2.07), Executive Committee (from 16.2.07) and SFC (HKEC Listing) Committee. Director of the Investor Compensation Company Ltd.



Mark Steward

Executive Director,
Enforcement Division

(From 25 September 2006.
Current appointment expires on
24 September 2009.)

Deputy Executive Director, Enforcement, Australian Securities and Investments Commission (ASIC) (2004); ASIC, 1991-2006; Solicitor admitted in Australia in 1990.

Member of Management Committee (from 25.9.06 to 16.2.07), Executive Committee (from 16.2.07) and SFC (HKEC Listing) Committee (from 25.9.06).



Alan Linning

Executive Director,
Enforcement Division

(From 1 November 2001. Appointment
ended on 6.6.06.)

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 (to 6.6.06) and SFC (HKEC Listing) Committee (to 6.6.06).

Chairman's Statement



I became the first non-executive Chairman of the SFC on 20 October 2006 and I am very pleased to deliver this, my first, Chairman's Statement in our annual report.

I feel privileged to be chairman of an organisation which was rated by many of the participants, in our Stakeholder Survey last year¹, as the best securities regulator in Asia. At the same time, I also feel a tremendous responsibility, together with my fellow Board members, to ensure that our policies and direction continue to assist the development of Hong Kong as an international financial centre.

The non-executive Chairman position was created in June 2006 through the introduction of the Securities and Futures (Amendment) Ordinance 2006. This Government initiative to separate the executive and non-executive roles is consistent with the SFC's long-held policy of aspiring to the highest standards of corporate governance and leading by example. In this and other areas, we continue to enhance our internal governance and structure to ensure that we are both transparent and effective in the execution of our responsibilities.

The amendment ordinance provides for the separation of the role of the Chairman from the executive arm, which is now headed by the Chief Executive Officer (CEO) who has responsibility for the day-to-day running of the organisation. As Chairman I lead the Board in setting the overall direction, policies and strategy. Since my appointment, I have made efforts to strengthen communication among Board members and have been working to encourage all to fully participate in the affairs of the SFC.

The challenges ahead...

Globalisation has revolutionised the marketplace. The reform of Mainland China's financial market has focused world attention on investment opportunities in this part of the world.

Chairman's Statement

“Our core mission is to provide a regulatory environment that is conducive to both market development and market regulation.”

To maintain its competitive strengths, Hong Kong has to continuously assess its internal and external environment. Two main strength areas that Hong Kong must work on, in which the SFC has a significant role to play, are: first, to capitalise and build on the Mainland connection and on Hong Kong's unique ability to serve as a bridge between the Mainland and the rest of the world; and, second, to reinforce Hong Kong's competitive edge by constantly reviewing and enhancing the quality of the market.

Hong Kong's international characteristics enable it to serve as a bridge between the Mainland and the rest of the world, both in terms of raising capital and raising governance standards for Mainland enterprises. From a different perspective, the Mainland connection makes Hong Kong an attractive platform for international players to invest in the Mainland.

The SFC's role is to put in place world-class standards of regulation that will facilitate market development. The SFC is here not only to set the rules for the securities market and police against malpractices, but also to actively help enhance the market's quality and status. Our core mission is to provide a regulatory environment that is conducive to both market development and market regulation.

We also need to continue to develop closer regulatory co-operation with the Mainland authorities, in particular our counterpart, the China Securities Regulatory Commission (CSRC). We believe that this relationship is sound and gaining in strength, to the benefit of both regulatory bodies, and I was very pleased to have recently signed a side-letter to our memoranda of regulatory co-operation which will enhance our

ability to conduct inquiries into cross-border crime. We will continue to take every opportunity to enhance and strengthen the current levels of co-operation.

...and the opportunities

Earlier this year, the Government published a financial services Action Agenda in its Report on the Economic Summit on “China's 11th Five-Year Plan and the Development of Hong Kong”. The agenda proposes a wide range of projects for the development of the Hong Kong financial services market. The SFC, with others, is actively participating in a number of these initiatives: facilitating the listing of overseas companies; coordinating various issues relating to dual listing of H and A shares; and studying the potential of setting up a commodity futures market in Hong Kong, to name a few².

All these initiatives can only be achieved with the participation of the market as a whole. This is also true for our investor education work, as increasingly complex investment products have made a more elaborate and coordinated effort necessary. In this regard, with support from the other financial regulators, we are proposing to form a new investor education body so that more resources can be devoted to effective investor education.

All in all, it is essential for the SFC as a regulator to find the right balance between investor protection and facilitation of market development. This is possibly the biggest challenge for the SFC over the next few years. I shall work closely with my fellow Directors and other SFC colleagues, the Government, and, of course, our stakeholders in the financial community to ensure that we achieve this balance.

Finally, I would like to thank my fellow Directors and my other SFC colleagues for their contributions and dedication over the past year.

Eddy C Fong
Chairman

¹ See more on the Stakeholder Survey on page 50.

² See more on page 46.

Chief Executive Officer's Statement



The past year has seen unprecedented levels of activity and growth in Hong Kong's securities and futures markets. We have seen the world's largest ever IPO take place in Hong Kong and we have been ranked ahead of New York in terms of capital raised. It has been a busy year for everybody in the market including us as its regulator.

Market overview

In 2006-07, we saw a rise both in the number of new listing applications submitted for our review under the Dual Filing arrangements and also the size and complexity of the proposed offers. Out of the 95 new listing applications submitted in 2006-07, 62% planned to raise more than \$500 million, compared to 42% out of the 86 applications in 2005-06, with the vast majority of applications relating to Mainland based businesses.

The average daily turnover of shares over the past 12 months has increased substantially to \$39 billion per day, 83% higher than the previous 12-month period. Trading in futures and options contracts was also active increasing 71% over the same period. This increase in activity has been accompanied by changes in the mix of trading in particular towards listed warrants and Mainland related stocks. This has required us to consider carefully the focus of our market monitoring activities both from a compliance perspective as well as for matters that might have implications for market stability.

The strong performance of the local market together with the resurgence in interest in Mainland issues was reflected in activity in the retail investment funds industry. 314 products were authorised during the year to 31 March 2007, bringing the total number of SFC-authorized investment products to 2,686. We also authorised 8,235 marketing documents for fund products, 24% more than the previous year.

We also saw a significant rise in the number of structured products and authorised 106 prospectuses of retail structured note issues, with an aggregate issue size of \$10,691 million. The number of offer documents/marketing materials applications for retail equity linked investments also increased significantly - 64% up over the previous year - with an aggregate issue size of \$142,736 million.

Chief Executive Officer's Statement

“We need to constantly improve the efficiency of the market, maintain and improve its integrity and above all take measure to ensure that we promote and maintain investors' confidence.”

The favourable market conditions attracted many newcomers to our market and we have had a steady flow of individuals and corporations seeking licences over the past 12 months. The number of licensees as at 31 March 2007 stood at 28,940, a rise of 13% over the previous year.

The high levels of market activity have been reflected in the financial results of market intermediaries who recorded strong growth in the year to 31 December 2006. Operating income of securities dealers and securities margin financiers increased 69%, as compared to 2005, while profitability jumped 124%. The number of active clients of securities firms also increased, by 12%, with more investors being attracted by favourable market conditions.

Some further details on retail investment funds, SFC licensees and the stockbroking industry are provided for the interest of the reader in the chapter on Activity and Market Data starting on page 104.

What we have done

Our work each year is influenced by developments in the market and also our view of the future changes that may occur and how we, as a regulator, need to respond. This year the big issues which we feel will influence our future remain the same; namely the development of the Mainland's economy, in particular its financial markets, and increasing global competition.

Listings by Mainland enterprises have continued to play a vital and increasingly significant role in the development of the Hong Kong capital market and they presently account for about half of both the market capitalisation and turnover of the Hong Kong stock market. China's continuing financial

market reform poses further opportunities but also significant challenges for Hong Kong. The SFC has therefore been working increasingly closely with the Mainland authorities with a view to facilitating Hong Kong's participation in the overall growth opportunities that the development of Mainland financial markets presents. This will continue to be an area of emphasis for us going forward.

Leading markets such as New York and London have recognised the need to improve their competitive position in order to attract new business, and Hong Kong must recognise and face the challenges that this will present. We need to constantly improve the efficiency of the market, maintain and improve its integrity and above all take measures to ensure that we promote and maintain investors' confidence. We have made progress in a number of these areas and for the coming year will be focusing our attention on increasing the efficiency of our processes and in particular how we interface with market participants. While we will still consider investors' interest first we will also re-examine how we can balance this responsibility with our role in facilitating market development.

Hong Kong's development and growth has not gone unnoticed and there have been a number of articles in the international press ranking Hong Kong as the leading Asian financial market. A recent survey of competitiveness of the major financial markets by the City of London Corporation ranked Hong Kong third in world financial centres behind London and New York. The report on the Global Financial Centres Index concluded that Hong Kong “performs well in all of the key competitiveness areas, especially in regulation” and “is a real contender to become a genuinely global financial centre”. Whilst everybody in the industry will have been delighted by these comments, for us it is tempered by the report's observation that it is most likely to be a change in the regulatory environment that could alter the competitiveness of a financial centre most quickly. We are aware of our responsibility in this area and we are not complacent about the need to continually reappraise what we have done and what we still need to do. We have a number of initiatives in place which are looking at regulatory reform most notably the work which has been ongoing for some years to establish statutory backing for certain parts of the listing rules and we have been considering this change very carefully. However, if we are to maintain our new position in the world order we will need to be prepared to make further changes in order to keep our market attractive to both issuers and investors.

The SFC has made progress over the past year in the three principal areas of our work - Regulate, Facilitate, and Educate.

Chief Executive Officer's Statement

Regulate

With effect from 1 January 2007 we introduced a new sponsor regime, to ensure that only firms and individuals with suitable qualifications can act as sponsors to listing candidates.

We believe that raising the standards of sponsors is key to promoting high standards of corporate governance and behaviour in the Hong Kong market, which in turn is crucial to Hong Kong maintaining its status as a fund raising centre.

Major progress has been made in the exercise to give statutory backing to certain important listing requirements. Together with the Government, we have developed proposals that address concerns previously expressed by market participants that the statutory rules would be too onerous. We will work closely with the Government to introduce a bill to the Legislative Council to give legal effect to these proposals.

During the year we announced the conclusions of a major consultation regarding modernisation of the prospectus regime set out in the Companies Ordinance. This is a part of the ordinance, governing the public offering of securities, that the SFC administers. The proposed reforms include measures which will enhance investor protection and harmonise regulations and we are now moving forward with drafting the necessary legislation to give effect to these proposals.

Our inspection teams identified several cases of misappropriation of client assets at brokerage firms during 2006-07. We took swift action to safeguard clients' interests and to ensure that those responsible faced disciplinary or legal consequences. Several persons have since been jailed following Police prosecution or banned by us from the industry for life. In one case, we were pleased to be able to assist in the negotiation of a white knight deal that restructured a failed brokerage so that clients would have their assets returned in full.

Facilitate

During late 2006 the SFC was a member of the Financial Services Focus Group of the Economic Summit on "China's 11th Five-Year Plan and the Development of Hong Kong". The group submitted a report to the Government outlining 80 action items aimed at addressing the challenges and opportunities arising from this Five-Year Plan. Some of these initiatives have already been implemented, including the adjustment of position limits on futures and options on the H-share index, the launch of Callable Bull/Bear Contracts and the Hang Seng China H-Financials Index futures on the exchange. Others are still being worked on with the SFC leading a number of important initiatives.

Together with Hong Kong Exchanges and Clearing Ltd, we have recently published a policy statement to clarify the listing requirements for overseas companies, and have issued guidance on compliance. This helps broaden the sources of companies able to list in Hong Kong and is part of the Action Agenda of the Economic Summit Report.

We continue to look at ways to facilitate the growth of the market and improve its efficiency. Going forward we propose to devote considerable resources to developing the other initiatives in the Economic Summit Report, in consultation with industry as appropriate. We are currently making good progress in a review of the position limits for Hang Seng Index futures and options contracts, as well as the regulations on short selling.

A landmark event last year, which raised Hong Kong's international status, was the SFC's hosting of the Annual Conference of IOSCO, the International Organization of Securities Commissions. This was the first time that Hong Kong had hosted the event. It attracted over 650 delegates and market practitioners from 135 jurisdictions, making it one of the most well attended IOSCO annual conferences.

Educate

In 2006 we introduced "Before you invest, ask the right questions" as our investor education (IE) theme, and various activities were conducted throughout the year around this. We produced a TV drama series with the Radio Television Hong Kong to explain the features and risks of complex or structured investment products. We also used the radio to advise investors to ask the right questions in different investment activities.

Continuing the success of the 2006 IE theme, we introduced "Know your risk" as the IE theme for 2007. For the first time we have used real life examples we have seen as regulators to create investor education material. In particular a short drama series advising investors on several risk related topics, has been broadcast on Cable TV.

Following the introduction of a new personal finance course at the Chinese University of Hong Kong, the SFC has now collaborated with all the eight local universities to promote the right investment attitude among undergraduates.

At the request of the Financial Secretary we have recently put forward a proposal to form an Investor Education Council. This will be funded from reserves that have accumulated from levy income as a result of the present high levels of stock market turnover. This proposal has received the support of other

Chief Executive Officer's Statement

financial sector regulators and will commit significant resources to providing investor education across the whole of the financial sector. A cross-regulatory working group has now been formed to discuss how to take this initiative forward.

Corporate matters

Corporate Social Responsibility

As a statutory market regulator, the SFC's regulatory objectives are determined by the SFO. As a corporate citizen of Hong Kong we aim to pursue these objectives by following responsible policies and practices that allow us to make a positive impact on society.

To the SFC, corporate social responsibility (CSR) is considered in three main areas: (a) corporate governance; (b) care for employees; and (c) care for society, including our concern for the environment and the people around us. We have long been an advocate of good governance practices and believe that we set a good example in this area. However, in this Annual Report we have for the first time included a dedicated discussion on CSR issues as they relate to us and we are committed to moving forward in all three key areas during the coming year.

As an organisation we are particularly pleased that this year the Hong Kong Council of Social Service has named the SFC a Caring Organisation. The award is in recognition of our work in encouraging and supporting employee volunteering, providing family-friendly work arrangements and staff activities, and assisting social service organisations. However, I would also like to take this opportunity to commend those individuals on our staff who devote their personal time to activities in support of the community.

Finances

The SFC's revenue for 2006-07 has grown 54% from a year ago to \$1,307 million as a result of increased levy income derived from robust market activities. Despite this increase in revenue, we continue to exercise tight budgetary controls. The total expenditure for the year of \$542 million was within budget and we recorded a surplus of \$765 million.

Our budget for 2007-08 does not assume the same level of market activity as 2006-07, and this is reflected in lower budgeted revenue, of \$1,077.8 million, for 2007-08. Total operating expenses are budgeted at \$599.3 million for 2007-08 which includes only a modest increase of six posts in our headcount. While we have experienced significant increases in our workload in recent years we plan to continue to focus

on achieving operational efficiency. However, further increases in our workload are expected as we assume new regulatory functions and other additional responsibilities in the future and this may require headcount increases in future years.

The team

The past year saw changes in our Executive Director management team. Mr Alan Linning, head of Enforcement, and Mr Peter Au-Yang, Chief Operating Officer (COO) and head of Corporate Finance, returned to the private sector in mid-2006. I would like to thank them for their valuable contributions. The Government subsequently appointed Mr Mark Steward as head of Enforcement and Mr Paul Kennedy as COO. They bring to the SFC rich experience in public sector enforcement in Australia and private sector management in Hong Kong and Mainland China. I was also delighted when Mr Brian Ho and Mr Keith Lui, both having many years of SFC service, were appointed Executive Directors to lead the Corporate Finance and Supervision of Markets divisions respectively. We now have a full complement of Executive Directors and I look forward to working with them on the challenges we face.

Much of the work done by our staff may not be immediately apparent to the public. Typically in an active market, like last year, we have to watch trading activities very closely, we have to review more listing and investment product applications as well as licence applications, and we have to ensure the market infrastructure can cope with high volumes and volatility. Meanwhile, we have to constantly remind investors to assess the risks of investments and communicate to the public and the market any regulatory developments. To all my colleagues I offer my sincere thanks for their commitment and hard work during this very busy year.

Martin Wheatley

Chief Executive Officer





Corporate Social Responsibility

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To the SFC, corporate social responsibility (CSR) consists of three main areas: (a) corporate governance; (b) care for employees; and (c) care for society, including our concern for the environment and for the people around us.

Corporate Social Responsibility

We aim to be a good corporate citizen by adopting responsible policies and practices that enable us to make a positive impact on the society in which we operate.

We believe that our role as a regulator, by its very nature, makes a positive contribution to society. However, we try hard to enhance this core contribution by also considering carefully how we carry out our duties and how we interact with the community. Whilst we believe that we already have high standards, we also recognise that improvements are possible and we are committed to doing even better.

We think about our performance on CSR issues in three main areas – Corporate Governance, Care for Employees and Care for Society.

Corporate Governance

To maintain high corporate governance standards, we have laid down a comprehensive and cohesive corporate governance framework by making reference to best governance practices for public bodies such as those set out in “Corporate Governance for Public Bodies – A Basic Framework” published by the Hong Kong Institute of Certified Public Accountants (HKICPA).

Our governance framework comprises a clearly defined governing structure, high conduct standards, sound operational and financial control procedures and vigorous external checks and balances. This framework ensures that we practise the principles of transparency, accountability, fairness, objectivity and integrity in our work.

Our Board (the Commission)

Our highest governance body is the Commission referred to in our name. On appointment by the HKSAR Government,

all Non-Executive Directors (NEDs) and Executive Directors (EDs) are appointed members of the Commission, who are tasked to perform duties set out in the Securities and Futures Ordinance (SFO). Within our governance structure, the terms Commission and Board are synonymous.

The Board leads the organisation in fulfilling our objectives and performing the functions set out in the SFO. The Board provides strategic guidance to senior management and provides independent oversight of executive functions.

The Board has delegated a number of regulatory powers and functions to the EDs, senior staff or committees, while retaining at Board level those functions required to perform an effective oversight role. These functions include those that could have far reaching consequences for the securities and futures markets in Hong Kong and the non-delegable functions set out in the SFO. Equally, EDs are authorised where appropriate to sub-delegate functions to their staff and committees, for the efficient discharge of their duties.

All the members of the Board are appointed by the HKSAR Chief Executive for a fixed term. The SFO requires that the majority of the members of the Board must be independent NEDs. The composition of the NEDs brings to the Board a good mix of experience and expertise and facilitates effective oversight of the executive functions. At the year-end, the Board comprised 14 members: the Chairman, seven NEDs and six EDs.

There have been a number of changes in our Board during the year. In line with good corporate governance practice, the posts of the Chairman and Chief Executive Officer (CEO) were separated by the passage of the Securities and Futures (Amendment) Ordinance 2006. The HKSAR Chief Executive subsequently appointed Mr Eddy Fong as our first non-executive Chairman for a term of three years from

Corporate Social Responsibility

20 October 2006 and appointed Mr Martin Wheatley as our CEO for a term running from 23 June 2006 to 30 September 2008. The separation of these positions has enhanced Board level checks and balances. Under this new governance structure, the non-executive Chairman leads the Board in setting the overall direction, policies and strategy of the SFC and in monitoring the performance of the executive arm. The CEO has the executive responsibility for the day-to-day running of the SFC. He has the duty to implement the objectives set by the Board and to facilitate the effective functioning of the SFC. While the Chairman and the CEO play distinct roles, they discharge their duties in a complementary manner. The respective roles and responsibilities of the Chairman and CEO have been clearly set out and published on the SFC website for the information of our stakeholders.

Two new NEDs were appointed during the year: Mrs Angelina Lee and Mr Shengman Zhang were appointed for a term of two years, from 1 August 2006 and 1 January 2007 respectively. Mr Kenneth Kwok and Professor Liu Pak Wai were re-appointed NEDs for a term of two years from 1 January 2007. There were also four new appointments of EDs: Mr Brian Ho and Mr Keith Lui were appointed for a term of three years from 28 August 2006; while Mr Mark Steward and Mr Paul Kennedy were appointed also for three years from 25 September 2006 and 16 October 2006 respectively. Former EDs, Mr Alan Linning and Mr Peter Au-Yang, left the SFC, and former NED Mr Raymond Kwok stepped down during the year.

The Board meets regularly every month and holds additional meetings as necessary. In addition to the matters requiring Board approval under the SFO, all important policies and decisions are discussed and approved by the Board. Members are also briefed on certain key operational issues and provided with financial statements on a monthly basis. Divisional staff also attend Board meetings as necessary to brief members on specific policy proposals, operational matters and regulatory issues. The Chief Counsel also attends Board meetings to advise on legal issues.

Attendance of Directors at Commission meetings in 2006-07

Number of meetings	18	
Attendance of individual Directors		
Eddy C Fong ¹	15	83%
Martin Wheatley	17	94%
Peter Au-Yang ²	2	100%
Brian Ho ³	8	100%
Paul Kennedy ⁴	6	100%
Alexa Lam	16	89%
Alan Linning ⁵	1	25%
Keith Lui ⁶	8	100%
Mark Steward ⁷	7	100%
Christopher W C Cheng	13	72%
Kenneth H W Kwok	11	61%
Raymond P L Kwok ⁸	5	63%
Angelina Lee ⁹	8	89%
York Liao	13	72%
Liu Pak Wai	15	83%
Jasper Y S Tsang	14	78%
Shengman Zhang ¹⁰	4	100%
Average attendance of meetings	80%	

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.

¹ Membership from 20.10.06

² Membership until 25.5.06

³ Membership from 28.8.06

⁴ Membership from 16.10.06

⁵ Membership until 6.6.06

⁶ Membership from 28.8.06

⁷ Membership from 25.9.06

⁸ Membership until 31.7.06

⁹ Membership from 1.8.06

¹⁰ Membership from 1.1.07

Board members have separate and independent access to senior management and divisional staff for any additional information they feel that they require about any policy proposal. They also have access to the Commission Secretary, who is responsible for ensuring the procedures of the SFC are complied with. Board members and the Board committees may also seek independent professional advice, at the expense of the SFC, should they consider this necessary.

Board members receive timely and adequate information to enable them to consider issues to be discussed at Board meetings. Minutes of the Board meetings are kept in safe custody by the Commission Secretary, and are open for inspection by Board members.

Corporate Social Responsibility

All newly appointed Board members receive briefings on the work of the SFC and are provided with relevant SFC documents including a copy of the Code of Conduct, which sets out the legal obligations and the SFC's requirements on confidentiality, conflict of interests and personal investment. The most important statutory obligations are those relating to the preservation of secrecy and avoidance of conflict of interests. All Board members are required to disclose their investment portfolio upon appointment and to report any subsequent changes.

NEDs bring an independent and informed perspective to matters discussed and deliberated at the Board and play an important role in ensuring that the Board is accountable and transparent. NEDs also chair and participate in various statutory committees established by the Board which each have written terms of reference. All Board committees circulate their minutes and report important issues to the Board regularly.

Internal committees

The **Audit Committee** comprises only NEDs. Mrs Angelina Lee is the Chairman. Senior personnel including the Chief Operating Officer and the Director of Finance and Administration are invited to attend meetings where necessary.

Attendance of Directors at Audit Committee meetings in 2006-07

Number of meetings	4	
<i>Attendance of individual Directors</i>		
Eddy C Fong (Chairman) ¹	3	100%
Angelina Lee (Chairman) ²	3	100%
Kenneth H W Kwok (Deputy Chairman) ³	4	100%
Raymond P L Kwok (Deputy Chairman) ⁴	1	100%
Liu Pak Wai ⁵	3	100%
Shengman Zhang ⁶	N/A	N/A
Average attendance of meetings	100%	

¹ Membership until 15.1.07

² Appointed as Chairman on 15.1.07

³ Appointed as Deputy Chairman on 17.7.06

⁴ Membership until 31.7.06

⁵ Membership from 17.7.06

⁶ Membership from 15.1.07

The Audit Committee holds meetings on a quarterly basis. It reviews the annual financial statements before their submission to the Board for approval and recommends the appointment of external auditors for the Board's approval. It considers the scope and planning of the external audit, reviews any audit findings set out in the external auditors' management letters and monitors the implementation of agreed improvements.

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

All non-audit services conducted by external auditors are considered critically by the Audit Committee, which considers each engagement on a merit basis. To ensure independence and objectivity of the annual audit, different external auditors are appointed to perform the annual internal control review of the SFC.

During the year, we paid KPMG, our external auditor, \$275,000 for audit-related services and \$2,800,000 for non-audit related activity involving circularisation of client accounts of selected brokers.

KPMG was also engaged as the external auditor of compensation funds which are directly or indirectly under the supervision of the SFC as required by the law. In total, they paid KPMG \$206,000 for annual audits and half-yearly interim reviews.

Apart from performing audit-related and internal control functions, the Audit Committee also plays an important role in the handling of complaints against SFC staff, cases of staff grievances, public interest grievances, and complaints of discrimination. If a case involves staff at ED level, the Audit Committee will normally handle the case itself. For other cases, a quarterly report is made to the Audit Committee providing information on the complaints or grievances raised and decisions taken. We are pleased to report that we did not have any substantiated cases during the past year.

Corporate Social Responsibility

The **Remuneration Committee** comprises only NEDs. Dr York Liao is the Chairman. Senior staff including EDs are invited to attend the meetings where necessary to brief the committee members on matters under consideration.

Attendance of Directors at Remuneration Committee meetings in 2006-07

Number of meetings	3	
Attendance of individual Directors		
York Liao (Chairman)	3	100%
Christopher W C Cheng (Deputy Chairman)	3	67%
Eddy C Fong	2	67%
Kenneth H W Kwok	2	67%
Raymond P L Kwok ¹	0	0%
Angelina Lee ²	2	100%
Liu Pak Wai	2	67%
Jasper Y S Tsang	2	67%
Shengman Zhang ³	1	100%
Average attendance of meetings	76%	

¹ Membership until 31.7.06

² Membership from 1.8.06

³ Membership from 1.1.07

The goal of our remuneration policy is to ensure that overall remuneration levels, including benefits, are effective in attracting, retaining and motivating appropriate levels of competent staff such that we can effectively execute our statutory responsibilities. The Remuneration Committee reviews policy on both the structure and level of staff remuneration and makes recommendations to the Board. It reviews reports on trends in salary and benefits and recommends to the Board any periodic adjustment. It is also consulted on the appointment of EDs and makes recommendations to the Government on appropriate remuneration levels.

The HKSAR Chief Executive (or the Financial Secretary under delegated authority) determines the remuneration packages of EDs, taking into consideration recommendations by the Remuneration Committee. Details of the EDs' remuneration on an individual named basis are set out on page 67. The EDs' remuneration packages comprise annual fixed pay and performance-related variable pay. The Chairman and NEDs receive a fixed sum honorarium every year.

The **Budget Committee** comprises both NEDs and EDs.

NED Mr Christopher Cheng is the Chairman. It examines and approves the parameters and basis used in the preparation of the annual budget, which will then be submitted to the Board for approval. It reviews performance against the approved annual budget half-yearly and makes recommendation to the Board regarding any revisions or actions that may be required.

Attendance of Directors at Budget Committee meetings in 2006-07

Number of meetings	1	
Attendance of individual Directors		
Christopher W C Cheng (Chairman) ¹	1	100%
Raymond P L Kwok (Chairman) ²	N/A	N/A
Liu Pak Wai (Deputy Chairman) ³	1	100%
Peter Au-Yang ⁴	N/A	N/A
Paul Kennedy ⁵	1	100%
Alexa Lam	1	100%
Angelina Lee ⁶	1	100%
Martin Wheatley	1	100%
Average attendance of meetings	100%	

¹ Appointed as Chairman on 17.7.06

² Membership until 31.7.06

³ Appointed as Deputy Chairman on 17.7.06

⁴ Membership until 25.5.06

⁵ Membership from 28.11.06

⁶ Membership from 1.8.06

The **Executive Committee** comprises all EDs and the Chief Counsel. Mr Martin Wheatley, CEO, is the Chairman. This committee was formed during the year, with Board approval, to enhance the efficiency and effectiveness of the executive decision-making process. It performs administrative, financial and management functions as delegated by the Board and considers policy issues for recommendation to the Board. The Executive Committee also coordinates and oversees the exercise of functions that have been delegated to individual EDs. The Management Committee, which previously performed certain administrative, financial and management functions, was absorbed into the new Executive Committee. Minutes of the Executive Committee are provided to the Board on a regular basis.

Corporate Social Responsibility

Conduct standards

The SFC requires the highest standards of integrity and conduct from its staff and is conscious of the role this has in promoting and maintaining public confidence in the SFC. Our requirements and the relevant legal obligations in respect of confidentiality, conflict of interests and personal investment etc are set out in our Code of Conduct which all staff must formally acknowledge. Disciplinary action is considered against any staff who do not comply with the Code. In addition to disciplinary action, the staff concerned may be subject to penalties specified by law.

We encourage open communications within the SFC and seek to handle grievances and complaints in an efficient and open manner. We have established standard procedures for handling grievances concerning the employment of individual employees, grievances concerning the public interest and complaints in relation to equal employment opportunities. We have published the procedures for public interest grievances on our website to assist those who believe that they have discovered improper practices or misconduct relating to the running of the SFC or work-related activities of SFC employees, to report these to the SFC in a constructive and confidential manner. The procedures enable the following persons to report confidentially: any person who has an employment contract with the SFC, is on secondment to the SFC, is engaged as an independent consultant by the SFC or is a contractor or supplier of services to the SFC.

We take seriously any dissatisfaction regarding the way in which SFC staff have carried out or failed to carry out their duties. The Procedures for Handling Complaints against SFC 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 in making such complaints.

Accountability, transparency and internal control

We strive to act firmly, fairly and in a transparent and accountable manner in exercising our powers and carrying out our duties. To achieve this aim, individual divisions and departments of the SFC follow established procedures and guidelines in making decisions and taking actions.

To ensure proper use and management of financial resources, we have established detailed policies and procedures for

financial control. The financial control procedures set out levels of authority and delegation of functions for administration, financial and management functions. Matters such as the appointment of consultants, collection of fees, investment, and purchasing or disposal of fixed assets etc are all clearly set out in the financial control procedures.

We have certain statutory obligations in terms of financial control and reporting such as keeping proper accounts and records of transactions. We are also required by law to prepare financial statements to give a true and fair view of the state of affairs of the SFC as at the end of the financial year and of the results of its operations and cash flows in the financial year. These financial statements are subject to an annual independent audit, approved by the Board and signed by the Chairman and the CEO. Each year, the revised and proposed budgets are submitted to the Financial Secretary for approval and laid before the Legislative Council after consideration by the Board. The Director of Audit may also examine any books, accounts, vouchers, records or documents that we keep.

We are committed to open communication with our stakeholders and the public. We discuss our operations and activities through our Quarterly Reports which are published voluntarily, Annual Report, press conferences and other publications. We also maintain a user-friendly website to provide the public with comprehensive and updated information about us including contact details for enquiries and complaints. Last year, we conducted the second periodic survey to obtain the views of our stakeholders about our work, our effectiveness as a regulator, and the areas where we should apply more focus. The results of this survey were communicated to the public through a press release and are available on our website.

We have the power to make rules under various provisions of the SFO. It is a statutory requirement that we consult the public on any rule changes and subsequently publish a document setting out in general terms the public's representations on the draft rules, our response to the representations, and details of any major modifications to the draft rules. Although we are only required to consult the public on rule changes, we consistently exceed statutory requirements by also consulting on proposed non-statutory codes and guidelines, and amendments to them.

We have appointed an external audit firm, PricewaterhouseCoopers, to conduct annual internal control reviews for us. The focus

Corporate Social Responsibility

of this review is approved annually by the Audit Committee and forms part of the SFC's overall annual internal control review programme.

The purpose of the internal control review is to assess whether the systems of internal control as set out in the various SFC's manuals are adhered to, to evaluate the adequacy of the controls in place, 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.

We have an internal contingency plan to deal with emergency situations that may affect the SFC's operations, such as fire, flooding and other natural or man-made disasters. The plan details the contingency measures for all operational and support functions in recovering and resuming their business during and after any emergency.

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

Independent checks and balances

The SFC is subject to various external checks and balances designed to ensure fairness and observance of due process, and to prevent misuse of regulatory powers.

The Process Review Panel (PRP) for the SFC is an independent, non-statutory panel, established by the HKSAR Chief Executive in November 2000, to review and advise upon the adequacy of the SFC's internal procedures governing the operational decisions and actions. The SFC is the first securities regulator in the world to introduce such an external review system of its internal operations. The PRP has the power to review files of any completed or discontinued cases to verify that we have followed the procedures that govern our operational decisions and actions. The PRP currently comprises 10 members, including eight members from the financial sector, academia and the legal and accountancy professions, and two ex-officio members, the representative of the Secretary for Justice and the Chairman of the SFC. In July 2006, the PRP published its annual report on its 2005 review. It concluded that, in general, the SFC had been

adhering to established internal procedures in its decisions and actions. In 2006, the PRP reviewed 40 completed cases. These cases covered: licensing and inspection of intermediaries, authorisation of collective investment schemes, handling of complaints, and enforcement actions including settlement and fining.

A wide range of the regulatory decisions of the SFC are subject to a full merits review by the Securities and Futures Appeals Tribunal (SFAT), which is chaired by a High Court judge and comprises two other members appointed by the Secretary for Financial Services and the Treasury. The SFAT has the power to call new evidence, stay any of the proceedings in the review, confirm, vary or set aside SFC decisions. There were 10 applications for review lodged with the SFAT during the year: one was determined, four were withdrawn and five are in progress. In addition, 11 cases were carried forward from 2005-06, of which three were determined, five were withdrawn and three are in progress.

The Independent Commission Against Corruption (ICAC) has conducted periodic corruption prevention reviews on the procedures and practices of the SFC since 1990. The ICAC conducted a review on the work of the Licensing Department in 2006 with no adverse findings.

Members of the public can complain to the Ombudsman against the SFC regarding the actions taken by the SFC and its staff in the discharge of their functions and powers. During the year, there were eight complaints. The Ombudsman found six of the cases not substantiated and is still dealing with the remaining two cases.

Anyone who is dissatisfied with the SFC's performance of its functions may take civil action in the Courts, by either applying for judicial review of the SFC's decisions or seeking remedies. There were two applications for judicial review against the SFC last year. The applicant in one of the cases was not granted leave by the court to proceed with the judicial review. The applicant's subsequent appeal to the Court of Appeal was dismissed. The other case of judicial review is in progress.

Although, the SFC is an independent regulatory body, it reports regularly and furnishes information to the Financial Secretary, the Secretary for Financial Services and the Treasury, and the Financial Services and the Treasury Bureau regarding important regulatory or market issues. We are also required to consult the Financial Secretary before exercising certain powers.

Corporate Social Responsibility

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 our pledges last year.

Performance pledges			% of cases meeting the pledge in 2006-07
Investor enquiries			
■ Preliminary response to telephone enquiries	4 business days		100%
■ Preliminary response to written enquiries	2 weeks		100%
General enquiries			
■ Preliminary response to enquiries via enquiry@sfc.hk	4 business days		99.7% ¹
Public complaints			
■ Preliminary response to verbal & written complaints	2 weeks		99.8% ²
Processing of licensing applications ³			
■ Representatives (provisional licence)	7 business days		90%
■ Representatives (normal licence)	8 weeks		65% ⁴
■ Representatives (responsible officers)	10 weeks		90%
■ Corporations	15 weeks		97%
■ Transfer of accreditation	7 business days		87%
Modification/waiver and subordinated loan applications			
■ Acknowledgement of receipt upon receiving any application	2 business days		100%
Investment products authorisation			
■ Take-up of applications upon receipt	2 business days		100%
■ Preliminary response to applicants after take-up for unit trusts, mutual funds, investment-linked assurance schemes and Mandatory Provident Fund pooled investment funds	7 business days		100%
■ Preliminary response to applications after take-up for other schemes	14 business days		100%

¹ Some cases failed to meet the pledge due to the exceptionally heavy workload when the enquiries were received.

² Two cases failed to meet the pledge due to its complexity. More time was needed to collect information to facilitate assessment.

³ Performance pledges only applied to cases where the applicants had supplied all the required documentation in their applications and satisfied all regulatory requirements.

⁴ The percentage has fallen (87% in 2005-06) due to the high staff turnover, additional work load (13% increase in the number of licensees compared to the year before) and having had to divert resources to process corporate applications. Nevertheless, the majority of the applications were approved within one to two weeks after the pledge.

Care for Employees

The SFC considers its staff its greatest asset and treating them well is fundamental to the development of our organisation. We aim to be an employer of choice by providing appropriate and comprehensive remuneration and benefits, personal development opportunities, a healthy and safe environment and a family-friendly workplace. We are pleased to have been able to adopt a five-day week this year which has considerably improved the overall working circumstances of our staff.

As at 31 March 2007, there were 443 staff (2005-06: 441), comprising 402 permanent and 41 temporary staff. At the end of March 2007, 197 (44%) of our staff held professional qualifications. We also employed 69 undergraduates from local and overseas universities as part time interns for periods of several weeks each.

Corporate Social Responsibility

During the year, our overall staff turnover remained lower than comparable indicators in the financial sector and decreased slightly from last year, from 12.5% to 11.8%. However, the turnover at some middle management grades was relatively higher and is an issue which has been receiving attention in order that this does not impact our overall performance.

We are heavily dependent on recruiting and retaining skilled and dedicated people in fulfilling our role as a regulator and we ensure that our remuneration packages are competitive by benchmarking against market data and other relevant organisations. The structure of our remuneration packages is designed to provide clear incentives for good performance. Accordingly, with increasing seniority increasing amounts of an individual's pay are based on performance. We have also increased the transparency of our remuneration structure this year by explaining clearly to staff how pay rises and bonus payments are determined.

We offer our staff and their families comprehensive insurance on medical, dental, group life, disability and travel. We take precautions for outbreaks of societal communicable diseases and offer vaccination programmes at special rates to staff. We also provide retirement benefit schemes for all of our staff.



Colleagues from the Information Technology Department experienced the importance of team work in a team building workshop.

To ensure that our staff are informed of the SFC's latest developments, goals and priorities, a number of our senior executives have held briefing sessions with staff at various levels. We also conduct staff opinion surveys to understand staff needs and concerns and also to encourage suggestions for improvement. We have established a Staff Social Committee to strengthen communication and working relationships among staff and to provide another channel for communication with senior management.

To facilitate personal development of staff, we sponsor training and study programmes, both locally and overseas, and also professional examinations. We are accredited as an Approved Employer of the Association of Chartered Certified Accountants in recognition of our training and development opportunities. We are also an Authorised Employer of the HKICPA meaning that HKICPA's registered students can acquire qualifying experience from us for their membership admission.

We organised 435 training programmes for our staff during 2006-07 covering industry topics, management skills, language training and information technology. The average training time per employee was 6.21 man-days. We utilise both our own senior staff and outside experts and practitioners to provide industry-related training to staff. During the year, we engaged professional training consultants to organise workshops on a variety of topics including: fixed income, structured products, IT security and control, advocacy skills and testifying in court.

Last year, we introduced a three-tier Structured Management Programme to cater for the development needs of our staff. This programme covers management skills catering for staff at different levels of seniority on topics such as: people management, negotiating and influencing, presentation and public speaking. The programme will run annually and allow all relevant staff to participate.

Corporate Social Responsibility

We try to contribute to the well-being of our staff through different social and sports activities for staff and their families. These activities include staff lunches and dinners, barbeques, and sports activities like Baduanjin classes, table tennis, badminton and bowling. Last year, our basketball team was runner-up in the Supervisory Cup Basketball Competition 2006 played against other regulatory bodies. We also had a friendly football match with the Monetary Authority of Singapore in the city state. Staff also receive a subsidy to organise recreational activities within their work groups to foster team spirit. Where, on occasion, a member of staff suffers from serious stress, emotional difficulties, interpersonal relationship, marriage, parenting, or mental health issues, a confidential external counselling service is available to the member of staff and their family.

Care for Society

For the environment

We aim to adopt environment-friendly practices in our offices and operations and encourage our staff to contribute to a greener and cleaner environment.

Energy saving light bulbs and low-voltage tubes are used to reduce consumption and offices are visited after office hours to switch off unnecessary lighting and equipment. Our policy of allowing staff to dress smart-casual enables us to avoid unnecessary air conditioning while keeping the room

temperature at a comfortable level. To improve the working environment, we regularly inspect and clean the air-conditioning system, while ceiling-mounted air cleaners are installed in the office to improve air quality. Flow-restricting faucets are used in pantries and washrooms to avoid water wastage. We are also very conscious of our paper usage and regularly remind staff to use fewer paper cups and towels and to recycle paper where practical. We recycle waste paper, envelopes, carton boxes and newspapers. Confidential documents are also collected in sealed boxes for recycling. Wherever possible we use emails and intranet for communication and adopt e-filing and e-faxing to use less paper. With effect from 1 April 2007, we buy our writing paper manufactured from well-managed forests run by the Forest Stewardship Council. By improving the presentation of information in this year's annual report, the number of pages has been reduced by more than 20%. The report is also printed on recycled paper.

As part of our commitment to improvement we have recently reviewed our environmental policies and are developing high level statements on our environmental commitments. During 2007-08, a task force will formulate policies and programmes to improve our environment-friendly practices and to benchmark our practices against applicable standards.

For the people around us

We aim to contribute to the well-being of the community in which we operate and encourage staff to actively support voluntary activities.

Corporate Social Responsibility

The SFC has been named a Caring Organisation by the Hong Kong Council of Social Service for its achievements in encouraging and supporting employee volunteering, providing family-friendly work arrangements and staff activities, and assisting social service organisations. While as a public body we do not make corporate donations, we do encourage staff to donate directly to charitable organisations especially in times of natural disasters, and facilitate this by centrally coordinating collective donations.

We provide administrative assistance for activities organised by the Community Chest, and participate in the Hong Kong Red Cross blood donation campaign. The SFC is also a corporate partner of the Tung Wah Group of Hospitals on joint community projects.

To support equal access to the Internet, our corporate website has a text-only version for visually impaired people who use text recognition software. We have been given the Gold Award in the e-Inclusion Campaign (formerly known as Web Care Campaign) of the Internet Professional Association since 2005 for our efforts in promoting a barrier-free Internet environment. We also donated more than 50 used computers last year to a social organisation which distributes computers to children who cannot afford their own.



The “Commission Possible Volunteers Group”, which was formed in 2004 by staff members on a voluntary basis, organised three events in 2006-07 providing over 400 man-hours of voluntary work that reached 150 underprivileged children and elderly. Some staff also serve the Civil Aid Service, act as mentors for university students, or act as adjudicators in educational contests organised by charitable or non-governmental organisations.

Our goal is to continuously look for opportunities to strengthen and deepen our involvement in voluntary community activities. We are considering a number of initiatives for 2007-08 where we as an employer can facilitate our staff’s involvement and contribution to our society in addition to the work that they perform on a daily basis.



Residents of the Enhanced Home and Community Care Services received gifts from an SFC volunteer dressed up as Santa Claus.

Achievements and Work in Progress

We are pleased to present a summary of our achievements during the year and the major initiatives that are in progress. Items in achievements marked # were included as work in progress in our last annual report and have been progressed over the past 12 months.

Regulation

Achievements in 2006-07

- Introduced eligibility criteria and ongoing requirements to raise standards for sponsors and compliance advisers #
- Published consultation conclusions informing the market of the latest approach to giving statutory backing to certain listing rules #
- Implemented measures to strengthen the regulation of derivative warrants #
- Advanced proposals to reform the prospectus regime #
- Revised the rules on securities margin financing to address risks arising from the pooling and re-pledging of clients' collateral #
- Reviewed and reported on Hong Kong Exchanges and Clearing Ltd's (HKEx) performance in its regulation of listing matters
- Uncovered three cases of misappropriation by brokers and took prompt action to protect their clients' interests
- Implemented a three-pronged action plan to minimise broker misappropriation
- Jointly inspected with the US Securities and Exchange Commission (SEC) hedge fund managers in Hong Kong that were also registered with the SEC
- Concluded 664 enforcement cases, 509 of them within one year of the commencement of the cases
- Six cases referred to the Insider Dealing Tribunal (IDT) following SFC investigations were concluded
- Successfully prosecuted 51 entities, including the first case for breaching the SFO's secrecy provisions
- Disciplined 80 licensees or their management, including banning a record 18 licensees, a case on sponsor failure, the first action with Hong Kong Monetary Authority on unlicensed activities, and concluded disciplinary action with an investment adviser which agreed to make record ex-gratia payments, funded by its holding company, to investors
- Obtained for the first time a bankruptcy order against a person who failed to pay costs awarded to the SFC
- Exchanged side-letters with the China Securities Regulatory Commission (CSRC) to strengthen cross-border enforcement
- Introduced a time recording system and other measures to enhance the efficiency of the investigation process

Work in Progress

- Work with the Government on proposed legislative amendments to give statutory backing to certain listing rules
- Implement further proposals to strengthen the regulation of derivative warrants
- Work with the Government on legislative amendments to implement the prospectus regime reform
- Monitor compensation payments to clients of brokers who defaulted last year
- Consider regulatory responses to address concerns about product mis-selling
- Continue the investigation of the 181 cases and 115 disciplinary proceedings carried forward as at 31 March 2007

Achievements and Work in Progress

Facilitation

Achievements in 2006-07

- Implemented initiatives under the Economic Summit Report: adjusted the position limits of H-shares index futures and options, facilitated the launch of Callable Bull/Bear Contracts (CBBCs) # and Hang Seng China H-Financials Index futures contract, and facilitated the listing of overseas companies
- Facilitated the first simultaneous offering of A shares and H shares of a company in Shanghai and Hong Kong
- Approved the rules to abolish the listing requirement for companies to publish paid advertisements in newspapers
- Approved rules to enhance the Stock Segregated Account services
- Authorised innovative products including the first open-ended China A-share fund, the first commodities futures index exchange traded fund, the first REIT with exposure to Grade A offices in Central and the first hotel REIT in Hong Kong #
- Streamlined the application process of Undertakings for Collective Investment in Transferable Securities III funds with special features
- Released findings of a survey on the hedge funds industry in Hong Kong which showed that the aggregate assets managed by licensed hedge fund managers and advisers had grown 268% over a two-year period
- Renewed fidelity insurance scheme offering additional investor protection for clients of stock and futures exchanges participants
- Successfully hosted the International Organization of Securities Commissions (IOSCO) Annual Conference 2006
- Received awards for disclosure and governance for the Annual Report 2005-06
- Reduced transaction levies on securities and futures trading by 20%

Work in Progress

- Review other initiatives recommended in the Economic Summit Report including position limit adjustments for HSI futures and options contracts, transfer of HKEx trading rights, the possibility of setting up a commodity futures market in Hong Kong and the introduction of more Mainland related products
- Implement proposals to simplify the disclosure requirements of interests in listed securities
- Review the advertising guidelines and authorisation process of marketing materials for retail funds
- Review and streamline the licensing process to discharge our functions more efficiently and effectively

Education

Achievements in 2006-07

- Produced two new TV dramas and one radio series as part of the 2006 investor education (IE) campaign to remind investors to ask the right questions before investing #
- Conducted three investor surveys on stock investing, dealing with investment advisers and investing in structured products #
- Expanded IE to all local universities
- Introduced IE theme 2007: "Know your risk"
- A record 10,130 people attended our seminars throughout the year
- Answered 5,944 investor enquiries and handled 1,056 complaints

Work in Progress

- Publish a new series of IE publications
- Enrich the content and improve the navigation of the InvestEd website
- Take forward a proposal to form a new body providing IE across the whole of the financial sector

Statistical Comparisons

The following table shows certain key market data and statistics related to the work of the SFC in the past three years. Figures in brackets are changes from the preceding year. More statistics of the SFC's activities are provided in the chapter on Activity and Market Data starting on page 104.

	2006-07	2005-06	2004-05
Market activities and transactions			
Number of listed companies on the Stock Exchange Main Board	983 (+5%)	940 (+5%)	891
Market capitalisation (\$ billion)	13,442.2 (+44%)	9,331.8 (+43%)	6,506.1
Average daily market turnover (\$ billion)	39.2 (+83%)	21.3 (+38%)	15.5
Total number of listing applications reviewed under the Dual Filing regime	95 (+10%)	86 (-30%)	122
Total number of takeovers and share repurchases transactions handled	284 (-4%)¹	295 (+18%)	251
Total NAV of all compensation funds (\$ million)	1,794 (+4%)²	1,726 (+15%)	1,506 (+17%)
Licensees and investment products			
Applications for SFC licences	6,628 (+16%)	5,704 (+16%)	4,915
Applications to conduct new regulated activity	17,553 (+27%)	13,809 (+12%)	12,275
Total number of SFC licensees	28,940 (+13%)	25,691 (+13%)	22,726
Total number of SFC-authorized schemes	2,686 (+1%)	2,667 (+4%)	2,553
NAV of authorised unit trusts and mutual funds (US\$ billion) [#]	910 (+36%)	668 (+21%)	551

Statistical Comparisons

	2006-07	2005-06	2004-05
Enforcement action			
Total number of cases handled	1,068 (+5%)³	1,018 (-3%)	1,047
Entities successfully prosecuted	51 (-29%)⁴	72 (-5%)	76
Unsuccessful prosecutions	3 (+200%)	1 (-83%)	6
Disciplinary inquiries conducted	211 (+2%)	206 (-1%)	209
Actions against licensees	80 (-18%)⁴	98 (+11%)	88
Reaching out			
Press releases issued	264 (-5%)	279 (-3%)	289
Total average daily hit rate of corporate and InvestEd websites	537,186 (+30%)	414,099 (+8%)	385,154
Investor enquiries	5,944 (+24%)	4,811 (+6%)	4,523
Public complaints	1,056 (-3%)	1,091 (-10%)	1,214
Consultation papers issued	0 (-100%)	5 (-44%)	9
Consultation conclusions issued	6 (-25%)	8 (+60%)	5
Codes and guidelines issued	6 (+100%)	3 (0%)	3
Finances and staff			
Income (\$ million)	1,307.2 (+54%)	851.5 (+36%)	625.4
Expenses including depreciation (\$ million)	541.9 (+9%)	496.9 (+9%)	456.3
Number of staff ⁵	443 (+0.5%)	441 (+2.3%)	431

[#] Net Asset Value (NAV) as at 31 December 2006, 2005 and 2004.

¹ Including 36 general and partial offers, eight privatisations, 23 whitewash waivers, two off-market and general offer repurchases, and 215 other applications.

² The figure includes Investor Compensation Fund and Unified Exchange Compensation Fund only as Commodity Exchange Compensation Fund was wound up in May 2006.

³ The figure includes 620 new cases and 448 carried forward as at year-end.

⁴ The number of actions has reduced, reflecting a shift in focus towards the more serious malpractice and complex investigations confronting us.

⁵ The basis of disclosure of staff numbers has changed this year. Previously the disclosure provided was approved permanent staff regardless of whether the position was filled and excluding temporary positions. This year number of staff refers to the actual number of employees as at 31 March 2007. An analysis of total number of staff on these two bases is provided for comparison in this year of change:

	31 March 2007		31 March 2006	
	Actual	Approved	Actual	Approved
Professional	319	332	317	324
Support	124	87	124	89
	443	419	441	413
Executive	266	306	254	299
Non-executive	177	113	187	114
	443	419	441	413

Significant Events

2006

May

2 An investment adviser severely reprimanded for mis-selling offered record payments to thousands of investors.

14 Broadcast an SFC-RTHK TV drama series "Investment Challenge" to enhance public understanding of the features and risks of various investment products.

26 Issued a restriction notice on Whole Win Securities Ltd to protect the interests of its clients. Two more brokers defaulted in July and August following misappropriation of client assets.

June

5-8 Hosted the IOSCO Annual Conference in Hong Kong for the first time. The event, opened by the Hon Rafael S Y Hui, Acting Chief Executive of HKSAR (below), attracted over 650 participants from 135 jurisdictions.



12 Launch of CBBCs on the stock exchange.

16 Authorisation of the first open-ended China A-share fund in Hong Kong.

27 A licensed corporation refrained from acting as sponsor for nine months and its responsible officer undertook not to act as supervisor of any sponsorship mandate for six months over sponsor failures.

July

4 Broadcast an SFC-MetroFinance radio series "Learn More About Investing" to help investors ask the right questions before investing.

14 The Financial Secretary appointed Mrs Angelina Lee as SFC NED for two years, effective from 1 August 2006.

August

25 The Financial Secretary appointed Mr Brian Ho as SFC ED of Corporate Finance and Mr Keith Lui as SFC ED of Supervision of Markets, both for three years, effective from 28 August 2006; and Mr Mark Steward as SFC ED of Enforcement for three years, effective from 25 September 2006.

September

22 Announced the way forward for the possible reforms of the prospectus regime.

October

1 New rules to address risks arising from securities margin financing came into effect.

3 The Financial Secretary appointed Mr Paul Kennedy as SFC ED, Chief Operating Officer for three years, effective from 16 October 2006.

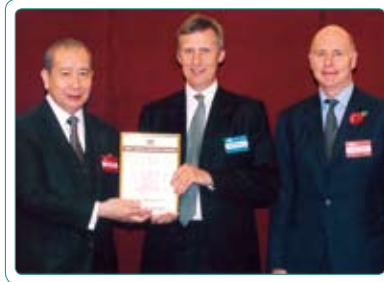
18 Released the findings of a survey on the hedge funds industry in Hong Kong which showed that the aggregate assets under management had grown 268% over a two-year period.

20 The HKSAR Chief Executive appointed Mr Eddy Fong as SFC Chairman for three years, effective from 20 October 2006.

Significant Events

November

6 The SFC's Annual Report 2005-06 won top awards for disclosure and governance in the 2006 Hong Kong Management Association Best Annual Reports Awards. SFC CEO Mr Martin Wheatley (middle) received the award from Dr David K P Li, the Association's Chairman (left) and Mr Howard Gorges, Chairman of the Panel of Adjudicators. The report was also a winner in the HKICPA Best Corporate Governance Disclosure Awards 2006.



7 Facilitated a restructuring package for Whole Win Securities Ltd so that clients would have their assets returned in full.

28 Mr Eddy Fong (left) made his first visit as SFC Chairman to the CSRC in Beijing and met its Chairman, Mr Shang Fulin.



December

1 Reduction of the transaction levy by 20%.

22 The Financial Secretary appointed Mr Shengman Zhang, and re-appointed Mr Kenneth Kwok and Professor Liu Pak Wai as SFC NEDs for two years, effective from 1 January 2007.

2007

January

1 The new sponsor regime took effect.

18 Unveiled investor education theme for 2007: "Know Your Risk".

22 SFC-RTHK TV drama "Wising up with Experience" started screening on Cable TV.

February

28 Announced proposed amendments to give statutory backing to certain listing rules.

March

30 Exchanged side-letters to the existing memoranda of co-operation with the CSRC in Beijing to enhance cross-border enforcement.

Listing of Regal REIT, the first hotel REIT in Hong Kong.



We Regulate

In carrying out our regulatory responsibilities we adopt a philosophy of considering the interest of investors first. However, in establishing and maintaining the regulatory environment we aim to achieve an appropriate balance between facilitating the efficient functioning and continuing development of the securities and futures markets and at the same time providing adequate, but not absolute, protection to investors.

Last year, we

- introduced a new sponsor regime
- published consultation conclusions informing the market of the latest approach to giving statutory backing to certain listing rules
- implemented measures to strengthen the regulation of derivative warrants
- revised the rules on securities margin financing
- successfully prosecuted 51 firms and persons and disciplined 80 licensees or their management
- concluded disciplinary action with an investment adviser which agreed to make record ex-gratia payments to investors

Regulation

Of each of our primary roles, Regulation, Facilitation and Education it is the first which is our core responsibility and which occupies the majority of our time and effort. As with any regulator, much of our time is spent on day-to-day monitoring, supervising and enforcing activities. However, we are also conscious of the need to constantly review the application of the existing regulatory regime to ensure that it continues to be appropriate for the market which we regulate. In order to do this we work closely with the industry, Mainland authorities and overseas regulators to keep ourselves abreast of regulatory and enforcement issues and international best practices.

From time to time market developments require us to make changes to regulations and changes are also made where opportunities are identified to improve the existing regulatory regime. Where this involves changes in the legislation we need to work with the Government and legislature in order to ensure the passage of new laws. However, there are also occasions where we are able to enhance the regulatory regime by modifying codes and guidelines alone. In these circumstances we will usually conduct a public consultation before implementing any changes.

In considering any changes to rules and regulations we always consider the needs of investors first. However, we also try to put in place rules and regulations that are conducive to market development. We also try to encourage compliance with regulations through selective enforcement action. This is intended to demonstrate to the market that the small proportion of participants who do not conduct their activities appropriately will not profit from their behaviour. We also try and assist market participants comply with regulations by issuing guidance to them through circulars, Frequently Asked Questions (FAQs) and other means.

We are pleased to highlight below some of the major initiatives and actions taken last year in strengthening our regulatory regime.

Market standards

To enhance the quality of listing, we introduced eligibility criteria and ongoing **requirements for sponsors/compliance advisers** under a new sponsor regime, which became effective on 1 January 2007. Under this new regime, firms have to demonstrate that they have appropriate levels of expertise and meet other eligibility requirements, in order to be confirmed as sponsors, or they will have a licensing condition imposed restricting them from acting as sponsors. As at 31 March 2007, 190 out of the 267 relevant intermediaries had such restrictions imposed; most of these firms had been inactive or had not previously acted as sponsors and indicated to us they did not wish to act as sponsors. The majority of those who wished to continue to act as sponsors have been confirmed although we are still assessing a small number of applications.

For some years there has been a debate concerning how to provide **statutory backing** to certain listing rules relating to the responsibilities of companies listed in Hong Kong. These rules are currently included in a contractual agreement between Hong Kong Exchanges and Clearing Ltd (HKEx) and listed companies, but they have no basis in Hong Kong law. As a result of this, HKEx does not have full investigative powers with which to examine breaches of the Listing Rules. It also lacks a broad range of disciplinary responses to deal with breaches when they occur. In order to provide protection for shareholders, it is necessary that both of these deficiencies are addressed. Within the current structure, the SFC is also unable to properly investigate potential breaches or take action in the event of non-compliance by listed companies with reporting and disclosure obligations under the Listing Rules. This is because the breaches would only be of the Listing Rules which are effectively breaches of a contract with HKEx, and they would not be breaches of the SFO where the SFC can use its investigatory powers.

Regulation

On 28 February 2007 we published consultation conclusions on proposed amendments to the Securities and Futures (Stock Market Listing) Rules which would give statutory backing to certain of these listing rules. These rules cover the following three areas: periodic financial reporting by listed companies; disclosure of price sensitive information by listed companies; and shareholders' approval for certain notifiable transactions and connected transactions.

Since then we have been working closely with the Government and HKEx to produce detailed instructions which can be turned into legislation.



We will work closely with the Government to introduce a bill to the Legislative Council to give legal effect to certain listing rules.

Under the **Dual Filing regime**, listing applications and listed company announcements are filed with and reviewed by both HKEx and the SFC to ensure disclosure quality. The SFC raised comments on 58 out of the 95 listing applications received during the year within, on average, seven working days. Of these 58 applications, 22 were listed, 10 were rejected/withdrawn or lapsed, and 26 remained active as at 31 March 2007. We informed the industry of a number of major issues identified by our reviews including: failure to present key information relating to the prospects and sustainability of the business in a fair and accurate manner; deficient disclosure of the relationship between the applicant and its key business partners; and insufficient due diligence by sponsors in relation to the prospectuses.

In March 2006 we proposed measures under a Six-point Plan to enhance the regulation of the **derivative warrants** market in Hong Kong. Rule changes, which facilitated further and identical warrant issues and banned commission rebates and other incentive schemes offered by issuers, came into effect on 30 September 2006. New marketing guidelines also came into effect on 1 October 2006. We are continuing to work with HKEx and the market on proposals to tighten liquidity provider provisions and require the use of plain language and summaries in offering documents.

Real Estate Investment Trusts (REITs) became more common during the year with three more REITs being listed. To clarify the potential risks of REITs with special features, we introduced further disclosure requirements for offering circulars to ensure upfront and prominent disclosure of these risks using simple language.

For the past few years the SFC has taken measures to modernise the regulatory regime in the Companies Ordinance (CO) governing the public offering of shares and debentures. On 22 September 2006, we published consultation conclusions with proposals on the way forward for the third and final phase of the **prospectus regime reform**. Key proposals to be pursued included: harmonisation in the regulation of financial products with similar risk and reward exposure; enhancement of investor protection by extending the scope of the prospectus liability regime to offerors, and requiring publication of supplemental prospectus and granting investors withdrawal rights under certain circumstances; and incorporation by reference to make the production of prospectus less costly and more environment- and reader-friendly. We will work with the Government on the proposed legislative amendments to the CO and SFO and will further consult the market when appropriate.

The Takeovers Executive, comprising SFC staff, administers all **takeover** transactions relating to public companies under the Codes on Takeovers and Mergers and Share Repurchases. We comment on takeovers announcements and documents, give rulings and interpretations under the Codes. The takeovers' market in Hong Kong remained very active during the past year with the Takeovers Executive handling a total of 284 transactions. We also commenced a review of various issues that arise under the Codes concerning stock borrowing and lending and hope to consult the market in this regard later this year.

Regulation

We worked with the Federation of Share Registrars, the Hong Kong Monetary Authority (HKMA), and the Hong Kong Association of Banks to introduce a new measure, effective from 2 April 2007, to deter **multiple applications** for initial public offerings (IPO). We will continue to work with the industry to identify ways to improve the operation and the integrity of the IPO application process.

Amendments to the financial resources and other related rules, to provide better protection for investors against the pooling risks arising from **securities margin financing**, came into effect on 1 October 2006. There is now a re-pledging limit to cap the maximum amount of client securities collateral that securities margin finance providers can re-pledge to secure their borrowings.

To assist market participants understand our policy requirements and any regulatory changes, we maintain close dialogue and provide assistance with compliance issues. We have also published **circulars and FAQs** on various subjects, including the new sponsor regime, securities margin financing, interpretation of the REIT Code, anti-money laundering and combat of terrorist financing, information security measures for on-line trading, and licensing matters. We also gave talks to members of the Hong Kong Securities Institute and other industry bodies on issues such as preventing misappropriation of client assets and new requirements on securities margin financing. The public and industry are also made aware of matters where we have taken enforcement actions through our monthly publication Enforcement Reporter and other regulatory matters through the bi-monthly newsletter SFC Alert. We also met with compliance officers from the industry in February 2007 to discuss various regulatory and compliance issues.

The SFC has a statutory role to supervise, monitor and regulate the **activities of HKEx** as operator of the stock market and we conduct an annual review of the performance of HKEx in its regulation of listing matters. Our report is made public, after review by the Financial Secretary and is also available on the SFC website. During the year, we reviewed HKEx's procedures in certain key listing-related areas and concluded that the procedures examined were adequate to enable it to discharge its statutory obligation to maintain an orderly, informed and fair

market. However, we also made a number of recommendations to HKEx regarding the transparency of its policies and practices in certain areas. HKEx has already committed to taking appropriate steps to address the majority of the points raised and is considering the remaining issues.

We closely monitor the risks associated with the securities and futures markets. To ensure that we are well prepared for market-wide contingency events, we have put in place a **market contingency plan** which details procedures for dealing with emergency situations that may affect our markets. Last year, we participated in a market-wide contingency rehearsal coordinated by the Financial Services and the Treasury Bureau.

Regulatory actions

We monitor the activities of the market and intermediaries closely to combat misconduct that jeopardises the interests of investors. We will take firm regulatory actions including disciplinary or legal proceedings against the parties concerned.

We continue to adopt a risk-based approach to the supervision of intermediaries and to encourage licensed corporations to maintain and raise their own standards. One of our key supervisory tools is on-site inspections; routine inspections are



One of our key tools in our risk-based approach to the supervision of intermediaries is on-site inspection.

Regulation

conducted to assess the general compliance of a firm; theme inspections are held on selected samples of firms with similar activities; and special inspections are targeted at specific firms considered to pose serious or immediate risks to their clients or the market. These inspections also help us identify trends and gaps for policy consideration.

We inspected 136 licensed corporations (65 routine inspections and 71 theme/special inspections) during the year and noted 391 rules breaches where licensed corporations were required to take rectification measures (see further details in Table 6 in the Activity and Market Data chapter). Apart from that, we conducted 154 prudential visits and meetings with management of licensed corporations to discuss the concerns identified and to obtain the latest information about their business operations for our ongoing monitoring purposes. Our inspections and monitoring work found 23 serious breaches which we recommended for investigation and possible disciplinary action.

Among the **theme inspections** conducted this year was a second round of inspections on selected licensed corporations engaged in financial planning and wealth management activities. In reviewing their selling practices and regulatory compliance, we identified deficiencies such as inadequate client and product due diligence and lack of justification of suitability of advice. To address issues concerning the standards of investment advisers, we have issued a set of FAQs for their guidance. The SFC will also continue to take enforcement action against those who committed serious breaches of their obligations.

We conducted a joint inspection with the US Securities and Exchange Commission (SEC) on selected licensed **hedge fund managers** that were also registered with the SEC. The firms inspected were of varying sizes but mainly holding long/short equities with limited use of derivatives and leverage. Both regulators were concerned about the finding that there was inadequate disclosure made of side-letter arrangements, whereby certain investors of a hedge fund are

provided with information and terms that differ from those offered to the majority of the fund's investors, and the extent to which these arrangements might confer material benefits on preferred investors.

During the inspections of brokers last year, we uncovered three cases of **misappropriation of client assets** at Whole Win Securities Ltd, Tiffit Securities (Hong Kong) Ltd and Wing Yip Company Ltd. The total amounts involved were about \$16 million, \$55 million and \$13 million respectively. All three brokers were also found to have failed the financial resources requirements.

In all three cases, we took prompt and decisive action to prohibit those brokers from carrying on business and handling client assets and their own properties. We secured the appointment of administrators by the Court to take control of the firms and worked closely with the administrators to enable the efficient and orderly return of client assets. We also referred these cases to the Police for further investigation.

On Whole Win, we facilitated an agreement between the administrator and a Hong Kong businessman to fund a rescue package which restructured the brokerage so that clients would have their assets returned in full. The process of returning assets to clients was continuing as at 31 March 2007.

In the case of Tiffit, we obtained a prohibition order under which Tiffit's majority shareholder and responsible officer was required to refrain from leaving Hong Kong in order to facilitate the administrators carrying out their duties. We also obtained a Mareva injunction against the majority shareholder and his wife to freeze their assets and banned the majority shareholder from the industry for life. In February 2007, we petitioned for the winding up of Tiffit and secured the appointment of provisional liquidators to preserve the interests of Tiffit's clients.

In Wing Yip's case, the majority shareholder and responsible officer was sentenced to 40 months' imprisonment on 14 December 2006 for theft and false accounting. We

Regulation

also banned him from the industry for life. Wing Yip's administrators had returned \$105 million worth of securities to clients by end of March 2007.

We have adopted a three-pronged approach to minimise broker fraud and enhance the protection of client assets held by brokers: first, the continuance of rigorous supervision of brokers to assess their risks and financial positions including, the circularisation of a sample of clients' account balances of selected brokers with the assistance of an audit firm; second, launch of investor education highlighting misappropriation risks; and third, discussion with the Hong Kong Institute of Certified Public Accountants (HKICPA) on how to make more effective use of circularisation of client accounts during annual audits. We have also referred two cases of possible negligence by the auditors of broker firms to the HKICPA and spoken at seminars for their members on securities regulations and audit requirements for licensed corporations.

The SFO provides compensation arrangements to investors who sustain a loss as a result of insolvency, bankruptcy or winding up, breach of trust, defalcation, fraud or misfeasance of an intermediary. The **Investor Compensation Company Ltd** (ICC) administers an investor compensation fund for this purpose. Claims have been received from clients of both Tiffit and Wing Yip and are currently being assessed. As at 31 March 2007, 133 clients of Tiffit had received \$3.36 million from the fund. The SFC will continue to work closely with the ICC on processing the outstanding claims arising from the above cases.

Enforcement actions

During the year, we continued 448 inquiries or investigations from 2005-06 and opened 620 new ones. We have highlighted in this section some of the most noteworthy cases and issues, and have provided key statistics in the Activity and Market Data chapter.

We employ leading edge software to closely monitor day-to-day trading in the securities and futures markets and identify **unusual price and turnover movements**. This system was upgraded last year to provide enhanced search and analysis features to handle the increasing market turnover. We also search the Internet to detect possible unlicensed dealing, unauthorised advertising of investment services, and other illegal or deceptive financial activities.



We actively monitor media reports and liaise regularly with HKEx on corporate disclosure matters.

During the year, we conducted 191 inquiries into untoward share price and volume movements, 62 cases were investigated further.

We conducted 20 inquiries into suspicious activities in the **derivative warrants** market, including possible false trading, improper fixing of the settlement price during the expiry process, non-compliance with the liquidity provider obligations and illegal short selling. Three cases are under investigation.

During the year, SFC staff gave expert evidence before the Courts or Insider Dealing Tribunal (IDT) on six occasions and assisted in investigations by other law enforcement agencies.

Last year we handled 26 investigations concerning listed companies. We are particularly concerned with cases that raise issues of suspected poor **corporate governance and behaviour**. A significant case that remains under investigation concerns the collapse of Ocean Grand Holdings Ltd and Ocean Grand Chemicals Holdings Ltd. We commenced an inquiry into the affairs of the companies in July 2006 to establish if their business had been conducted for any fraudulent or unlawful purpose. We are liaising closely with the Commercial Crime Bureau (CCB) in its investigations and have also raised this case with our Mainland counterparts.

The SFC has commenced proceedings in the High Court against five former directors of GP NanoTechnology Group Ltd (in liquidation), seeking orders to disqualify them from being directors of or involved in the management of companies. The five persons are alleged to have failed to exercise reasonable skill, care and diligence, and act in the

Regulation

best interests of the company. This was the second time an action was taken under SFO section 214 to seek remedies in case of unfair prejudice to the interest of members of listed companies. The first action was against a former director of Riverhill Holdings Ltd who faced similar allegations – the SFC is continuing its preparation for a hearing on this case, expected in mid-2007.

The SFO provides parallel civil and criminal regimes to combat **market misconduct**. A Market Misconduct Tribunal (MMT) has been set up to handle civil cases on six types of market misconduct. These are insider dealing, market manipulation, false trading, price rigging and the dissemination of false or misleading information about securities or futures contracts. During the year, we referred four cases to the Financial Secretary for his consideration of instituting proceedings before the MMT. The cases are currently under review by the Department of Justice.

The Insider Dealing Tribunal (IDT), which will be replaced by the MMT once its cases are completed, concluded six cases in 2006-07. A total of 17 persons were found to be insider dealers in four of the cases and penalties ordered (see Table 7 in Activity and Market Data), while no one was found to be an insider dealer in the remaining two cases. In 2006-07, we continued to investigate 15 cases of suspected insider dealing and opened 14 new ones.

Prosecutions

In 2006-07, we successfully prosecuted 51 entities, of which four were prosecuted for more than one offence. We offered no evidence against three entities and there were three acquittals after trial. We have provided an analysis of the prosecutions conducted in the section below. More details including the penalties imposed are given in the Activity and Market Data chapter.

- **Market manipulation** undermines the integrity of the market and is a serious offence. We successfully prosecuted two people for manipulating the shares of SIS International Holdings Ltd and VST Holdings, respectively.
- Making unsolicited calls that pressure members of the public to open trading accounts, or to make hasty and often risky investment decisions, is prohibited by the SFO. During the year, seven people were prosecuted for **cold calling**.
- We prosecuted 13 individuals and four companies for carrying on or aiding and abetting the carrying on of

different types of **unlicensed activities**. In addition, four entities were convicted of issuing to the public advertisements or invitations, to acquire an interest in securities or in a collective investment scheme, which had not been authorised by the SFC.

- We also looked into cases of late filing of **disclosure of substantial interests** in listed companies. Minor failures and first time offenders are usually warned with no further action. In 2006-07, HKEx referred 5,176 late filings cases to us, of which 18 were followed by further investigation. We prosecuted six people and seven companies, and issued 96 warnings.
- Anyone attending an interview at the SFC, or providing answers in response to a requirement imposed by an investigator, is under a statutory duty to give complete, accurate and truthful answers. Failure to do so without reasonable excuse is a criminal offence. In 2006-07, five people were convicted of either failing to fulfil this statutory obligation or **misleading the SFC**.
- The SFO prohibits the sale of securities when a person does not have a presently exercisable and unconditional right to sell them. During the year, six people were prosecuted for **short selling**.
- This year, for the first time, we prosecuted a person for **breach of the secrecy provisions** under the SFO. That person disclosed to other people details of an interview with the SFC regarding an investigation. All SFC investigations, inquiries and inspections, are conducted in secret in order to keep confidential the identity of the persons under investigation and to protect the integrity of the SFC's regulatory functions.

Disciplinary actions

Intermediaries must be honest, competent, efficient and financially sound. A person who has committed an offence, such as those mentioned in the previous section, is liable to prosecution in the courts. A licensee who breaches a non-statutory requirement such as a conduct code provision is on the other hand subject to our disciplinary proceedings which may result in administrative penalties. We take tough disciplinary action against those whose misconduct causes loss or damage to the investing public.

In 2006-07, we took action against 80 licensees or their management. We took no further action in disciplinary

Regulation

proceedings commenced against six licensees. Penalty levels have been kept consistent with those in the previous three years, after we raised them in 2003 on the commencement of the SFO. In total, we banned a record 18 licensees, some for life for serious misconduct. We suspended 34 licensees for up to three years and accepted three voluntary undertakings not to conduct certain activities.

Some significant actions were taken during the year against sponsor failure, mis-selling by investment advisers, misappropriation by licensed persons, and lack of internal controls of licensed corporation.

During the year, following a joint action with HKEx, Deloitte & Touche Corporate Finance Ltd refrained from acting as a **sponsor** for nine months for failing to discharge its responsibilities as a sponsor in a listing application. Its responsible officer refrained from acting as a supervisor of sponsorship mandates for six months for failing to adequately supervise his subordinates. We currently have a further three significant actions against sponsors in progress, all of which we hope to conclude in the coming year.

Mis-selling continues to be a problem in the industry. During the year, we concluded our largest case to date involving an investment adviser over allegations of mis-selling of funds and concerns about the sale of geared products. The investment adviser, UKFP (Asia) HK Ltd (formerly Towry Law (Asia) HK Ltd), had decided to cease its activities in Hong Kong, limiting the regulatory options that were available to us. Nevertheless, we successfully negotiated a settlement with UKFP (Asia), to make record ex-gratia payments, funded by its holding company, to thousands of affected investors.

The SFC revokes the licences of persons who misappropriate client assets and bans them from the industry for life. Lax **internal controls** and management's failure to supervise staff properly often make misappropriation of clients' assets possible. We are pursuing disciplinary action against a number of companies with lax controls or inadequate management supervision. We aim to conclude these cases in the coming year and send a deterrent message to intermediaries to ensure that they have sufficient internal controls.

We co-operated with HKMA, in the first such joint action, in disciplining Wing Lung Futures Ltd and related parties for unlicensed dealing and aiding and abetting unlicensed dealing. We imposed a suspension of six months, public reprimands, a prohibition order for eight months, and a fine of \$900,000.

More details on the most significant disciplinary actions during the year are given in the Activity and Market Data chapter.

Securities and Futures Appeals Tribunal

The Securities and Futures Appeals Tribunal (SFAT) is a full-time review body established to ensure that regulatory decisions made by the SFC are reasonable and fair.

During the year, the SFAT dismissed four applications and confirmed the SFC's decisions in these cases.

In one dismissed case, the applicant argued that the SFC was under an obligation to "warn" or "caution" him as to his status as a person under investigation in a disciplinary matter. The SFAT held that there was no privilege against self-incrimination in disciplinary proceedings, and a caution about such proceedings to an interviewee would not serve any legal purpose. The SFAT also held that the SFC was entitled to use the records of prior interviews with the applicant as evidence against him in subsequent disciplinary proceedings.

In another two dismissed cases, the SFAT indicated that usually it would only interfere with the SFC's decision when it was plainly wrong. The SFAT also warned that appellants making unmeritorious appeals would run the risk of costs awarded against them being assessed on a higher than normal basis.

The SFAT also upheld the SFC's decision to refuse a licence application by an individual who had been convicted of using a forged identity card.

In September 2006, the Court of Appeal upheld the decision of the SFAT that affirmed the SFC's decision to suspend a former licensed **investment adviser** for giving unsuitable advice to a client. The Court ruled that it was not sufficient for him to merely talk a client through all the relevant documentation, but that he had to make clear to his client the full picture of the

Regulation

investment, including the downside risks of the product, by showing an individualised example of possible loss scenarios. The Court's judgement in this case is a landmark ruling on the duties of investment advisers.

In November 2006 the SFC obtained, for the first time, a **bankruptcy order** against a former licensed person who failed to pay costs awarded by the SFAT following an unsuccessful appeal against an SFC decision. This was followed a month later by another case in which the SFC obtained a bankruptcy order against a person who failed to pay costs awarded to the SFC as a result of an unsuccessful civil action. The SFC recovered indemnity costs from another person involved in the same action.

Enforcement co-operation with other regulators

We continue to maintain close contact with other Hong Kong law enforcement agencies, our Mainland counterpart, the China Securities Regulatory Commission (CSRC), and overseas regulatory organisations, such as the SEC, in order to combat international financial crime and misconduct. During the year, we provided assistance to a number of overseas regulators concerning enforcement or licensing-related matters and also requested assistance from them on some occasions (see Table 16 in Activity and Market Data for details).

During the year, we referred 13 cases to the Police and three cases to the Independent Commission Against Corruption (ICAC) for further action. We worked closely with the Police particularly in relation to misappropriation of client assets. In February 2007, three former staff of the now liquidated Lawsons Securities Company were sentenced to imprisonment for between 14 and 17 months in a case which was originally uncovered by the SFC and referred to the CCB.

In 2004, we referred a case to the ICAC relating to a former licensee who we banned from the industry for life for stealing clients' securities. On 10 February 2006, that person pleaded guilty to nine counts of theft and one count of conspiracy to pervert the course of public justice and received a custodial

sentence. His solicitor was also convicted of perverting the course of justice by instructing one of her clients to withdraw complaints relating to the licensee's misconduct made to the Police and the SFC, and was also sent to jail.

The Mainland's Securities Law was amended last year to give the CSRC wider investigatory powers to gather evidence on behalf of non-Mainland regulatory authorities, including the SFC. On 30 March 2007, the SFC and the CSRC signed and exchanged side-letters to the Memorandum of Regulatory Co-operation and the Memorandum of Regulatory Co-operation Concerning Futures. Under this arrangement, the SFC may request assistance from CSRC in obtaining information in the Mainland for SFC investigations.



CSRC Chairman Mr Shang Fulin (left) and SFC Chairman Mr Eddy Fong signed the side-letters in Beijing, accompanied by senior officials from the two agencies.





We Facilitate

We recognise the importance of effective regulation to the success of the financial markets and our role in supporting Hong Kong's continued development as an international financial centre. In the execution of our regulatory functions and in considering market developments and regulatory changes, we therefore aim to achieve a balance between innovation and appropriate levels of investor protection.

Last year, we

- implemented initiatives under the Economic Summit Report: adjusted the position limits of H-shares index futures and options, facilitated the launch of CBBCs and Hang Seng China H-Financials Index futures contract, and facilitated the listing of overseas companies and the transfer of HKEx trading rights
- facilitated the first simultaneous offering of A shares and H shares of a company in Shanghai and Hong Kong
- authorised new funds, ETFs, the first REIT in Grade A Central offices, and the first hotel REIT
- successfully hosted the IOSCO Annual Conference 2006
- reduced transaction levies on securities and futures trading by 20%

Facilitation

While we are conscious of our primary role as a market regulator we also recognise our important role in facilitating market development. As financial markets become more global and competition increases we believe that our facilitation role has become increasingly important. Hong Kong has achieved much in recent years and has achieved recognition for its position as an international financial centre (IFC). However, we still remain some way behind the largest IFCs and the pace of change in financial markets, most importantly in the Mainland, means that we cannot afford to be complacent. We need to work increasingly hard, together with others involved in the financial services market, to ensure that we retain and improve the attractiveness of Hong Kong's financial market. This has required, and will continue to require, us to work closely with industry and Mainland and overseas regulators to ensure that we keep abreast of emerging issues which could have an impact on the attractiveness of our market. Facilitation has been a focus for us over the last year and will be an area of increased effort and focus for us going forward.

During late 2006 the SFC was an active participant in an important facilitation project, initiated by the HKSAR Government, as a member of the Financial Services Focus Group of the **Economic Summit** on "China's 11th Five-Year Plan and the Development of Hong Kong". In January 2007 the group submitted a report to the Government outlining



HKSAR Chief Executive the Hon Donald Tsang presented the Economic Summit Report in January 2007.

80 action items aimed at addressing the challenges and opportunities arising from this Five-Year Plan. Some of these initiatives have already been implemented and are reported in the sections that follow. Others are still being worked on with the SFC leading the effort on a number of important initiatives.

Our role as the regulator of **Hong Kong Exchanges and Clearing Ltd** (HKEx) requires us to balance our regulatory oversight responsibility, including protecting investors' interests, with our shared goal of ensuring the success of Hong Kong's securities and future markets. Over the years we have developed an effective and appropriate relationship with HKEx, which is proving increasingly productive. Last year this resulted in numerous initiatives, described in the sections below, where we have either approved HKEx initiatives or, increasingly, worked together with HKEx on the matter under consideration.

We respond to the needs of the market and facilitate the launch of new investment products to the market. We also meet with prospective issuers of new products, professionals such as valuers, accountants etc to keep abreast of new developments in the market.

We are pleased to set out below a detailed summary of the facilitation activities and results we have seen during the past year.

Listed companies and the stock exchange

We worked together with HKEx, the China Securities Regulatory Commission (CSRC) and the Shanghai Stock Exchange in a coordinated effort to facilitate the first simultaneous offering of A shares and H shares in Shanghai and Hong Kong. This was also the world's largest public offering.

During the year, the SFC and HKEx jointly issued a policy statement to clarify the Listing Rules requirement governing the **listing of overseas companies** as recommended in the Economic Summit Report. We have provided a clear roadmap to assist overseas companies to deal with shareholder protection matters when seeking a listing in Hong Kong.

Facilitation

To enable faster disclosures by listed companies and investors' access to information, we worked closely with HKEx to abolish the Main Board requirement for companies to publish **paid announcements** in newspapers. The new information dissemination regime, which will commence on 25 June 2007, will pave way for the development of real time electronic disclosure during trading hours and the elimination of unnecessary suspensions.

Together with HKEx, we also granted listed property developers a conditional **waiver** from the Listing Rules requirement to obtain shareholders' approval for acquiring land or property development projects in Hong Kong from the Government or Government-controlled entities through public auctions or tenders. The waiver provides temporary relief pending Listing Rules amendments.

To facilitate and promote better flow of information to the market, we worked with HKEx on clarification to the market, by way of an announcement, that on the Main Board, reporting accountants are only required to review and report on profit forecasts that are included in listing documents, or documents issued in connection with a notifiable or connected transaction.

We are working on the proposals to simplify the **disclosure requirements** of interests in listed securities to make the regime more user-friendly while still preserving market transparency.

In March 2007, we approved HKEx's launch of **Hang Seng China H-Financials Index** (HFI) futures contract. HFI tracks the performance of Mainland financial stocks listed in Hong Kong.

We worked closely with HKEx to facilitate the launch, in June 2006, of Callable Bull/Bear Contracts (**CBBCs**). The number of stocks that are eligible as underlying asset has since been expanded to 28 from the initial five stocks with the highest turnover.

To meet market needs and promote growth in the futures and options markets, we adjusted the **position limits** of Hang Seng China Enterprises Index (H-shares index) futures and options contracts. The limit changed from 6,000 contracts per futures contract month/options contracts series to an aggregate delta limit of 12,000 applicable to all futures contract months/options series. We are now reviewing the position limits of HSI futures and options contracts and will shortly consult the market regarding proposed changes. These adjustments were

initiatives included in the Economic Summit Report and we are also studying further recommendations relating to contracts limits and reportable positions.

In July 2006, we approved HKEx's rule amendments on the reduction of **minimum trading spreads** for shares trading between \$2 and \$20 to increase the efficiency of order execution.

Hong Kong Securities Clearing Company (HKSCC) operates the **Stock Segregated Account** (SSA) service where an investor's stockholding under a broker's custody can be separated from that of the broker and other investors. Following SFC's approval, HKSCC increased the scope of the service and enabled SSA holders to access stock balance and movements online, receive electronic statements and SMS/email alerts of stock movements. We will continue to work with HKSCC on further enhancements.

To facilitate interested brokers to obtain **trading rights** without having to seek out and bargain with sellers, we worked with HKEx regarding its proposal to introduce a tender process inviting relinquishment of a transferable trading right from an existing holder. This proposal will ensure the availability of trading rights at a reasonable cost as HKEx will be able to issue new trading rights if there is no offer or tender for sale of existing trading rights. The proposal will be conducive to market development of the exchanges.

We are currently working with the market and other regulators on a number of market development issues under the Economic Summit Report including the possibility of setting up a commodity futures market in Hong Kong and the introduction of more Mainland related products.

Products and intermediaries

As the performance of Mainland markets improved in recent years, there has been increasing interest by funds in exposure to the Mainland **A-share market**. In June 2006 we authorised the first open-ended China A-share fund that primarily invests directly in A shares through Qualified Foreign Institutional Investors (QFII), a scheme which allows approved qualified foreign institutional investors to invest in Mainland securities.

During the year, we authorised three **REITs**, including the first REIT that invests in hotel properties, and one with exposure

Facilitation

to Grade A offices in Central. At the end of March 2007, six REITs have been listed on HKEx, with an aggregate market capitalisation of \$70 billion and an average daily trading turnover of \$186 million.

We authorised more **exchange traded funds** (ETFs) during the year, including the first ETF that tracks the Indian stock market. The nine ETFs had a total net asset value of US\$9.8 billion as at 31 March 2007. A further six ETFs, including the first ETF that tracks a commodities futures index, were approved in April 2007.

Funds domiciled in the European Union states have to comply with the new European based Undertaking for Collective Investment in Transferable Securities (**UCITS**) III directive. To facilitate these funds being offered in Hong Kong, we issued a guide on risk management process for applications last year, and simplified authorisation procedures for UCITS III funds with special features.

A working group with industry representatives was formed in March 2007 to review existing **advertising guidelines** in the Code on Unit Trusts and Mutual Funds and the process for approval of marketing materials of retail funds.

We continue to focus on the development of the **hedge fund industry** in Hong Kong as an important and emerging growth area. Our specialised team which handles non-conventional fund managers' licences granted 32 licences to hedge fund managers in 2006-07. During the year we conducted a survey of licensed corporations whose business involved the management of and/or provision of advisory services to hedge funds. The results showed that the industry had grown significantly with aggregate assets managed from Hong Kong by licensed hedge fund managers and advisers reaching US\$33.5 billion as at 31 March 2006, up 268% from March 2004. In order to develop our own expertise and to ensure that we are as facilitative as possible in this growth area we have taken opportunities to exchange views on the trends and challenges of the hedge fund industry with the industry and senior officials of the UK Financial Services Authority and the US Securities and Exchange Commission (SEC).

We facilitate business development by flexibly applying our rules and regulations under circumstances where investor protection will not be jeopardised. In this context, we granted

77 **modifications or waivers** regarding licensing conditions and financial resources requirements to licensed persons and applicants during the year.

By working closely with an industry group, a **fidelity insurance** scheme was successfully secured for participants of the stock and futures exchanges. This insurance protects participants from losses due to fidelity risks arising from dealing activities. Under the scheme participants will pay 10% to 20% less in gross premiums than previously.

Co-operation with Mainland authorities

The activities of the SFC in connection with the Mainland market are in a large part related to our facilitation role. We closely monitor developments in the Mainland financial market, and determine appropriate responses in order that Hong Kong is well positioned to participate in the significant growth of the Mainland financial market.

In order to be able to carry out our role most effectively we continue to be active in promoting exchange of personnel with our counterpart, the CSRC. This year we sent 18 staff for short-term secondments to the CSRC and in return hosted 14 of their staff in Hong Kong to share experience and develop the important personal connections which will facilitate an increasingly interactive and dynamic relationship. During the year we provided training at the CSRC offices and most recently we have agreed to the long-term secondment of a senior member of staff from the CSRC to assist us with the development of our Mainland related activities.

The SFC actively participates in a working group formed with the China Banking Regulatory Commission (CBRC), State Administration of Foreign Exchange and Hong Kong Monetary Authority to study issues of mutual concern regarding the development of China's Qualified Domestic Institutional Investors (**QDII**) scheme for Mainland commercial banks. QDII allows Mainland investors to invest in foreign securities markets via approved financial institutions.

This effort culminated in the signing in April 2007 of a Memorandum of Understanding (MOU) with CBRC for co-operation and information sharing with respect to Hong Kong licensed intermediaries who provide services to Mainland

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SFC Chairman Mr Eddy Fong (right) exchanged the MOU with Mr Liu Mingkang, Chairman of the CBRC.

commercial banks conducting overseas wealth management business on behalf of their clients.

Following the implementation of the commitment under the third phase of the Closer Economic Partnership Arrangement (CEPA) on 1 January 2006, Mainland securities and futures brokers have been able to establish a presence in Hong Kong. As at 31 March 2007, Mainland brokers controlled more than 20 Hong Kong licensed intermediaries engaged in a variety of regulated activities.

International co-operation and external relations

We work closely with our counterparts worldwide, principally through our active participation in the International Organization of Securities Commissions (IOSCO). IOSCO is the pre-eminent forum for international co-operation among securities regulators and the international standard setter for the securities sector. The SFC is a member of the Technical Committee, which comprises regulators from the major markets. The IOSCO Multilateral Memorandum of Understanding (IOSCO MMOU) is an agreement that allows regulatory co-operation among signatory jurisdictions of which Hong Kong is one. We also have 39 bilateral or multilateral co-operation arrangements with regulatory bodies around the world. Our involvement enables us to participate and influence the emergence of global standards for the securities and futures markets.

In June 2006, we successfully hosted the 31st Annual Conference of IOSCO, the first time that this had been held in Hong Kong. The presence of more than 650 regulators and market practitioners from 135 jurisdictions around the world made the event the largest gathering for an IOSCO Annual Conference in recent years. During the four-day conference, member jurisdictions reached important decisions, including a new resolution that encourages members to examine the legal framework under which they operate and to enable the freezing of assets derived from cross-border securities and derivatives violations.



The Hon Rafael S Y Hui, Acting Chief Executive of HKSAR (third from left), SFC CEO Mr Martin Wheatley (fourth from left) and other international guests officiated at the Opening Ceremony of the IOSCO Annual Conference.



The Hon Henry Tang (right), Financial Secretary, and SFC CEO Mr Martin Wheatley proposed a toast at the Farewell Gala Dinner of the IOSCO Annual Conference.

Facilitation

We are active participants in all five Standing Committees of IOSCO's Technical Committee which examined a number of issues during the year including: accounting and auditing standards and disclosure; multi-jurisdictional information sharing for market oversight and regulatory issues arising from exchange evolution; regulation of intermediaries, their recordkeeping, security issues and conflicts issues; international asset freezing, cross-border boiler rooms and Internet frauds; hedge fund valuation, distribution costs and soft commission arrangements for collective investment scheme; and disclosure of information at point of sale.

We took part in the IOSCO Asia Pacific Regional Committee Mutual Recognition of Collective Investment Scheme Working Group to enhance regulatory co-operation and to facilitate cross-border marketing of products within the region.

During the year, we met with different governmental or regulatory representatives from Australia, Singapore, Thailand and the US to share our experience and discuss policy issues relating to regulation of retail products. We arranged for staff to be seconded to securities regulators in the US and Australia to update themselves on the latest developments in the global securities industry and to exchange views on each jurisdiction's regulatory approach.

We also met with various overseas industry associations, e.g. the Association of the Luxembourg Fund Industry, Alternative Investment Management Association, Dublin Funds Industry Association, UK Investment Management Association, and the Bond Market Association from New York to exchange views about market developments.

Communication with the market

We believe that communication with all of our stakeholders, including both practitioners and investors, regarding all of our activities is important in helping develop a robust and well-developed financial market. Greater clarity of rules and regulations will of itself lead to greater confidence in the financial market and promote increased activity. We also use our communications to try and lead by example in the area of enhancing transparency and corporate governance, which are also important to attract investors to our markets.

In 2006-07, we conducted a **Stakeholder Survey**, which found that stakeholders regarded the SFC as Asia's best securities regulator and believed that the SFC's programmes had a positive impact on the securities and futures markets in Hong Kong. They generally wanted the SFC to: ensure the quality of listings, particularly from the Mainland; support Hong Kong's competitiveness in a global market; to be more proactive in developing Hong Kong as a major financial centre and be less conservative in its approach to the introduction of new products; exercise its powers to take on large enforcement cases and in the administration of Dual Filing; address the high turnover of middle and junior level staff and the need to have more experienced/market familiar staff at these levels; improve clarity of rules, speed of response and consistency of decisions; and reduce the need for unnecessary documentation. Whilst we are pleased with the results of the survey we also acknowledge the areas where more needs to be done. In particular a number of comments received appear to want us to increase the facilitation aspects of our work and this will be a focus for us in the immediate future.



According to a report by the City of London Corporation released in March 2007, Hong Kong ranks third, after London and New York, as a world financial centre, and is "a real contender to become a genuinely global financial centre".

Facilitation

We publish regular **research** papers and market statistics to help the public understand the Hong Kong market. In 2006-07, one report concerned Hong Kong's competitiveness in Asia, which concluded that Hong Kong took the lead in Asia in most factors that are considered important to a financial centre. We also launched an information note series, which aims to provide simple but valuable market information and facts to the public.

We assist the market's understanding of our policies and initiatives through our publications such as circulars and Frequently Asked Questions, and seminars or talks with industry associations, professional bodies or government departments. In 2006-07, we provided guidance on a number of matters including funds authorisation policy, licensing matters concerning insurance requirements, emergency contacts and business premises etc.

In communicating our work and policies to stakeholders, the mass media has been an important partner. During the year, we issued 264 press releases. Our executives gave 21 interviews to local, Mainland and international news organisations and we held 10 press conferences or sharing sessions. We handled 1,112 media enquiries and received 2,336 public enquiries, of which 2,113 were made online (enquiry@sfc.hk). Full replies were given within four days to 99.1% of the email enquiries we received.

The SFC voluntarily publishes a **Quarterly Report** on its work and financial position in order to set a good example for the market. Our **Annual Report** has for many years been recognised for its high standards of disclosure. In the 2006 Hong Kong Management Association's Best Annual Reports Awards, it was awarded the Gold Award (Non-profit Making and Charitable Organisations category) and named the category winner in Citation for Achievement in Corporate Governance Disclosure. Our report also 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 2006.

All of our publications are made available online and our corporate website, www.sfc.hk, drew a daily average of 378,561 hits during the year. It again received the Gold Award in the e-Inclusion Campaign (formerly known as Web Care Campaign) of the Internet Professional Association, which promotes equal opportunity to Internet access.

We published the fourth edition of the English-Chinese Glossary of Securities, Futures and Financial Terms to provide the public with a practical tool with enhanced content.

Other measures

FinNet is a network run by the SFC which enables the financial community to conduct electronic transactions and information delivery in a secure environment. In 2006-07, FinNet users grew from 144 to 171 and Hong Kong Interbank Clearing Ltd (HKCL) launched a service through FinNet where banks may transfer files of scanned cheques to HKCL and eliminate paper cheque processing. We are currently holding discussions with the fund management industry to establish whether or not FinNet can also be utilised to provide a common order exchange platform.

In 2006-07, we continued to implement measures to enhance market efficiency and reduce transaction costs. Effective from 1 December 2006, investors pay 20% less in **transaction levies**. Under the Securities and Futures (Reduction of Levy) Order 2006, levy rates have been lowered from 0.005% to 0.004% for securities transactions and from \$1 to \$0.80 per futures contract transaction.

To facilitate the provision of **automated trading services (ATS)** in Hong Kong, we authorised three overseas exchanges to operate ATS and are considering two new applications. There were 12 ATS providers at the financial year-end.



A photograph of four children riding yellow tricycles on a paved area. In the background, there is a tall, multi-story apartment building with many windows. The scene is brightly lit, suggesting a sunny day. The right side of the image is overlaid with a semi-transparent blue box containing text.

We Educate

Well-informed and financially literate investors are the first line of defence against fraud and malpractice.

We conduct a variety of activities to advise the public of both their rights and responsibilities as investors in the securities and futures markets.

We educate investors to allow them to make informed choices especially in the area of new products, structured products or areas where potential abuses may occur. We also remind investors of their own responsibility for their investment decisions.

Last year, we

- produced two new TV dramas and one radio series as part of the 2006 investor education (IE) campaign to remind investors to ask the right questions before investing
- conducted three investor surveys on stock investing, dealing with investment advisers and investing in structured products
- introduced IE theme 2007: "Know your risk"
- expanded IE to all universities
- reached a record 10,130 people in our seminars

Education

Financially literate and well-informed investors are the first line of defence against inappropriate activities and behaviour by market participants and intermediaries. We educate the public about investments and investors' rights and responsibilities through a variety of different channels including TV, radio, newspapers, publications e.g. the monthly Dr Wise column, press releases and Frequently Asked Questions (FAQs). We also maintain a user-friendly investor portal – www.InvestEd.hk – which is a one-stop shop supplying key facts about investments, research and interactive investor education (IE) materials and videos. Our programmes are also targeted at people of different ages and occupations – from university undergraduates to retirees.

We are pleased to discuss below the key IE work we accomplished last year.

In 2006-07, we launched a number of activities as part of the **2006 IE theme** of “**Before you invest, ask the right questions**”. These included the joint production with the Radio Television Hong Kong of a 10-episode TV drama series “Investment Challenge”. These programmes explained the features and risks of complex and structured products including equity-linked instruments, warrants, investment-linked assurance schemes and leveraged foreign exchange contracts. Together with MetroFinance, we also launched a series of 20 radio segments “Learn More About Investing” to help investors ask the right questions in different investment situations. In addition, we broadcast an educational video “Know the Pooling Risk” on the Finance Channel of Cable TV and public buses which explained re-pledging and the pooling risk associated with securities margin accounts.

During the year, we launched a Webinar, a “virtual seminar” on the **InvestEd website** with educational material shown side-by-side with a speaker who presents the topic. The Webinar enables investors to access workshops on personal financial planning and investor protection at anytime convenient to them.

There were three **broker fraud** cases in mid-2006 and we launched a thematic campaign to remind investors to protect themselves against misappropriation. In particular, investors

were asked to diligently check their monthly statements, to avoid hold-mail arrangements and to respond directly to confirmation requests from external auditors. We also encouraged investors to use CCASS Investor Participant Accounts to hold their securities and warned them about some common tactics which have previously been used by dishonest brokers to misappropriate client assets.

During the year, we conducted three new investor surveys to help us understand better what education messages might be needed:

- The **Stock Investor Survey** found that while around half of investors referred to company financial reports and announcements when making stock trading decisions, another half relied primarily on stock commentators' recommendations and media reports.



Our survey found that stock investors who did not read financial reports of listed companies suffered a bigger trading loss.

- To help us tackle the regulatory challenge of mis-selling of complex products, the **Survey on Engagement of Investment Advisers (IAs)** studied how investors choose their IAs and their experience with those IAs. The survey indicated that nine out of 10 investors were satisfied overall with their IAs' services, but that they wanted more suitable product recommendations. In choosing an IA firm, investors primarily looked at reputation and service quality.

Education

- The **Structured Product Investor Survey** found that many investors who purchased unlisted, retail structured products for their perceived higher returns did not fully understand the nature of these products. Nearly 30% of investors interviewed purchased these products for capital preservation or perceived them as low risk investments which are not features of these products.

In view of the survey findings, we have stepped up our efforts in explaining product features and risks, clarifying misconceptions and reminding investors to ask the right questions when considering potential investments. We have also highlighted the risks in investing in emerging markets and commodities related instruments, explained the different emerging features of REITs, and the particular risks associated with hotel REITs.



Our IE theme for 2007 is **“Know Your Risk”**. We encourage the public to understand and consider the different aspects of “risk” in their investment choices, including market volatility, increasing complexity of products, and common known malpractices. We launched various programmes under this IE theme in January 2007, which we designated IE month.

In early 2007 we broadcast a new TV drama series “Wising up with Experience” on the Finance Channel of Cable TV. For the first time the stories used reflected directly (with identities changed to preserve privacy) examples of real-life malpractices we have seen in the market place. The five-episode series covered: misappropriation; mis-selling; cold calling; the importance of knowing your broker; and misconceptions about derivative warrants.

We actively collaborate with a number of educational bodies to promote a responsible and informed attitude towards personal financial management to the younger generation.

- Together with The Open University of Hong Kong we organised six seminars, attracting over 1,000 participants. The seminars focused on the assessment of the risks of investing. We have expanded our IE efforts to all eight local universities. For the first time, we partnered with The Chinese University of Hong Kong to launch a new course on personal financial management for non-business-major students in September 2006.



Popular financial columnist Mr Cho Chi Ming (left) talked about “The Ten Commandments of Investing” at a seminar organised with The Open University of Hong Kong.

- For the third year, we jointly organised with Lingnan University two five-session courses which this year had an expanded curriculum.
- We ran another round of 15 IE workshops covering wide-ranging topics for secondary school and vocational education teachers. These train-the-trainer workshops are recognised as Continuing Professional Development courses by the Education and Manpower Bureau.

In total, we held 87 seminars during the year, reaching a record 10,130 secondary school teachers, civil servants and other members of the public. 85 articles were published in newspapers and magazines.



A record 10,130 people attended our seminars throughout the year.

Education

During the year, we received 5,944 investor enquiries (2005-06: 4,811) and handled 1,056 complaints (2005-06: 1,091). 416 (2005-06: 459) complaints were under further assessment, while 195 (2005-06: 162) cases were investigated.

Alerting the public to financial scams is a priority. We are also conscious of the need to consider the impact on Hong Kong's reputation of financial scams that target overseas investors and which have any Hong Kong connection. Therefore, starting

in 2000, we have published an **Alert List** on the InvestEd website naming suspected boiler rooms as a service to caution investors. As more types of fraudulent activities and tactics have surfaced, the Alert List has been expanded to include scam websites, phishes (emails to trick investors into disclosing information such as bank account number and password), and unlicensed overseas companies targeting Hong Kong investors. During the year, we posted 38 entities to the Alert List, which now has 370 entities.

Statistics of public complaints

Nature of complaints	2006-07	2005-06	% change
Conduct of licensed intermediaries and registered institutions	309	255	21%
Listing related matters & disclosure of interests	339	364	-7%
Market misconduct	195	185	5%
Financial products	26	32	-19%
Other financial activities	178	240	-26%
Miscellaneous	9	15	-40%
Total	1,056	1,091	-3%

“Alert List helps investor

Ms Georgina Lestini of France wrote to thank the SFC last July. Ms Lestini was contacted by a company named Vannex Corporation, which offered to buy some shares from her that she had previously bought in an investment scam five years ago. However, she was asked to first make a deposit in order for the offer to proceed. She became suspicious and visited the SFC's Alert List, where she found that Vannex was identified as a suspected boiler room operator.

Boiler rooms usually cold call investors to lure them into lucrative-sounding investments with high-pressure sales tactics. The tricksters often use “virtual offices” or business centres to redirect calls and mail to overseas locations. When investors have parted with their money, the fraudsters will no longer be contactable. ”

Securities and Futures Commission

Independent Auditor's Report to the Securities and Futures Commission

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

We have audited the consolidated financial statements of the Securities and Futures Commission (the "SFC") set out on pages 58 to 76 which comprise the consolidated and the SFC balance sheet as at 31 March 2007 and the consolidated income and expenditure account, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Directors' responsibility for the financial statements

The Hong Kong Securities and Futures Ordinance requires the directors to prepare financial statements which give a true and fair view. The directors of the SFC are responsible for the preparation and the true and fair presentation of these financial statements in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. This report is made solely to you, 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.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and true and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the SFC and of the Group as at 31 March 2007 and of the results of the Group's operations and cash flows for the year then ended in accordance with International Financial Reporting Standards.

KPMG

Certified Public Accountants
8th Floor, Prince's Building
10 Chater Road
Central, Hong Kong

4 May 2007

Securities and Futures Commission

Consolidated Income and Expenditure Account

For the year ended 31 March 2007

(Expressed in Hong Kong dollars)

	Note	2007 \$'000	2006 \$'000
Income			
Levies		1,007,423	612,512
Fees and charges		217,848	196,677
Investment income	5	69,259	36,278
Recoveries from Investor Compensation Fund		3,893	3,263
Other income	6	8,796	2,753
		<u>1,307,219</u>	<u>851,483</u>
Expenses			
Staff costs and directors' emoluments	7	416,334	384,227
Premises			
Rent		21,279	21,432
Other		15,073	13,758
Other expenses	8	75,438	56,563
Depreciation		13,735	20,994
		<u>541,859</u>	<u>496,974</u>
Surplus for the year		765,360	354,509
Accumulated surplus brought forward		1,171,754	817,245
Accumulated surplus carried forward		1,937,114	1,171,754

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

The notes on pages 62 to 76 form part of these financial statements.

Securities and Futures Commission

Consolidated Balance Sheet

At 31 March 2007

(Expressed in Hong Kong dollars)

	Note	2007 \$'000	2006 \$'000
Non-current assets			
Fixed assets	9(a)	18,076	17,934
Held-to-maturity debt securities	10	1,285,072	580,962
		1,303,148	598,896
Current assets			
Held-to-maturity debt securities	10	624,828	617,931
Bank deposits	11	53,642	47,505
Debtors, deposits and prepayments		135,592	96,562
Cash at bank and in hand	11	3,509	2,378
		817,571	764,376
Current liabilities			
Fees received in advance		52,225	52,195
Creditors and accrued charges		34,304	33,343
		86,529	85,538
Net current assets			
		731,042	678,838
Total assets less current liabilities			
		2,034,190	1,277,734
Non-current liabilities			
	13	54,236	63,140
Net assets			
		1,979,954	1,214,594
Funding and reserves			
Initial funding by Government			
	16	42,840	42,840
Income and expenditure account			
		1,937,114	1,171,754
		1,979,954	1,214,594

Approved and authorised for issue by the SFC on 4 May 2007 and signed on its behalf by

Martin Wheatley
Chief Executive Officer

Eddy C Fong
Chairman

The notes on pages 62 to 76 form part of these financial statements.

Securities and Futures Commission

Balance Sheet

At 31 March 2007

(Expressed in Hong Kong dollars)

	Note	2007 \$'000	2006 \$'000
Non-current assets			
Fixed assets	9(b)	18,025	17,866
Held-to-maturity debt securities	10	1,285,072	580,962
		1,303,097	598,828
Current assets			
Held-to-maturity debt securities	10	624,828	617,931
Bank deposits	11	53,642	47,505
Debtors, deposits and prepayments		135,431	96,223
Cash at bank and in hand	11	2,797	1,014
		816,698	762,673
Current liabilities			
Fees received in advance		52,225	52,195
Creditors and accrued charges		33,380	31,572
		85,605	83,767
Net current assets			
		731,093	678,906
Total assets less current liabilities			
		2,034,190	1,277,734
Non-current liabilities			
	13	54,236	63,140
Net assets			
		1,979,954	1,214,594
Funding and reserves			
Initial funding by Government			
	16	42,840	42,840
Income and expenditure account			
		1,937,114	1,171,754
		1,979,954	1,214,594

Approved and authorised for issue by the SFC on 4 May 2007 and signed on its behalf by

Martin Wheatley
Chief Executive Officer

Eddy C Fong
Chairman

The notes on pages 62 to 76 form part of these financial statements.

Securities and Futures Commission

Consolidated Cash Flow Statement

For the year ended 31 March 2007

(Expressed in Hong Kong dollars)

	2007 \$'000	2006 \$'000
Cash flows from operating activities		
Surplus for the year	765,360	354,509
Adjustments for:		
Depreciation	13,735	20,994
Investment income	(69,259)	(36,278)
Profit on disposal of fixed assets	(19)	(11)
	<u>709,817</u>	<u>339,214</u>
Increase in debtors, deposits and prepayments	(21,063)	(33,170)
Increase in fees received in advance	30	15,520
Increase in creditors and accrued charges	740	3,626
Decrease in non-current liabilities	(8,904)	(8,927)
Net cash generated from operating activities	<u>680,620</u>	<u>316,263</u>
Cash flows from investing activities		
Interest received	48,174	34,579
Held-to-maturity debt securities purchased	(1,325,009)	(758,117)
Held-to-maturity debt securities redeemed	617,120	400,517
Fixed assets bought	(13,658)	(14,718)
Fixed assets sold	21	11
Net cash used in investing activities	<u>(673,352)</u>	<u>(337,728)</u>
Net increase/(decrease) in cash and cash equivalents	<u>7,268</u>	<u>(21,465)</u>
Cash and cash equivalents at beginning of the year	<u>49,883</u>	<u>71,348</u>
Cash and cash equivalents at end of the year	<u>57,151</u>	<u>49,883</u>
Analysis of the balance of cash and cash equivalents:		
	2007	2006
	\$'000	\$'000
Bank deposits	53,642	47,505
Cash at bank and in hand	3,509	2,378
	<u>57,151</u>	<u>49,883</u>

Securities and Futures Commission

Notes to the Consolidated Financial Statements

For the year ended 31 March 2007

(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 page 65). 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

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.

Securities and Futures Commission

3. Significant accounting policies (cont'd)

Fixed assets and depreciation (cont'd)

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 page 65). 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.

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.

Securities and Futures Commission

3. Significant accounting policies (cont'd)

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".)

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.

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.

Securities and Futures Commission

3. Significant accounting policies (cont'd)

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.

4. Taxation

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

5. Investment income

	2007	2006
	\$'000	\$'000
Interest income	66,141	39,790
Amortisation of premium on held-to-maturity debt securities	(3,556)	(7,429)
Amortisation of discount on held-to-maturity debt securities	6,674	3,917
	69,259	36,278

6. Other income

	2007	2006
	\$'000	\$'000
IOSCO 2006 Annual Conference	5,025	–
Investigation costs awarded	1,944	1,903
FinNet managed network and support fee	1,403	373
Sale of SFC publications	352	401
Profit on disposal of fixed assets	19	11
Others	53	65
	8,796	2,753

Securities and Futures Commission

7. Staff costs and directors' emoluments

	2007 \$'000	2006 \$'000
Salaries and allowances	385,123	362,898
Retirement benefits	18,578	10,520
Medical and life insurance	12,126	10,382
Overtime pay	507	427
	416,334	384,227

The total number of staff as at 31 March 2007 was 446, comprising 405 regular staff (402 for SFC and 3 for Investor Compensation Company Limited) and 41 temporary staff (at 31 March 2006: the total number of staff was 443, comprising 397 regular staff and 46 temporary staff).

Directors' emoluments included in the above comprised:

	Directors' fee \$'000	Salaries, allowances & benefits in kind \$'000	Discretionary pay \$'000	Retirement scheme contribution \$'000	2007 Total \$'000	2006 Total \$'000
Chairman						
Andrew Sheng (retired 30 September 2005 ^(Note 1))	-	-	-	-	-	6,202 ^(Note 2)
Chief Executive Officer						
Martin Wheatley ^(Note 3)	-	6,350	1,064	184	7,598	4,848
Executive Directors						
Alexa Lam	-	4,000	1,000	225	5,225	5,050
Brian Ho (appointed 28 August 2006)	-	2,139	497	184	2,820	-
Keith Lui (appointed 28 August 2006)	-	2,139	497	184	2,820	-
Mark Steward (appointed 26 September 2006)	-	2,067	479	100	2,646	-
Paul Kennedy (appointed 16 October 2006)	-	2,068	-	94	2,162	-
Peter Au-Yang (retired 25 May 2006 ^(Note 1))	-	1,137 ^(Note 4)	1,000	2	2,139	4,675
Alan Linning (resigned 6 June 2006)	-	770	-	3	773	4,737
	-	20,670	4,537	976	26,183	25,512
Non-executive Chairman						
Eddy C Fong, SBS, JP ^(Note 5)	444	-	-	-	444	234
Non-executive Directors						
Angelina Lee, JP (appointed 1 August 2006)	156	-	-	-	156	-
Christopher W C Cheng, GBS, JP	234	-	-	-	234	234
Kenneth H W Kwok, BBS, SC	234	-	-	-	234	234
Raymond P L Kwok, JP (retired 31 July 2006 ^(Note 1))	78	-	-	-	78	234
Prof. Liu Pak Wai, SBS	234	-	-	-	234	234
Shengman Zhang (appointed 1 January 2007)	59	-	-	-	59	-
The Hon Jasper Y S Tsang, GBS, JP	234	-	-	-	234	234
Dr. York Liao, SBS, JP	234	-	-	-	234	234
	1,907	-	-	-	1,907	1,638
Total directors' emoluments	1,907	20,670	4,537	976	28,090	27,150

Note 1: retired having completed appointment period

Note 2: including leave pay of \$2,802,000

Note 3: as executive director to 30 September 2005; appointed as Chairman from 1 October 2005 and subsequently redesignated as Chief Executive Officer from 23 June 2006

Note 4: including leave pay of \$535,000

Note 5: as non-executive director to 19 October 2006 and appointed as non-executive Chairman from 20 October 2006

Securities and Futures Commission

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

Of the five individuals with the highest emoluments, four are executive directors (2005/2006: five executive directors). The aggregate of the emoluments of these five individuals was \$26,311,000 (2005/2006: \$25,512,000) with the breakdown as follows:

	2007	2006
	\$'000	\$'000
Salaries, allowances & benefits in kind	21,144	22,885
Discretionary pay	4,181	2,491
Retirement scheme contribution	986	136
	26,311	25,512

Their emoluments are within the following bands:

	2007	2006
	No. of	No. of
	individuals	individuals
\$3,500,001 to \$4,000,000	1	–
\$4,000,001 to \$4,500,000	1	–
\$4,500,001 to \$5,000,000	–	3
\$5,000,001 to \$5,500,000	1	1
\$5,500,001 to \$6,000,000	1	–
\$6,000,001 to \$6,500,000	–	1
\$7,500,001 to \$8,000,000	1	–

Securities and Futures Commission

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

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, subject to a vesting scale with the benefit fully vested upon completion of 10 years' service. 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 \$27,000 (2006: \$53,000).

Professional staff For professional staff, we make monthly contributions in the range of 5% to 10% of their fixed pay, depending on the period of service and subject to a vesting scale with the benefit fully vested upon completion of 10 years' service. With effect from 1 October 2006, the monthly cap of \$4,166 was removed.

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 \$1,330,000 (2006: \$1,627,000) and the amount so forfeited available at the balance sheet date was \$115,000 (2006: \$20,000).

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

(b) MPF Scheme

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

8. Other expenses

	2007	2006
	\$'000	\$'000
Training and development	7,590	6,709
Legal and professional services	21,163	14,645
Information and systems services	20,483	19,528
Auditor's remuneration	268	253
Funding for the Financial Reporting Council	7,500	–
General office and insurance	7,075	5,852
FinNet	1,921	4,053
External relations	9,131	5,107
Exchange loss	307	416
	75,438	56,563

Securities and Futures Commission

9. Fixed assets

(a) The Group

	Furniture, fixtures and leasehold improvements \$'000	Office equipment \$'000	Mainframe computers and application systems \$'000	Personal computers and software \$'000	Motor vehicles \$'000	Total \$'000
Cost						
At 1 April 2006	35,218	9,506	117,002	24,532	1,456	187,714
Additions	389	435	7,351	4,717	988	13,880
Disposals	(87)	(680)	(4,703)	(3,219)	(477)	(9,166)
At 31 March 2007	35,520	9,261	119,650	26,030	1,967	192,428
Accumulated depreciation						
At 1 April 2006	33,448	7,908	106,960	20,008	1,456	169,780
Charge for the year	1,823	824	6,474	4,367	247	13,735
Written back on disposals	(87)	(679)	(4,703)	(3,217)	(477)	(9,163)
At 31 March 2007	35,184	8,053	108,731	21,158	1,226	174,352
Net book value						
At 31 March 2007	336	1,208	10,919	4,872	741	18,076
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

Securities and Futures Commission

9. Fixed assets (cont'd)

(b) The SFC

	Furniture, fixtures and leasehold improvements	Office equipment	Mainframe computers and application systems	Personal computers and software	Motor vehicles	Total
	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000
Cost						
At 1 April 2006	34,864	9,474	117,002	24,169	1,456	186,965
Additions	356	435	7,351	4,717	988	13,847
Disposals	(44)	(679)	(4,703)	(3,211)	(477)	(9,114)
At 31 March 2007	35,176	9,230	119,650	25,675	1,967	191,698
Accumulated depreciation						
At 1 April 2006	33,102	7,890	106,960	19,691	1,456	169,099
Charge for the year	1,804	818	6,474	4,343	247	13,686
Written back on disposals	(44)	(679)	(4,703)	(3,209)	(477)	(9,112)
At 31 March 2007	34,862	8,029	108,731	20,825	1,226	173,673
Net book value						
At 31 March 2007	314	1,201	10,919	4,850	741	18,025
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

Securities and Futures Commission

10. Held-to-maturity debt securities

The Group and the SFC

			2007 \$'000	2006 \$'000
Maturing after one year				
In the second to third years	–	unlisted	583,165	424,870
	–	listed outside Hong Kong	701,907	156,092
			1,285,072	580,962
Maturing within one year				
	–	unlisted	420,712	362,760
	–	listed outside Hong Kong	204,116	255,171
			624,828	617,931
			1,909,900	1,198,893
Cost at 31 March				
	–	unlisted	1,003,877	787,630
	–	listed outside Hong Kong	906,023	411,263
			1,909,900	1,198,893
Market value at 31 March				
	–	unlisted	1,003,853	781,237
	–	listed outside Hong Kong	908,594	406,234
			1,912,447	1,187,471

The weighted average effective interest rate of the debt securities was 4.82% at 31 March 2007 (2006: 4.17%).

11. Bank deposits and cash at bank

The effective interest rate of bank deposits and cash at bank at 31 March 2007 ranged from 3.7% to 4.4% (2006: 3.9% to 4.2%). These balances matured within one year at both 31 March 2007 and 31 March 2006.

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 2007, 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 2007 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

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 2007. Therefore we do not provide an ageing analysis of debtors and creditors.

15. Advance to an executive

Included in debtors and accounts receivable is an interest-free advance to an executive for initial settling-in purpose amounting to \$333,000 (2006: nil). This amount is repayable in equal instalments over 6 months.

The maximum balance of outstanding advance to an executive during the year was \$667,000 (2006: nil).

16. Initial funding by Government

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

Securities and Futures Commission

17. Capital commitments

Capital commitments outstanding at 31 March 2007 not provided for in the financial statements were as follows:

	2007	2006
	\$'000	\$'000
Authorised and contracted for	14,571	10,471
Authorised but not contracted for	12,231	11,361

18. 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 2007 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	
	2007	2006	2007	2006
	\$'000	\$'000	\$'000	\$'000
Payable next year	30,860	31,022	30,860	30,935
Payable in one to five years	7,696	38,555	7,696	38,555
Payable in more than five years	–	–	–	–
	38,556	69,577	38,556	69,490

During the year ended 31 March 2007, \$21,279,000, net of lease incentives, was recognised as an expense in the income and expenditure account in respect of operating leases (2006: \$21,432,000).

Securities and Futures Commission

19. Related party transactions

We have a related party relationship with the Unified Exchange Compensation Fund (UECF), 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, in accordance with Section 242(1) of the SFO

During the year, \$3,893,000 was recovered from ICF for ICC's expenses (2006: \$3,263,000). As at 31 March 2007, the amount due to ICF from ICC was \$863,000 (at 31 March 2006: \$1,726,000).

(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.

20. 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.

Securities and Futures Commission

21. Possible impact of new standard and amendment issued but not yet effective for the annual accounting period ended 31 March 2007

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 2007 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
Amendments to IAS 1, Presentation of financial statements: capital disclosures	1 January 2007

We are in the process of making an assessment of what the impact of the new standard and amendment is expected to be in the period of initial application. So far we have concluded that while the adoption of the new standard and amendment 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 2007.

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 79 to 91.

3. Members of the Committee

The members of the Committee during the year ended 31 March 2007 and up to the date of this report were:

Mr. Keith Lui (Chairman)	[appointed on 19 September 2006]
Mr. Gerald Greiner	
Mrs. Alexa Lam	
Mr. Kenneth H W Kwok, BBS, SC	[appointed on 16 January 2007]
Mr. Eddy C Fong, SBS, JP	[resigned on 15 January 2007]
Mr. Martin Wheatley	[resigned on 18 September 2006]
Ms. Anna H Y Wu, SBS, JP	[resigned on 11 August 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

KPMG were first appointed as auditors of the Fund in 2003. KPMG retire and being eligible, offer themselves for re-appointment.

On behalf of the Committee

Keith Lui

Chairman

4 May 2007

Investor Compensation Fund

Independent Auditor's Report to the Securities & Futures Commission (the SFC)

We have audited the financial statements of Investor Compensation Fund (the Fund) established under Part XII of the Securities and Futures Ordinance set out on pages 79 to 91 which comprise the balance sheet as at 31 March 2007 and the income and expenditure account, the statement of changes in equity and the cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

The SFC's responsibility for the financial statements

The Securities and Futures Ordinance requires the directors of 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 and in accordance with International Financial Reporting Standards promulgated by the International Accounting Standards Board. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. This report is made solely to you and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and true and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements give a true and fair view of the state of affairs of the Fund as at 31 March 2007 and of its result and cash flows for the year then ended in accordance with International Financial Reporting Standards.

KPMG

Certified Public Accountants

8th Floor, Prince's Building

10 Chater Road

Central, Hong Kong

4 May 2007

Investor Compensation Fund

Income and Expenditure Account

For the year ended 31 March 2007

(Expressed in Hong Kong dollars)

	Note	2007 \$'000	2006 \$'000
Income			
Net investment income	3&5	108,932	73,212
Exchange difference		5,262	(4,687)
Levy from the SEHK	3&6	–	144,983
Levy from the HKFE	3&6	–	11,464
		114,194	224,972
Expenses			
ICC expenses	7	3,893	3,263
Compensation expenses		48,570	–
Auditor's remuneration		72	65
Bank charges		758	1,125
Professional fees		2,668	2,469
Sundry expenses		1	1
		55,962	6,923
Surplus		58,232	218,049
Accumulated surplus brought forward		571,528	353,479
Accumulated surplus carried forward		629,760	571,528

The notes on pages 83 to 91 form part of these financial statements.

Investor Compensation Fund

Balance Sheet

At 31 March 2007

(Expressed in Hong Kong dollars)

	Note	2007 \$'000	2006 \$'000
Current assets			
Financial assets designated at fair value through profit or loss			
– Debt securities	9	1,548,070	1,357,440
– Equity securities	9	177,925	145,608
Interest receivable		24,516	17,848
Due from ICC		863	1,726
Fixed and call deposits with banks	10	27,800	152,341
Cash at bank	10	263	9
		1,779,437	1,674,972
Current liabilities			
Provision for compensation	8	45,214	–
Accounts payable and accrued charges		822	766
		46,036	766
Net current assets		1,733,401	1,674,206
Net assets		1,733,401	1,674,206
Representing:			
<u>Compensation fund</u>			
Contributions from UECF	11	994,718	994,718
Contributions from CECF	11	108,923	107,960
Accumulated surplus		629,760	571,528
		1,733,401	1,674,206

Approved and authorised for issue by the Securities and Futures Commission (the SFC) on 4 May 2007 and signed on its behalf by

Eddy C Fong
Chairman of the SFC

Martin Wheatley
Chief Executive Officer of the SFC

The notes on pages 83 to 91 form part of these financial statements.

Investor Compensation Fund

Statement of Changes in Equity

For the year ended 31 March 2007

(Expressed in Hong Kong dollars)

	2007	2006
	\$'000	\$'000
Compensation Fund balance as at 1 April	1,674,206	1,456,157
Surplus for the year	58,232	218,049
Contributions from CECF	963	–
Compensation Fund balance as at 31 March	1,733,401	1,674,206

The notes on pages 83 to 91 form part of these financial statements.

Investor Compensation Fund

Cash Flow Statement

For the year ended 31 March 2007

(Expressed in Hong Kong dollars)

	2007 \$'000	2006 \$'000
Cash flows from operating activities		
Surplus for the year	58,232	218,049
Net investment income	(108,932)	(73,212)
Exchange difference	(5,262)	4,687
Decrease in levies receivable	–	17,717
Decrease/(increase) in amount due from ICC	863	(615)
Increase in provision for compensation	45,214	–
Increase/(decrease) in accounts payable and accrued charges	56	(52)
Net cash (used in)/from operating activities	(9,829)	166,574
Cash flows from investing activities		
Purchase of debt securities	(1,827,241)	(3,331,795)
Sale or maturity of debt securities	1,650,868	3,146,281
Sale of equity securities	752	641
Interest received	60,200	51,691
Net cash used in investing activities	(115,421)	(133,182)
Cash flows from financing activities		
Contributions received from CECF	963	–
Net cash from financing activities	963	–
Net (decrease)/increase in cash and cash equivalents	(124,287)	33,392
Cash and cash equivalents at beginning of the year	152,350	118,958
Cash and cash equivalents at end of the year	28,063	152,350
Analysis of the balance of cash and cash equivalents:		
	2007 \$'000	2006 \$'000
Fixed and call deposits with banks	27,800	152,341
Cash at bank	263	9
	28,063	152,350

Investor Compensation Fund

Notes to the Financial Statements

For the year ended 31 March 2007

(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 compensation funds, the Unified Exchange Compensation Fund (UECF) and the Commodity Exchange Compensation Fund (CECF) (wound up on 26 May 2006). 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 (see also note 6).

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 Levy income was recorded 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.

Investor Compensation Fund

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 and other financial liabilities.

We initially 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 the Fund 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 our 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.

Investor Compensation Fund

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.

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

	2007	2006
	\$'000	\$'000
Interest income from bank deposits and debt securities	66,744	47,985
Realised gain/(loss) on disposal of equity securities	3	(1)
Realised gain on redemption/disposal of debt securities	3,629	5,578
Gain on revaluation of equity securities	31,967	24,467
Gain/(loss) on revaluation of debt securities	6,589	(4,817)
Net investment income	108,932	73,212

Investor Compensation Fund

6. Levy from the SEHK/HKFE

From 1 April 2003, the Fund received a 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 was 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 2007, ICC incurred cost of \$3,893,000 for its operations (2006: \$3,263,000).

8. Provision for compensation

	\$'000
Balance as at 31 March 2006	–
Add: provision made during the year ended 31 March 2007	48,570
Less: compensation paid during the year ended 31 March 2007	(3,356)
Balance as at 31 March 2007	<u>45,214</u>

We made provision for liabilities arising from claims received resulting from two default cases (Tiffit Securities (Hong Kong) Limited and Wing Yip Company Limited) for which ICC has published a notice calling for claims pursuant to Section 3 of the Securities & Futures (Investor Compensation-Claims) Rules. The maximum liability of the Fund to claims for each default case is set at \$150,000 per claimant.

Investor Compensation Fund

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

	2007	2006
	\$'000	\$'000
(a) Debt securities		
(i) Listing status		
Listed - outside Hong Kong	365,445	385,850
Listed - in Hong Kong	106,428	–
Unlisted	1,076,197	971,590
	1,548,070	1,357,440
(ii) Maturity profile		
– Within one year	686,980	695,808
– After one year but within two years	491,983	442,602
– After two years but within five years	321,163	156,279
– After five years	47,944	62,751
	1,548,070	1,357,440
(iii) The weighted average effective interest rate of debt securities at 31 March 2007 was 4.66% (2006: 4.88%).		
(b) Equity securities		
Unlisted	177,925	145,608

10. Deposits with banks and cash at bank

The effective interest rate of deposits with banks and cash at bank at 31 March 2007 ranged from 3.91% to 5.3% (2006: 3.8% to 4.72%). The balances matured within one year at both 31 March 2007 and 31 March 2006.

11. 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. Up to 31 March 2007, the SFC paid \$994,718,000 (2006: \$994,718,000) and \$108,923,000 (2006: \$107,960,000) into the Fund from the UECF and the CECF respectively.

12. Related party transactions

We have related party relationships with the SFC, the ICC, the SEHK, the HKFE, the UECF and the CECF. The CECF was wound up in May 2006 and the remaining balance of \$962,535 was transferred to the Fund in accordance with Section 75(9) of the SFO. During the year, there were no significant related party transactions other than those disclosed in the financial statements (refer to notes 6, 7 & 11).

Investor Compensation Fund

13. Financial instruments

The financial assets of the Fund comprise debt securities and units in a pooled fund. The underlying investments of the pooled fund mainly comprise 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, Hong Kong Government 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. The maximum exposure to credit risk is the carrying value of the assets in the balance sheet.

(ii) Liquidity risk

The Fund's policy is to regularly monitor current and expected liquidity requirement to ensure that it maintains sufficient reserves of cash to meet its liquidity requirements in the short and longer term.

(iii) 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 debt 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.

(iv) 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.

(v) 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.

(vi) Fair values

All financial instruments are carried at amounts not materially different from their fair values as at 31 March 2007 and 2006.

14. Contingent liabilities

As at the date of this report, the Fund has eighty-one outstanding claims in respect of two intermediaries. The validity of these claims is under investigation. SFC or ICC has not yet published any notice calling for claims pursuant to Section 3 of the Securities & Futures (Investor Compensation-Claims) Rules in respect of these cases. We have not made any provision for these claims in view of the probability of outflow of economic benefit being remote. The maximum contingent liability of the Fund to these claims is \$7,784,000 (As at 31 March 2006: \$900,000).

Investor Compensation Fund

15. Possible impact of amendments, new standards and interpretations issued but not yet effective for the annual accounting period ended 31 March 2007

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 2007 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
Amendments to IAS 1, Presentation of financial statements: capital disclosures	1 January 2007

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

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 2007.

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 94 to 103.

3. Members of the Committee

The members of the Committee during the year ended 31 March 2007 and up to the date of this report were:

Mr. Keith Lui (Chairman)	[appointed on 19 September 2006]
Mr. Gerald Greiner	
Mrs. Alexa Lam	
Mr. Kenneth H W Kwok, BBS, SC	[appointed on 16 January 2007]
Mr. Eric Yip	[appointed on 1 April 2007]
Mr. Roger Lee	[appointed on 1 April 2006 and resigned on 1 April 2007]
Mr. Eddy C Fong, SBS, JP	[resigned on 15 January 2007]
Mr. Martin Wheatley	[resigned on 18 September 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

KPMG were first appointed as auditors of the Fund in 1996. KPMG retire and being eligible, offer themselves for re-appointment.

On behalf of the Committee

Keith Lui
Chairman

27 April 2007

Unified Exchange Compensation Fund

Independent Auditor's Report to the Securities & Futures Commission (the SFC)

We have audited the financial statements of the Unified Exchange Compensation Fund (the Fund) established under Section 99 of the repealed Hong Kong Securities Ordinance set out on pages 94 to 103 which comprise the balance sheet as at 31 March 2007 and the income and expenditure account, the statement of changes in equity and the cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

The SFC's responsibility for the financial statements

The repealed Hong Kong Securities Ordinance (Chapter 333) requires the directors of 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 and in accordance with International Financial Reporting Standards promulgated by the International Accounting Standards Board. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. This report is made solely to you and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and true and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements give a true and fair view of the state of affairs of the Fund as at 31 March 2007 and of its result and cash flows for the year then ended in accordance with International Financial Reporting Standards.

KPMG

Certified Public Accountants

8th Floor, Prince's Building

10 Chater Road

Central, Hong Kong

27 April 2007

Unified Exchange Compensation Fund

Income and Expenditure Account

For the year ended 31 March 2007

(Expressed in Hong Kong dollars)

	Note	2007 \$'000	2006 \$'000
Income			
Interest income	3	2,584	1,792
Recoveries	3&5	8,754	2,384
Replenishments from the SEHK		–	1
		11,338	4,177
Expenses			
Compensation expenses		1,667	2,005
Auditor's remuneration		33	30
Professional fees		11	10
Sundry expenses		1	3
		1,712	2,048
Surplus for the year		9,626	2,129
Accumulated surplus brought forward		9,584	7,455
Accumulated surplus carried forward		19,210	9,584

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

The notes on pages 97 to 103 form part of these financial statements.

Unified Exchange Compensation Fund

Balance Sheet

At 31 March 2007

(Expressed in Hong Kong dollars)

	Note	2007 \$'000	2006 \$'000
Current assets			
Equity securities received under subrogation	5	560	721
Interest receivable		113	91
Fixed and call deposits with banks		66,324	57,236
Cash at bank		13	14
		67,010	58,062
Current liabilities			
Accounts payable and accrued charges	6	4,306	4,254
Provision for compensation	3&8	1,823	2,553
		6,129	6,807
Net current assets		60,881	51,255
Net assets		60,881	51,255
Representing:			
<u>Compensation fund</u>			
Contributions from the SEHK	9	46,100	46,100
Excess transaction levy from the SEHK	10	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	11	3,002	3,002
Accumulated surplus		19,210	9,584
		1,055,599	1,045,973
Contributions to Investor Compensation Fund	12	(994,718)	(994,718)
		60,881	51,255

Approved and authorised for issue by the Securities Compensation Fund Committee on behalf of the Securities and Futures Commission on 27 April 2007 and signed on its behalf by

Keith Lui
Chairman

Alexa Lam
Committee Member

Gerald Greiner
Committee Member

The notes on pages 97 to 103 form part of these financial statements.

Unified Exchange Compensation Fund

Cash Flow Statement

For the year ended 31 March 2007

(Expressed in Hong Kong dollars)

	2007 \$'000	2006 \$'000
Cash flows from operating activities		
Surplus for the year	9,626	2,129
Net investment income	(2,584)	(1,792)
Decrease in equity securities received under subrogation	161	7,072
(Decrease)/increase in provision for compensation	(730)	1,061
Increase/(decrease) in accounts payable and accrued charges	52	(37)
Net cash from operating activities	<u>6,525</u>	<u>8,433</u>
Cash flows from investing activities		
Interest received	2,562	1,737
Net cash from investing activities	<u>2,562</u>	<u>1,737</u>
Net increase in cash and cash equivalents	<u>9,087</u>	<u>10,170</u>
Cash and cash equivalents at beginning of the year	<u>57,250</u>	<u>47,080</u>
Cash and cash equivalents at end of the year	<u>66,337</u>	<u>57,250</u>

Analysis of the balance of cash and cash equivalents:

	2007 \$'000	2006 \$'000
Fixed and call deposits with banks	66,324	57,236
Cash at bank	13	14
	<u>66,337</u>	<u>57,250</u>

Unified Exchange Compensation Fund

Notes to the Financial Statements

For the year ended 31 March 2007

(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 (2006: nil).

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

Other sources of money for the Fund include: recoveries; SEHK replenishments detailed in note 15; special levy surplus detailed in note 11; and transaction levy received before the SFO became effective from 1 April 2003.

Unified Exchange Compensation 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.

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

Interest income We record interest income from bank deposits on accrual basis.

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.

Unified Exchange 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.

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 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.

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.

4. Taxation

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

5. 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 2007 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 to the claimants. We will proceed to make the refund once the verification process is completed.

Unified Exchange Compensation Fund

6. 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 auditor's remuneration.

7. 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 13 trading rights having been transferred during the six months to 31 March 2007 (2006: 8 trading rights had been transferred during the six months to 31 March 2006).

The SEHK also advised the SFC of four trading rights in total having been relinquished in December 2006 and March 2007. The SFC should refund to the SEHK the deposit of \$50,000 in respect of each trading right at the end of a six-month period after the relinquishment took effect.

8. Provision for compensation

	2007	2006
	\$'000	\$'000
Balance brought forward	2,553	1,492
Less: Amount paid during the year	(2,397)	(944)
Add: Net provision made	1,667	2,005
Balance carried forward	1,823	2,553

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

9. Contributions from the SEHK

According to Section 104 of the repealed Securities Ordinance, the SEHK contributes to the Fund in respect of each trading right at the rate of \$50,000 per trading right.

Unified Exchange Compensation Fund

10. 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.

11. 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.

12. 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 2007 amounted to \$994,718,000.

13. 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 7, 10, 12 and 15).

14. Financial instruments

Exposure to credit and liquidity risks arises in the normal course of the Fund's operation. The Fund is not exposed to any foreign exchange risk as all transactions and balances are denominated in HKD.

The Fund's credit risk is primarily attributable to cash at bank. Management's policy is that cash balances are placed only with licensed banks in Hong Kong.

The Fund's policy is to regularly monitor current and expected liquidity requirements to ensure that it maintains sufficient reserves of cash to meet its liquidity requirements in the short and longer term.

All financial instruments are carried at amounts not materially different from their fair values as at 31 March 2007 and 2006.

15. 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.

Unified Exchange Compensation Fund

15. Replenishments from the SEHK (cont'd)

Up to 31 March 2007, 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 \$69,608,000 to the Fund as follows:

	2007 \$'000	2006 \$'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	(29,507)	(29,019)
Add: Recoveries re-distributed to claimants	16,385	16,385
Less: Replenishments from the SEHK	(16,361)	(16,361)
Net amount the SFC may request the SEHK for replenishment	<u>69,608</u>	<u>70,096</u>

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.

Replenishments from the SEHK are not recognised in the balance sheet given that the Fund is not aware of any need for requesting the SEHK for replenishment in the near future.

16. Contingent liabilities

As at the date of this report, the validity of outstanding claims received against two exchange participants is still under investigation by the SEHK. They are subject to the normal \$8 million ceiling 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 contingent liability of the Fund to these claims is \$16 million (2006: \$24 million).

17. Possible impact of amendments, new standards and interpretations issued but not yet effective for the annual accounting period ended 31 March 2007

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 2007 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
Amendments to IAS 1, Presentation of financial statements: capital disclosures	1 January 2007

The Fund is 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 the adoption of them is unlikely to have a significant impact on the Fund's results of operations and financial position.

Activity and Market Data

Table 1 Number of authorised investment products

	As at 31/03/2007	As at 31/03/2006
Unit trusts and mutual funds	1,980	1,998
Investment-linked assurance schemes	201	197
Pooled retirement funds	37	37
MPF master trust schemes	38	44
MPF pooled investment funds*	287	280
Others [#]	143	111
Total	2,686	2,667

* 124 funds included in this category were offered both as retail unit trusts as well as pooled investment funds for MPF purposes.

Other schemes comprised 125 investment-linked deposits, 12 paper gold schemes and six REITs. The market for investment-linked deposits continued to expand with more exotic product features last year. There was a 29% jump in the number of authorised schemes from a year ago.

Table 2 Authorised unit trusts and mutual funds as at 31 March 2007 — breakdown by type

	Number	%	Total NAV* (US\$ million)	%
Bond	350	19.1	184,431 ¹	20.3
Equity	887	48.5	510,371 ¹	56.1
Diversified	124	6.8	55,033	6.0
Money market	68	3.7	126,790	13.9
Fund of funds	97	5.3	6,794	0.7
Index	27	1.5	11,632	1.3
Guaranteed	253	13.8	11,838	1.3
Hedge	14	0.8	1,662	0.2
Other specialised [#]	9	0.5	1,703	0.2
	1,829	100	910,254	100
Umbrella structures	151			
No. of authorised funds	1,980			

* Net Asset Value as at 31 December 2006

Includes Futures & Options Funds and Leveraged Funds

¹ Standard equity and bond funds still comprised the bulk of the funds population, with a growth in aggregate asset size of 43% and 25% respectively.

Table 3 Authorised unit trusts and mutual funds as at 31 March 2007 — breakdown by origin

	Umbrella funds	Sub-funds	Single funds	Total	%	Total NAV* (US\$ million)	%
Hong Kong	16	58	26	100	5.0	11,609	1.3
Luxembourg	48	963	4	1,015	51.2	644,813	70.8
Ireland	40	297	4	341	17.2	180,490	19.8
Guernsey	3	31	1	35	1.8	6,618	0.7
United Kingdom	2	37	5	44	2.2	35,752	3.9
Other Europe	1	2	0	3	0.2	44	0.0
Bermuda	1	21	7	29	1.5	3,402	0.4
British Virgin Islands	5	10	9	24	1.2	3,157	0.4
Cayman Islands	35	289	60	384	19.4	21,996	2.4
Others	0	0	5	5	0.3	2,373	0.3
No of authorised funds	151	1,708	121	1,980	100	910,254	100

* Net Asset Value as at 31 December 2006 (excluding "umbrella funds")

Activity and Market Data

Table 4 Number of licensees as at 31 March 2007 (31 March 2006 in brackets)

	Corporations		Representatives		Responsible Officers		Total		% Change
SEHK participants	411	(411)	8,293	(7,793)	1,241	(1,220)	9,945	(9,424)	6%
HKFE participants	111	(115)	433	(380)	63	(63)	607	(558)	9%
SEHK and HKFE participants	23	(22)	1,257	(1,063)	130	(128)	1,410	(1,213)	16%
Non-participants	787	(742)	14,124	(11,974)	2,067	(1,780)	16,978	(14,496)	17%
Grand total	1,332	(1,290)	24,107	(21,210)	3,501	(3,191)	28,940	(25,691)	13%

Table 5 Statistical information and financial position of the Hong Kong securities industry¹

	As at 31/12/2006	As at 31/12/2005
Total number of securities dealers and securities margin financiers	641	647
Total number of active cash clients ²	730,356	650,899
Total number of active margin clients ²	80,348	72,290
Total number of active clients (+12%)	810,704	723,189
Balance Sheet	(\$ million)	(\$ million)
Cash in hand and at bank ³	150,573	106,798
Amounts receivable from margin clients ⁴	20,591	14,639
Amounts receivable from clients and other dealers arising from dealing in securities	160,604	102,724
Proprietary positions	114,788	96,892
Other assets	171,520	118,124
Total assets (+41%)	618,076	439,177
Amounts payable to clients and other dealers arising from dealing in securities	244,766	155,237
Total borrowings from financial institutions	118,484	102,171
Short positions held for own account	62,714	34,480
Other liabilities	85,196	67,093
Total shareholders' fund (+33%)	106,916	80,196
Total liabilities and shareholders' fund (+41%)	618,076	439,177
	12 months to 31/12/2006	12 months to 31/12/2005
Profit and loss	(\$ million)	(\$ million)
Total value of transactions ⁵	30,754,491	20,367,924
Net securities commission income	29,456	18,531
Gross interest income	10,903	4,526
Other income ⁶	53,784	32,811
Total operating income (+69%)	94,143	55,868
Total overheads and interest expense ⁷	-71,855	-46,378
Total operating profit (+135%)	22,288	9,490
Net profit on proprietary trading	2,733	1,657
Net profit (+124%)	25,021	11,147

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 figures.

² Active clients are clients for whom the licensed corporation is required to prepare and deliver monthly statement of accounts 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 \$65,463 million (2005: \$38,496 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 31/12/2006	As at 31/12/2005
5.2	4.8

While the total value of collateral deposited with securities margin finance providers increased by 59% as compared to 2005, the total value of client securities re-pledged by these providers only increased slightly by 7%.

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

⁶ Other income mainly comprises intercompany management fee income, fund management income, corporate finance income 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 deducted from the net securities commission income.

Activity and Market Data

Table 6 Breaches by licensed corporations noted during inspections

Nature of breaches	Number of breaches 2006-07	Number of breaches 2005-06
Failure to comply with Financial Resources Rules	13	6
Failure to safekeep client securities	15	7
Failure to maintain proper books and records	21	26
Failure to safekeep clients' money	23	26
Unlicensed dealing & other registration issues	9	6
Breach of licensing condition	4	3
Breach of requirements of contract notes / statements of account / receipts	26	20
Failure to make filing / notification	3	1
Breach of margin requirements	2	8
Marketing malpractices	5	2
Illegal short selling of securities	1	2
Dealing malpractices	2	0
Breach of Code of Conduct	126	150
Breach of Code on Unit Trusts & Mutual Funds	1	3
Breach of Corporate Finance Adviser Code of Conduct	0	3
Breach of Fund Manager Code of Conduct	14	17
Non-compliance with anti-money laundering guidelines	5	6
Breach of other rules and regulations of the Exchanges	1	9
Internal control weaknesses	100	118
Others	20	26
Total	391	439

Table 7 Penalty orders by Insider Dealing Tribunal on insiders

Case	Insider dealers	Shares of listed company	Date of decision/penalty	Disgorgement of profit /loss avoided (\$)	Penalty (\$)	Cost (\$)	Barred from being a director
1	William Lam Chun Ming	Siu Fung Ceramics Holding Ltd	2.11.2006	–	100,000*	–	–
	Tai Hon Leung Henry			–	100,000*	–	–
2	Thomas Lau	Asia Orient Holdings Ltd	14.12.2006	15,301,676	15,000,000	3,860,506	1 year
3	James Wang	Dransfield Holding Ltd (now known as Pearl Oriental Innovation Ltd)	22.12.2006	185,809	50,000	–	1 year
	Tai Ching Nam			57,526	35,000	–	1 year
	Denny Wu Shiyue			48,855	25,000	–	1 year
4	Lam Hon Nam	Vanda Systems & Communications Holding Ltd	28.3.2007	–	1,200,000	725,861	2 years
	Chan Yuk			1,748,456	750,000	725,861	1 year
	Choy Ming Yan			640,909	900,000	580,689	2 years
	Chan Lai King			640,909	750,000	580,689	1 year
	Tse Kwok Fai			60,000	1,500,000	943,619	3 years
	Li Yat Tung			225,000	750,000	725,861	2 years
	Ng Kit Ying			572,295	600,000	725,861	2 years
	Wo Man Shan			471,155	750,000	580,689	2 years
	Chong Wai Lee			1,273,063	825,000	1,033,405	2.5 years
	Chong Bun Bun			2,707,560	750,000	1,033,405	1 year
	Wong Cheung Hung			1,195,504	750,000	508,102	2 years
Total: 17 entities				25,128,717	24,835,000	12,024,548	

* The appeal hearings of the case were concluded on 2 November 2006 with additional fines of \$100,000 each awarded to two implicated parties. As a result, the five implicated parties were ordered to pay a total of \$247.5 million in refund of losses avoided, inquiry expenses and fines.

Activity and Market Data

Table 8 Successful prosecutions — market manipulation

Case	Defendants	Date of conviction	Fine (\$)	Investigation costs awarded(\$)
1	Wong Wei Yin	26.4.2006	16,000	8,459
2	Chaw Chi Wai Ivan	8.3.2007	10,000	27,887
Total: 2 entities			26,000	36,346

Table 9 Successful prosecutions — cold calling

Case	Defendants	Date of conviction	Fine (\$)	Investigation costs awarded(\$)
1	Law Chun Pon	27.4.2006	18,000	22,732
2	Choi Chi Ming	9.6.2006	12,000	2,681
3	Law Wing Sang Vincent	14.6.2006	3,000	3,545
4	Wong Yick Keung	7.7.2006	8,000	8,405
5	Chu Soi Pio	3.8.2006	10,000	12,144
6	Chow Lai Yin	9.11.2006	3,000	3,670
7	Wong Man Suen	29.3.2007	5,000	8,790
Total: 7 entities			59,000	61,967

Table 10 Successful prosecutions — unlicensed/unauthorised activities

Case	Defendants	Date of conviction	Fine (\$)	Investigation costs awarded (\$)
Unregistered dealing/aiding and abetting				
1	Wing Lung Futures Ltd*	27.4.2006	–	23,571
	Chow Lai Him*	27.4.2006	–	–
	Ho Po Hung*	27.4.2006	–	–
2	World Trade Assets Market Inc.	23.6.2006	12,000	21,017
	Chan Tai Jee	23.6.2006	12,000	21,017
3	Wu Mei Mui	3.8.2006	1,000	–
4	Wall Street Global (Hong Kong) Ltd	5.12.2006	7,000	4,462
	Everts Todd Gilmer	5.12.2006	7,000	4,462
	Norman Alan John	5.12.2006	7,000	4,462
Unlicensed investment adviser				
1	Bottomley Amanda Elizabeth [^]	1.12.2006	–	34,122
2	Yeung Chun Man	29.3.2007	5,000	14,326
Unlicensed securities margin financing/aiding and abetting				
1	Sun's Finance Investment Ltd	28.9.2006	5,000	15,000
	Ng Shiu Shing Sunny	28.9.2006	5,000	15,000
Unlicensed foreign exchange trading/aiding and abetting				
1	Lai Chung Wong	8.6.2006	1,500	4,000
2	Yu Hoi Yan Cherie	20.7.2006	2,000	20,000
3	Chow Lai Yin	9.11.2006	1,500	3,670
4	Ling Man Siu	21.12.2006	4,000	13,429
Issuing unauthorised advertisements, invitations or documents				
1	World Trade Assets Markets Inc.	23.6.2006	12,000	–
2	Centaline (China) Property Consultants	21.12.2006	25,000	6,728
	Dalian Victory Plaza Development	21.12.2006	39,000	6,728
	Lee King Fung	21.12.2006	8,000	–
Total: 21 entities			154,000	211,994

* Convicted but absolute discharge granted.

[^] Convicted but conditional discharge on her recognisance of \$2,000 for a period of 12 months granted.

Activity and Market Data

Table 11 Successful prosecutions — disclosure of interests

Case	Defendants	Date of conviction	Fine (\$)	Investigation costs awarded (\$)
1	Link Silver International Ltd	4.5.2006	2,000	12,258
	Universal Technologies Holdings Ltd	4.5.2006	1,800	12,258
2	Kingston Finance Ltd	11.5.2006	8,000	7,279
3	Fong For	11.5.2006	6,000	6,330
	Wang Joel J	11.5.2006	5,000	8,198
4	Cheung Tak Woo	1.6.2006	15,000	4,855
	Tang Yuk Kuen	1.6.2006	15,000	4,923
5	Tiger Tech Holdings Ltd	22.6.2006	11,800	16,539
6	Power Hero International Ltd	24.8.2006	4,000	17,276
	Victoria Treasure International Ltd	24.8.2006	4,000	6,733
7	Chang Wing Yu	31.8.2006	40,000	45,771
8	Metro Capital Finance Ltd	14.12.2006	4,000	7,084
	Vong Kuoc Meng	14.12.2006	4,000	-
Total: 13 entities			120,600	149,504

Table 12 Successful prosecutions — provision of false or misleading information

Case	Defendants	Date of conviction	Fine (\$)	Investigation costs awarded (\$)
1	Wong Wei Yin	26.4.2006	12,000	8,459*
	Ngai Leung Wai	11.5.2006	5,000	3,000
2	Mak Ka Po Alex	10.8.2006	10,000	11,393
	Yip Kit Yin Angela	10.8.2006	5,000	11,393
3	Li Kwok Keung Asser	3.11.2006	4,000	12,261
Total: 5 entities			36,000	38,047

* Investigation costs also related to another summons

Table 13 Successful prosecutions — short selling

Case	Defendants	Date of conviction	Fine (\$)	Investigation costs awarded (\$)
1	Cheng Chun Kin Bill	11.5.2006	21,000	11,127
2	Chow Yin Ling	22.6.2006	16,000	8,758
3	Ko Hay Tat Michael	29.6.2006	35,000	23,880
4	Ma Yuk Fat	7.9.2006	18,000	10,023
	Yuen Wai Chun	7.9.2006	18,000	10,023
5	Li Kwok Wah	1.3.2007	64,000	8,171
Total: 6 entities			135,000	52,097

Table 14 Successful prosecutions — preservation of secrecy

Case	Defendant	Date of conviction	Fine (\$)	Investigation costs awarded (\$)
1	Choi Chi Ming	9.6.2006	6,600	2,681
Total: 1 entity			6,600	2,681

Activity and Market Data

Table 15 Most significant disciplinary actions in 2006-07

Case	Parties involved	Date of action	Misconduct	Action / settlement / SFAT decision
1	UKFP (Asia) HK Ltd formerly Towry Law (Asia) HK Ltd	2.5.2006	Mis-selling of funds and geared products	As a result of a settlement, UKFP (Asia) was severely reprimanded. UKFP (Asia) undertook a compensation scheme, funded by its holding company, which provided record ex-gratia payments.
2	Ng Ting Shag	17.5.2006	Misappropriation of clients' assets, giving false information to the SFC, and conspiring to pervert the course of justice	Licence revoked and banned for life
3	Ng Shun Fu	30.5.2006	Failure to conduct enquiries into the financial standing of sub-underwriters and other supervisory and internal control failures	SFAT dismissed Ng's appeal and upheld SFC's decision to suspend Ng's licence for nine months
4	Deloitte & Touche Corporate Finance Ltd	27.6.2006	Failure to discharge due diligence and listing responsibilities as sponsor	As a result of a settlement, Deloitte undertook, without admission of fault, to refrain from acting as a sponsor for nine months
5	Chia Kee Loong	27.6.2006	Failure to discharge due diligence and listing responsibilities as supervisor of a sponsorship mandate	As a result of a settlement, Chia undertook, without admission of fault, to refrain from acting as a supervisor of any sponsorship mandate for six months
6	Schmitt, Charles Lee	18.10.2006	Misappropriation of clients' assets and false accounting	Banned for life
7	Ching Chun Kuen	9.11.2006	Misappropriation of clients' assets and forgery	Banned for life
8	Fung Kit Ching Bandie	9.11.2006	Misappropriation of clients' assets and falsification of statements of accounts	Banned for life
9	Leung Moon Tong	13.11.2006	Misappropriation of clients' assets and producing false transaction records to clients	Banned for life
10	Ma Ching Ning Rick	13.11.2006	Misappropriation of clients' assets and falsification of clients' transaction records	Banned for life
11	Yip Kwok Kay	12.1.2007	Misappropriation of clients' assets and producing false transaction records to clients	Banned for life
12	Wong Ka Chun	22.2.2007	Misappropriation of clients' assets	Banned for life
13	Kwok Wood Yan	28.2.2007	Failure to account for missing clients' assets	Licence revoked and banned for life

Table 16 Requests for regulatory co-operation

	2006-07		2005-06		2004-05	
	In	Out	In	Out	In	out
Enforcement-related requests for assistance	68	23	71	18	47	7
Licensing-related requests for assistance	233	853	186	631	140	668

'In' represents requests received, while 'out' are requests made

Activity and Market Data

Table 17 Comparison with overseas regulatory agencies

It is difficult to obtain detailed data, in a consistent format, for sensible comparison of key performance measures with other regulators and this is complicated further by the different mandates which each of these regulators have. Nevertheless, we have set out in this table some key data relating to the size of certain other regulators for the interest of readers.

All foreign currency amounts have been translated into Hong Kong dollars at 31 March 2007 exchange rate for the purpose of comparison.

	2006-07	2005-06	2004-05
Securities and Futures Commission (SFC) (year ended on 31 March)¹			
Number of staff	443	441	431
Total expenditure (\$ million)	542	497	456
US Securities and Exchange Commission (SEC) (year ended on 30 September)²			
Number of staff	3,685*	3,764*	3,851*
Total expenditure (\$ million)	7,072*	6,939*	6,931*
Financial Services Authority (FSA) (year ended on 31 March)³			
Number of staff (at year-end date)	2,820 [#]	2,667	2,467
Total expenditure (\$ million)	4,542 [#]	4,323	3,967
Australian Securities & Investment Commission (ASIC) (year ended on 30 June)⁴			
Number of staff (at year-end date)	DNA	1,471	1,570
Total expenditure (\$ million)	DNA	1,375	1,315

¹ The SFC is an independent non-governmental statutory body funded mainly by a market levy and is responsible for regulating the securities and futures markets in Hong Kong.

² The US SEC is an independent, non-partisan, quasi-judicial regulatory government agency with responsibility for administering the federal securities laws.

³ The FSA is an independent non-governmental body funded by the firms it regulates. It has been given statutory powers to regulate the financial services in the UK including authorisation and regulation of deposit taking, insurance, mortgage lending, general insurance advice, mortgage advice and investment business.

⁴ The ASIC is an independent Commonwealth government body which enforces and regulates company and financial services laws to protect consumers, investors and creditors.

* Budget figures extracted from Congressional Budget Request 2007

[#] Budget figures extracted from FSA Business Plan 2006/2007

DNA Data not available

Committees, Panels and Tribunal

A number of committees and panels have been set up to advise the SFC on various matters and perform other functions as set out in their terms of reference. This section outlines the activities of these bodies and provides a list of the members. For information on the **Audit Committee**, **Remuneration Committee** and **Budget Committee**, please see our discussion on Corporate Governance under the Corporate Social Responsibility chapter.

Committees of the SFC

Advisory Committee

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

Chairman

Eddy C Fong, SBS, JP (from 20.10.06)
Martin Wheatley (to 19.10.06)

Members

Peter Au-Yang (to 25.5.06)	Christine Loh
Thaddeus Beczak	Jack Maisano
Henry Chan	Blair Pickerell
Ambrose Cheung, JP	Samuel Poon
Paul Chow, SBS, JP	Peter Sullivan
Paul Fan, BBS, JP	Ada Tse
Paul Kennedy (from 28.11.06)	Martin Wheatley (from 20.10.06)
Alexa Lam	Yip Lai Shing

No of meetings: 4

Average attendance rate: 76%

Takeovers and Mergers Panel

Administers the Code on Takeovers and Mergers.

During the year, the Panel met once to consider various policy issues under the Takeovers Code and on three occasions in respect of an ongoing disciplinary matter.

Chairman

Kevin Westley

Deputy Chairmen

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

Members

Nicholas Allen	Nicholas Norris
Jim Baird	Grace Fung Oei
Malcolm Brown	Michael Palin
Julia Charlton	William Ryback
Roy Chen	Patricia Shih
Stephen Cheung	Frank J Slevin
Eddy C Fong, SBS, JP (to 19.10.06)	May Tan
Herbert Hui (to 28.7.06)	Gregory Terry (to 15.2.07)
Bill C P Kwok	Carlson Tong
Clement K M Kwok	David M Webb
Angelina Lee, JP	Kenneth Willman
John Lees	Christine Wong
Liu Chee-Ming	Harold Wong
Michael Liu	V-Nee Yeh
John Maguire	Benita Yu
Gavin Nesbitt	

No of meetings: 1

Average attendance rate: 71%

Committees, Panels and Tribunal

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.

During the year, there were no circumstances that called for the convening of a meeting of the Committee.

Chairman

Angelina Lee, JP (to 31.7.06)

Deputy Chairman

Teresa Ko

Members

Nicholas Allen

Jim Baird

Malcolm Brown

Julia Charlton

Roy Chen

Stephen Cheung

Clifton Chiu

Stephen Clark

The Hon Henry H L Fan, SBS, JP

Eddy C Fong, SBS, JP (to 19.10.06)

David Graham

Herbert Hui (to 28.7.06)

Bill C P Kwok

Clement K M Kwok

Angelina Lee, JP (from 1.8.06)

John Lees

Liu Chee-Ming

Michael Liu

John Maguire

Gavin Nesbitt

Nicholas Norris

Grace Fung Oei

Michael Palin

William Ryback

Patricia Shih

Frank J Slevin

May Tan

Gregory Terry (to 15.2.07)

Carlson Tong

David M Webb

Kevin Westley

Kenneth Willman

Christine Wong

Harold Wong

V-Nee Yeh

Benita Yu

No of meetings: 0

Average attendance rate: N/A

Committee on Unit Trusts

Considers new policies for the regulation of collective investment schemes commonly regarded as mutual funds and unit trusts, considers the acceptability of new management groups, authorises schemes with novel product features, and imposes conditions and/or grants waivers on such schemes.

During the year, the Committee met twice to discuss the approval of a new fund group, a new waiver request and some policy issues.

Chairman

Alexa Lam

Full Members

Dr Au King Lun

Prof. Ka Lok Chan

Christina Choi

Heung Shu Fai

David Hughes

Dr York Liao, SBS, JP

Darren McShane

Andreas Mondovits

Simon Ng

Elisabeth Scott

Alternate Members

Matt Dillon

Joseph Ho

Sau Kwan

Mak Tat Cheung

Blair Pickerell

Ken Sue (to 30.5.06)

No of meetings: 2

Average attendance rate: 82%

Committees, Panels and Tribunal

Committee on Investment-Linked Assurance and Pooled Retirement Funds

Considers new policies for the regulation of collective investment schemes commonly regarded as investment-linked assurance schemes and pooled retirement funds, considers the acceptability of new insurance/management groups, authorises schemes with novel product features, and imposes conditions and/or grants waivers on such schemes.

During the year, there were no circumstances that called for the convening of a meeting of the Committee.

Chairman

Alexa Lam

Members

Prof. Ka Lok Chan
Raymond Chan (to 3.7.06)
Christina Choi
Francine W T Fu
Angel Hon
Michael Huddart (from 4.7.06)

Kevin Lee
Dr York Liao, SBS, JP
Mak Tat Cheung
Darren McShane
Alastair Murray

No of meetings: 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 Real Estate Investment Trusts (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.

During the year, the Committee met once to discuss the policy for authorising hotel REITs to ensure compliance with the recurrent income requirement in the REIT Code and the key disclosure issues of a hotel REIT.

Chairman

Alexa Lam

Members

F K Au
Henry Cheong (to 31.8.06)
Christina Choi
Susan Chow
Martin Cubbon (to 31.8.06)
Heung Shu Fai
Stephen C C Hui
Alice Law

C Y Leung, JP
Vernon F Moore (from 1.9.06)
Alastair Murray
Stephen Po
David Richardson
T Brian Stevenson, SBS
Kevin Westley
K L Wong (from 1.9.06)

No of meetings: 1

Average attendance rate: 92%

Committees, Panels and Tribunal

Securities Compensation Fund Committee

Administers the Unified Exchange Compensation 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.

During the year, the Committee met once to consider the financial statements of the Fund. It also dealt with other administrative matters relating to the Fund.

Chairman

Keith Lui (from 19.9.06)
Martin Wheatley (to 18.9.06)

Members

Eddy C Fong, SBS, JP (to 15.1.07) Alexa Lam
Gerald Greiner Roger Lee
Kenneth H W Kwok, BBS, SC (from 16.1.07)

No of meetings: 1

Average attendance rate: 100%

Futures Compensation Fund Committee

Administered the Commodity Exchange Compensation Fund and regulated 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, continued to apply to and in relation to any claim for compensation from the Fund made before 1 April 2003.

During the year, the Committee met once to consider the financial statements of the Fund. It also dealt with other administrative matters relating to the Fund. The Committee was abolished on the winding up of the Commodity Exchange Compensation Fund on 26 May 2006.

Chairman

Martin Wheatley

Members

Eddy C Fong, SBS, JP Alexa Lam
Gerald Greiner Calvin Tai

No of meetings: 1

Average attendance rate: 100%

Investor Compensation Fund Committee

Administers the Investor Compensation Fund and regulates its procedures in accordance with Part XII of the Securities and Futures Ordinance.

During the year, the Committee met once to consider the financial statements of the Fund. It also dealt with other administrative matters relating to the Fund.

Chairman

Keith Lui (from 19.9.06)
Martin Wheatley (to 18.9.06)

Members

Eddy C Fong, SBS, JP (to 15.1.07) Alexa Lam
Gerald Greiner Anna H Y Wu, SBS, JP (to 11.8.06)
Kenneth H W Kwok, BBS, SC (from 16.1.07)

No of meetings: 1

Average attendance rate: 80%

Committees, Panels and Tribunal

Investor Education Advisory Committee

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

During the year, the Committee met three times to advise the Commission on setting its investor education focus for 2007, positioning of its Dr Wise's Column and areas of common investors' misconceptions and improper investment behaviour.

Chairman

Peter Au-Yang (to 25.5.06)
Paul Kennedy (from 16.10.06)

Full Members

The Hon Choy So Yuk
Anthony Espina
Mark C Fong
Eric W M Fu
Francine W T Fu
Ivy W Y Lai

David Y N Lam
Connie Y H Lau
Henry M W Law
Siu Sai Wo
Prof. Raymond W M So
Howard H P Sou

Alternate Members

Bonnie S Y Chan
Wong Koon Shing

Sally Wong

No of meetings: 3

Average attendance rate: 90%

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.

During the year, the Committee met once to discuss the issues raised by the market on the licensing exams provided by Hong Kong Securities Institute and to resolve to request it to conduct a thorough review of all licensing exam papers.

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

Andreas Mondovits
Derek Shek
Prof. Raymond W M So
Judy Vas

No of meetings: 1

Average attendance rate: 80%

Committees, Panels and Tribunal

Public Shareholders Group

Advises on issues relating to shareholders' rights and interests. It is a standing committee under section 8 of the Securities and Futures Ordinance.

During the year, the Group met four times to discuss various policy issues. Topics discussed include SEHK policy issues relating to long term suspensions, listing of overseas companies, periodic financial reporting, and HKEx's discussion paper on GEM.

Chairman

Peter Au-Yang (to 25.5.06)
Brian Ho (from 28.8.06)

Members

Jamie Allen	Prof. Stephen Cheung
Rex Auyeung	Vincent Duhamel (to 30.6.06)
Prof. Andrew Chan (to 30.6.06)	William Kerr
Prof. K C Chan	Stuart Leckie, OBE, JP
Vincent Chan	Karl Lung
Chan Wing Luk	David M Webb
David Cheung	

No of meetings: 4

Average attendance rate: 70%

SFC Dual Filing Advisory Group

Advises on treatment of cases and policy issues under the Dual Filing regime.

During the year, the Group met twice to advise on two applications where the companies and the sponsors had failed to address certain fundamental issues.

Members

Ashley Alder	Terry Ng
Dennis Cassidy	Mike Scales
David Cheung	James Siu
Raymond Lee	Frank J Slevin
W Gage McAfee	Carlson Tong
Gavin Nesbitt	V-Nee Yeh

No of meetings: 2

Average attendance rate: 67%

Committees, Panels and Tribunal

SFC (HKEC Listing) Committee

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

During the year, there were no circumstances that called for the convening of a meeting of the Committee.

Chairman

Members present in each Committee meeting will elect a Chairman among themselves at the beginning of that meeting

Members

Eric Cheng (to 15.10.06)	Alan Linning (to 6.6.06)
Christina Choi (to 22.6.06)	Keith Lui
Stephen J Clark	Mark Steward (from 25.9.06)
Paul Kennedy (from 16.10.06)	Carlson Tong
Teresa Ko	Martin Wheatley (from 23.6.06)
Alexa Lam	V-Nee Yeh
Michael Lee	

No of meetings: 0

Average attendance rate: N/A

SFC (HKEC Listing) Appeals Committee

Exercises powers and functions equivalent to those of SEHK's Listing Appeals Committee when actual or potential conflicts arise between the interests of HKEx and those of the proper performance of SEHK's listing functions. In such cases, the relevant powers and functions may be exercised by the SFC.

During the year, there were no circumstances that called for the convening of a meeting of the Committee.

Chairman

Members present in each Committee meeting will elect a Chairman among themselves at the beginning of that meeting

Members

Christopher W C Cheng, GBS, JP	Dr York Liao, SBS, JP
Eddy C Fong, SBS, JP	Prof. Liu Pak Wai, SBS, JP
Kenneth H W Kwok, BBS, SC	The Hon Jasper Y S Tsang, GBS, JP
Raymond P L Kwok, JP (to 31.7.06)	Martin Wheatley (to 22.6.06)
Angelina Lee, JP (from 1.8.06)	Shengman Zhang (from 1.1.07)

No of meetings: 0

Average attendance rate: N/A

Committees, Panels and Tribunal

Share Registrars' Disciplinary Committee

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

During the year, there were no circumstances that called for the convening of a meeting of the Committee.

Chairman

Martin Rogers

Deputy Chairman

Stephen Clark

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

Alan Lee

Clifford Levy

Mark Lin

Teresa Ma

Mike Scales

T Brian Stevenson, SBS

David T K Sun

Carlson Tong

Jabson Webber

Kevin Westley

V-Nee Yeh

No of meetings: 0

Average attendance rate: N/A

Share Registrars' Disciplinary Appeals Committee

Hears and determines appeals from the Share Registrars' Disciplinary Committee. 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.

During the year, there were no circumstances that called for the convening of a meeting of the Committee.

Committees, Panels and Tribunal

Independent Panels and Tribunal

Process Review Panel for the Securities and Futures Commission

Reviews and advises the SFC upon the adequacy of the SFC's internal procedures and operational guidelines governing the action taken and operational decisions made by the SFC and its staff in the performance of its regulatory functions, including the receipt and handling of complaints, licensing and inspection of intermediaries, and disciplinary action.

Chairman

Chow Wing Kin, Anthony, SBS, JP

Members

Prof. Chan Yuk Shee, BBS, JP

Clifton Chiu

Eddy C Fong, SBS, JP (from 1.11.06)

Andrew H C Fung

Kam Pok Man

Lai Ying Sie, Benedict, JP

Lee Jor Hung, Dannis, BBS

Liu Che Ning

David T K Sun, BBS

Arbitration Panel under Securities and Futures (Leveraged Foreign Exchange Trading) (Arbitration) Rules

Resolves disputes in accordance with the Securities and Futures (Leverage Foreign Exchange Trading) (Arbitration) Rules.

During the year, no new cases were received and the Panel issued one arbitration award. There was no outstanding case as at year-end.

Chairman

Patrick Gillot

Members

Justin S C Chan

Andrew H C Fung

Deputy Chairman

Eddie C S Tan

Securities and Futures Appeals Tribunal

Hears appeals against a range of regulatory decisions made under the Securities and Futures Ordinance by the SFC and to determine any question or issue arising out of or in connection with any appeal.

Chairman

The Honourable 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. Richard Y K Ho

Prof. Simon S M Ho

Stephen C C Hui, JP

Teresa Ko

Dr Bill C P Kwok

Clement K M Kwok

Angelina Lee, JP (to 10.8.06)

Vincent Marshall K H Lee

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

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Australian Securities & Investments Commission (ASIC)

The ASIC is an independent government body which enforces and regulates company and financial services laws to protect consumers, investors and creditors.

p. 110

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.

p. 51

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. 50, 56

Budget Committee

p. 21

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. 14, 47

Central Clearing and Settlement System (CCASS)

HKEX's clearing and settlement system for its cash market.

p. 54

Chief Executive, Hong Kong Special Administrative Region (HKSAR)

pp. 18, 23, 46

Chief Executive Officer (CEO), SFC

pp. 10, 12, 18, 21

Chief Operating Officer (COO), SFC

pp. 15, 20

China Securities Regulatory Commission (CSRC)

The authorised department under the State Council that governs the securities and futures markets of China.

pp. 11, 43, 46, 48

China Banking Regulatory Commission (CBRC)

The authorised department under the State Council that governs the banking sector of China.

p. 48

Closer Economic Partnership Arrangement (CEPA)

p. 49

Code of Conduct, SFC

pp. 20, 106

Codes on Takeovers and Mergers and Share Repurchases

p. 37

Commission Possible Volunteers Group

p. 27

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.

pp. 40, 43

Commodity Exchange Compensation Fund (CECF)

p. 114

Companies Ordinance

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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.

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Corporate Social Responsibility (CSR)

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Department of Justice

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Derivative warrants

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Director of Audit

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Disclosure of Interests

Anyone who has an interest of 5% or more of the voting shares of a listed company is required to disclose that interest within three business days of acquiring or disposing of the interest. Directors and chief executives of listed companies are required to disclose any acquisition or disposal of their company's shares, irrespective of the percentage they hold.

pp. 56, 108

Dr Wise column

pp. 4, 54, 115

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. 12, 37, 50, 116

Dual Filing Advisory Group

p. 116

E

Economic Summit on "China's 11th Five-Year Plan and the Development of Hong Kong"

Convened by the HKSAR Chief Executive to discuss how Hong Kong should respond to the challenges and opportunities arising from the 11th Five-Year Plan. Four Focus Groups were established to discuss the development strategy for Hong Kong's four major economic sectors: financial services; maritime, logistics and infrastructure; trade and business; professional services, information & technology and tourism.

pp. 11, 14, 46

Exchange Traded Fund (ETF)

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

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Executive Committee

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Executive Directors (EDs), SFC

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F

Federation of Share Registrars Ltd

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Fidelity insurance

p. 48

Financial Secretary, HKSAR

pp. 3, 14, 15, 21-22, 38, 41

Financial Services and the Treasury Bureau (FSTB)

pp. 23, 38

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. 48, 110

Financial Services Network (FinNet)

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

p. 51

Forest Stewardship Council

A non-profit organisation based in Germany with a mission to promote environmentally appropriate, socially beneficial and economically viable management of the world's forests.

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Index

G

Global Financial Centres Index (GFCI)
Launched by the City of London Corporation, it is an index of indices tracking changing perceptions of cities as financial centres on an ongoing basis.
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Growth Enterprise Market (GEM)
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H-shares Index Futures
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Hang Seng Index (HSI)
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Hedge fund
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Hong Kong Association of Banks
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Hong Kong Council of Social Service
pp. 15, 27

Hong Kong Exchanges and Clearing Ltd (HKEx)
HKEx owns and operates the only stock exchange and futures exchange in Hong Kong. It is the holding company of The Stock Exchange of Hong Kong Ltd, Hong Kong Futures Exchange Ltd and Hong Kong Securities Clearing Company Ltd. It went public in June 2000 following the integration of the securities and futures market.
pp. 2-3, 14, 36, 41-42, 46, 116-117

Hong Kong Futures Exchange Ltd (HKFE)
A subsidiary of HKEx where futures and options contracts are traded.
p. 105

Hong Kong Institute of Certified Public Accountants (HKICPA)
pp. 18, 25, 40, 51

Hong Kong Interbank Clearing Ltd (HKCL)
The HKCL is a private company jointly owned by the Hong Kong Monetary Authority (HKMA) and the Hong Kong Association of Banks (HKAB) which provides interbank clearing and settlement services to all banks in Hong Kong and operates a central clearing and settlement system for public and private debt securities on behalf of the HKMA.
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Hong Kong Management Association
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Hong Kong Monetary Authority (HKMA)
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Hong Kong Securities Clearing Company Ltd (HKSCC)
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Hong Kong Securities Institute (HKSI)
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I

Independent Commission Against Corruption (ICAC)
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Insider dealing
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Insider Dealing Tribunal (IDT)
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International Organization of Securities Commissions (IOSCO)
IOSCO is an international co-operative body recognised as the international standard setter for securities markets.
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Internet Professional Association
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InvestEd
An SFC operated portal to provide investors with educational information on investments and regulations.
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Investment advisers
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Investment-linked assurance schemes
pp. 24, 54, 104

Investor Compensation Company Ltd (ICC)
p. 40

Investor Compensation Fund (ICF)
pp. 3, 40

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.
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Margin financing pp. 38, 105, 107

Market manipulation pp. 41, 107

Market misconduct pp. 3, 41, 56

Market Misconduct Tribunal (MMT) pp. 3, 41

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. 43

Memorandum of Understanding (MOU)
Co-operative arrangements or agreements the SFC signed with other local or international organisations. p. 48

Mis-selling pp. 42, 54-55

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. 49

N

Non-Executive Directors (NEDs), SFC p. 18

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P

Performance pledges p. 24

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Position limits pp. 14, 47

Process Review Panel (PRP) pp. 23, 119

Public Shareholders Group p. 116

Q

Qualified Domestic Institutional Investor Scheme (QDII)
A scheme which allows Mainland investors to invest in foreign securities markets via certain approved financial institutions such as fund management companies, insurance companies and securities companies. p. 48

Qualified Foreign Institutional Investor Scheme (QFII)
A scheme which allows approved qualified foreign institutional investors to invest in Mainland securities. p. 47

R

Radio Television Hong Kong (RTHK) pp. 14, 54

Real Estate Investment Trusts (REITs)
Collective investment schemes constituted as a trust that invest primarily in real estate with the aim providing returns to holders derived from the rental income of the real estate. pp. 37, 47, 55, 104, 113

Remuneration Committee p. 21

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S

- Securities and Exchange Commission (SEC), US**
The SEC is a United States government agency having primary responsibility for enforcing the Federal securities laws and regulating the securities industry.
pp. 39, 48, 110
- Securities and Futures Appeals Tribunal (SFAT)**
pp. 23, 42, 109, 119
- 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.
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- Securities and Futures Ordinance (SFO)**
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- Shanghai Stock Exchange**
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- Sponsors**
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- Staff Social Committee**
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- Stakeholder Survey**
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- State Administration of Foreign Exchange (SAFE)**
The authorised department under the State Council that governs the foreign exchange market of China.
p. 48
- Statutory backing**
pp. 13, 36
- Stock Exchange of Hong Kong Ltd (SEHK)**
A subsidiary of HKEx where a wide range of securities including equities, debts, unit trusts, exchange-traded funds and warrants are traded.
pp. 105, 116-117
- Stock Segregated Account (SSA) service**
A service provided by Hong Kong Securities and Clearing Company where investors will receive an account balance statement when there are changes in the stock balance.
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T

- Takeovers and Mergers Panel**
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- Takeovers Executive**
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- Trading spread**
The minimum allowable change in price of securities traded on the SEHK.
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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.
p. 48
- Unified Exchange Compensation Fund (UECF)**
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Publisher Information

Publisher Securities and Futures Commission

Office 8th Floor, Chater House
8 Connaught Road Central
Hong Kong

Telephone: (852) 2840 9222

Facsimile: (852) 2521 7836

Website: www.sfc.hk

InvestEd Website: www.InvestEd.hk

Auditor KPMG

Enquiries General: (852) 2840 9222
SFC Infoline: (852) 2840 9393
(General information and information for intermediaries)
Media Hotline: (852) 2840 9287
Investor Hotline: (852) 2840 9333
(Investor enquiries and complaints)
Email: enquiry@sfc.hk

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Securities and Futures Commission

8th Floor, Chater House
8 Connaught Road Central
Hong Kong

Telephone : (852) 2840 9222

Facsimile : (852) 2521 7836

Website : www.sfc.hk

InvestEd Website : www.InvestEd.hk