

# 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 2008.

### 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 80 to 92.

### 3. Members of the Committee

The members of the Committee during the year ended 31 March 2008 and up to the date of this report were:

Mr Keith Lui (Chairman)

Mr Gerald Greiner

Mr Kenneth H W Kwok, BBS, SC

Mrs Alexa Lam

### 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*

13 May 2008

## Independent auditor's report to the Securities and 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 80 to 92 which comprise the balance sheet as at 31 March 2008 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 the SFC to keep proper accounts of the Fund and to prepare financial statements of the Fund in respect of each financial year. The directors of the SFC do so on the basis that these financial statements should give a true and fair view 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 2008 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

13 May 2008

## Investor Compensation Fund

### Income and expenditure account

For the year ended 31 March 2008

(Expressed in Hong Kong dollars)

	Note	2008 \$'000	2007 \$'000
<b>Income</b>			
Net investment income	3&5	<b>126,894</b>	108,932
Exchange difference		<b>(3,720)</b>	5,262
		<b>123,174</b>	114,194
<b>Expenses</b>			
Investor Compensation Company expenses	7	<b>3,809</b>	3,893
Compensations (write backs) / expenses	8	<b>(10,873)</b>	48,570
Auditor's remuneration		<b>77</b>	72
Bank charges		<b>770</b>	758
Professional fees		<b>2,965</b>	2,668
Sundry expenses		<b>1</b>	1
		<b>(3,251)</b>	55,962
<b>Surplus</b>		<b>126,425</b>	58,232
<b>Accumulated surplus brought forward</b>		<b>629,760</b>	571,528
<b>Accumulated surplus carried forward</b>		<b>756,185</b>	629,760

## Balance sheet

At 31 March 2008

(Expressed in Hong Kong dollars)

	Note	2008 \$'000	2007 \$'000
<b>Current assets</b>			
Financial assets designated at fair value through profit or loss			
– Debt securities	9	1,502,130	1,548,070
– Equity securities	9	202,926	177,925
Interest receivable		21,411	24,516
Unsettled regular purchases of financial assets		46,987	–
Due from Investor Compensation Company		536	863
Fixed and call deposits with banks	10	104,916	27,800
Cash at bank	10	4,784	263
		<b>1,883,690</b>	1,779,437
<b>Current liabilities</b>			
Provision for compensation	8	22,978	45,214
Accounts payable and accrued charges		886	822
		<b>23,864</b>	46,036
		<b>1,859,826</b>	1,733,401
<b>Net current assets</b>			
		<b>1,859,826</b>	1,733,401
<b>Net assets</b>			
		<b>1,859,826</b>	1,733,401
Representing:			
<u>Compensation fund</u>			
Contributions from Unified Exchange Compensation Fund	11	994,718	994,718
Contributions from Commodity Exchange Compensation Fund	11	108,923	108,923
Accumulated surplus		756,185	629,760
		<b>1,859,826</b>	1,733,401

Approved and authorised for issue by the Securities and Futures Commission (the SFC) on 13 May 2008 and signed on its behalf by

**Eddy C Fong**

*Chairman of the SFC*

**Martin Wheatley**

*Chief Executive Officer of the SFC*

## Investor Compensation Fund

### Statement of changes in equity

For the year ended 31 March 2008

(Expressed in Hong Kong dollars)

	<b>2008</b>	2007
	<b>\$'000</b>	\$'000
Compensation Fund balance as at 1 April	<b>1,733,401</b>	1,674,206
Surplus for the year	<b>126,425</b>	58,232
Contributions from Commodity Exchange Compensation Fund	—	963
Compensation Fund balance as at 31 March	<b>1,859,826</b>	1,733,401

## Cash flow statement

For the year ended 31 March 2008

(Expressed in Hong Kong dollars)

	2008	2007
	\$'000	\$'000
<b>Cash flows from operating activities</b>		
Surplus for the year	126,425	58,232
Net investment income	(126,894)	(108,932)
Exchange difference	3,720	(5,262)
Decrease in amount due from Investor Compensation Company	327	863
Increase in unsettled regular purchases of financial assets	(46,987)	–
(Decrease) / Increase in provision for compensation	(22,236)	45,214
Increase in accounts payable and accrued charges	64	56
Net cash used in operating activities	(65,581)	(9,829)
<b>Cash flows from investing activities</b>		
Purchase of debt securities	(1,305,142)	(1,827,241)
Sale or maturity of debt securities	1,375,047	1,650,868
Sale of equity securities	970	752
Interest received	76,343	60,200
Net cash from / (used in) investing activities	147,218	(115,421)
<b>Cash flows from financing activities</b>		
Contributions received from Commodity Exchange Compensation Fund	–	963
Net cash from financing activities	–	963
<b>Net increase / (decrease) in cash and cash equivalents</b>	<b>81,637</b>	<b>(124,287)</b>
<b>Cash and cash equivalents at beginning of the year</b>	<b>28,063</b>	<b>152,350</b>
<b>Cash and cash equivalents at end of the year</b>	<b>109,700</b>	<b>28,063</b>

### Analysis of the balance of cash and cash equivalents:

	2008	2007
	\$'000	\$'000
Fixed and call deposits with banks	104,916	27,800
Cash at bank	4,784	263
	109,700	28,063

## Investor Compensation Fund

### Notes to the financial statements

For the year ended 31 March 2008

(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 and 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 though it is not likely that these payments will be made within the coming year.

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 5).

#### 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

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.

### 3. Significant accounting policies (cont'd)

#### **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.

#### **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.

#### **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 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 consist 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. Unlisted equity investments are shares in pooled funds. The fair value is determined based on the Fund's share in the net assets of the pooled funds as determined by the custodian. The majority of the underlying assets of the pooled funds are listed securities.

##### *(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.

## Investor Compensation Fund

### 3. Significant accounting policies (cont'd)

#### (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.

#### 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 are 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. These are classified as loans and receivables in accordance with the determination in International Accounting Standard ("IAS") 39, are due within one year and are unsecured.

#### Provision for compensation

We make provision for liabilities arising from claims resulting from defaults for which it is probable that the Fund will require an outflow of economic benefits to settle the obligation and the amount can be estimated reliably, independent of whether a notice calling for claims pursuant to Section 3 of the Securities and Futures (Investor Compensation-Claims) Rules has been published. The provision covers all such claims received up to the date on which the financial statements are approved by the SFC. If the effect is material, we determine provisions by discounting the expected future cash flows that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

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. These liabilities are classified as financial liabilities measured at amortised cost in accordance with the determination in IAS 39, are due within one year and are unsecured.

### 3. Significant accounting policies (cont'd)

#### **Contingent liability**

When 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.

#### **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.

#### **Changes in accounting policies**

A number of new and revised standards and interpretations that are first effective or available for early adoption for the current accounting period of the Fund were issued.

As a result of the adoption of IFRS 7 "Financial instruments: Disclosures", the financial statements include expanded disclosures about the significance of the financial instruments and the nature and extent of risks arising from those instruments, compared with the information previously required to be disclosed by IAS 32, "Financial instruments: Disclosure and presentation". These disclosures are provided throughout these financial statements, in particular in note 13.

Further, as a result of the adoption of the amendment to IAS 1 "Presentation of financial statements" which introduces new disclosures on the level of capital and objectives, policies and processes for managing capital, additional disclosures in relation to the Fund's solvency and funding requirements have been provided. These new disclosures are set out in notes 2, 6 and 11.

Neither IFRS 7 nor the amendment to IAS 1 have any material impact on the classification, recognition and measurement of the amounts recognised in the financial statements.

### 4. Taxation

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

## Investor Compensation Fund

### 5. Net investment income

	<b>2008</b>	2007
	<b>\$'000</b>	\$'000
Interest income from bank deposits	<b>3,887</b>	3,871
Interest income on financial assets designated at fair value through profit or loss	<b>68,268</b>	62,873
Realised (loss) / gain on disposal of equity securities	<b>(34)</b>	3
Realised gain on redemption / disposal of debt securities	<b>5,544</b>	3,629
Gain on revaluation of equity securities	<b>26,835</b>	31,967
Gain on revaluation of debt securities	<b>22,394</b>	6,589
Net investment income	<b>126,894</b>	108,932

Interest income from bank deposits and debt securities is derived as follows:

	<b>2008</b>	2007
	<b>\$'000</b>	\$'000
Total interest income on financial assets not at fair value through profit or loss	<b>3,887</b>	3,871
Interest income on financial assets designated at fair value through profit or loss	<b>68,268</b>	62,873
	<b>72,155</b>	66,744

### 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 2008, ICC incurred costs of \$3,809,000 for its operations (2007: \$3,893,000).

## 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	45,214
Add: provision made during the year ended 31 March 2008	6,450
Less: provision reversed during the year ended 31 March 2008	(17,323)
Less: compensation paid during the year ended 31 March 2008	(11,363)
Balance as at 31 March 2008	22,978

We maintained provision for liabilities arising from claims received resulting from two default cases for which ICC has published a notice calling for claims pursuant to Section 3 of the Securities and Futures (Investor Compensation-Claims) Rules. We also made provision for a case for which ICC has not published the notice calling for claims but it is probable the case will result in compensation payments from the Fund. The maximum liability of the Fund to claims for these cases is set at \$150,000 per claimant. As at 31 March 2008 all provisions were expected to be paid within one year.

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

	2008	2007
	\$'000	\$'000
(a) Debt securities		
(i) Listing status		
Listed – outside Hong Kong	<b>317,043</b>	365,445
Listed – in Hong Kong	<b>126,294</b>	106,428
Unlisted	<b>1,058,793</b>	1,076,197
	<b>1,502,130</b>	1,548,070
(ii) Maturity profile		
– Within one year	<b>621,703</b>	686,980
– After one year but within two years	<b>546,878</b>	491,983
– After two years but within five years	<b>276,348</b>	321,163
– After five years	<b>57,201</b>	47,944
	<b>1,502,130</b>	1,548,070
(iii) The weighted average effective interest rate of debt securities on 31 March 2008 was 2.54% (2007: 4.66%).		
(b) Equity securities		
Unlisted	<b>202,926</b>	177,925

## Investor Compensation Fund

### 10. Deposits with banks and cash at bank

The effective interest rate on deposits with banks and cash at bank at 31 March 2008 ranged from 1.33% to 2.85% (2007: 3.91% to 5.3%). The balances mature within one year at both 31 March 2008 and 31 March 2007.

### 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 2008, the SFC had paid \$994,718,000 (2007: \$994,718,000) and \$108,923,000 (2007: \$108,923,000) into the Fund from the UECF and the CECF respectively.

The Fund defines "capital" as including contributions from UECF and CECF and the accumulated surplus.

### 12. Related party transactions

We have related party relationships with the SFC, the ICC, the SEHK, the HKFE and the UECF. During the year, there were no significant related party transactions other than those disclosed in the financial statements (refer to notes 6, 7 & 11).

### 13. Financial instruments

The financial assets of the Fund mainly comprise debt securities and units in a pooled fund. The underlying investments of the pooled fund mainly comprise equity securities.

The main financial risks of the Fund arise from its investments in debt and equity securities. The SFC appoints external investment managers to manage the Fund's investments and to ensure that the portfolio's investments comply with the Fund's investment policy approved by the SFC which sets control limits on credit risk, market risk, interest rate risk, liquidity risk and foreign exchange risk. The external investment managers report thereon to the SFC on a regular basis.

#### (i) Credit risk

The Fund's Investment Policy and Administrative Guidelines (Policy) only allows the Fund to invest in pooled funds, fixed rate dated securities rated A or above or in bank deposits. The Policy further limits the Fund's exposure to each issuer and each country, except for holdings of the US Treasuries, any issuances by Hong Kong Government and specified multilateral agencies rated AAA by Moody's or S&P's and approved pooled funds. The Fund's investment managers are responsible for managing the portfolio and ensuring the portfolio's investments meet the investment policy and restrictions and reports thereon on a monthly basis. 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.

## 13. Financial instruments (cont'd)

### (iii) Interest rate risk

The Fund's interest bearing assets mainly comprise fixed interest rate bearing debt securities and bank deposits. The Fund's bank deposits are exposed to short term bank deposit interest re-pricing risk.

The Fund is subject to the risk that future cash flows of a debt security will fluctuate because of changes in market interest rates. In order to manage the re-pricing risk, the Fund adopts a policy of maintaining duration at no more than 2.5 years within its debt securities portfolio. As at 31 March 2008 the duration was 1.42 years (31 March 2007: 1.31 years).

At 31 March 2008, it is estimated that a general increase / decrease of 100 basis points in 3 month interest rates, with all other variables held constant, would decrease / increase the Fund's gains on revaluation of debt securities and the accumulated surplus by approximately \$23.5 million (2007: \$20.6 million). Further, at 31 March 2008, it is estimated that a general increase / decrease of 100 basis points in 3 month interest rates, with all other variables held constant, would increase / decrease the Fund's interest income and the accumulated surplus by approximately \$3.8 million (2007: \$4.1 million). Other components of accumulated surplus would not be affected (2007: Nil) by the changes in interest rates.

The sensitivity analysis above has been determined assuming that the change in interest rates had occurred at the balance sheet date and had been applied to the exposure to interest rate risk for financial instruments in existence at that date. The 100 basis point increase or decrease represents the Fund's assessment of a reasonably possible change in interest rates over the period until the next annual balance sheet date. The analysis is performed on the same basis for 2007.

### (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.

The Fund invests in units of a pooled fund which mainly comprises equity securities, the performance of which is measured against the benchmark index MSCI AC Pacific ex Japan. It is estimated that a general increase / decrease of 20% in the benchmark index would increase/decrease the Fund's profit and accumulated surplus by approximately \$30.6 million (2007: a general increase / decrease of 17.6% in the benchmark index would increase / decrease the Fund's profit and accumulated surplus by approximately \$26.7 million).

The sensitivity analysis has been determined assuming that the reasonably possible changes in the benchmark index had occurred at the balance sheet date and had been applied to the exposure to equity price risk in existence at that date. It is also assumed that the fair values of the Fund's equity investments would change in accordance with the historical correlation with the relevant benchmark index since the portfolio is diversified in terms of industry distribution and that all other variables remain constant. The stated changes represent the Fund's assessment of reasonably possible changes in the relevant benchmark index based on risk analysis of the pooled fund over the period until the next annual balance sheet date. The analysis is performed on the same basis for 2007.

## Investor Compensation Fund

### 13. Financial instruments (cont'd)

#### (vi) Fair values

All financial instruments are carried at amounts not materially different from their fair values as at 31 March 2008 and 2007.

Where available, the fair value of the debt securities is the quoted market price. The fair value of unlisted debt securities is determined based on quotes from bond market-makers.

Unlisted investments are shares in pooled funds. The fair value is determined based on the Fund's share in the net assets of the pooled funds as determined by the custodian. The majority of the underlying assets of the pooled funds are listed securities.

### 14. Contingent liabilities

As at the date of this report, in addition to the provision made, as described in note 8, there are other claims received for which currently there is insufficient information to determine the likely level of payment. The maximum liability in respect of these claims of \$2,403,000 (as at 31 March 2007: \$7,784,000) is a contingent liability of the Fund and this is determined based on the lower of the maximum compensation limit of \$150,000 per claimant or the amount claimed.

### 15. Comparative figures

As a result of adopting IFRS 7 "Financial instruments: Disclosures", certain comparative figures have been adjusted to conform with changes in disclosures in the current year and to show separately comparative amounts in respect of items disclosed for the first time in 2008.

### 16. Possible impact of amendments, new standards and interpretations issued but not yet effective for the annual accounting period ended 31 March 2008

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 year ended 31 March 2008 and which have not been adopted in these financial statements.

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.