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# 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 2010.

### 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Part X of the repealed Securities Ordinance (Chapter 333) established the Fund.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 settlement of all claims against the Fund 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Part X of the repealed Securities Ordinance remains effective in respect of the operation of the Fund to the extent described in Section 74 of Schedule 10 of the SFO.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 98 to 108.

### 3. Members of the committee

The members of the Committee during the year ended 31 March 2010 and up to the date of this report were:

Mr Keith Lui (Chairman)  
Mr Gerald Greiner  
Mrs Alexa Lam  
Mr Kenneth H W Kwok, BBS, SC  
Mr Eric Yip

### 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 end of the reporting period or at any time during the year.

### 5. Auditor

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

On behalf of the Committee

**Keith Lui**

*Chairman*

10 May 2010

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## 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the financial statements of the Unified Exchange Compensation Fund (the Fund) established under Section 99 of the repealed Hong Kong Securities Ordinance set out on pages 98 to 108 which comprise the statement of financial position as at 31 March 2010 and the statement of comprehensive income, the statement of changes in equity and the statement of cash flows 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 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 2010 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

10 May 2010

## Statement of comprehensive income

For the year ended 31 March 2010

(Expressed in Hong Kong dollars)

	Note	2010 \$'000	2009 \$'000
<b>Income</b>			
Interest income		149	1,146
Recoveries	5	310	99
		<b>459</b>	1,245
<b>Expenses</b>			
Auditor's remuneration		38	38
Professional fees		13	13
Sundry expenses		1	1
		<b>52</b>	52
<b>Surplus and total comprehensive income for the year</b>		<b>407</b>	1,193

The notes on pages 102 to 108 form part of these financial statements.

## Statement of financial position

At 31 March 2010

(Expressed in Hong Kong dollars)

	Note	2010 \$'000	2009 \$'000
<b>Current assets</b>			
Equity securities received under subrogation		2	307
Interest receivable		4	44
Fixed and call deposits with banks		68,958	67,270
Cash at bank		22	334
		<b>68,986</b>	67,955
<b>Current liabilities</b>			
Creditors and accrued charges	6	10,305	10,281
		<b>10,305</b>	10,281
<b>Net current assets</b>		<b>58,681</b>	57,674
<b>Net assets</b>		<b>58,681</b>	57,674
Representing:			
<b>Compensation fund</b>			
Contributions from the SEHK	7	47,600	47,000
Excess transaction levy from the SEHK	9	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	10	3,002	3,002
Accumulated surplus		15,510	15,103
		<b>1,053,399</b>	1,052,392
Contributions to Investor Compensation Fund	11	(994,718)	(994,718)
		<b>58,681</b>	57,674

Approved and authorised for issue by the Securities Compensation Fund Committee on behalf of the Securities and Futures Commission on 10 May 2010 and signed on its behalf by

**Keith Lui**  
Chairman

**Gerald Greiner**  
Committee Member

The notes on pages 102 to 108 form part of these financial statements.

## Statement of changes in equity

For the year ended 31 March 2010

(Expressed in Hong Kong dollars)

	<b>2010</b>	2009
	<b>\$'000</b>	\$'000
Compensation Fund balance as at 1 April	<b>57,674</b>	56,031
Net contribution from the SEHK	<b>600</b>	450
Total comprehensive income for the year	<b>407</b>	1,193
Compensation Fund balance as at 31 March	<b>58,681</b>	57,674

The notes on pages 102 to 108 form part of these financial statements.

## Statement of cash flows

For the year ended 31 March 2010  
(Expressed in Hong Kong dollars)

	<b>2010</b>	2009
	<b>\$'000</b>	\$'000
<b>Cash flows from operating activities</b>		
Surplus for the year	<b>407</b>	1,193
Interest income	<b>(149)</b>	(1,146)
Decrease in equity securities received under subrogation	<b>305</b>	363
Decrease in provision for compensation	–	(27)
Increase in creditors and accrued charges	<b>24</b>	5,973
Net cash generated from operating activities	<b>587</b>	6,356
<b>Cash flows from investing activities</b>		
Interest received	<b>189</b>	1,202
Net cash generated from investing activities	<b>189</b>	1,202
<b>Cash flows from financing activities</b>		
Contributions from the SEHK	<b>600</b>	450
Net cash generated from financing activities	<b>600</b>	450
Net increase in cash and cash equivalents	<b>1,376</b>	8,008
Cash and cash equivalents at beginning of the year	<b>67,604</b>	59,596
<b>Cash and cash equivalents at end of the year</b>	<b>68,980</b>	67,604

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

	<b>2010</b>	2009
	<b>\$'000</b>	\$'000
Fixed and call deposits with banks	<b>68,958</b>	67,270
Cash at bank	<b>22</b>	334
	<b>68,980</b>	67,604

## Notes to the financial statements

For the year ended 31 March 2010  
(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 Securities and Futures Commission (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 settlement of all claims against the Fund 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 (2009: 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 14; special levy surplus detailed in note 10; and transaction levy received before the SFO became effective from 1 April 2003.

The Fund defines "capital" as including all elements of the Fund less contributions to the ICF and less contributions from the SEHK (deposits for transferred trading rights) as disclosed on the face of the statement of financial position.

### 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 end of the reporting period 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

<b>Interest income</b>	We record interest income from bank deposits on an accruals basis.
<b>Recoveries</b>	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 be virtually certain that the recoveries will be received and paid.
<b>Replenishments by the SEHK</b>	We record replenishments from the SEHK pursuant to Section 107 of the repealed Securities Ordinance as income of the Fund on a receipt basis. For the purpose of calculating the amount to be replenished by the SEHK, we deem compensation payments up to the amount of \$8,000,000 for each default to be charged to the contribution from the SEHK.

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

#### Impairment

##### (i) Recognition of impairment loss

We review the carrying amounts of the Fund's assets at the end of each reporting period 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 statement of comprehensive income 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.

#### Creditors and accrued charges

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

#### Contingent liabilities

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.

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

#### Related parties

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

- (i) parties that the Fund has the ability, directly or indirectly, to control or to significantly influence in making financial and operating decisions;
- (ii) parties that have the ability, directly or indirectly, to control or to significantly influence the Fund in making financial and operating decisions; and
- (iii) parties that are subject to common control or common significant influence.

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

#### Changes in accounting policies

The IASB has issued one new IFRS, a number of amendments to IFRSs and new Interpretations that are first effective for the current accounting period of the Fund. Of these, the following development is relevant to the Fund's financial statements:

– IAS 1 (revised 2007), Presentation of financial statements

The revised standard requires all owner changes in equity to be presented in the statement of changes in equity, whereas all non-owner changes in equity are presented in the statement of comprehensive income. The application of the revised standard did not have any impact on reported surplus or deficit, total income and expense or net assets for any period presented.

### 4. Taxation

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

### 5. 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 has arranged to liquidate a substantial portion of shares during the year. The Fund recognised as recoveries the payments from liquidators, the sale proceeds of shares allocated and the remaining shares at market value as of 31 March 2010 after deducting relevant processing fees and charges for collecting and selling the shares received.

The shares allocated to the Fund under its subrogation rights are classified as designated at fair value through profit and loss securities in accordance with the determination in IAS 39. According to IFRS 7, these subrogated shares shall be classified as level 1 financial instruments as they all have quoted market price (unadjusted) in an active market for an identical instrument. At the end of each reporting period the fair value is remeasured, with any resultant gain or loss being recognised in "Recoveries". Dividend income, if any, is also recognised in "Recoveries".

## 6. Creditors and accrued charges

Creditors 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.

These liabilities classified as financial liabilities measured at amortised costs in accordance with the determination in IAS 39 unless the effect of discounting would be immaterial, in which case they are stated at cost, are due on demand or within one year and are unsecured.

## 7. Set-off of SEHK deposits and refunds/contributions from the SEHK

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 off these amounts for trading right transferred 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 seven trading rights having been transferred during the six months to 31 March 2010 (2009: five trading rights had been transferred during the six months to 31 March 2009).

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. During the year, deposits of \$1,300,000 in respect of 26 new trading rights were received from the SEHK.

The SEHK also advised the SFC of 27 trading rights in total having been relinquished since September 2008. Unless the money is required to satisfy any claims or liabilities arising before such relinquishment, the SFC will refund to the SEHK the deposit of \$50,000 in respect of each trading right at or about the end of a six-month period after the relinquishment took effect. During the year, the SFC refunded deposits of total \$700,000 to the SEHK in respect of 14 of these relinquished trading rights.

The movement of contributions from the SEHK during the year was as follows:

	<b>2010</b>	2009
	<b>\$'000</b>	\$'000
Balance brought forward	<b>47,000</b>	46,550
Add: 26 new trading rights issued (2009: 19)	<b>1,300</b>	950
Less: 14 relinquished trading rights refunded (2009: 10)	<b>(700)</b>	(500)
Balance carried forward	<b>47,600</b>	47,000

## 8. Contingent liabilities

As at the date of this report, there is no outstanding claim against the Fund.

Shares were allocated to the Fund under its subrogation rights in relation to the C.A. Pacific case (refer to note 5). As at 31 March 2010, shares with a market value \$2,009, which are listed on the SEHK, remained unsold. Any excess of recovered amounts (if any) after disposal of these remaining shares will be re-distributed to claimants. As the timing of re-distribution and amount of these potential excess amounts are uncertain at the date of this report, we disclose this as a contingent liability.

## 9. 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.

## 10. Special levy surplus

In November 2000, the former Financial Services Bureau of the HKSAR Government transferred to the Fund \$3,002,000 under the provisions of the Exchanges (Special Levy) Ordinance.

## 11. 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 2010 amounted to \$994,718,000 (2009: \$994,718,000).

## 12. 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, 9, 11 and 14).

## 13. Financial risk management

Interest bearing assets include mainly deposits at banks which mature or re-price in the short term, as a result of which the Fund is subject to a limited exposure to interest rate risk due to fluctuations in the prevailing market rates. At 31 March 2010, it is estimated that a general increase of 100 basis points, with all other variables held constant, would increase the Fund's surplus and accumulated surplus by approximately \$0.69 million (2009: \$0.67 million). The extent of any decrease in interest rates is expected to be minimal (2009: 1%) which would decrease the Fund's surplus by an insignificant amount (2009: \$0.67 million). 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 HK dollar.

The Fund's credit risk is primarily attributable to amounts at bank. Management's policy is that bank balances are placed only with licensed banks in Hong Kong. The maximum exposure to credit risk without taking account of any collateral held is represented by the carrying amount of each financial asset in the statement of financial position after deducting any impairment allowance.

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.

#### 14. Replenishments from the SEHK

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

Up to 31 March 2010, the SEHK has replenished \$16,361,000 to the Fund. In compliance with Section 107 of the repealed Securities Ordinance, if no further recoveries were to be collected, the SFC may require the SEHK to further replenish \$70,816,000 to the Fund as follows:

	<b>2010</b>	2009
	<b>\$'000</b>	\$'000
Compensation paid up to the \$8 million limit as set out in Section 109(3) of the repealed Securities Ordinance	<b>100,738</b>	100,738
Less: Recoveries received for compensation paid up to \$8 million	<b>(29,946)</b>	(29,946)
Add: Recoveries re-distributed to claimants	<b>16,385</b>	16,385
Less: Replenishments from the SEHK	<b>(16,361)</b>	(16,361)
Net amount the SFC may request the SEHK for replenishment	<b>70,816</b>	70,816

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.

Replenishment from the SEHK are not recognised in the statement of financial position given that the Fund is not aware of any need for requesting the SEHK for replenishment in the near future.

#### 15. Possible impact of amendments, new standards and interpretations issued but not yet effective for the annual accounting period ended 31 March 2010

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 2010 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 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 result in a restatement of the Fund's results of operations and financial position.

In addition, the following developments may result in amended disclosures in the financial statements, including restatement of comparative amounts in the first period of adoption:

	Effective for accounting periods beginning on or after
Improvements to IFRSs 2009	1 July 2009 or 1 January 2010