

## Report of the Securities Compensation Fund Committee

The members of the Securities Compensation Fund Committee (the Committee) present their annual report and the audited financial statements for the year ended 31 March 1999.

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

The Fund was established for the purposes set out in Part X of the Securities Ordinance (Chapter 333).

### 2. Financial Results

The financial results are set out in the financial statements presented on pages 78 to 85.

### 3. Members of the Committee

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

Mr Mark Dickens	(appointed on 1 April 1999)
Mr David White, JP	(resigned on 31 March 1999)
Mr Alec Y W Tsui	
Mr Roderick Chalmers	
Mr David Roberts	(appointed on 16 November 1998)
Mr Andrew Procter	(appointed on 25 November 1998)
Mr Syed Bagh Ali Shah Bokhary	(resigned on 15 November 1998)
Mrs Laura M Cha, JP	(resigned on 24 November 1998)

### 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

On 19 November 1998, KPMG Peat Marwick changed the name under which they practise to KPMG and, accordingly, have signed their report in their new name.

KPMG retire and, being eligible, offer themselves for reappointment.

On behalf of the Committee

**Mark Dickens**

Chairman

15 June 1999

## **Auditors' Report To the Securities and Futures Commission (SFC)**

We have audited the financial statements of the Unified Exchange Compensation Fund (the Fund) established under S.99 of the Securities Ordinance set out on pages 78 to 85 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

### **Respective Responsibilities of the SFC and Auditors**

The Securities Ordinance requires the SFC to keep proper accounts of the Fund and to prepare an income and expenditure account and a balance sheet (the financial statements) of the Fund in respect of each financial year. The directors of the SFC do so on the basis that these financial statements should give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently, that judgments and accounting estimates are made which are prudent and reasonable and that the reasons for any significant departure from applicable accounting standards are stated.

It is our responsibility to form an independent opinion, based on our audit, on those financial statements and to report our opinion to you.

### **Basis of Opinion**

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Society of Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the SFC in the preparation of the financial statements and of whether the accounting policies are appropriate to the Fund's circumstances, have been consistently applied and are adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

### **Opinion**

In our opinion the financial statements give a true and fair view, in all material respects, of the state of affairs of the Fund at 31 March 1999 and of its surplus and cash flows for the year then ended, and have been properly prepared in accordance with accounting principles generally accepted in Hong Kong.

### **KPMG**

Certified Public Accountants  
Hong Kong

15 June 1999

## Income and Expenditure Account

For the year ended 31 March 1999 (Expressed in HK\$)

	Note	1999	1998
<b>Income</b>			
Interest and investment income	3	\$ 33,173,011	\$ 33,081,351
Other income	3	–	60,000
		<u>\$ 33,173,011</u>	<u>\$ 33,141,351</u>
<b>Expenditure</b>			
Auditors' remuneration		\$ 37,000	\$ 36,000
Premium amortised	3	479,252	443,433
Loss on disposal of dated securities	3	65,100	–
Bank charges		195,700	213,779
Legal and professional fees		2,248,828	169,798
Sundry expenses		20,935	150
		<u>\$ 3,046,815</u>	<u>\$ 863,160</u>
<b>Surplus of Income Over Expenditure Before Appropriations</b>		<b>\$ 30,126,196</b>	<b>\$ 32,278,191</b>
<b>Balance Brought Forward</b>		<b>\$ –</b>	<b>\$ –</b>
<b>Appropriations</b>			
Payment to The Stock Exchange of Hong Kong Limited (SEHK) of interest declared at 5.3915% p.a. (1998: 7.0848% p.a.) pursuant to S.105(2)(a) of the Securities Ordinance (Chapter 333)		857,625	2,155,125
Transfer to Compensation Fund Account	10	29,268,571	30,123,066
<b>Balance Carried Forward</b>		<b>\$ –</b>	<b>\$ –</b>

The notes on pages 81 to 85 form an integral part of the financial statements

Unified Exchange Compensation Fund

**Balance Sheet**

At 31 March 1999 (Expressed in HK\$)

	Note	1999	1998 (Restated)
<b>Investments</b>	3&4	<u>\$ 187,271,810</u>	<u>\$ 385,711,370</u>
<b>Current assets</b>			
Investments	3&4	\$ 182,102,034	\$ 84,065,800
Contributions receivable	9	300,000,000	–
Interest receivable		3,705,637	4,579,482
Bank fixed and call deposits		29,250,549	18,120,134
Cash at bank		145,651	56,259
		<u>\$ 515,203,871</u>	<u>\$ 106,821,675</u>
<b>Liabilities</b>			
Accounts payable and accrued charges		\$ 521,844	\$ 506,822
Interest payable		857,625	2,155,125
Provision for compensation	3	435,619,591	40,000,000
		<u>\$ 436,999,060</u>	<u>\$ 42,661,947</u>
<b>Net Current Assets</b>		<u>\$ 78,204,811</u>	<u>\$ 64,159,728</u>
<b>Net Assets</b>		<u>\$ 265,476,621</u>	<u>\$ 449,871,098</u>
Representing :			
<i>Compensation Fund</i>			
Contributions from the SEHK	5	\$ 46,450,000	\$ 46,450,000
less: Compensation paid	3&6	(59,339,040)	(31,323,562)
Provision for compensation	3	(11,984,522)	(40,000,000)
add: Recovery under subrogation	3&7	936,529	936,529
Replenishment from the SEHK	3	7,327,089	7,327,089
		<u>\$ (16,609,944)</u>	<u>\$ (16,609,944)</u>
Excess transaction levy from the SEHK	8	\$ 353,786,882	\$ 353,786,882
Special Contribution		3,500,000	3,500,000
Contributions from the SEHK and the SFC	9	300,000,000	–
Transfer from income and expenditure account	10	138,462,731	109,194,160
		<u>\$ 795,749,613</u>	<u>\$ 466,481,042</u>
less: Compensation paid	3&6	(90,027,979)	–
Provision for compensation	3	(423,635,069)	–
		<u>\$ 282,086,565</u>	<u>\$ 466,481,042</u>
		<u>\$ 265,476,621</u>	<u>\$ 449,871,098</u>

Approved by the Committee on behalf of the SFC on 15 June 1999 and signed on its behalf by

**Mark Dickens**  
Chairman

**Alec Y W Tsui**  
Committee Member

**Andrew Procter**  
Committee Member

The notes on pages 81 to 85 form an integral part of the financial statements

## Cash Flow Statement

For the year ended 31 March 1999 (Expressed in HK\$)

	Note	1999	1998
Net cash outflow from operating activities	a	\$ (2,487,441)	\$ (248,691)
Returns on investments and servicing of finance			
Interest received		\$ 34,046,856	\$ 32,887,257
Interest paid		(2,155,125)	(2,055,568)
Net cash inflow from returns on investments and servicing of finance		\$ 31,891,731	\$ 30,831,689
Investing activities			
Receipts from redemption of dated securities		\$ 84,000,000	\$ 222,000,000
Proceeds from disposal of dated securities		20,955,974	–
Payments to acquire dated securities		(5,097,000)	(242,879,600)
Net cash inflow/(outflow) from investing activities		\$ 99,858,974	\$ (20,879,600)
Funding			
Recovery under subrogation		\$ –	\$ 477,064
Replenishment received from SEHK		–	5,062,996
Compensation paid		(118,043,457)	(16,000,000)
Net cash outflow from funding		\$ (118,043,457)	\$ (10,459,940)
Increase / (decrease) in cash and cash equivalents		\$ 11,219,807	\$ (756,542)
Cash and cash equivalents at beginning of the year		18,176,393	18,932,935
Cash and cash equivalents at end of the year	b	\$ 29,396,200	\$ 18,176,393

(a) Reconciliation of surplus of income over expenditure to net cash outflow from operating activities :

	1999	1998
Surplus of income over expenditure for the year	\$ 30,126,196	\$ 32,278,191
Interest income	(33,173,011)	(33,081,351)
Premium on investments amortised	493,860	458,844
Discount on investments accreted	(14,608)	(15,411)
Loss on disposal of dated securities	65,100	–
Increase in creditors and accrued charges	15,022	111,036
Net cash outflow from operating activities	\$ (2,487,441)	\$ (248,691)

(b) Analysis of the balance of cash and cash equivalents as shown in the balance sheet :

Cash at bank	\$ 145,651	\$ 56,259
Bank fixed and call deposits	29,250,549	18,120,134
	\$ 29,396,200	\$ 18,176,393

The notes on pages 81 to 85 form an integral part of the financial statements

## Notes to the Financial Statements

For the year ended 31 March 1999 (Expressed in HK\$)

### 1. Money Constituting the Fund

The Fund is derived principally from monies paid to the SFC by way of deposits by the SEHK in respect of its memberships, by way of excess transaction levy from the SEHK in accordance with an agreement between the SFC and the SEHK (see note 8), by way of money lawfully paid into the Fund pursuant to S.101(1) of the Securities Ordinance (Chapter 333) (the SO) and by way of appropriation from return or profit on the investment of surplus funds.

### 2. Purpose and Limitation

The purpose of the Fund is to meet claims, as determined and allowed by the SEHK, for pecuniary losses suffered by persons as a result of defaults on the part of members of the SEHK.

The total amount of compensation including interest that may be paid to claimants consequent upon the default of any one member committed after 7 October 1992 is normally limited to \$8,000,000 (before 7 October 1992 the limit was \$2,000,000) pursuant to the amendment made to S.109(3) of the SO that came into operation on 7 October 1992. If the aggregate of the allowed claims in respect of a member exceeds the \$8,000,000 limit, that amount shall be apportioned among claimants as determined to be equitable by the SEHK. Further amendment to S.113 of the SO was enacted on 20 November 1998 to empower the SFC to approve the SEHK to allow the total amount of compensation payable to claimants in respect of the default of a member to exceed the \$8,000,000 limit after considering the circumstances of the default and the financial position of the Fund.

Should defaults at any given time on the part of members of the SEHK give rise to allowed and/or apportioned claims exceeding the net assets of the Fund, compensation payments to claimants would be apportioned in accordance with S.120(1) of the SO, the unpaid amount of such allowed and /or apportioned claims being charged against further receipts by the Fund and paid out as and when money is available.

### 3. Accounting Policies

These accounts have been prepared in accordance with Hong Kong Statements of Standard Accounting Practice and accounting principles generally accepted in Hong Kong. A summary of the significant accounting policies is set out below :

- a Interest and investment income is recognised in the financial statements on an accruals basis.
- b Premium or discount on the purchase of dated securities is amortised or accreted respectively to the income and expenditure account on a straight line basis over the holding periods to redemption.
- c Recovery of any payment out of the Fund in respect of any claim under subrogation pursuant to S.118 of the SO, and replenishment from the SEHK pursuant to S.107 of the SO, are recognised in the financial statements on a cash basis and taken directly to the Fund.
- d Investments, representing dated securities which are intended to be held to maturity, are stated at cost adjusted for the amortisation of premiums and accretion of discounts on purchase over the holding periods to redemption, and less provisions where there has been a permanent diminution in value.

## Notes to the Financial Statements

For the year ended 31 March 1999 (Expressed in HK\$)

### 3. Accounting Policies (cont'd)

- e As a result of the enactment of the amendments to S.113 of the SO in November 1998, the maximum liability of the Fund to claims for each default case can exceed the normal \$8 million limit. In order to more appropriately reflect the liability of the Fund for outstanding claims in respect of default cases, provision for compensation is now made for known liabilities arising from claims which have been received up to the date on which the accounts are approved by the Committee for pecuniary losses suffered by persons as a result of defaults on the part of the SEHK's members for which the SEHK has published a notice calling for claims pursuant to S.112 of the SO. Compensation payments and provisions for each default are charged to the contributions from the SEHK as required pursuant to S.104 and 106 of the SO to the limit of \$8 million. Any excesses over the \$8 million limit are charged to other components of the Fund.

The above represents a change from last year where a provision for compensation was made for known liabilities arising from claims for pecuniary losses suffered by persons as a result of defaults on the part of members of the SEHK which were determined up to the date on which the accounts were approved by the Committee. The effect of the change in accounting policy is to increase the provision for compensation by \$371 million as at 31 March 1999. The comparative statements for the year ended 31 March 1998 have been restated to conform to the changed policy. The effect of the change in respect of the year ended 31 March 1998 is an increase in the provision for compensation of \$32 million representing the maximum liability of the Fund to the undetermined claims arising from four default cases which were subject to the \$8 million limit pursuant to S.109 of the SO when the accounts for the year ended 31 March 1998 were approved in June 1998 by the Committee.

- f The Fund is exempt from taxation pursuant to S.87 of the Inland Revenue Ordinance (Chapter 112).
- g For the purposes of these financial statements, parties are considered to be related to the Fund if the Committee has the ability, directly or indirectly, to control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the Fund and the party are subject to common control or common significant influence. Related parties may be individuals or other entities.

#### 4. Investments

		1999	1998
Dated securities			
maturing after one year	– listed in Hong Kong	\$ –	\$ 33,065,311
	– unlisted	<u>187,271,810</u>	<u>352,646,059</u>
		<u>\$ 187,271,810</u>	<u>\$ 385,711,370</u>
maturing within one year	– listed in Hong Kong	\$ 33,014,246	\$ 1,986,000
	– listed outside Hong Kong	–	27,061,195
	– unlisted	<u>149,087,788</u>	<u>55,018,605</u>
		<u>\$ 182,102,034</u>	<u>\$ 84,065,800</u>
		<u>\$ 369,373,844</u>	<u>\$ 469,777,170</u>
Market value at 31 March			
– listed in Hong Kong	– listed in Hong Kong	\$ 33,093,600	\$ 34,423,600
	– listed outside Hong Kong	–	26,754,300
	– unlisted	<u>335,640,300</u>	<u>396,533,500</u>
		<u>\$ 368,733,900</u>	<u>\$ 457,711,400</u>

#### 5. Contributions from the SEHK

In accordance with S.104 and 106 of the SO, the SEHK is required to deposit with the SFC a sum of \$50,000 in respect of each membership of the SEHK not later than one month after membership is taken up. In the absence of claims or other provisions as set out in S.106 of the SO, the SFC is required to refund to the SEHK from the Fund such deposit within six months after membership ceases.

The SEHK has advised the SFC of eleven (11) memberships having been taken up during the six (6) months to 31 March 1999. However, the SEHK had not at 31 March 1999 deposited with the SFC a sum of \$50,000 in respect of each such membership. The liability of the SEHK to the Fund in this respect has not been taken up in these accounts. Any monetary liability of the SEHK that may have existed due to memberships taken up prior to six (6) months before 31 March 1999 would be extinguished by the requirement of the Fund to refund to the SEHK deposits of ceased memberships in accordance with S.106(1) of the SO, as the number of new members equalled the number of members leaving the SEHK during the period.

## Notes to the Financial Statements

For the year ended 31 March 1999 (Expressed in HK\$)

### 6. Compensation Paid

	1999	1998
.....		
Compensation paid up to the \$8 million limit as set out by S.109(3) of the SO		
Balance brought forward	\$ 31,323,562	\$ 15,323,562
Add : Compensation paid during the year	<u>28,015,478</u>	<u>16,000,000</u>
Balance carried forward	<u>\$ 59,339,040</u>	<u>\$ 31,323,562</u>
.....		
Compensation paid in excess of the \$8 million limit pursuant to S.113(5A) of the SO		
Compensation paid during the year	<u>\$ 90,027,979</u>	<u>\$ -</u>
Total compensation paid	<u>\$ 149,367,019</u>	<u>\$ 31,323,562</u>

The total amount of compensation including interest in respect of each defaulted member is normally limited to \$8 million pursuant to S.109(3) of the SO. In respect of the claims against CA Pacific Securities Limited (CA Pacific), the SEHK and the SFC announced on 10 June 1998 that compensation payable to each claimant would be allowed up to the higher of \$150,000 or the pro rata share of the statutory maximum limit of \$8 million. The legislative amendments for the aforesaid arrangements were enacted on 20 November 1998. The SEHK and the SFC have also decided to apply these compensation arrangements to claims against Forlux Securities Limited (Forlux), Foreground Securities Company Limited (Foreground) and Chark Fung Securities Limited (Chark Fung) but not to other new cases.

During the year, compensation payments totalling \$118,043,457 were made in respect of four defaulted members, including the settlement of claims against Cheong Woon Securities Company which were subject to the normal \$8 million limit and the settlement of 1,174 claims against CA Pacific, 58 claims against Foreground and 74 claims against Forlux which have been so far determined within the \$150,000 limit per claimant under the aforesaid compensation arrangements.

### 7. Recovery Under Subrogation

	1999	1998
.....		
Balance brought forward	\$ 936,529	\$ 459,465
Amount recovered during the year	<u>-</u>	<u>477,064</u>
Total recovery under subrogation	<u>\$ 936,529</u>	<u>\$ 936,529</u>

Under S.118 of the SO, the SFC is entitled to receive in place of the claimant, all claims, remedies and distribution of surplus assets on liquidation of the dealer in relation to the loss sustained by the claimant, to the extent of the payment made by the SFC out of the Fund.

**8. Excess Transaction Levy from the SEHK**

In accordance with an agreement reached in 1991 between the SFC and the SEHK, the SEHK is to remit to the Fund any excess of its transaction levy revenue over one third of its budgeted expenses and any income from the transaction levy when its reserves exceed the sum of its immediately preceding two years' recurrent expenditure.

According to the 1994/95 budget of the SEHK approved by the Financial Secretary in August 1994, excess transaction levy will be diverted to the reserves of the SEHK instead of the Fund when the Fund reaches \$400 million.

Accordingly, no excess transaction levy was transferred to the Fund during the year.

**9. Contributions from the SEHK and the SFC**

In connection with the compensation arrangements announced in June 1998 (please refer to Note 6), the SEHK and the SFC announced that they would make a contribution towards the compensation arrangements of \$150 million each initially and if necessary, another \$150 million each, to the Fund. The initial contribution of \$300 million in total was recognised during the year and taken directly to the Fund.

**10. Transfer from Income and Expenditure Account**

	1999	1998
Balance brought forward	\$ 109,194,160	\$ 79,071,094
Add : Transfer of surplus for the year	<u>29,268,571</u>	<u>30,123,066</u>
Balance carried forward	<u>\$ 138,462,731</u>	<u>\$ 109,194,160</u>

**11. Related Party Transactions**

- a During the year the Fund sold investments at a book cost of \$16,020,474 to the SFC.
- b The Fund recognised the initial contribution of \$150 million from the SFC regarding the compensation arrangements announced in June 1998 during the year. The SFC has also committed to contribute a further \$150 million to the Fund if necessary.

**12. Contingent Liabilities**

As at the date of this report, claims against six members had been received by the SEHK. They are subject to the normal \$8,000,000 limit pursuant to S.109 of the SO. The determination of these claims had not yet been completed. The maximum liabilities of the Fund to the claims is \$48 million. No provision has been made in these accounts for these undetermined claims in respect of any of these cases.