



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

Quarterly Report

April - June 2003



2003-2004



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This is the Securities and Futures Commission's first Quarterly Report for the financial year from 1 April 2003 to 31 March 2004. The report aims to enhance the transparency and accountability of the Commission.


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Operations Highlights

1 April to 30 June 2003

1. The SFC recorded a deficit of \$7.4 million in the first quarter, 70% lower than the projected deficit of \$24.8 million in the approved budget. Reserves stood at \$558 million on 30 June.
2. Total revenue increased to \$93.5 million, 3% higher than a year ago, due to higher market turnover and the receipt of dual filing fees from the Stock Exchange. Total expenditure also rose 3% to \$100.8 million as a result of office relocation and additional personnel expenses for dual filing.
3. Implementation of the SFO has been smooth and intermediaries' migration to the single licensing regime orderly. As far as possible, the SFC provided guidance to the market on the new law.
4. Under dual filing, the SFC reviewed 42 listing applications submitted from March to June and commented on 16.
5. The SFC and HKEx jointly consulted the market on the regulation of IPO sponsors and independent financial advisers. The SFC and the Financial Services and the Treasury Bureau also issued a joint consultation paper on a proposal to empower the SFC to initiate derivative actions. Responses to both consultations are being studied.
6. The SFC formed a working group to classify securities related fees into broad and standardised categories, so as to help investors compare the securities services and charges of brokers and banks. A market-wide consultation is planned in the next few months.
7. The SFC chaired an Investor Participant (IP) Account Task Force to develop an enhanced IP account model, which should remove custody and settlement risks from brokers. HKEx will consult the market on the proposed model.
8. Following a survey of licensed firms in January, the SFC polled investors on analysts' conflict of interests. The SFC will consider the survey results and other factors when formulating regulatory proposals for public consultation.
9. The SFC requested Tai Wah Securities Limited to make arrangement for clients to withdraw shares, after the firm had been declared a defaulter by Hong Kong Securities Clearing Limited.
10. To facilitate share offering, the Companies (Amendment) Bill, which provided expressly for the facilitative measures contained in earlier guidelines, was introduced before the Legislative Council.

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11. The SFC published a Code on Real Estate Investment Trusts (REITs) in July, following a consultation that ended in April. The introduction of REITs broadens the choice of investment products available to the public.
 12. The consultation on the regulation of Exchange Traded Funds ended in May. The SFC is revising the proposed guidelines. The final guidelines will be released in the third quarter of 2003.
 13. Phase 3 of HKEx's CCASS/3 clearing system was launched in May and the implementation of its derivative clearing system DCASS is underway. The SFC continues to monitor their performance and implementation.
 14. During the quarter, the SFC had 17 successful prosecutions and disciplined 17 licensees for various regulatory breaches, including, for the first time, reprimanding a research analyst for unfair selective disclosure of non-public price sensitive information.
 15. The SFC announced that it had been assisting the ICAC in the investigation of certain listed companies and their personnel.
 16. The SFC rolled out an educational campaign on portfolio planning. Other education materials on hedge funds and exotic warrants were also published.
 17. The SFC signed a Declaration on Co-operation and Supervision of Cross-Border Investment Management Activity with the Australian Securities and Investments Commission, facilitating information exchange and regulatory assistance.
 18. Mr Peter Au-Yang was appointed an Executive Director of the SFC and assumed the position of Chief Operating Officer. Dr York Liao was appointed a Non-Executive Director. The SFC also moved its offices to Chater House in June.

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



Review of Operations

1 April to 30 June 2003

This is the Securities and Futures Commission's first Quarterly Report for the financial year starting 1 April 2003.

With the commencement of the Securities and Futures Ordinance (SFO) on 1 April, we now have a world-class regulatory framework for a fair, efficient and transparent market. Our priority is to enforce the law to protect investors.

During the first quarter, we continued to strengthen our enforcement work. We also co-operated with the Administration and Hong Kong Exchanges and Clearing Limited (HKEx) to press ahead with reforms to enhance corporate governance standards and facilitate market developments.

Global equity markets picked up on the end of the Iraq War. Local markets also rebounded after the World Health Organisation lifted its travel advisory against Hong Kong and subsequently removed Hong Kong from the list of SARS infected areas. The Hang Seng Index gained 10.9% during the quarter to close at 9,577 on 30 June, compared to 8,634 on 31 March. The index reached a six-month peak of 10,030 on 17 June. The new S&P/HKEx GEM Index finished the quarter at 1,096, rising 9.6% from its launch base of 1,000 on 3 March.


Financial Highlights

The SFC continued to successfully keep most expenditure categories below its approved budget level. First quarter expenditure (including depreciation) amounted to \$100.8 million, 3% higher than the same quarter last year mainly due to the office relocation expenditure and additional personnel expenses for dual filing functions. The total number of staff at the end of June 2003 was 408, comprising 370 regular staff and 38 temporary staff. There were 405 staff a year ago.

Total revenue was \$93.5 million, 3% higher than the same period last year. The average daily market turnover for the quarter increased to \$8.1 billion from \$6.1 billion in January-March and was close to the \$8 billion achieved for the same period last year. Fees and charges income was considerably higher due to the receipt of dual filing fees from the Stock Exchange. But the increase in fees was partially offset by the decrease in investment income because interest rates remained low and investment funds were drawn down to fund the SFC's operation.

As a result, the Commission recorded a deficit of \$7.4 million in the first quarter, comparable to the \$7 million deficit for the same period last year but far below the projected deficit of \$24.8 million in our approved budget. At the end of June, the reserves stood at \$558 million, compared with \$617 million at the end of June 2002.

The Investor Compensation Company Limited (ICC) and Investor Compensation Fund (ICF) under the SFO became operational on 1 April. ICC is wholly owned by SFC and the ICF will replace the Unified



Exchange Compensation Fund (UECF) and the Commodity Exchange Compensation Fund (CECF). While the UECF and CECF apply to compensation claims related to defaults before 1 April 2003, the ICF will deal with claims related to defaults after that date.

After allowing a sufficient sum of money to meet all claims and outstanding liabilities of the UECF and CECF, the SFC will transfer the balance in the UECF and CECF into ICF. As a first step, \$330 million and \$52 million were transferred from UECF and CECF respectively to ICF in April. As of 30 June, the net asset value of the ICF stood at \$402.9 million. As the balance sheet as at end-June and the income and expenditure account for the quarter of ICC were immaterial, we have not prepared consolidated financial statements.

The ICC has its own website at www.hkicc.org.hk. A pamphlet to introduce the company and the new compensation arrangement is available.

Guiding the Market on the New SFO

Implementation of the SFO has been smooth and we have endeavoured to provide guidance to the market to assist practitioners in their understanding of the new law. Our operational divisions, assisted by the Legal Services Division, responded to many questions from the industry on various provisions of the SFO and its subsidiary legislation. We further revised the Outline of Part XV of the SFO to address comments and questions we had received on the new disclosure of interests regime. The updated Outline was published in early August.

We have been witnessing orderly migration to the single licensing regime. By the end of June, 860 existing licensees had obtained new SFO licences. We continued to assist market practitioners to familiarise themselves with the new licensing system through seminars, circulars and website information such as Frequently Asked Questions.


In addition, two press briefings were held on dual filing and the SFC's new disciplinary focus respectively.

Strengthening Corporate Governance Standards

The Government published in January 2003 a Corporate Governance Action Plan, which the SFC fully supports. The roll out of the SFO is one of the major initiatives under the Action Plan. In particular, the dual filing arrangement under the SFO helps strengthen listed company disclosure standards because of the more serious regulatory consequences of false or misleading statements.

We have reviewed 42 listing applications submitted from March to June and commented on 16 under dual filing - of which seven had fundamental problems. On average, our response time was less than seven working days and we did not add any time to the overall listing process. We have not exercised our reserve power to object to any listing applications.

In May, the SFC and HKEx jointly consulted the market on strengthening the regulation of sponsors and independent financial advisers. Separately, the Financial Services and the Treasury Bureau (FSTB) and the SFC published a consultation paper on a proposal to empower the SFC to initiate, without court



approval, derivative actions against wrongdoers in relation to listed companies. Both consultations ended in July and we are studying the submissions.

HKEx issued a conclusions report in January 2003 on its corporate governance consultation. HKEx is drafting amendments to the Listing Rules for consideration by the Listing Committee in the third quarter of 2003. We will work with the Exchange on the rule amendments.

The Government has indicated it will consult the market on the recommendations of the Expert Group to Review the Operation of the Securities and Futures Market Regulatory Structure. We will work closely with the Administration and the Exchange on the consultation exercise.

Regulating the Industry through Upholding Standards

The number of licensed persons and registered institutions has remained relatively stable. As of 30 June, there were 20,354 licensed persons and 99 registered institutions.

The outbreak of SARS affected the economy, but the brokerage industry has remained resilient. Despite SARS, stock market turnover gradually increased and we are pleased to note that transaction volumes for all three Exchange Participant categories actually rose over the period.

To take forward the recommendations of the Working Group on the Business Environment of the Stockbroking Industry, the SFC formed a working group with industry representatives to classify the fees and charges on securities transaction services into broad and standardised categories. This is to enhance fees transparency and facilitate investors to understand and compare the securities services and charges of brokers and banks.

Next, the SFC will work with the Hong Kong Monetary Authority (HKMA) and, through HKMA, collect the views of banks on the proposed categorisation. We aim to consult the market in the next few months and implement the changes across the industry before year-end.

To relieve brokers' compliance burden and rationalise regulatory costs, HKEx abolished in April and May a number of fees including those for registration of authorised clerks, sales representatives, branch offices and branch office managers.

The SFC chaired an Investor Participant (IP) Account Task Force comprising brokers, HKEx and SFC representatives to study and design an enhanced, user-friendly and cost effective IP account model. The model should remove custody and settlement risks from small and medium sized brokers and help them better compete with banks and larger brokers. It will also provide enhanced protection to investors. HKEx would be consulting the market on the proposed model.

In co-operation with the SFC, the Hong Kong Securities Institute (HKSI) started its new examination programme in June, offering exam modules on various regulated activities under the SFO, such as dealing in and advising on securities and futures, asset management, etc.

The Academic and Accreditation Advisory Committee of the SFC has approved the Vocational Training Council to continue to administer the Leveraged Foreign Exchange Examination programme. Applicants who have completed the programme are considered to have met the competence exam requirements under the new licensing regime.

Following a survey of licensed firms' investment research activities in the previous quarter, we polled investors as part of our effort to address analysts' conflicts of interest. We will consider the survey results and other factors such as IOSCO standards when formulating regulatory proposals most suitable for Hong Kong for public consultation.

On 3 April, Tai Wah Securities Limited was declared a defaulter by the Hong Kong Securities Clearing Limited (HKSCC) following its failure to meet settlement obligations to HKSCC. The SFC had been closely monitoring the financial position of Tai Wah since its trading suspension on 1 April. The SFC requested Tai Wah to ensure that all client withdrawal instructions would be dealt with promptly and documented properly. Most of Tai Wah's clients had withdrawn their shares.

Statistical Information and Financial Position of the Securities Industry (Note 1)		
	As at 30 June 2003	As at 30 June 2002
Total number of Securities Dealers and Securities		
Margin Financiers (SMFs) (Note 2)	676	715
Total number of active cash clients (Note 3)	729,591	571,534
Total number of active margin clients (Note 3)	66,053	57,358
Balance Sheet	(\$ Million)	(\$ Million)
Cash in hand and at bank (Note 4)	63,930	59,660
Amounts receivable from margin clients (Note 5)	11,810	13,658
Amounts receivable from SMFs and clients / other dealers arising from dealing in securities	48,763	40,617
Other assets	33,400	30,212
Total assets	157,903	144,147
Amounts payable to SMFs and clients / other dealers arising from dealing in securities	79,576	65,332
Total borrowings from financial institutions	4,431	6,472
Other liabilities	21,600	21,706
Total shareholders' fund	52,296	50,637
Total liabilities and shareholders' fund	157,903	144,147
<p>Note 1: The data were extracted from the monthly Financial Resources Rules Returns submitted by securities dealers and securities margin financiers.</p> <p>Note 2: Due to lower market turnover, the number of securities dealers and securities margin financiers declined as a number of firms ceased operations. However, there was an increase in the number of clients. The number of securities advisers as at end-June also increased to 503, compared with 479 a year ago.</p> <p>Note 3: Active clients as at 30 June 2003 refer to clients for whom the licensed corporation is required to prepare and deliver monthly statements of account in respect of the relevant reporting month in accordance with the Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules and active clients as at 30 June 2002 refer to those who conducted at least one transaction during the past 12 months.</p> <p>Note 4: Cash in hand and at bank includes trust monies held on behalf of clients.</p> <p>Note 5: 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):</p>		
	<u>As at 30 June 2003</u>	<u>As at 30 June 2002</u>
	3.63	3.63

Facilitating Market Development

Following the publication of three sets of guidelines in February 2003 to facilitate the offering of shares and debentures under the prospectus regime of the Companies Ordinance (CO), two class exemptions came into force in May 2003. They exempt prospectuses relating to debentures from content requirements of the CO that are considered either irrelevant for investors or unduly burdensome for issuers. Prospectuses relating to listed debentures are also exempted from content requirements that duplicate the Listing Rules requirements.

The above constituted the first phase of market facilitation on securities offerings. In the second phase, the Companies (Amendment) Bill was introduced before the Legislative Council in June after market consultation, to provide expressly for the measures in the guidelines and make other improvements to the prospectus regime.

The SFC will in the third phase conduct a comprehensive review of the existing laws and regulations relating to public offerings of securities, with a view to adopting international best practices that are applicable to Hong Kong. We hope to make recommendations for reform in the third quarter of 2004.


On product development, we published in July a Code on Real Estate Investment Trusts (REITs) following market consultation. Market respondents welcomed this new product initiative. The introduction of REITs is part of the SFC's continuous efforts to broaden the choice of investment products available to the public and reinforce Hong Kong's position as an international financial hub. Retail investors will be able to invest in large-scale income-generating real estate in a cost effective manner, with a relatively transparent and well-defined investment strategy.

The consultation on the draft guidelines for regulating Exchange Traded Funds (ETFs) ended in May. Almost all respondents welcomed the SFC's initiative to develop the ETF market; some have indicated an interest in bringing ETFs into Hong Kong. We are revising the proposals in light of the comments received. We aim to publish the final guidelines in the third quarter of 2003.

Hong Kong is one of the world's few jurisdictions that allow retail offering of hedge funds. As of 30 June, the SFC had authorised five hedge funds - three single hedge funds and two funds-of-hedge-funds.

Number of SFC Authorised Collective Investment Schemes			
	30 June 2003	31 March 2003	30 June 2002
Unit Trusts and Mutual Funds	1,952	1,965	1,899
Investment-Linked Assurance Schemes	136	129	109
Pooled Retirement Funds	37	37	39
MPF Master Trust / Industry Schemes	46	47	49
MPF Pooled Investment Funds (Note1)	250	241	220
Other Schemes	41	38	24
Total	2,462	2,457	2,340

Note 1: There are 108 funds included in this category that are offered both as retail unit trusts as well as pooled investment funds for MPF purpose.



On the enhancement of financial infrastructure, phase 3 of HKEx's new generation of clearing and settlement system, CCASS/3, was successfully launched in May, allowing participants' supplied systems to directly access to CCASS/3 through an open gateway. Implementation of the integrated derivatives clearing system, DCASS, is also underway. HKEx has indicated a target launch of DCASS in the first quarter of 2004. The SFC will continue to monitor the performance and implementation of these new systems.

In addition to the consultation on IP accounts, HKEx is also planning to consult the market on its Third Party Clearing proposal and the implications of implementing a scripless market model in the coming few months. We will work with the Exchange on its consultation.

Enforcement

The SFO has given us more flexibility and powers to pursue and combat market crimes and misconduct. We will not hesitate to use our new statutory powers to punish offenders and protect the investing public.

Corporate misgovernance, serious misconduct by intermediaries and market misconduct such as market manipulation and insider dealing remain our enforcement priorities. We have also refined our disciplinary priorities with a two-focus approach. The focus on industry sectors would be extended from brokerages to cover banks' capital markets departments, corporate finance advisers, fund managers and investment advisers. On the types of misconduct, our new disciplinary focus would be on dishonesty, conflicts of interest, and serious internal control and management failings which put investors at risk.

On 17 June, an analyst for a large investment bank was reprimanded for unfair selective disclosure of price sensitive information. The SFC advises analysts not to disclose any non-public price sensitive information. It is for a listed company itself to disclose the information to the investing public in accordance with the Listing Rules.

We have also reminded market participants of their reporting obligations under Part XV of the SFO. The SFC takes a serious view on non-disclosure and false or misleading disclosure of interests in Hong Kong listed companies. The SFC will issue a considerable number of warning letters for minor breaches in the initial months of the law.

The SFC has always enjoyed a good working relationship with the Independent Commission Against Corruption (ICAC) and the Commercial Crime Bureau of the Police. In June, we announced that we had been assisting the ICAC in the investigation of certain listed companies and listed company personnel. We will continue the co-operation.

During the quarter, the SFC had 17 successful prosecutions. The crimes involved included market manipulation, contravention of the Securities (Disclosure of Interests) Ordinance and Protection of Investors Ordinance, unlicensed leveraged foreign exchange trading, unlicensed advising on futures, provision of false information to the SFC and non-compliance with the Financial Resources Rules.

We also disciplined 17 licensees for regulatory breaches. There were one revocation and seven suspensions of licences, and eight public reprimands. A dealer's representative surrendered her licence.

Statistics of Enforcement Actions			
	April - June 2003	January - March 2003	April - June 2002
Successful Prosecutions	17	7	9
SFC Licensees Disciplined	17	29	14
Warning Letters Issued	47	50	38
Cases under Investigation*#	788	313	275
Disciplinary Inquiries in Progress#	75	73	74
* Some cases are ongoing investigations from the previous quarter.			
# Number of cases as at end of quarters.			

On 4 July, the SFC issued a statement confirming that it had commenced an inquiry into the affairs of China Rare Earth Holdings Limited and the inquiry was continuing. The statement was issued to clarify the position following earlier media reports on the inquiry.

Strengthening Communication with Investors and Other Stakeholders

In view of the emergence of new and increasingly complex financial products, the SFC has tailor-made educational materials to help investors make informed decisions.

Further to providing fundamental investment knowledge, we rolled out a new campaign on portfolio planning in May. A leaflet entitled *Portfolio Planning - Managing Your Investments to Suit You* was supplemented by website articles on the Electronic Investor Resources Centre that discussed risk management and related techniques. More educational materials on hedge funds and exotic warrants were published. We also launched two weekly columns in the Apple Daily and Sing Tao Daily to explain how the SFO affects retail investors and to address misconceptions and risks of various investment products and activities.

Statistics of Investor Enquiries and Public Complaints			
	April - June 2003	January - March 2003	April - June 2002
Enquiries	1,007	788	1,229
Complaints	329	222	195

We are committed to being an accountable regulator. In our *Annual Report 2002-2003* published in May, we detailed the Commission's work and financial results in the last financial year and discussed plans for the current year. To further enhance transparency, the Annual Report has for the first time published individual attendance rates of members of the Commission and other internal committees. Remuneration of the top three tiers of senior executives was also disclosed.

We continued to publish our bi-monthly newsletter *SFC Alert* as well as the monthly *SFC Enforcement Reporter* to keep the market informed of our work and enforcement actions. The Spring issue of the research-based *SFC Quarterly Bulletin* was published.



International Co-operation and External Relations

In June, the SFC signed a Declaration on Co-operation and Supervision of Cross-Border Investment Management Activity (MoU) with the Australian Securities and Investments Commission (ASIC). Under the MoU, the SFC and ASIC would be able to exchange information and offer assistance to each other concerning the activities of fund managers licensed in their own jurisdiction.

The MoU lays the groundwork for the recognition of Australia as an Acceptable Inspection Regime (AIR) under the SFC's Code on Unit Trusts and Mutual Funds. We will be revising the Code so that fund managers licensed with ASIC will be eligible to manage SFC authorised funds, subject to fulfilment of specified conditions.

The SFC continued to participate actively in different aspects of the work of the International Organisation of Securities Commissions (IOSCO), including the work on the regulation of securities analysts and rating agencies.

The SFC participated in the International Monetary Fund's (IMF) Financial Sector Assessment Programme (FSAP) review conducted in the second half of 2002. On 27 June 2003, the IMF published its Financial System Stability Assessment based on FSAP and concluded that Hong Kong's financial system was resilient, sound and overseen by a comprehensive supervisory framework.


In the area of enforcement co-operation, the SFC received nine requests from overseas regulators: three requesting assistance, three seeking public information and three seeking non-public information. The SFC did not make any requests to overseas regulators during the quarter.

In June, the SFC welcomed a Mainland delegation comprising 15 officials participating in a Training Scheme in Common law organised by the Department of Justice.

Corporate Affairs

The Government published the Process Review Panel's second Annual Report in May. We welcome the conclusion that in general adequate safeguards and checks and balances were in place in the SFC's internal procedures and the decisions and actions of the SFC in carrying out its regulatory functions had adhered to established internal procedures. The SFC has adopted a number of specific recommendations of the Panel and we look forward to continuing our co-operation with the Panel in its third year of work.

Mr Peter Au-Yang has been appointed by the Financial Secretary as an Executive Director of the SFC, assuming the role of Chief Operating Officer. At the same time, the Financial Secretary appointed Dr York Liao, JP as a Non-Executive Director of the Commission. I warmly welcome them both and look forward to working closely with them to strengthen the work of the Commission.



In June, the SFC moved its offices to Chater House, after being given notice to vacate The Landmark. The relocation process was smooth and we managed to keep related costs, including fitting out expenses, to a minimum. We have adopted a modest fitting standard and reused old furniture as far as possible. Our new offices became fully operational on 30 June.

Looking Ahead

We will make good use of the more flexible and extensive regulatory tools under the SFO to pursue those who undermine the integrity of our market. We will try our best to ensure that the Hong Kong market is fair and transparent, and investors are afforded appropriate protection.

Together with the Government, HKEx, other law-enforcement agencies and self-regulatory organisations, we will be working on all fronts to continue improving the quality of our market.

Despite an apparent recovery of the market in the first quarter, the financial outlook of the Commission for the remainder of the year remains uncertain. However, based on current information and by keeping a tight rein on expenditures, we expect that the projected \$21.9 million deficit for the next quarter will not be exceeded.

Andrew Sheng
Chairman

14 August 2003

Securities and Futures Commission

Income and Expenditure Account
For the quarter ended 30 June 2003
(Expressed in Hong Kong dollars)

	Note	Unaudited Quarter Ended 30 June 2003 \$'000	Unaudited Quarter Ended 30 June 2002 \$'000
Income			
Levies		54,468	54,061
Fees and charges		33,008	27,702
Investment income		5,503	8,604
Other income		<u>488</u>	<u>588</u>
		93,467	90,955
		-----	-----
Expenses			
Staff costs		77,206	76,574
Premises			
- rent		5,002	5,002
- other		5,080	2,826
Other expenses		<u>7,081</u>	<u>8,353</u>
		94,369	92,755
Depreciation		<u>6,478</u>	<u>5,185</u>
		100,847	97,940
		-----	-----
Deficit	2	<u>(7,380)</u>	<u>(6,985)</u>

We have not prepared a separate statement of recognised gains and losses as the deficit would be the only component of such a statement.

The notes on pages 15 and 16 form part of the condensed financial statements.

Securities and Futures Commission

Balance Sheet

At 30 June 2003

(Expressed in Hong Kong dollars)

	<u>Note</u>	Unaudited <u>At 30 June 2003</u> \$'000	Audited <u>At 31 March 2003</u> \$'000
Non-current assets			
Fixed assets		49,884	30,976
Held-to-maturity debt securities		285,296	388,794
Current assets			
Held-to-maturity debt securities		141,243	39,036
Bank deposits		164,443	178,371
Debtors, deposits and prepayments		33,398	25,749
Cash at bank and in hand		<u>657</u>	<u>421</u>
		<u>339,741</u>	<u>243,577</u>
Current liabilities			
Fees received in advance		25,988	31,557
Creditors and accrued charges		<u>90,700</u>	<u>66,177</u>
		<u>116,688</u>	<u>97,734</u>
Net current assets		<u>223,053</u>	<u>145,843</u>
Net assets		<u>558,233</u>	<u>565,613</u>
Funding and reserves:			
Initial funding by Government		42,840	42,840
Accumulated surplus	2	<u>515,393</u>	<u>522,773</u>
		<u>558,233</u>	<u>565,613</u>

The notes on pages 15 and 16 form part of the condensed financial statements.

Securities and Futures Commission

Cash Flow Statement

For the quarter ended 30 June 2003

(Expressed in Hong Kong dollars)

	Unaudited Quarter ended 30 June 2003 \$'000	Unaudited Quarter ended 30 June 2002 \$'000
Net cash outflow from operating activities	(10,419)	(24,198)
Returns on investments - interest received	5,540	8,111
Investing activities		
Held-to-maturity debt securities redeemed	-	9,000
Fixed assets bought	(8,813)	(4,171)
Net cash (outflow)/inflow from investing activities	(8,813)	4,829
Decrease in cash and cash equivalents	(13,692)	(11,258)
Cash and cash equivalents at beginning of the quarter	178,792	39,891
Cash and cash equivalents at end of the quarter	165,100	28,633
Reconciliation of deficit for the quarter to net cash outflow from operating activities :		
Deficit	(7,380)	(6,985)
Investment income	(5,503)	(8,604)
Depreciation	6,478	5,185
Loss on sale of fixed assets	-	2
Increase in debtors, deposits and prepayments	(6,395)	(6,809)
Increase/(decrease) in creditors and accrued charges	7,950	(4,284)
Decrease in fees received in advance	(5,569)	(2,703)
Net cash outflow from operating activities	(10,419)	(24,198)
Analysis of the balance of cash and cash equivalents :		
	Unaudited At 30 June 2003 \$'000	Unaudited At 30 June 2002 \$'000
Bank deposits	164,443	27,990
Cash at bank and in hand	657	643
	165,100	28,633

Securities and Futures Commission

Notes to the Condensed Financial Statements

For the quarter ended 30 June 2003

(Expressed in Hong Kong dollars)

1. Basis of preparation

The interim financial report has been prepared in accordance with the requirements of the Main Board Listing Rules of the Stock Exchange of Hong Kong Limited, including compliance with International Accounting Standard 34 "Interim financial reporting" issued by the International Accounting Standards Board.

The interim financial report is unaudited and the financial information relating to the financial year ended 31 March 2003 included in this report does not constitute the SFC's statutory accounts for that financial year but is derived from those accounts.

The same accounting policies adopted in the financial statements for the year ended 31 March 2003 have been applied to the interim financial report.

2. Accumulated surplus

Movements of accumulated surplus during the quarter are as follows :

	<u>Unaudited</u>
	\$'000
Balance at 31 March 2003	522,773
Deficit for the quarter	(7,380)
	<hr/>
Balance at 30 June 2003	<u>515,393</u>

3. Held-to-maturity debt securities

As of 30 June 2003, the total market value of held-to-maturity debt securities amounted to \$444,545,000 (31 March 2003 : \$447,562,000), which was above the total carrying cost of \$426,539,000 (31 March 2003 : \$427,830,000).



Securities and Futures Commission

Notes to the Condensed Financial Statements

For the quarter ended 30 June 2003

(Expressed in Hong Kong dollars)

4. 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 30 June 2003. Therefore we do not provide ageing analysis on debtors and creditors.

5. Exchange fluctuation

All our balance sheet items are denominated in either United States dollars or Hong Kong dollars, and, as a result, we are not exposed to significant exchange rate risk.

6. 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.

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 perform functions relating to the compensation of investors and other functions under Parts III and XII of the Securities and Futures Ordinance.

Both companies are wholly owned subsidiaries of the SFC. However, they were not shown in the balance sheet which was expressed in thousand dollars.

The balance sheets of the companies as at 30 June 2003 and the income and expenditure accounts for the three months then ended were immaterial. Therefore, we have not prepared consolidated financial statements.



Unified Exchange Compensation Fund (the Fund)

Report of the Securities Compensation Fund Committee (the Committee)

The members of the Committee present their quarterly report and the unaudited condensed financial statements for the quarter ended 30 June 2003.

1. ESTABLISHMENT OF THE FUND

Part X of the Securities Ordinance (Chapter 333) established the Fund.

2. FINANCIAL RESULTS

The Committee presents the financial results which are set out in the condensed financial statements on pages 18 to 22.

3. MEMBERS OF THE COMMITTEE

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

Mr. Mark Dickens, JP

Mr. Paul Chow Man Yiu [appointed on 19 May 2003]

Mr. Kwong Ki Chi, GBS [nomination revoked on 16 April 2003]

Mrs. Alexa Lam

Mr. David M. Roberts

Mr. T. Brian Stevenson, SBS

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 quarter.

On behalf of the Committee

Mark Dickens, JP
Chairman

6 August 2003

Unified Exchange Compensation Fund

Income and Expenditure Account
For quarter ended 30 June 2003
(Expressed in Hong Kong dollars)

	<u>Note</u>	Unaudited Quarter Ended 30 June 2003 \$'000	Unaudited Quarter Ended 30 June 2002 (Restated) \$'000
Income			
Net investment income		4,282	16,027
Transaction levy		(4)	20,099
Recoveries		-	59
Compensation refund from claimants	2	620	-
		<u>4,898</u>	<u>36,185</u>
Expenses			
Provision for compensation made		-	22,277
Unused provision for compensation reversed		(1,922)	(339)
Recoveries re-distributed to claimants		-	1,298
Auditors' remuneration		10	11
Bank charges		42	69
Professional fees		43	47
Sundry expenses		64	1
		<u>(1,763)</u>	<u>23,364</u>
Surplus		6,661	12,821
Accumulated deficit brought forward		<u>(165,136)</u>	<u>(256,992)</u>
Accumulated deficit carried forward		<u>(158,475)</u>	<u>(244,171)</u>

We have not prepared a separate statement of recognised gains and losses as the surplus would be the only component of such a statement.

The notes on pages 21 to 22 form part of the condensed financial statements.

Unified Exchange Compensation Fund

Balance Sheet

At 30 June 2003

(Expressed in Hong Kong dollars)

	Note	Unaudited At 30 June 2003 \$'000	Audited At 31 March 2003 \$'000
Current assets			
Debt securities		482,899	555,930
Interest receivable		3,448	5,580
Levy receivable		-	5,607
Bank fixed and call deposits		88,691	339,687
Cash at bank		<u>918</u>	<u>17</u>
		575,956	906,821
		-----	-----
Current liabilities			
Accounts payable and accrued charges		4,578	4,590
Provision for compensation	3	<u>22,614</u>	<u>30,628</u>
		27,192	35,218
		-----	-----
Net current assets		<u>548,764</u>	<u>871,603</u>
		-----	-----
Net assets		<u>548,764</u>	<u>871,603</u>
		-----	-----
Representing:			
<u>Compensation fund</u>			
Contributions from the SEHK		46,450	46,450
Excess transaction levy from the SEHK		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		3,002	3,002
Accumulated deficit		(158,475)	(165,136)
Contributions to Investor Compensation Fund	4	<u>(329,500)</u>	<u>-</u>
		548,764	871,603
		-----	-----

The notes on pages 21 to 22 form part of the condensed financial statements.

Unified Exchange Compensation Fund

Cash Flow Statement

For the quarter ended 30 June 2003

(Expressed in Hong Kong dollars)

	Unaudited Quarter Ended 30 June 2003	Unaudited Quarter Ended 30 June 2002 (Restated)
	\$'000	\$'000
Net cash (outflow) / inflow from operating activities	(40)	17,283
Returns on investments - interest received	8,445	14,155
Investing activities		
Debt securities redeemed	71,000	78,000
Debt securities bought	-	(83,583)
Net cash inflow / (outflow) from investing activities	71,000	(5,583)
Financing		
Contributions to Investor Compensation Fund	(329,500)	-
Net cash outflow from financing	(329,500)	-
Decrease / (increase) in cash and cash equivalents	(250,095)	25,855
Cash and cash equivalents at beginning of the quarter	339,704	49,934
Cash and cash equivalents at end of the quarter	89,609	75,789
Reconciliation of surplus for the quarter to net cash (outflow) / inflow from operating activities:		
Surplus	6,661	12,821
Net investment income	(4,282)	(16,027)
Decrease in levy receivable	5,607	777
(Decrease)/increase in provision for compensation	(8,014)	19,759
Decrease in accounts payable and accrued charges	(12)	(47)
Net cash (outflow) / inflow from operating activities	(40)	17,283
Analysis of the balance of cash and cash equivalents:		
	Unaudited At 30 June 2003	Unaudited At 30 June 2002
	\$'000	\$'000
Cash at bank	918	181
Bank fixed and call deposits	88,691	75,608
	89,609	75,789

Unified Exchange Compensation Fund

Notes to the Condensed Financial Statements

For the quarter ended 30 June 2003

(Expressed in Hong Kong dollars)

1. ACCOUNTING POLICIES

The Fund prepares the interim financial report in accordance with the requirements of the Main Board Listing Rules of the Stock Exchange of Hong Kong Limited, including compliance with International Accounting Standard 34 "Interim financial reporting" adopted by the International Accounting Standards Board.

The interim financial report is unaudited and the financial information relating to the financial year ended 31 March 2003 included in this report does not constitute the Fund's statutory accounts for that financial year but is derived from those accounts.

We adopted a new accounting policy for the year ended 31 March 2003 to recognise receipts (including transaction levy, recoveries and replenishments from the SEHK) and distributions (including provision made for compensation payments and re-distribution of recoveries) as income and expenses respectively in the Fund's income and expenditure account. We applied the same accounting policies adopted in the financial statements for the year ended 31 March 2003 to the interim financial report. We have restated the comparative information for the quarter ended 30 June 2002 retrospectively to conform to the new policy.


2. COMPENSATION REFUND FROM CLAIMANTS

The liquidator of C.A. Pacific Securities Ltd. (CAPS) has obtained the court's approval to distribute the shares to all the cash clients, starting from 30 June, 2003. The CAPS cash clients could either keep the compensation payment paid by the Fund or return the compensation payment to the Fund to get back the shares allotted to them from the liquidator. As at 30 June 2003, the Fund received repayments of compensation of \$620,000 from the CAPS cash clients.

3. PROVISION FOR COMPENSATION

	\$'000
Balance as at 1 April 2002	40,613
Less: amount paid during the year ended 31 March 2003	(25,576)
	(4,443)
unused provision reversed during the year ended 31 March 2003	20,034
additional provision made for the year ended 31 March 2003	15,591
Add: net provision made for the year ended 31 March 2003	<u>15,591</u>
Balance as at 31 March 2003	30,628
Less: amount paid during the quarter ended 30 June 2003	(6,092)
Less: unused provision reversed during the quarter ended 30 June 2003	<u>(1,922)</u>
Balance as at 30 June 2003	<u><u>22,614</u></u>

We made provision for claims in respect of seven SEHK exchange participants for which the SEHK has published a notice calling for claims. The maximum liabilities of the Fund in respect of six of these default cases can exceed the normal \$8 million limit.



Unified Exchange Compensation Fund
Notes to the Condensed Financial Statements
For the quarter ended 30 June 2003
(Expressed in Hong Kong dollars)

4. CONTRIBUTIONS TO INVESTOR COMPENSATION FUND

Under section 75(2) of Schedule 10 of the SFO, the Securities and Futures Commission (SFC) may after 1 April 2003 pay into the Investor Compensation Fund (ICF), which came into operation after 1 April 2003, such sum of money from the Fund as it considers appropriate. During the quarter ended 30 June 2003, the SFC paid \$329,500,000 into the ICF from the Fund.

5. CONTINGENT LIABILITIES

As at the date of this report, the SEHK has received claims against nine exchange participants. They are subject to the normal \$8 million ceiling pursuant to Section 109 of the Securities Ordinance. The validity of these claims is under investigation. We have not made any provision for these claims. The maximum contingent liability of the Fund to these claims is \$72 million (As at 31 March 2003 : \$72 million).



Commodity Exchange Compensation Fund (the Fund)

Report of the Futures Compensation Fund Committee (the Committee)

The members of the Committee present their quarterly report and the unaudited condensed financial statements for the quarter ended 30 June 2003.

1. ESTABLISHMENT OF THE FUND

Part VIII of the Commodities Trading Ordinance (Chapter 250) established the Fund.

2. FINANCIAL RESULTS

The Committee presents the financial results which are set out in the condensed financial statements on pages 24 to 27.

3. MEMBERS OF THE COMMITTEE

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

Mr. Mark Dickens, JP	
Mr. Lawrence Fok	[appointed on 16 June 2003]
Mr. William D. Grossman	[nomination revoked on 13 May 2003]
Mr. Mark Ho	[nomination revoked on 3 June 2003]
Mrs. Alexa Lam	
Mr. Lobo Lee	[appointed on 19 May 2003 and nomination revoked on 3 June 2003]
Mr. T. Brian Stevenson, SBS	
Mr. Calvin Tai	[appointed on 16 June 2003]

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 quarter.

On behalf of the Committee

Mark Dickens, JP
Chairman

6 August 2003

Commodity Exchange Compensation Fund

Income and Expenditure Account
For the quarter ended 30 June 2003
(Expressed in Hong Kong dollars)

	Unaudited Quarter Ended 30 June 2003	Unaudited Quarter Ended 30 June 2002 (Restated)
	\$'000	\$'000
Income		
Net investment income	492	2,552
Contract levy	-	1,509
	<u>492</u>	<u>4,061</u>
	-----	-----
Expenses		
Auditors' remuneration	11	10
Bank charges	8	14
Professional fees	4	4
Sundry expenses	1	1
	<u>24</u>	<u>29</u>
	-----	-----
Surplus	468	4,032
Accumulated surplus brought forward	<u>107,613</u>	<u>94,678</u>
Accumulated surplus carried forward	<u>108,081</u>	<u>98,710</u>

We have not prepared a separate statement of recognised gains and losses as the surplus would be the only component of such a statement.

The notes on page 27 form part of the condensed financial statements.

Commodity Exchange Compensation Fund

Balance Sheet

At 30 June 2003

(Expressed in Hong Kong dollars)

	<u>Note</u>	<u>Unaudited</u> <u>At 30 June 2003</u> \$'000	<u>Audited</u> <u>At 31 Mar 2003</u> \$'000
Current assets			
Debt securities		72,097	75,633
Interest receivable		574	957
Levy receivable		-	772
Bank fixed and call deposits		5,077	51,767
Cash at bank		64	136
		<hr/>	<hr/>
		77,812	129,265
Current liabilities			
Accounts payable and accrued charges		221	252
		<hr/>	<hr/>
Net current assets		<u>77,591</u>	<u>129,013</u>
Net assets		<u>77,591</u>	<u>129,013</u>
Representing:			
<u>Compensation fund</u>			
Contributions from HKFE	2	21,200	21,400
Contributions to Investor Compensation Fund	3	(51,690)	-
Accumulated surplus		108,081	107,613
		<hr/>	<hr/>
		<u>77,591</u>	<u>129,013</u>

The notes on page 27 form part of the condensed financial statements.

Commodity Exchange Compensation Fund

Cash Flow Statement

For the quarter ended 30 June 2003
(Expressed in Hong Kong dollars)

	Unaudited Quarter Ended 30 June 2003	Unaudited Quarter Ended 30 June 2002 (Restated)
	\$'000	\$'000
Net cash inflow from operating activities	717	1,469
Returns on investments - interest received	1,411	2,228
Investing activities		
Debt securities redeemed	3,000	7,000
Debt securities bought	-	(7,507)
Net cash inflow / (outflow) from investing activities	3,000	(507)
Financing		
Net contribution refunded to HKFE	(200)	(100)
Contributions to Investor Compensation Fund	(51,690)	-
Net cash outflow from financing	(51,890)	(100)
(Decrease) / increase in cash and cash equivalents	(46,762)	3,090
Cash and cash equivalents at beginning of the quarter	51,903	3,737
Cash and cash equivalents at end of the quarter	5,141	6,827

Reconciliation of surplus for the quarter to net cash inflow from operating activities:

Surplus	468	4,032
Net investment income	(492)	(2,552)
Decrease in levy receivable	772	20
Decrease in accounts payable and accrued charges	(31)	(31)
Net cash inflow from operating activities	717	1,469

Analysis of the balance of cash and cash equivalents:

	Unaudited At 30 June 2003	Unaudited At 30 June 2002
	\$'000	\$'000
Cash at bank	64	3
Bank fixed and call deposits	5,077	6,824
	5,141	6,827

Commodity Exchange Compensation Fund

Notes to the Condensed Financial Statements

For the quarter ended 30 June 2003

(Expressed in Hong Kong dollars)

1. ACCOUNTING POLICIES

The Fund prepares the interim financial report in accordance with the requirements of the Main Board Listing Rules of the Stock Exchange of Hong Kong Limited, including compliance with International Accounting Standard 34 "Interim financial reporting" adopted by the International Accounting Standards Board.

The interim financial report is unaudited and the financial information relating to the financial year ended 31 March 2003 included in this report does not constitute the Fund's statutory accounts for that financial year but is derived from those accounts.

We adopted a new accounting policy for the year ended 31 March 2003 to recognise receipts (including contract levy and recoveries) and distributions (including provision made for compensation payments) as income and expenses respectively in the Fund's income and expenditure account. We applied the same accounting policies adopted in the financial statements for the year ended 31 March 2003 to the interim financial report. We have restated the comparative information for the quarter ended 30 June 2002 retrospectively to conform to the new policy.

2. CONTRIBUTIONS FROM HKFE

	\$'000
Balance as at 1 April 2002	21,600
Add: Contributions received during the year ended 31 March 2003	700
Deduct: Refunds to outgoing shareholders during the year ended 31 March 2003	<u>(900)</u>
Balance as at 31 March 2003	21,400
Add: Contributions received during the quarter ended 30 June 2003	-
Deduct: Refunds to outgoing shareholders during the quarter ended 30 June 2003	<u>(200)</u>
Balance as at 30 June 2003	<u>21,200</u>

3. CONTRIBUTIONS TO INVESTOR COMPENSATION FUND

Under section 75(2) of Schedule 10 of the SFO, the Securities and Futures Commission (SFC) may after 1 April 2003 pay into the Investor Compensation Fund (ICF), which came into operation after 1 April 2003, such sum of money from the Fund as it considers appropriate. During the quarter ended 30 June 2003, the SFC paid \$51,690,000 into the ICF from the Fund.



Investor Compensation Fund (the Fund)

Report of the Investor Compensation Fund Committee (the Committee)

The members of the Committee present their quarterly report and the unaudited condensed financial statements for the quarter ended 30 June 2003.

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 29 to 35.

3. MEMBERS OF THE COMMITTEE

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

Mr. Mark Dickens, JP	[appointed on 1 April 2003]
Mr. Paul Chow Man Yiu	[appointed on 30 June 2003]
Mr. Frederick J. Grede	[appointed on 1 April 2003 and resigned on 29 June 2003]
Mrs. Alexa Lam	[appointed on 1 April 2003]
Ms. Anna H. Y. Wu, SBS, JP	[appointed on 1 April 2003]

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 quarter.

On behalf of the Committee

Mark Dickens, JP
Chairman

6 August 2003

Investor Compensation Fund

Income and Expenditure Account

For the quarter from 1 April 2003 (date of establishment) to 30 June 2003

(Expressed in Hong Kong dollars)

	<u>Note</u>	Unaudited Quarter Ended 30 June 2003 \$'000
Income		
Interest income	3	875
Transaction levy from SEHK	3 & 5	19,955
Contract levy from HKFE	3 & 6	2,296
		<hr/>
		23,126

Expenses		
ICC expenses	7	1,386
		<hr/>
Surplus		21,740
Accumulated surplus brought forward		-
		<hr/>
Accumulated surplus carried forward		21,740
		<hr/> <hr/>

We have not prepared a separate statement of recognised gains and losses as the surplus would be the only component of such a statement.

The notes on pages 32 to 35 form part of these financial statements.

Investor Compensation Fund

Balance Sheet

At 30 June 2003

(Expressed in Hong Kong dollars)

	<u>Note</u>	Unaudited <u>At 30 June 2003</u> \$'000
Current assets		
Interest receivable		470
Levy receivable from SEHK		7,339
Levy receivable from HKFE		750
Fixed and call deposits with banks		395,755
Cash at bank		2
		<hr/> 404,316
Current liabilities		
Accounts payable and accrued charges		<hr/> 1,386
		<hr/> 402,930
Net current assets		<hr/> <hr/> 402,930
Net assets		<hr/> <hr/> 402,930
Representing:		
<u>Compensation fund</u>		
Contributions from UECF	8	329,500
Contributions from CECF	8	51,690
Accumulated surplus		21,740
		<hr/> 402,930
		<hr/> <hr/> 402,930

The notes on pages 32 to 35 form part of these financial statements.

Investor Compensation Fund

Cash Flow Statement

For the quarter from 1 April 2003 (date of establishment) to 30 June 2003
(Expressed in Hong Kong dollars)

	Unaudited Quarter Ended 30 June 2003
	\$'000
Net cash inflow from operating activities	14,162
Returns on investments - interest received	405
Financing	
Contributions received from UECF	329,500
Contributions received from CECF	51,690
Net cash inflow from financing	381,190
Increase in cash and cash equivalents	395,757
Cash and cash equivalents at beginning of the quarter	-
Cash and cash equivalents at end of the quarter	<u>395,757</u>
Reconciliation of surplus for the quarter to net cash inflow from operating activities:	
Surplus	21,740
Net investment income	(875)
Increase in levy receivable	(8,089)
Increase in accounts payable and accrued charges	1,386
Net cash inflow from operating activities	<u>14,162</u>
Analysis of the balance of cash and cash equivalents as show in the balance sheet:	
	Unaudited At 30 June 2003
	\$'000
Cash at bank	2
Fixed and call deposits with banks	395,755
	<u>395,757</u>



Investor Compensation Fund

Notes to the Financial Statements

For the quarter from 1 April 2003 (date of establishment) to 30 June 2003

(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 also transferred such 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, ICC is subrogated to the claimant's right against the defaulter.

Pursuant to section 244 of the SFO, the Chief Executive 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 were available in the Fund.

2. MONEY CONSTITUTING THE FUND

The Fund mainly consists of the amounts paid from the two existing compensation funds, the Unified Exchange Compensation Fund ("UECF") and the Commodity Exchange Compensation Fund ("CECF"). The SFC will also pay into the Fund any remaining balance in the Securities Dealers' Deposits Funds and the Commodities Dealers' Deposits Funds 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 contract traded on the HKFE, and returns earned on the investment of the Fund.



Investor Compensation Fund

Notes to the Financial Statements

For the quarter from 1 April 2003 (date of establishment) to 30 June 2003

(Expressed in Hong Kong dollars)

3. SIGNIFICANT ACCOUNTING POLICIES

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

Recognition of income

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

Transaction Levy / Contract levy We record levy as income at a fixed rate on every leviable SEHK and HKFE transaction on an accrual basis.

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 Committee.

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 at cost.

Contingent liability

Unless the probability of outflow of economic benefits is remote, we disclose obligation 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.



Investor Compensation Fund

Notes to the Financial Statements

For the quarter from 1 April 2003 (date of establishment) to 30 June 2003

(Expressed in Hong Kong dollars)

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 significantly influence in making financial and operating decisions;
- (ii) parties that have the ability, directly or indirectly, to control or 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 or corporate entities.

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. TRANSACTION LEVY FROM SEHK

From 1 April 2003, the Fund received a transaction levy chargeable at 0.002% of every leviable SEHK transaction.

6. TRANSACTION LEVY FROM HKFE

From 1 April 2003, the Fund received a contract levy chargeable at \$0.5 per leviable HKFE transaction except for Mini-Hang Seng Index Futures Contracts, Mini-Hang Seng Index Options Contracts, Stock futures contracts and Options on Stock futures contracts, all of which are chargeable at \$0.1 per transaction.



Investor Compensation Fund

Notes to the Financial Statements

For the quarter from 1 April 2003 (date of establishment) to 30 June 2003

(Expressed in Hong Kong dollars)

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. As at 30 June 2003, \$1,386,000 were incurred for setting up ICC.

8. 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 from the UECF and the CECF as it considers appropriate after 1 April 2003. During the quarter ended 30 June 2003, the SFC paid \$329,500,000 and \$51,690,000 into the Fund from the UECF and the CECF respectively.

9. RELATED PARTY TRANSACTIONS

We have related party relationship with the SFC, the ICC, the SEHK, the HKFE, the UECF and the CECF. During the period, there were no significant related party transactions other than those disclosed in the financial statements (refer to notes 5 to 8).

10. CONTINGENT LIABILITIES

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