

Unified Exchange Compensation Fund Financial Statements

Report of the Securities Compensation Fund Committee

The members of the Committee present their annual report and the audited financial statements for the year ended 31 March 2000.

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

The Fund was established for the purpose 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 71 to 80.

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 Andrew Procter

Mr Roderick Chalmers

Mr Alec Tsui

Mr David M Roberts

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

The retiring auditors, Messrs KPMG, being eligible, offer themselves for re-appointment.

On behalf of the Committee

Mark Dickens

Chairman

10 May 2000

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 Section 99 of the Hong Kong Securities Ordinance set out on pages 71 to 80 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

Respective Responsibilities of the SFC and Auditors

The Hong Kong 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 of the state of affairs of the Fund at 31 March 2000 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

10 May 2000

Income and Expenditure Account

For the year ended 31 March 2000 (Expressed in HK dollars)

	Note	2000	1999
Income			
Interest and investment income	4	\$ 21,696,925	\$ 33,173,011
Gain on disposal of held-to-maturity debt securities	4	117,034	–
		<u>\$ 21,813,959</u>	<u>\$ 33,173,011</u>
Expenditure			
Auditors' remuneration			
– current year		\$ 38,900	\$ 37,000
– under provision in respect of previous year		25,000	–
Premium on investments amortized	4	324,971	479,252
Loss on disposal of held-to-maturity debt securities	4	–	65,100
Bank charges		146,532	195,700
Legal and professional fees		132,000	2,248,828
Sundry expenses		57,798	20,935
		<u>\$ 725,201</u>	<u>\$ 3,046,815</u>
Surplus of Income Over Expenditure Before Appropriations		\$ 21,088,758	\$ 30,126,196
Balance Brought Forward		\$ –	\$ –
Appropriations			
Payment to The Stock Exchange of Hong Kong Limited pursuant to S105(2)(a) of the Securities Ordinance, Chapter 333(2000 - Nil, 1999 - 5.3915%)		–	857,625
Transfer to Compensation Fund Account	12	21,088,758	29,268,571
Balance Carried Forward		\$ –	\$ –

The notes on pages 76 to 80 form an integral part of the financial statements.

Balance Sheet

As at 31 March 2000 (Expressed in HK dollars)

	Note	2000	1999
Non current held-to-maturity debt securities	4&5	\$ 22,096,617	\$ 187,271,810
Current Assets			
Current held-to-maturity debt securities	4&5	\$ 142,033,530	\$ 182,102,034
Contributions receivable	11	100,000,000	300,000,000
Interest receivable		2,244,468	3,705,637
Bank fixed and call deposits		175,751,462	29,250,549
Cash at bank		125,582	145,651
		<u>\$ 420,155,042</u>	<u>\$ 515,203,871</u>
Current Liabilities			
Accounts payable and accrued charges		\$ 1,028,418	\$ 521,844
Interest payable		-	857,625
Provision for compensation	4	177,950,000	435,619,591
		<u>\$ 178,978,418</u>	<u>\$ 436,999,060</u>
Net Current Assets		<u>\$ 241,176,624</u>	<u>\$ 78,204,811</u>
Net Assets		<u>\$ 263,273,241</u>	<u>\$ 265,476,621</u>
Representing:			
Compensation Fund			
Contributions from The Stock Exchange of Hong Kong Limited (the SEHK)	6	\$ 46,450,000	\$ 46,450,000
less: Compensation paid	4&7	(68,815,176)	(59,339,040)
Provision for compensation	4	(26,658,386)	(11,984,522)
add: Recovery under subrogation	4&8	3,530,920	936,529
Replenishment from the SEHK	4&9	12,732,698	7,327,089
		<u>\$ (32,759,944)</u>	<u>\$ (16,609,944)</u>
Excess transaction levy from the SEHK	10	\$ 353,786,882	\$ 353,786,882
Special Contribution		3,500,000	3,500,000
Additional contributions from the SEHK and the SFC	11	300,000,000	300,000,000
Income and expenditure account	12	159,551,489	138,462,731
		<u>\$ 816,838,371</u>	<u>\$ 795,749,613</u>
less: Compensation paid	4&7	(369,513,572)	(90,027,979)
Provision for compensation	4	(151,291,614)	(423,635,069)
		<u>\$ 296,033,185</u>	<u>\$ 282,086,565</u>
		<u>\$ 263,273,241</u>	<u>\$ 265,476,621</u>

Approved by the Securities Compensation Fund Committee on behalf of the Securities and Futures Commission on 10 May 2000 and signed on its behalf by

Mark Dickens
Chairman

Roderick Chalmers
Committee Member

Alec Tsui
Committee Member

Statement of Recognized Gains and Losses

For the year ended 31 March 2000 (Expressed in HK dollars)

	Note	2000	1999
Recovery under subrogation	8	\$ 2,594,391	\$ –
Replenishment received from the SEHK	9	5,405,609	–
Additional contributions from the SEHK and the SFC	11	–	300,000,000
Decrease / (increase) in provision for compensation		257,669,591	(395,619,591)
Compensation paid out of the Fund	7	(288,961,729)	(118,043,457)
Net losses not recognized in the income statement		\$ (23,292,138)	\$ (213,663,048)
Net surplus for the year		21,088,758	30,126,196
Total recognized losses		\$ (2,203,380)	\$ (183,536,852)

The notes on pages 76 to 80 form an integral part of the financial statements.

Cash Flow Statement

For the year ended 31 March 2000 (Expressed in HK dollars)

	Note	2000	1999
Net cash inflow / (outflow) from operating activities	a	\$ 106,344	\$ (2,487,441)
Returns on investments and servicing of finance			
Interest received		\$ 23,158,094	\$ 34,046,856
Interest paid		(857,625)	(2,155,125)
Net cash inflow from returns on investments and servicing of finance		\$ 22,300,469	\$ 31,891,731
Investing activities			
Receipts from redemption of held-to-maturity debt securities		\$ 137,000,000	\$ 84,000,000
Proceeds from disposal of held-to-maturity debt securities		90,172,160	20,955,974
Payments to acquire held-to-maturity debt securities		(22,136,400)	(5,097,000)
Net cash inflow from investing activities		\$ 205,035,760	\$ 99,858,974
Financing			
Recovery under subrogation	b	\$ 2,594,391	\$ -
Replenishment received from the SEHK	b	5,405,609	-
Additional contributions received from the SEHK and the SFC	b	200,000,000	-
Compensation paid	b	(288,961,729)	(118,043,457)
Net cash outflow from financing		\$ (80,961,729)	\$ (118,043,457)
Increase in cash and cash equivalents		\$ 146,480,844	\$ 11,219,807
Cash and cash equivalents at beginning of the year		29,396,200	18,176,393
Cash and cash equivalents at end of the year	c	\$ 175,877,044	\$ 29,396,200

Cash Flow Statement (cont'd)

For the year ended 31 March 2000 (Expressed in HK dollars)

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

	2000	1999
Surplus of income over expenditure for the year	\$ 21,088,758	\$ 30,126,196
Interest income	(21,696,925)	(33,173,011)
Premium on investments amortized	324,971	493,860
Discount on investments accreted	–	(14,608)
(Gain) / loss on disposal of held-to-maturity debt securities	(117,034)	65,100
Increase in creditors and accrued charges	506,574	15,022
Net cash inflow / (outflow) from operating activities	<u>\$ 106,344</u>	<u>\$ (2,487,441)</u>

(b) Analysis of changes in financing:

	Recovery under subrogation	Replenishment received	Additional contributions received from the SEHK and the SFC	Compensation paid
Balance at 1 April 1998	\$ 936,529	\$ 7,327,089	\$ –	\$ (31,323,562)
Cash outflow from financing	–	–	–	(118,043,457)
Balance at 31 March 1999	<u>\$ 936,529</u>	<u>\$ 7,327,089</u>	<u>\$ –</u>	<u>\$ (149,367,019)</u>
Balance at 1 April 1999	\$ 936,529	\$ 7,327,089	\$ –	\$ (149,367,019)
Cash inflow / (outflow) from financing	2,594,391	5,405,609	200,000,000	(288,961,729)
Balance at 31 March 2000	<u>\$ 3,530,920</u>	<u>\$ 12,732,698</u>	<u>\$ 200,000,000</u>	<u>\$ (438,328,748)</u>

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

	2000	1999
Cash at bank	\$ 125,582	\$ 145,651
Bank fixed and call deposits	175,751,462	29,250,549
	<u>\$ 175,877,044</u>	<u>\$ 29,396,200</u>

Notes to the Financial Statements

For the year ended 31 March 2000 (Expressed in HK dollars)

1. Status Change of the SEHK Members

As a result of a scheme of arrangement, on 6 March 2000 the Stock Exchange of Hong Kong Limited (the SEHK) became a wholly owned subsidiary of Hong Kong Exchanges and Clearing Limited (HKEx), and the ownership of shares in the SEHK was separated from access to its trading facilities. The existing members of the SEHK ceased to be shareholders of the SEHK and became either exchange participants or holders of a trading right only. To become an exchange participant of the SEHK, a person must first become a holder of a trading right.

Pursuant to the Exchanges and Clearing Houses (Merger) Ordinance, which came into effect on 6 March 2000 –

“exchange participant” means a person who, in accordance with the rules of the Exchange Company, may trade on or through the Exchange Company; and whose name is entered in a list, register or roll kept by the Exchange Company as a person who may trade on or through the Exchange Company; and
“trading right” means a right to be eligible to trade on or through the Exchange Company and entered as such a right in a list, register or roll kept by the Exchange Company.

2. Money Constituting the Fund

The Fund is derived principally from monies paid to the Securities and Futures Commission (SFC) by way of deposits by the SEHK in respect of the trading rights, by way of excess transaction levy from the SEHK in accordance with an agreement between the SFC and the SEHK (see note 10), by way of money lawfully paid into the Fund pursuant to Section 101(1) of the Securities Ordinance (Chapter 333) (SO) and from return or profit on the investment of surplus funds.

3. Purpose, Limitation and Principal Activity

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 exchange participants of the SEHK.

The total amount of compensation including interest that may be paid to claimants consequent upon the default of any one exchange participant 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 Section 109(3) of the SO that came into operation on 7 October 1992. If the aggregate of the allowed claims in respect of an exchange participant exceeds the \$8,000,000 limit, that amount shall be apportioned among claimants as determined to be equitable by the SEHK. Further amendment to Section 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 an exchange participant 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 exchange participants 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 Section 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.

Notes to the Financial Statements (cont'd)

For the year ended 31 March 2000 (Expressed in HK dollars)

4. Accounting Policies

a *Statement of compliance*

These financial statements have been prepared in accordance with all applicable Statements of Standard Accounting Practice and Interpretations issued by the Hong Kong Society of Accountants and accounting principles generally accepted in Hong Kong. The significant accounting policies adopted by the Fund are set out below.

b *Basis of preparation of financial statements*

These financial statements have been prepared on the historical cost basis.

c

- (i) Interest and investment income is recognized in the financial statements on an accruals basis.
- (ii) Premium or discount on the purchase of the held-to-maturity debt securities is amortized or accreted respectively to the income and expenditure account on a straight line basis over the holding periods to redemption.
- (iii) Profits or losses on disposal of investments in held-to-maturity debt securities are accounted for in the income and expenditure account as they arise.
- (iv) Investments, representing held-to-maturity debt securities, are stated at cost adjusted for the amortization of premiums and accretion of discounts on purchase over the holding periods to redemption, and less provisions for impairment. The carrying amounts of held-to-maturity debt securities are reviewed as at the balance sheet date in order to assess whether the carrying amounts are expected to be recovered. Provisions are made for the parts of the carrying amounts which are not expected to be recovered and are recognized as an expense in the income and expenditure account. Provisions against the carrying value of the held-to-maturity debt securities should be written back to income when the circumstances and events that lead to the write-down cease to exist and there is prominent evidence that the new circumstances and events will persist for the foreseeable future.
- (v) Recovery of any payment out of the Fund in respect of any claim under subrogation pursuant to Section 118 of the SO, and replenishment from the SEHK pursuant to Section 107 of the SO, are recognized in the financial statements on a cash basis and taken directly to the Fund.
- (vi) As a result of the enactment of the amendments to Section 113 of the SO in November 1998, the maximum liability of the Fund to claims for each default case can exceed the normal \$8,000,000 limit. In order to more appropriately reflect the liability of the Fund for outstanding claims in respect of default cases, provision for compensation is made for known liabilities arising from claims which have been received up to the date on which the financial statements are approved by the Committee for pecuniary losses suffered by persons as a result of defaults on the part of the SEHK's exchange participants for which the SEHK has published a notice calling for claims pursuant to Section 112 of the SO. Compensation payments and provisions for each default are charged to the contributions from the SEHK as required pursuant to Sections 104 and 106 of the SO to the limit of \$8,000,000. Any excesses over the \$8,000,000 limit are charged to other components of the Fund.
- (vii) The Fund is exempt from taxation pursuant to Section 87 of the Hong Kong Inland Revenue Ordinance, Chapter 112.
- (viii) 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.

Notes to the Financial Statements (cont'd)

For the year ended 31 March 2000 (Expressed in HK dollars)

5. Held-to-Maturity Debt Securities

		2000	1999
Maturing after one year	– unlisted	\$ 22,096,617	\$ 187,271,810
Maturing within one year	– listed in Hong Kong	\$ –	\$ 33,014,246
	– unlisted	142,033,530	149,087,788
		<u>\$ 142,033,530</u>	<u>\$ 182,102,034</u>
		<u>\$ 164,130,147</u>	<u>\$ 369,373,844</u>
Market value at 31 March	– listed in Hong Kong	\$ –	\$ 33,093,600
	– unlisted	164,336,800	335,640,300
		<u>\$ 164,336,800</u>	<u>\$ 368,733,900</u>

During the year, held-to-maturity debt securities, with an amortized cost of \$68,052,080, were disposed of (in order to meet liquidity needs) to pay compensation to claimants. In addition, due to the depletion of funds resulting from significant compensation payments made during the year, some holdings of the investment portfolio exceeded the country exposure limit specified in the Fund's investment policies and guidelines. In order to restore the country exposure of the portfolio to within the limit, held-to-maturity debt securities with an amortized cost of \$22,003,046 were disposed of. The aggregate profit on the disposal amounted to \$117,034.

6. Contributions from the SEHK

- a Before 6 March 2000, in accordance with Sections 104 and 106 of the SO, the SEHK was 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 was taken up. In the absence of claims or other provisions as set out in Section 106 of the SO, the SFC was required to refund to the SEHK from the Fund such deposit within six months after membership ceases.

The SEHK advised the SFC of thirty four (34) memberships having been taken up during the six (6) months to 6 March 2000. However, the SEHK had not at 6 March 2000 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 financial statements. Any monetary liability of the SEHK that may have existed due to memberships taken up prior to six (6) months before 6 March 2000 would be extinguished by the requirement of the Fund to refund to the SEHK deposits of ceased memberships in accordance with Section 106(1) of the SO, as the number of new members equalled the number of members leaving the SEHK during the period.

- b After 6 March 2000, pursuant to Sections 104 and 106 of the SO, the SEHK is required to deposit with the SFC a sum of \$50,000 in respect of each trading right of the SEHK not later than 1 month after the need to deposit \$50,000 for a trading right arises. In the absence of claims or other provisions as set out in Section 106 of the SO, the SFC is required to refund to the SEHK from the Fund such deposit in respect of a person who has ceased to be a holder of a trading right within six months after the cessation. During the period from 6 March 2000 to 31 March 2000, the SEHK advised the SFC of no change in the number of trading rights.

Notes to the Financial Statements (cont'd)

For the year ended 31 March 2000 (Expressed in HK dollars)

7. Compensation Paid

	2000	1999
Compensation paid up to the \$8 million limit as set out by Section 109(3) of the SO		
Balance brought forward	\$ 59,339,040	\$ 31,323,562
Add: Compensation paid during the year	9,476,136	28,015,478
Balance carried forward	\$ 68,815,176	\$ 59,339,040
Compensation paid in excess of the \$8 million limit pursuant to Section 113(5A) of the SO		
Balance brought forward	\$ 90,027,979	\$ -
Add: Compensation paid during the year	279,485,593	90,027,979
Balance carried forward	\$ 369,513,572	\$ 90,027,979
Total compensation paid	\$ 438,328,748	\$ 149,367,019

The total amount of compensation including interest in respect of each defaulted exchange participant is normally limited to \$8 million pursuant to Section 109(3) of the SO. In respect of the claims against C.A. Pacific Securities Ltd. (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 Ltd. (Forlux), Foreground Securities Co. Ltd. (Foreground) and Chark Fung Securities Ltd. (Chark Fung).

During the year, compensation payments totalling \$288,961,729 were made in respect of three defaulting exchange participants, CA Pacific, Chark Fung and Forlux which have been determined within the \$150,000 limit per claimant under the aforesaid compensation arrangements.

8. Recovery under Subrogation

	2000	1999
Balance brought forward	\$ 936,529	\$ 936,529
Amount recovered during the year	2,594,391	-
Total recovery under subrogation	\$ 3,530,920	\$ 936,529

Under Section 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 exchange participants in relation to the loss sustained by the claimants, to the extent of the payment made by the SFC out of the Fund. The SFC has passed all amounts so received back to the Fund.

9. Replenishment from the SEHK

	2000	1999
Balance brought forward	\$ 7,327,089	\$ 7,327,089
Amount replenished by the SEHK during the year	5,405,609	-
Total replenished by the SEHK	\$ 12,732,698	\$ 7,327,089

Notes to the Financial Statements (cont'd)

For the year ended 31 March 2000 (Expressed in HK dollars)

9. Replenishment from the SEHK (cont'd)

When all relevant rights of action and other legal remedies conferred by Section 118 of the SO against the exchange participant in relation to which the claim arose have been exhausted, the SEHK shall under Section 107 of the SO, on being required to do so by the SFC, replenish the fund with an amount that is equal to that paid in connection with the satisfaction of the claim, including any legal and other expenses paid or incurred in relation to the claim.

10. Excess Transaction Levy from the SEHK

In accordance with an agreement reached in 1991 between the SFC and the SEHK, the SEHK was 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 exceeded 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 revenue would be diverted to the reserves of the SEHK instead of the Fund after the Fund had reached \$400 million, which it did on 30 June 1994.

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

11. Additional Contributions from the SEHK and the SFC

In connection with the compensation arrangements announced in June 1998 (please refer to Note 7), the SEHK and the SFC had committed to make a contribution of \$150 million each to the Fund in the financial year 1998-99 and agreed to make a further contribution of \$150 million each should it become necessary. In respect of this commitment, a partial contribution of \$100 million each in relation to the first contribution of \$150 million was received from the SEHK and the SFC during the year.

12. Movement in Income and Expenditure Account

	2000	1999
Balance brought forward	\$ 138,462,731	\$ 109,194,160
Add: Transfer of surplus for the year	21,088,758	29,268,571
Balance carried forward	<u>\$ 159,551,489</u>	<u>\$ 138,462,731</u>

13. Related Party Transactions

In the financial year 1998-99, the Fund recognized the initial contribution of \$150 million from the SFC regarding the compensation arrangements announced in June 1998. \$100 million of this initial contribution was received during the year.

14. Contingent Liabilities

As at the date of this report, claims against four exchange participants had been received by the SEHK. They are subject to the normal \$8,000,000 limit pursuant to Section 109 of the SO. The validity of these claims is under investigation. The maximum liabilities of the Fund to the claims is \$32 million. No provision has been made in these financial statements for these claims in respect of any of these cases.